COMMISSION DECISION

of 10 July 2002

on the ais scheme implemented by Finland for Åland Islands captive insurance companies

(notified under document number C(2002) 2410)

(Only the Finnish and Swedish texts are authentic)

(Text with EEA relevance)

(2002/937/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above [1],

Whereas:

I. PROCEDURE

(1) By letter EUEC020-284 dated 15 July 1998 (registered under number SG A/38452), the Finnish authorities notified to the Commission an aid scheme for so-called captive insurance companies in the County of Åland. Since the measure had already entered into force in 1993, Finland's notification was late and could not be deemed valid under Article 88(3) of the EC Treaty. By letters dated 15 October 1998, 5 February 1999 and 2 June 1999, Finland provided the Commission with additional information. On 13 July 2000 the Commission sent a further letter (D/53912) to the Finnish authorities asking for confirmation that the State aid measure in question had never been applied. The Finnish authorities replied by letter EUEC096-217 of 25 August 2000 (A/37109), confirming that the measure had indeed not been applied since its entry into force.

(2) By letter dated 11 July 2001 (SG 2001 D/289763), the Commission informed Finland that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the aid. Comments from Finland were received by letter EUEC206-94 dated 9 August 2001.

(3) The Commission's decision to initiate the procedure was published in the *Official Journal of the European Communities* [2]. The Commission invited interested parties to submit their comments on the measure.

(4) The Commission received no comments from interested parties.

II. DETAILED DESCRIPTION OF THE AID

1. Provisions of the scheme

(5) The aid measure in question was introduced in Finland by the County of Åland for implementation on the latter's territory. An amendment to the Åland Local Government Taxation Law entered into force on 9 December 1993 (ÅFS 109/93). Under that amendment, captive insurance companies meeting certain criteria could benefit from lower taxation that would normally apply to companies and collective advantages. At the time the amendment was adopted, the tax advantage was equal to 10 percentage points. Captive insurance companies paid a lower overall rate of corporation tax than the standard rate of 25 % applicable at that time.

(6) The net advantage enjoyed by captive insurance companies in Åland Islands changed in 1996 and 1998 as a result of the decision by the relevant authorities to amend the standard rate of corporation tax.

(7) These changes and their subsequent adjustments are the subject of the present decision.

[1] OJ L 309, 1.11.2001, p. 4.

[2] See footnote 1.

2. **Conditions**

(8) Originally, in accordance with the amendment of 9 December 1993, captive insurance companies in the Åland Islands qualified for the tax advantage only if the following conditions were met:

(a) all of the company's shares or participatory rights had to be owned by one and the same foreign owner;

(b) only the company's owner or subsidiary could be insured by the company; and

(c) the day-to-day running of the company had to be carried out by a limited company (aktiebolag) which conducted operations subject to notification or licensing in the County of Åland.

3. **Amendments to the original measure which are relevant to this State aid procedure**

(9) The measure was amended for the first time in 1995 (ÅFS 82/95) with a view to extending its scope to include captive insurance companies with domestic owners, which had previously been excluded from the scope of the measure.

(10) In 1996 corporation tax in Finland was increased to 28 %. The level of the advantage previously granted to captive insurance companies was thus increased (second amendment) from 10 to 11,2 percentage points (ÅFS 40/96).

(11) In accordance with the third amendment in 1998 (ÅFS 17/98), the level of the advantage was reduced to 10 percentage points. This thus changed the rate of corporation tax payable by captive companies in the Åland Islands to 18 %. There have since been no further amendments to the measure.

III. **GROUNDS FOR INITIATING THE PROCEDURE UNDER ARTICLE 88(2) OF THE EC TREATY**

(12) In considering the information regarding the 1995, 1996 and 1998 amendments and submitted by Finland in the context of the preliminary assessment provided for in Article 6 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty ([3]), the Commission took the view that the measure might constitute non-notified state aid. Its doubts arose mainly from the fact that the amendments made after Finland's accession to the European Union were notifiable under Article 88(3) of the EC Treaty.

