Analysis

Tax implications of the Subsidy Control Bill

Speed read

The scope of the new UK subsidy control regime, set out in the Subsidy Control Bill that is currently before parliament, differs little from the EU state aid regime, apart from its non-application to UK primary legislation. The question of whether a tax ruling is a 'subsidy' will therefore typically depend on whether it is 'specific' – and the answer to that question in a tax context involves applying effectively the same principles as are used to decide whether a tax ruling or tax rule confers a 'selective advantage' in EU state aid law. However, while its scope is similar, enforcement and remedies under the new UK regime will be very different to the position under the EU regime: in particular, a substantial enforcement gap is created by the absence of an independent body with powers to initiate investigations of non-published subsidies and the restrictive rules on standing.

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The context of the Bill: state aid law, WTO rules and the TCA to tax measures

The fact that subsidy control regimes have major implications for tax has become increasingly obvious over the last decade, as the European Commission has used its powers under EU state aid law to override a number of member state's taxation decisions. Examples include the setting aside of allegedly over-generous tax rulings in favour of large multinationals on the treatment of intra-group transactions (Apple, Amazon, Starbucks) and the striking down of elements of the UK's controlled foreign companies regime. Though some of those decisions have not been sustained before the EU courts, others have been upheld: and the general point that EU state aid law applies not just in theory but also in real life to tax legislation and tax rulings in favour of business is now beyond dispute.

Nor is that a peculiar feature of EU state aid law. The subsidy rules in the World Trade Organization's Agreement on Subsidies and Countervailing Measures (SCM Agreement) apply to favourable tax treatment: see article 1.1(a)(1)(ii) (which defines 'government revenue, otherwise due, that is foregone' as being a subsidy), and, for example, the WTO Appellate Body's decision in *US Large Civil Aircraft (2nd complaint) (2012)* (bit.ly/3yNIMKO) at paras 801–831 (lower business-and-occupation tax rate on aircraft manufacturers than on other manufacturers amounted to a subsidy).

Rather closer to home, the subsidy control provisions in Chapter 3 of Title XI of the EU/UK Trade and Cooperation Agreement (TCA) expressly apply to tax measures: the definition of 'subsidy' in article 363(1)(b)(i)(B) uses equivalent language to that in the SCM Agreement ('forgoing of revenue that is otherwise due'), and article 363(2) sets out a set of principles for ascertaining whether tax measures are 'specific' (and therefore capable of being subsidies under article 363(1)(b)(iii)). Those principles bear more than a passing resemblance to the EU CJEU case law on the test to apply to determine whether a tax measure is 'selective' (see my article 'State aid and tax rulings: latest developments', *Tax Journal*, 9 July 2021).

The application of the Bill to tax measures

The Subsidy Control Bill (the Bill) was published in June 2021 and its second reading in the House of Commons is expected early in the autumn of 2021. A large part of its purpose is to implement the subsidy control commitments made in the TCA (as well as the much less extensive commitments made in other trade agreements, for example that with Japan).

Since both the SCM Agreement and the TCA subsidy provisions cover tax measures, it is unsurprising that the Bill expressly does so as well. Indeed, clause 4(2)-(5) precisely incorporates into domestic law the principles set out in article 363 of the TCA on whether tax measures count as a subsidy. It will therefore retain, at least, the pith of the EU approach to the question of when a tax measure amounts to a subsidy, even if (as may well happen) the UK case law develops that approach in new or different directions or, at least, tidies up some of the inconsistencies and problematic elements in the CJEU's case law.

There is, however, an important difference, with particular relevance in the area of tax. EU state aid law applies to all member state legislation. But the UK subsidy control regime, consistently with the principle of parliamentary sovereignty, excludes UK primary legislation from its scope. That exclusion, which is permitted by the TCA (see article 372(4)), is achieved by clause 6(1), which provides that the UK and devolved Parliaments are not 'public authorities', and is then qualified by Sch 3, which brings devolved, but not UK, primary legislation back into the subsidy control regime, but with the High Court or Court of Session replacing the CAT for challenges to devolved primary legislation. The Bill therefore precludes any possibility of domestic challenge to a tax measure in an Act of the UK Parliament as being a subsidy, but it permits such challenges to devolved primary legislation.

In terms of what it covers, therefore, the new UK subsidy control regime differs little from the EU state aid regime, apart from its non-application to UK primary legislation: the question of whether a tax ruling is a 'subsidy' will typically depend on whether it is 'specific' – and the answer to that question involves applying effectively the same principles as are used to decide whether a tax ruling or tax rule confers a 'selective advantage' in EU state aid law. In both systems, rulings or settlements in favour of businesses that are 'over-generous' in the sense that they fail to amount to any reasonable application of general tax law will almost certainly amount to a subsidy.

Is this, therefore, to paraphrase Tancredi in *The Leopard*, a case of everything changing so that everything remains the same? The answer is a definite 'no, there has been a real change': but the reason why it is 'no' is little to do with the substantive rules on what tax measures are subject to subsidy control rules and everything to do with enforcement and remedies.

