



Euro Tax Flash from KPMG's EU Tax Centre



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CJEU decision on the recovery of Gibraltar State aid

[Court of Justice of the European Union – Gibraltar – State aid – Interest and royalties – Recovery of unlawful State aid – Double tax relief](#)

On September 15, 2022, the Court of Justice of the European Union (CJEU or the Court) gave its [decision](#) in a case concerning the applicability of domestic double tax relief provisions in the context of recovering unlawful State aid (C-705/20).

The Court held that EU law does not preclude tax authorities responsible for the recovery of unlawful State aid from reducing the recoverable amount by crediting the taxes paid abroad against taxes that were due locally, provided that the tax credit was granted based on rules applicable at the time when the taxpayer benefited from the State aid.

Background

Following a complaint filed by Spain in June 2012, the European Commission launched in October 2013 a first in-depth investigation into whether the tax exemption for interest and royalty income applicable in Gibraltar between January 1, 2011 and June 30, 2013 and December 31, 2013, respectively, might grant a selective advantage to companies that generate these types of income. The inquiry was subsequently extended to 165 related tax rulings issued by the Gibraltar tax authorities between 2011 and 2013.

On December 19, 2018, the Commission [decided](#) that Gibraltar's exemption scheme constitutes State aid incompatible with the internal market (the Decision). In addition, the Commission

concluded that five individual rulings granted by the Gibraltar tax authorities – out of the 165 reviewed, involved illegal State aid.

The plaintiff in the case under dispute was not one of the 165 companies investigated by the European Commission and listed in the Decision. It did, however, receive passive income in the form of royalties during the period when the exemption was applicable and the revenue was taxed in the hands of its US shareholder. In order to comply with the Decision, Gibraltar amended its domestic legislation to permit retrospective taxation of royalty income and the local tax authorities sought to assess corporate income tax on the plaintiff's royalty income.

Following discussions with the EU's Directorate-General for Competition (DG), the DG stated that, for the purposes of assessing the tax payable, the local tax authorities could not take into account the tax paid in the US on the royalty income. The local tax authorities sent recovering orders to the plaintiff assessing the tax on this basis. The plaintiff decided to appeal the recovery orders that did not include credit for the US tax and the Income Tax Tribunal of Gibraltar referred the case to the CJEU¹.

On March 10, 2022, the Advocate General (AG) Juliane Kokott of the CJEU recommended that the Court finds that neither the Decision, nor EU law preclude the plaintiff from benefiting from a credit for taxes paid abroad – see E-news [Issue 150](#).

The CJEU decision

The local tax authorities and the Commission argued that the conditions required to benefit from the set off mechanism in accordance with the Gibraltar legislation appeared not be met but this was a point for the Income Tax Tribunal and not the CJEU. Therefore, the CJEU started from the presumption that under Gibraltar's rules applicable at that time the plaintiff was entitled to benefit from a credit for the taxes paid abroad.

In this context, the Court noted that the key question was whether the tax credit could compromise the effective enforcement of the recovery order included in the Decision.

The Court continued by recalling settled case-law based on which unlawful State aid recovery aims to restore the situation as it was before the aid was granted. For this purpose, when quantifying the amount of aid to be recovered, national courts are to take into account all relevant information. It can, therefore, not be excluded that the resulting amount is lower than that assessed under the relevant Commission decision, or even equal to zero.

Building from these considerations, the Court further noted that the content of the Decision related only to the recovery of corporate income tax that should have been levied in the absence of the exemption for passive interest and royalty income. In the Court's view, since the Decision did not address the issue of relying on deductions or reliefs that would have applied based on the legislation in force at that time, when calculating the tax due, the Decision did not preclude reliance on the tax credit under dispute.

¹ Gibraltar is a British Overseas Territory to which, before the UK's exit from the European Union, the fundamental freedoms under the TFEU applied. The Withdrawal Agreement concluded between the EU and the UK covered Gibraltar, and as a result the CJEU remained competent for judicial procedures concerning Gibraltar registered at the CJEU before the end of the transition period (i.e. December 31, 2020).

The Court continued by examining whether taking into account the tax credit at the recovery stage would undermine the effectiveness of the Decision by putting the plaintiff in a more favorable position compared to carrying out operations without the grant of the State aid measure. For this purpose, the Court noted that Member States were precluded from adopting compensatory measures that would circumvent the scope of the recovery decision. However, the recovery requirement did not imply that recipients of the aid were precluded from benefiting from deductions or reliefs provided by domestic legislation in force at that time. In particular, in the case under dispute, the recovery requirement did not impact the possibility of benefitting from a tax relief mechanism.

The Court also considered whether by implication the Gibraltar legislation on which the plaintiff was relying for the tax credit could also be prohibited State aid. In line with the AG's comments, the Court noted that Member States were in principle free to decide the most appropriate system and conditions for granting double tax relief and that these decisions are of a general nature. The Court recalled based on settled case law that a tax advantage resulting from a general measure applicable without distinction to all economic operators does not constitute prohibited State aid. The Court stated that the Gibraltar legislation falls, in principle, within the scope of fiscal autonomy, and cannot, unless it is established that it is based on discriminatory parameters, be classified as prohibited State aid.

In the light of the above, the Court concluded that neither the Decision, nor EU law, precludes the plaintiff from benefiting from a tax credit for taxes paid abroad against taxes for which it is liable in Gibraltar, where the provision was applicable on the relevant date

EU Tax Centre comment

The findings of the CJEU are in line with the opinion issued by the AG earlier this year. Whilst the CJEU did not express an opinion on the legality of the Decision – the General Court confirmed earlier this year that Gibraltar's historic general exemption for royalty income represented unlawful State aid (see Euro Tax Flash [Issue 473](#)), the Court confirmed that the Decision does not preclude the Gibraltar authorities responsible for the recovery of the unlawful State aid from applying a domestic provision that provides relief for taxes abroad, which was available at the time of the operations in question.

Should you have any queries, please do not hesitate to contact [KPMG's EU Tax Centre](#), or, as appropriate, your local KPMG tax advisor or KPMG in Gibraltar ([Darren Anton](#)).



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