(13) Since the measure appeared to constitute operating aid, the Commission had doubts as to its compatibility with the common market. According to the Commission's standard practice, such aid cannot be regarded as facilitating the development of certain economic activities or of certain economic areas.

(14) Accordingly, the Commission initiated the procedure under Article 88(2) of the EC Treaty.

IV. **COMMENTS FROM FINLAND**

1. **Background**

(15) Comments from Finland were submitted by letter EUEC206-94 dated 8 August 2001 (registered as received on 13 August 2001 under number SG (2001) A/9179).

(16) Finland stressed that the autonomous status of the Åland Islands is laid down in the constitution and is recognised under international law, as evidenced by the fact that the matter is specifically dealt with by Protocol 2 to the Accession Treaty.

(17) Under Section 18(5) of Law No 1144/1991 on self-government for the Åland Islands, the latter are empowered to legislate in areas concerning their entitlement to levy supplementary income tax, miscellaneous additional income tax, business and entertainment taxes and concerning the bases of assessment in areas where taxation falls within the remit of the County and its local authorities.

(18) The tax measure for the Åland Islands was adopted as part of local taxation and incorporated in Section 4a of the Åland Local Government Taxation Law (ÅFS 37/93).

(19) According to the Finnish authorities, the Åland Islands' economy is based on a small number of sectors. The County's insular nature gives rise to structural problems affecting the competitiveness of its businesses. Insurance and financial services are sectors well suited to the Åland Islands since the disadvantages of being an island region do not have the same impact in these sectors.

(20) The Finnish authorities stressed that in 1993, when the measure entered into force, the Åland Island's economy was depressed and unemployment was high.

([3]) OJ C 83, 27.3.1999, p. 1

(21) According to the Finnish authorities, the 1995 amendment, which broadened the scope of the measure to include non-foreign owners, was of minor importance, its consequences were at national level, and it did not involve any change to the tax measure's status as existing aid (assuming that the Commission considers it to constitute State aid within the meaning of Article 87(1) of the EC Treaty).

(22) Finally, the Finnish authorities described in detail the adjustments to the original amendment that were made in 1996, when the tax reduction was increased to 11,2 percentage points, and in 1998, when it was restored to 10 percentage points.

(23) Amendments to general corporation tax introduced after 1998 have indirectly affected the tax payable by captive insurance companies. On the basis of the tax measure in question, such a company is liable to corporation tax of 19,3975 % in the 2001 tax year.

2. **Appraisal by the Finnish authorities of the measure's status as aid**

(24) Finland stresses that the Åland Islands must be regarded as a separate jurisdiction for the relevant areas since legislative powers lie exclusively with the Åland Parliament.

(25) Firstly, Finland argues that the lower rate of tax for captive insurance companies does not distort or threaten to distort competition by favouring certain undertakings or certain sectors and does not affect trade between Member States. The measure does not affect competition between insurance companies since companies that receive the tax advantage can insure only their owners or their subsidiaries. According to the Finnish authorities, competition on the insurance market is not affected since a captive insurance company will normally re-insure itself on that market.

(26) The Finnish authorities claim that any natural or legal person, irrespective of the sector of activity concerned, can qualify for the tax reduction through ownership of a captive insurance company through which they insure their own risks. The reduced rate of tax applies only if a captive insurance company, under the regulations applicable to companies, insures its owners or its subsidiaries. The measure applicable to such companies thus merely constitutes a business taxation measure.

(27) Eligibility for the tax advantage requires that there be a close link between the captive insurance company and its owners and that they must therefore be considered a single unit. Finland argues that, since the financial benefit of the tax measure accrues to the owners of a captive insurance company and since they may operate in any sector whatsoever, the tax measure must be considered a general measure and not a measure affecting trade between Member States.

(28) According to Finland, the measure applied in the Åland Islands cannot be considered selective since it does not impose any requirements as to the sector in which the owners operate.

(29) It also claims that the measure is not selective from a regional standpoint either since the Åland Islands are autonomous and constitute a separate jurisdiction in relation to the rest of Finland.

