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HMGGoG Very Pleased with Substance of EU Commission State Aid Decision

By a decision taken today, the European Commission has opened a formal state aid investigation procedure in order to investigate certain aspects of Gibraltar's Income Tax Act 2010. HMGGoG notes that the investigation concerns only two limited aspects of our corporate tax regime. HMGGoG is confident that it can take legislative action swiftly in order to address the issues that appear to concern the European Commission. HMGGoG has already convened a meeting with the industry in order to consult them on this matter.

It is to be recalled that the origin of this decision to open a formal state aid investigation procedure is a complaint filed by the Spanish Government with the European Commission on 1 June 2012. In that complaint, Spain alleged that the Income Tax Act 2010, which entered into force on 1 January 2011, constituted a state aid for two principal reasons. Firstly, Spain alleged that the 2010 Act was a state aid in favour of an alleged offshore sector through the combined effect of the application of the territorial system of taxation and the tax exemption for passive income. Secondly, and touching an issue which is of the greatest significance for Gibraltar, Spain also alleged that the Gibraltar corporate tax system was regionally selective in that it differs from, and is more favourable than, the corporate tax system applied in the United Kingdom.

There is much in today's decision to be welcomed in Gibraltar.

First, the European Commission does not call into question the territorial system of taxation, which is the reference system of corporate taxation under the Income Tax Act 2010 and which has been in operation in Gibraltar since the 1950s. This is an important issue for Gibraltar because our entire corporate tax system has been underpinned by the territorial system since inception. Contrary to Spain's allegation, therefore, this is not called into question at all by the Commission, indeed they use it as the reference system against which other parts of the system, such as the treatment of interest and royalties, is compared. HMGGoG greatly welcomes this.

Second, and of even greater importance, the European Commission has categorically rejected Spain's argument that the corporate tax system in Gibraltar is regionally selective.

This is of fundamental importance. It is arguably the most important aspect of today's decision. It is the first time ever that the European Commission has officially and formally stated its opinion on the critical issue of regional selectivity and Gibraltar since the European Court judgments under the previous tax regime. It is the first time ever that the European Commission finds that the far-reaching principle of regional selectivity DOES NOT apply to Gibraltar. This is very positive news indeed.

So, what is today's decision about then? The decision is about a "preliminary view" formulated by the European Commission that two discreet aspects of our corporate tax system constitute a State aid. These are the non-taxation of passive (inter-company loan) interest income and the non-taxation of royalties. Representations will be made by third parties to the Commission now on these issues.

With regard to the non-taxation of passive (inter-company loan) interest income, it will be recalled that on 1 July 2013 HMGoG amended the Income Tax Act 2010 so that all inter-company loan interest income received after 1 July 2013 is subject to tax in as far as the interest received per source company exceeds an amount of £100,000 pa. In its decision today, the Commission itself acknowledges that this amendment removes the existence of State aid with respect to the inter-company loan interest. The Commission has also considered that the exemption of interests received per source company not exceeding £100,000 pa can be regarded as a legitimate simplification measure. So, in effect, the Commission is indicating that HMGoG has already taken the necessary legislative action to rectify this concern from this point onwards. The Commission's investigation on interest is therefore only concerned with the limited period between 1 January 2011 and 1 July 2013.

The only area in which HMGoG may be required to make changes is in relation to the non-taxation of royalties. HMGoG is of the view that the non-taxation of royalties does not fall foul of EU state aid rules. However, HMGoG will consider all options that are available to it in order to deliver legal certainty, including if necessary and appropriate making an amendment of the Income Tax Act 2010, without prejudice to the contention that it is entirely compliant with EU rules. HMGoG will make a further announcement on this issue once it has consulted the industry and made relevant representations to the Commission.

Commenting on today's decision, the Chief Minister said :

"We have been engaged with the European Commission for the last year or so and have already submitted a very significant amount of information to them (some of which is in the process of being provided to them) and met them on numerous occasions. I am certain that it is for this reason that the formal investigation that has been opened today is in relation to only two discreet elements of our corporate tax system. We had already anticipated the concern with the non-taxation of inter-company loan interest, which had also been raised by the Code of Conduct Group, and have addressed this through an amendment to the Income Tax Act 2010 that the Government already introduced on 1 July 2013. We will address the issues raised by the Commission in relation to non-taxation of royalties expeditiously and in consultation with the industry and the Commission. What is significant today is that the Commission has accepted the territoriality system as the system of reference, it has confirmed that the 2013 amendment addresses its concerns regarding interest and made a robust statement on regional selectivity. This is very good news for Gibraltar".

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