Application of the subsidy control principles

One very important contrast between the EU state aid regime and the regime under the Bill is that the question of whether subsidies are judged to be in the public interest is, under the state aid regime, a question for the Commission: whereas under the Bill, it is a question to be answered by the granting authority, applying the subsidy control principles set out in Sch 1, subject only to: (a) the requirement in some cases to seek the advice of the Competition and Markets Authority (CMA) (by whose advice the granting authority is not bound); and (b) the possibility of judicial review before the Competition Appeal Tribunal (CAT).

However, that difference will probably matter less in the case of tax measures than it does elsewhere, because the critical issue will be whether the measure is a subsidy at all – and if it is, then the tax authority will, typically, not have considered the subsidy control principles, so that the subsidy decision will inevitably have to be quashed (or, in Scotland, reduced) by the CAT on the basis that no consideration was given to matters that were required to be considered.

It is to be welcomed that the Bill largely maintains tax measures within the scope of the new regime. But when it comes to enforcement, the new regime is notably weaker

Absence of an independent authority with powers of investigation or enforcement

But a difference that matters very much in tax cases is the absence, in the regime to be created under the Bill, of any independent entity that has the remit and powers to investigate, on its own initiative or in response to a complaint, potential subsidies by tax authorities. Under the EU state aid law system, the Commission has extensive powers under article 12 of Council Regulation 2015/1589 to start an investigation of a possible unnotified state aid on its own initiative or in response to a complaint and to require member states to provide it with information: it then – if it finds that a tax measure amounts to unlawful state aid – has the power to order it to be brought to an end and the amount of the aid to be recovered from the taxpayer. Under the Bill, however, the CMA has no power to start an investigation of its own motion or in response to a third party complaint: it has no power to consider a subsidy unless the subsidy is referred to it by the granting authority or the secretary of state. But since the key issue in tax cases is whether the measure is a subsidy, with the tax authority denying that it is, none of those mechanisms for engaging the CMA will, in practice, ever be invoked by the tax authority – and, in practice, at least as far as central government tax measures are concerned, almost certainly not by the secretary of state. Further, the CMA has no enforcement powers at all, not even the power to bring the matter before a court.

The result is that, in the system under the Bill, a competitor or concerned public interest group that suspects that there has been a tax ruling or settlement amounting to a subsidy, or which considers that tax legislation has generated a subsidy, has no independent enforcement body to which it can turn. Its only possible remedy, subject to standing, will be litigation.

Enforcement in the CAT: its powers

In principle, if a tax measure amounts to a subsidy then the CAT will have judicial review jurisdiction, to the extent that it confers a subsidy, to prohibit or quash (or, in Scotland, reduce or interdict) that measure or to issue a declaration (or declarator) (clauses 72 and 73 of the Bill). As noted above, in a case where the tax authority takes the view that the measure is not a subsidy at all, the only practical issue is likely to be the issue – essentially one of law, though with some factual elements – of whether that view is correct: if it is held not to be correct then the authority's inevitable failure to assess the measure for compliance with the subsidy control principles will in practice lead to relief that has the effect of bringing the subsidy to an end.

In addition, the CAT will have the power – familiar from the state aid regime – to order recovery by the granting authority of the subsidy given to date (clause 74, which implements TCA article 373).

The CAT will not, however, have the power to award damages. Damages are not generally available as a remedy in English or Scots public law, and the possibility of *Francovich* damages (a remedy available to those affected by a breach of TFEU article 108(3)) has been expressly removed by the EU Withdrawal Act 2018 Sch 1 para 4. Moreover, TCA article 372 expressly refrains from requiring the UK to create any new public law remedies (apart from the recovery remedy referred to in Article 373).

In short, therefore, if a complainant can get the question of whether a tax measure is a subsidy before the CAT, and if it can persuade the CAT that it is a subsidy, then it can almost certainly get the subsidy brought to an end and obtain, if not damages or repayment of the tax that it has paid, then the *Schadenfreude* of seeing the beneficiaries of the measure having to repay the amount of the subsidy.

Getting the question there is, however, another matter.

Finding out about a tax measure that may be a subsidy

As far as tax rulings or settlements are concerned, the obvious initial problem is that no party other than the tax authority and the taxpayer is likely to know about the arrangement or, if it does, to know what its terms are or that they arguably amount to a subsidy. In the absence of any system of independent review of such decisions to establish whether they amount to a subsidy, or any enforcement authority with powers of investigation, the reality is likely to be that many go unspotted.