3. **Appraisal by the Finnish authorities of the compatibility issue**

(30) As far as compatibility is concerned, if the Commission were to regard the measure as aid, Finland takes the view that the derogations provided for in Article 87(3)(c) of the EC Treaty preclude the measure from being deemed to be incompatible State aid, at least in the case of captive insurance companies with their registered office outside Mariehamn, which since 1 January 1998 have not been eligible for the derogation for regional aid provided for in Article 87(3)(c). According to Finland, the Commission must bear in mind that the Åland Islands are a group of islands and need to diversify their economy.

(31) Finland further claims that account should be taken of Article 158 of the EC Treaty, which underlines the need for the Community to reduce disparities between the levels of development of the various regions and the backwardness of the least-favoured regions or islands. The same applies to the Declaration on island regions appended to the Amsterdam Treaty. Account should also be taken of point G of the Council Resolution of 1 December 1997 on a code of conduct for business taxation ([4]), which states that particular attention will be paid to special features and constraints in the case of the outermost regions and small islands. The Åland Islands consist of countless small islands with ill-balanced business activities that are restricted by the fact that the region forms an archipelago. The lower rate of tax for captive insurance companies in the Åland Islands promotes business development there.

(32) On the basis of the arguments set out above, Finland considers that the tax measure applied to captive insurance companies in the Åland Islands does not

([4]) OJ C 2, 6.1.1998, p. 2.

constitute State aid and, if it were to be regarded as constituting State aid, would not be incompatible with the common market.

(33) Finally, Finland points out that, since the tax measure has not yet been applied to any actual case, the question of recovery will not arise if the Commission decides that the measure constitutes incompatible State aid.

V. ASSESSMENT OF THE AID

1. Applicability of Article 87(1) of the EC Treaty

(34) Under Article 87(1) of the EC Treaty, aid granted by a Member State 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 is, in so far as it affects trade between Member States, incompatible with the common market.

(35) To be termed as prohibited aid under Article 87(1) of the EC Treaty, a measure must fulfil the following four criteria:

(a) the measure must confer on the beneficiaries an advantage that relieves them of charges they normally incur in the course of their business;

(b) the advantage must be granted from state resources;

(c) the measure must affect competition and trade between Member States;

(d) dthe measure must be specific or selective in that it favours 'certain undertakings or the production of certain goods'.

The Commission has accordingly examined the measure in the light of the conditions laid down in Article 87(1).

(36) Firstly, as regards the criterion that 'the measure must afford the beneficiaries an advantage', a lower rate of taxation confers an advantage on a company by enabling it to retain a greater proportion of its profits either for distribution to its members or shareholders or for reinvestment and therefore confers an advantage on eligible companies.

(37) According to point 9 of the Commission notice on the application of the State aid rules to measures relating to business taxation ([5]), the tax advantage may be provided through a reduction in the firm's tax burden in various ways, including a reduction in the amount of tax.

(38) The exemption from the obligation to pay the full amount of corporation tax applicable to captive insurance companies in the Åland Islands fulfils this criterion, both for captive insurance companies themselves and for the groups of companies to which they belong.

(39) Secondly, as regard the criterion of a measure being 'granted by a Member State or through state resources in any form whatsoever', the granting of a tax reduction involves a loss of tax revenue which, according to point 10 of the Commission Notice, is equivalent to consumption of State resources in the form of fiscal (tax) expenditure ([6]). As the Court of Justice has ruled, this principle also applies to aid granted by regional and local bodies in the Member States ([7]).

(40) In the present case, the tax relief is granted by the Åland Islands authorities. The state resources criterion can therefore be regarded as fulfilled.

(41) Thirdly, as regards the criterion to the effect that 'the aid distorts or threatens to distort competition', the Court of Justice has repeatedly ruled that intra-Community trade is to be deemed to be affected from the moment the beneficiary firm carries out an economic activity which is the subject of trade between Member States.

(42) The Finnish authorities claim that the lower rate of tax applicable to captive insurance companies in the Åland Islands does not distort competition since beneficiaries insure their owners or their subsidiaries and therefore are not in competition with each other. Moreover, Finland argues that, since captive insurance companies are active on the reinsurance market, no distortion of trade exists.

