Approval of Regulation on foreign subsidies distorting the internal market

European Council – Foreign subsidies – Fair competition

On November 28, 2022, the Council of the EU approved the European Parliament's position on the Regulation on foreign subsidies distorting the internal market. The Council's approval marks the adoption of the act, which will enter into force on the 20th day following its publication in the EU Official Journal.

The Regulation gives the European Commission (EC) powers to investigate financial contributions received in non-EU countries by groups operating in the EU internal market. Contributions that may be subject to investigation include tax exemptions granted to an undertaking where these are limited, in law or in fact, to one or more undertakings or industries.

Background

At present, subsidies granted by Member States are subject to compliance with EU State aid rules, which prevents Member States from granting State aid that unduly distorts competition in the internal market.

On the other hand, the European Commission did not have at its disposal an EU instrument that would allow it to check similar subsidies granted by non-EU countries, which could distort the internal market if the undertaking benefitting from the foreign subsidy engages in an economic activity in the EU.

To address this perceived gap, in May 2021, the European Commission put forward a proposal for a Regulation on foreign subsidies distorting the internal market. The Regulation establishes a framework for the European Commission to examine any economic activity benefiting from a subsidy granted by a non-EU country on the internal market. This file is subject to the ordinary legislative procedure, whereby the Council and the European Parliament are co-legislators and may adopt a proposal at the first reading.

On November 10, 2022, the European Parliament adopted its first reading position on the text agreed upon at political level with the Council, therefore paving the way for final adoption. The Parliament's position includes a requirement for the Commission to publish and regularly update guidelines regarding certain aspects of the Regulation, including the criteria for determining the existence of a distortion caused by a foreign subsidy on the internal market. According to a joint statement of the European Parliament, the Council and the

Commission, the EC will make such initial clarifications public at the latest 12 months after the date of application of the relevant provisions.

Regulation on foreign subsidies

According to its Preamble, the Regulation aims to restore fair competition between all undertakings engaging in an economic activity in the EU internal market.

More specifically, the Regulation addresses distortions created by subsidies that are granted by non-EU countries to undertakings operating on the EU single market and lays down the procedural rules for investigating these subsidies. The Regulation proposes three tools for the European Commission to investigate financial contributions granted by a public authority in a non-EU country:

(i) a notification-based tool to investigate concentrations (mergers and acquisitions),
(ii) a notification-based tool to investigate bids in public procurements, and
(iii) a general market investigation tool for investigating all other market situations as well as lower-value mergers and public procurement procedures.

The Regulation complements the EU State aid rules, which deal with distortions in the internal market caused by Member State subsidies. As is the case under the EU State aid rules, if the European Commission establishes that a foreign subsidy represents unlawful state aid, it may impose redressive measures in order to remedy the distortion.

The Regulation is structured into seven chapters that set out the rules, starting with Chapter 1 which sets out the general provisions including the subject matter and scope of the rules and Chapter 2, which governs the ex officio review and general provisions for the review of foreign subsidies. Chapters 3 and 4 contain specific rules for concentrations and public procurement procedures, respectively, followed by Chapter 5 which contains common procedural provisions. Chapter 6 concerns relationships with other instruments and Chapter 7 sets out transitional and final provisions.

Scope

The rules and procedures laid down by the Regulation concern foreign subsidies granted to an undertaking, including a public undertaking, which is directly or indirectly controlled by the State, engaging in an economic activity in the EU internal market. This includes undertakings acquiring control or merging with an undertaking established in the EU and undertakings participating in a public procurement procedure in the EU.

Existence of a foreign subsidy

A foreign subsidy in the context of this Regulation will be deemed to exist where a non-EU country provides, directly or indirectly, a financial contribution which generates a benefit for an in-scope undertaking and which is limited, in law or in fact, to one or more undertakings or industries.

According to the Preamble to the Regulation, a financial contribution will be considered to confer a benefit to an undertaking engaging in an economic activity in the internal market if it could not have been obtained under normal market conditions.

The existence of a benefit should be determined on the basis of comparative benchmarks, “such as the investment practice of private investors, rates for financing obtainable on the market, a comparable tax treatment, or the adequate remuneration for a given good or service.” Where comparable benchmarks are not available, alternative benchmarks could be determined based on generally accepted assessment methods.

In this context, the Preamble notes that transfer pricing in the context of goods and services exchanged within an undertaking may confer a benefit if not in line with normal market conditions.

A financial contribution includes, inter alia:

- the transfer of funds or liabilities, such as capital injections, grants, loans, loan guarantees, fiscal incentives, setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps or rescheduling;
- the foregoing of revenue that is otherwise due, such as tax exemptions or the granting of special or exclusive rights without adequate remuneration; or
- the provision of goods or services or the purchase of goods or services.

Distortions on the internal market and balancing

A distortion on the internal market will be considered to exist where a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market and consequently negatively affects competition on the internal market. The decision on whether there is a distortion on the internal market will take into account certain indicators, which may include, the amount and nature of the subsidy, the circumstances of the undertaking (e.g. size and relevant the markets) and the purpose and conditions attached to the foreign subsidy.

The Regulation furthermore provides for a list of foreign subsidy that are most likely to distort the internal market. However, an undertaking that is under investigation for receiving one of the listed subsidies will be given the opportunity to demonstrate that it does not distort the internal market.

The Commission may nevertheless balance the distortion on the internal market with positive effects on the development of the relevant subsidized economic activity on the internal market, including other positive effects of the foreign subsidy – in particular those related to relevant EU policy objectives.

Commitments and redressive measures

Where the foreign subsidy represents unlawful state aid in accordance with the Regulation, the European Commission may impose redressive measures in order to remedy the distortion on the internal market that were caused (or could potentially be caused) by a foreign subsidy. Alternatively, the European Commission, may instead accept commitments offered by the undertaking under investigation where such commitments fully and effectively remedy the distortion on the internal market.

Ex officio review of foreign subsidies

The Commission may – on its own initiative, examine information from any source regarding alleged distortive foreign subsidies. Source may include the Member States or members of the public.

Notification requirements

Undertakings in scope, will have to notify the European Commission of:

- mergers and acquisitions where at least one of the merging parties has an EU turnover of at least EUR 500 million and there is a foreign financial contribution of at least EUR 50 million;
- tenders in public procurement procedures, where the estimated contract value is at least EUR 250 million and the bid involves a foreign financial contribution of at least EUR 4 million per non-EU country.

Application period

In accordance with the transitional rules, the Regulation shall apply (subject to exceptions where applicable) to foreign subsidies granted in the five years prior to the date of its application, where such foreign subsidies distort the internal market after the start of its application.

Next steps

As a next step, the Regulation will be signed by the President of the European Parliament and the President of the European Council, prior to being published in the Official Journal of the EU.

An EU regulation is binding in its entirety and is directly applicable in all Member States. Accordingly, the Regulation would result in a swift EU-wide application of the rules without the need for transposition into national law.

ETC Comment

Undertakings that operate on the EU single market and that benefit from foreign subsidies should assess the impact of this Regulation, in particular in light of the EC's power to examine ex officio subsidies granted in the five years prior to the date of application of the rules. During its investigations, the Commission may request information and conduct inspections inside and outside the EU. Note also that, where the Commission suspects that foreign subsidies distorting the internal market exist, it may initiate a dialogue with the third country concerned and explore options for ending or modifying the relevant subsidies.

In-scope entities should also take note of the notification obligations that may arise on transactions entered into with respect to mergers and acquisitions and public tenders.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.


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