However, if a complainant does have some idea that there could be a subsidy and if (an important caveat: see below), it is an 'interested party' – then it does have a significant and helpful tool available to it under clause 76. That clause enables an interested party to serve a notice on the granting authority requiring the provision of information 'for the purpose of deciding whether to apply for a review of a subsidy decision'. The granting authority must then, within 28 days, 'provide such information as would enable, or assist in, the making of a determination as to whether the subsidy was given, or the scheme was made, in accordance with the requirements of [the Bill]'. That latter phrase would appear to include information that enabled, or assisted in, the determination of whether the measure at issue was a subsidy at all: which, in a tax ruling or settlement case, would include information that explained the tax treatment at issue and the factual and legal basis on which that treatment was given. It may be noted that the authority has no power to refuse provision of such information on the basis of 'taxpayer confidentiality' (though, under sub-s (5), the authority may impose proportionate measures to protect commercially sensitive or confidential information, e.g. to restrict circulation of the information to certain individuals within the requester or to its professional advisers). Moreover, and importantly, the obligation imposed by the clause will, under s 18(3) of the Commissioners of Revenue and Customs Act 2005, override the usual objection by HMRC to disclosure of any information about tax rulings or settlements, namely the prohibition in s 18(1) of that Act on disclosure of any information held by HMRC (subject to limited gateways).

Timing

The rules on timing of any challenge are set out in clause 71 of the Bill, inserting a new rule 98A into the CAT's rules.

The starting concept is that of the 'transparency date'. That is, generally under new rule 98A(4)(b)(ii), the date on which the subsidy is entered onto the statutory transparency register (which, in the case of tax measures, must be within one year of the relevant tax declaration: clause 33(3)(a)). In the case of most tax measures, however, the position will be that the tax authority will have taken the view that it is not a subsidy and will not have made an entry in the transparency register, even though (if the applicant is right and the measure is a subsidy) it should have done so. In that case, the principled answer would be that, in effect, there is no time limit at all: the applicant can bring a challenge at any time on the basis that either there is a subsidy (in which case time has not begun to run because nothing has been placed on the transparency register) or there is not (in which case the challenge fails in any event): but whether that answer is right remains to be seen.

In order to preserve its rights, the putative complainant must, within one month of the transparency date, either bring its challenge (rule 98A(2)(c)) or serve a clause 76 notice, in which case it must then bring its challenge within one month of receiving a response to that notice (see rule 98A(2)(a)).

Standing

The right to apply to the CAT (and the right to demand information under clause 76) is, under clause 70, granted only to an 'interested party' (by clause 70(7)(a), 'a person whose interests may be affected by the giving of the subsidy'.

Clause 70(7)(a) almost certainly imposes a much narrower test than the general, now fairly liberal, test of standing in English and Scots public law (particularly as it has to be seen against the background of articles 369(6) and 372, which allow the parties to limit standing to a 'natural or legal person, economic actor or association of economic actors whose interest might be affected by the granting of a subsidy, in particular the beneficiary, economic actors competing with the beneficiary or relevant trade associations'). So it appears that an entity such as the Good Law Project, which has recently brought general public interest challenges in relation to various spending and tax decisions by HMRC and other public bodies, could not apply under clause 70 (or demand information under clause 76).

The result is that there is likely to be a substantial enforcement gap. Perhaps particularly in the case of tax measures, there will in many, if not most, cases be no competitors large enough, determined enough, or sufficiently adversely affected to consider that spending money on a subsidy control challenge is a wise use of their resources. Moreover, if a tax measure benefits every company in a sector, there may well be no competitor with any interest in challenging the measure.

But the absence of likely competitor challengers is no indication that the measure is one that should not undergo scrutiny: on the contrary, the adverse economic effect of subsidies granted in the form of over-favourable tax rulings or settlements, or in the form of legislation tweaked to favour particular companies or sectors, will often be very substantial, even though it may be too widespread and general to generate anyone with a sufficient interest to obtain standing under the restrictive provisions of clause 70(7)(a).

It is important at this point to remember that the decision to restrict standing in this way is a matter of choice by the current government: although the TCA permits that choice, it does not preclude a more liberal approach to standing, if that is judged to be in the public interest. Moreover, it is hard to think of a principled reason why standing to bring a public law challenge to a tax or spending decision under the Bill should be more limited than is generally the case for public law challenges to these (or any other) public decisions.

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Final thoughts

The application of state aid and subsidy control law to tax measures has, in many respects, been controversial. However, it is beyond dispute that any coherent subsidy control regime must apply in principle to tax waivers, to tax rulings and settlements that are not justified by the relevant facts and tax law, and to tax rules that are designed to remove a generally applicable tax burden from particular favoured industries or companies: all of these measures are equivalent, in economic effect, to cash grants to those taxpayers. Further, although the driver behind any subsidy control regime is the need to ensure that subsidies that distort competition or adversely affect trading partners are not granted without at least due consideration of their likely benefits vis-à-vis their likely adverse effects, it is also a happy side-effect of such regimes that they provide a mechanism for holding tax authorities to account, operating as a safeguard against the inevitable risk that tax authorities faced with large multinational companies or sectors with effective lobbyists will make unjustifiable concessions or tweak tax rules in their favour.

Against that background, it is to be welcomed that the Bill largely maintains tax measures within the scope of the new regime. But when it comes to enforcement, the new regime is notably weaker, with a substantial enforcement gap: and since the economic distortions caused by subsidies in the form of tax measures may be widely spread but are nonetheless often large, that enforcement gap is serious. ■

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