(43) In this context, the Commission takes the view that the effect of the aid on trade between Member States is independent of any purpose for which the aid is granted ([8]).

([5]) OJ C 384, 10.12.1998, p. 3.

([6]) With regard to the concept of 'tax expenditure', see 'Tax expenditures. Recent experiences', OECD, Paris, 1996; see also Stanley S. Surrey, 'Tax incentives as a device for implementing government policy: A comparison with direct government expenditures', Harvard Law Review, Volume 83, No 4, pages 705 to 738.

([7]) See Case 248/84 Germany v Commission [1987] ECR 4013.

([8]) See Case 173/73 Italy v Commission [1976] ECR, 709 at paragraph 13.

(44) According to the Finnish authorities, competition on the insurance market is not affected since a captive insurance company normally reinsures itself on that market. The Commission considers the insurance market to be an open market, and insurance is therefore subject to intra-Community trade.

(45) The Commission takes the view that captive insurance companies are offsetting the risks on the insurance market through internal reinsurance. In that respect, reinsurance of subsidiaries does not constitute a separate insurance market since subsidiaries can normally be insured by other companies operating on the open market. The fact that the insurer is a captive insurance company is thus irrelevant.

(46) Competition between Member States is affected because the measure favours the establishment of captive insurance companies in the County of Åland and of the groups to which they belong, which operate within sectors in which there is trade between Member States.

(47) The fact that the insurer is a captive insurance company does not prevent trade between Member States from being affected, irrespective of whether one is talking of the company itself or the group to which it belongs.

(48) Fourthly, as regards the criterion that the aid should favour 'certain undertakings or the production of certain goods', the Finnish authorities claim that, since the financial benefit of the tax measure accrues to the owners of a captive insurance company and since there are no requirements as to the sector where the owners operate, the tax measure must be regarded as a general measure.

(49) In considering the benefits of the tax measure in question, a measure may be selective because it is granted either as an exception to general tax arrangements established by law, regulation or administrative practice or at the discretion of the tax administration.

(50) In the present case, the Commission considers that the measure is specific or selective in that it favours only captive insurance companies as the prime beneficiaries of the tax relief in cases where the necessary conditions are met.

(51) The measure debars insurance companies which normally insure non-affiliated companies from operating on exactly the same market and on the same conditions as captive insurance companies. It lays down conditions that can hardly be met by other companies whose activity is to insure non-affiliated related companies.

(52) The selectivity criterion is further met by the fact the conditions under which the measure applies implicitly require a certain economic strength and therefore could apply only to sufficiently large companies. It thus excludes other (owner) insurance companies operating in different sectors from qualifying for the tax relief. Indeed, the formation of a captive company implies that the group with which insurance contracts will be concluded is large enough to generate a turnover that will allow it to cover the fixed costs and obtain a profit. For example, one can hardly imagine that a group in the textile sector comprising three companies with ten employees each could afford to set up a captive insurance company. There can hardly be any doubt that the fixed costs in question would not be offset by the volume of premiums paid by the group's three companies. For these reasons, the measure is designed mainly for groups of companies which are large enough to afford to set up a captive insurance company.

(53) The Commission considers that the measure implemented by the County of Åland constitutes operating aid within the meaning of Article 87(1) of the EC Treaty. It therefore has to determine if such an aid can be deemed compatible with the common market on the basis of the derogations provided for in Article 87(2) and (3) of the EC Treaty.

2. **Assessment of whether the measure constitutes illegal aid**

(54) The measure was put into effect for the first time in 1993, when Finland was not yet a member of the European Union. According to Article 1(b)(i) of Council Regulation (EC) No 659/99, such a scheme may be regarded as existing aid. However, as indicated above, two amendments were made to it in 1995 and 1996.

(55) The first one in 1995 involved widening the scope of recipients to cover companies with their registered office in the Åland Islands, which were originally excluded from the scheme. As it extended the existing scheme, it should, under Article 88(3) of the EC Treaty, have been notified to the Commission. However, it could not affect the situation of companies not having their registered office in the County of Åland, which remained unchanged. Thus, this first amendment

constituted a separate event that did not alter the original existing scheme, which was applicable solely to companies which did not have their registered office in the County of Åland. In 1995, only the application of the scheme to companies with their registered office in the County of Åland was to be regarded as illegal aid.

(56) The second amendment was made in 1996 and involved increasing the reduction on corporation tax for companies with or without a registered office in the Åland Islands from 10 to 11.2 percentage points. There is no doubt that this amendment increased the advantage granted under the scheme and therefore constituted an event which should, under Article 88(3) of the EC Treaty, have been notified to the Commission. As with the 1995 amendment, the issue of whether it constitutes a separate act has to addressed. Unlike the 1995 amendment, the 1996 amendment did not apply to only some of the recipients as previously and did not constitute an exemption from another type of tax than the one with which the scheme was concerned, i.e. corporation tax. The Commission takes the view that such an amendment cannot be deemed to be separate from the original scheme for captive insurance companies applicable from 1993. The result of the 1996 amendment was to increase the advantage enjoyed by recipients to an extent which is impossible to determine. Increasing a tax reduction, even by only one percentage point, may have a indeterminable multiplier effect. This is because the increased tax reduction leads to increased competitiveness on the part of the recipient company. This additional distortion cannot be quantified, and it is therefore not possible to view this amendment separately from the rest of the scheme.

(57) For these reasons, the 1996 amendment cannot be deemed to constitute a separate act since it altered the effects of the scheme, turning it into a new scheme which should, under Article 88(3) of the EC Treaty, have been notified to the Commission.

(58) From that date, the scheme for captive insurance companies became illegal aid. The fact that the scheme was amended again in 1998 and restored to the form it had taken in 1993 (with the advantage limited to 10 percentage points) does not mean that its status as existing aid can be deemed to have been restored. Failure to notify the second amendment clearly rendered the measure illegal, and amending a scheme, even to make it more like a previous aid scheme, cannot restore its status as existing aid. The fact that no company has hitherto benefited from the scheme does not alter the fact that the amendments to the original 1993 scheme should have been notified twice, in 1995 and 1996.

3. **Compatibility of the aid measure with the EC Treaty**

(59) Measures caught by Article 87(1) of the EC Treaty are generally incompatible with the common market unless they qualify for one of the derogations in Article 87(2) or (3). Derogations are applicable only if it can be shown that, without the aid, market forces would not have been enough to induce the recipients to act in such a way that one of the aims of the derogation could be achieved.

(60) In this case, the derogations in Article 87(2) of the EC Treaty are not applicable because the aid is not designed to achieve any of the aims listed in the relevant provisions.

(61) Under Article 87(3)(a), aid is deemed compatible with the common market where it is designed to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment. Since the Commission does not consider the County of Åland to constitute such an area, this provision does not apply.

(62) As regards the derogations provided for in Article 87(3)(b) and (d), the aid in question is not intended to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of Finland, nor is it intended to promote culture or heritage conservation.

(63) Lastly, it is necessary to examine whether the aid qualifies for the derogation in Article 87(3)(c), which states that aid may be considered compatible with the common market where it facilitates the development of certain economic activities or of certain economic areas and does not adversely affect trading conditions to an extent contrary to the common interest.

(64) In the case of captive insurance companies with their registered office outside Mariehamn, which since 1 January 1998 have not been eligible to benefit from the derogation for regional aid provided for in Article 87(3)(c), Finland claims that the derogations contained

in that Article prevent the tax measure from constituting incompatible State aid.

(65) Finland also claims that Article 158 of the EC Treaty and the Declaration on island regions appended to the Amsterdam Treaty must be taken into account.

(66) As regards Article 158 of the EC Treaty, the Commission takes the view that the Community should develop and pursue its actions aimed at strengthening economic and social cohesion in order to promote harmonious development at all levels.

(67) In the present case, the Commission finds that the measure is restricted to captive insurance companies and, by its very nature, is not covered by the derogation provided for in Article 87(3)(c) of the EC Treaty, under which aid may be found compatible with the common market if it 'facilitates the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest'.

(68) In any case, an assessment in the light of Article 158 of the EC Treaty does not rule out an assessment under Article 87(3)(c) since the latter is aimed at safeguarding an overall harmonious development in line with Article 158 of the EC Treaty.

(69) The Finnish authorities further argue that account should also be taken of point G of the Council Resolution of 1 December 1997 on a code of conduct for business taxation ([9]), which states that particular attention will be paid to special features and constraints in the case of the outermost regions and small islands. In this respect, it should be borne in mind that the criteria applied in the context of the code of conduct for business taxation in assessing the harmful character of a measure are not relevant as regards the compatibility of the measure with the common market.

(70) The Commission considers that, in order to assess whether the aid measure in question is compatible with the common market, a distinction must be made between investment aid and operating aid. The rules applicable to capital insurance companies in the Åland Islands are not related to investment or the creation of employment and constitute an exemption from costs which those companies would normally have to bear in the course of pursuing their day-to-day business activities.

(71) Accordingly, the Commission takes the view that the aid measure in question constitutes operating aid.

(72) Operating aid is in principle prohibited. At present, the Commission authorises it only in exceptional cases and subject to certain conditions, for example in respect of certain types of environmental aid ([10]) and in regions, including outermost regions, covered by the derogation in Article 87(3)(a), provided that the aid is duly justified and its level is proportional to the handicaps it is intended to offset ([11]).

(73) Where a derogation is granted on the basis of regional criteria, the Commission must ensure in particular that the measures in question are targeted at genuine regional handicaps. It considers that there are no genuine regional handicaps since their additional costs e.g. the transport costs for insurance activities, have little impact.

(74) The measure constitutes operating aid and does not lead to any significant improvement in regional development terms since its positive effects will cease as soon as it is withdrawn and are therefore limited in time. As the measure is specifically aimed at captive insurance companies, the Commission does not consider that it offsets any genuine regional handicaps in the Åland Islands in the form of additional costs. Moreover, in view of the nature of the economic activity in question, the scheme does not promote economic development in the region to any significant extent.

(75) The Commission takes the view that, since the operating aid in the present case is not covered by any of the derogations set out in Article 87(3)(a), (b) or (c) of the EC Treaty, it must be deemed incompatible with the common market within the meaning of Article 87(1) of the EC Treaty.

4. **Recovery of aid**

(76) In connection with the initiation of the formal procedure, the Finnish authorities and interested parties were invited to give their comments on possible legitimate expectations of such a nature that would pose

([9]) See footnote 4.

([10]) Community guidelines on State aid for environmental protection (OJ C 72, 10.3.1994, p. 3).

([11]) Guidelines on national regional aid (OJ C 74, 10.3.1998, p. 9).

an obstacle to the recovery of the aid in the event of the aid being regarded as illegal and incompatible with the common market. As no aid has been granted to companies since the scheme entered into force, the issue of recovery does not arise.

VI. **CONCLUSION**

(77) As regards the information provided to the Commission by Finland and the measures covered by the decision to initiate the procedure under Article 88(2) of the Treaty, the Commission finds that:

(78) Finland has unlawfully implemented the County of Åland's captive insurance companies tax scheme, as amended in 1995 and 1996, in breach of Article 88(3) of the EC Treaty.

(79) The Commission also finds that the measure in favour of captive insurance companies in the County of Åland does not satisfy any of the criteria laid down in Article 87(3)(a), (b) or (c) of the EC Treaty. The measure is therefore incompatible with the common market pursuant to those provisions,

HAS ADOPTED THIS DECISION:

Article 1

The State aid which Finland has implemented for so-called captive insurance companies in the County of Åland (ÅFS 109/93 with subsequent amendments) is incompatible with the common market.

Article 2

Finland shall withdraw the scheme referred to in Article 1.

Article 3

Finland shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with it.

Article 4

This Decision is addressed to the Republic of Finland.

Done at Brussels, 10 July 2002.

For the Commission

Mario MONTI

Member of the Commission