COMMISSION DECISION

of 4 July 2006

on State Aid No C 30/2004 (ex NN 34/2004) implemented by Portugal exempting from corporation tax on capital gains certain operations/transactions by public undertakings

(notified under document number C(2006) 2950)

(Only the Portuguese version is authentic)

(Text with EEA relevance)

(2006/748/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 article cited above [1],

Whereas:

I. PROCEDURE

(1) Following information relating to alleged tax exemptions on capital gains granted by the Portuguese authorities to certain public undertakings under Article 25 of the Portuguese Tax Relief Regulations, *Estatuto dos Benefícios Fiscais* (hereinafter referred to as 'EBF') [2], the Commission asked the Portuguese authorities for detailed information by letter dated 14 March 2001.

(2) The Portuguese authorities replied by letter of 25 April 2001. A second request for information was sent on 28 October 2003 and a reply was received on 30 January 2004. The Portuguese authorities submitted further information by letter of 8 September 2004.

(3) By letter dated 6 October 2004 the Commission informed Portugal that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty on the aid measure in question [3]. In this decision, published in the Official Journal of the European Union [4], the Commission invited interested parties to submit their comments on the measure.

(4) By letter received by the Commission on 21 December 2005, the Portuguese authorities submitted their comments.

(5) No interested parties submitted any comment.

II. DETAILED DESCRIPTION OF THE AID SCHEME

(6) The tax exemptions are provided for in Article 25 of the EBF, entitled *Mais-valias no âmbito do processo de privatização* (capital gains as part of the privatisation process) which corresponds to Article 32-C in the original version of 2000 before the amendment of the EBF by Decree-Law 198/2001 of 3 July 2001.

(7) For the purposes of establishing the profit liable for corporation tax in the case of wholly publicly owned companies and companies controlled by them, Article 25 EBF provides for the exclusion from the taxable amount of capital gains from privatisation and restructuring operations carried out in accordance with the strategic guidelines for the performance of the State's shareholder function and recognised as such by order of the Finance Minister.

(8) Article 25 of the Portuguese EBF entered into force on 1 January 2000 pursuant to Article 103 of Law 3-B/2000 of 4 April 2000.

III. GROUNDS FOR INITIATING THE PROCEDURE

(9) The decision to initiate the formal investigation procedure stated that Article 25 EBF seemed to constitute a state aid scheme within the meaning of Article 87(1) of the EC Treaty. The scheme appeared to be an operating aid and, on the basis of the information available, was incompatible since it did not seem to be directed to any eligible investments or expense items. Furthermore, none of the exemptions provided for in Article 87(2) and (3) of the EC Treaty appeared applicable. Indeed, it constituted unjustified aid that gave public undertakings an advantage over their private competitors.

IV. COMMENTS FROM PORTUGAL

(10) By letter received by the Commission on 21 December 2005 Portugal confirmed the information already provided during the Commission's preliminary assessment.

[1] OJ C 256, 15.10.2005, p. 26.
[2] Decree-Law 215/89 of 1 July 1989.
[3] C(2004) 2637, 6.10.2004.
[4] See footnote 1.

(11) The Portuguese authorities summarise developments in corporation tax on capital gains in Portugal as follows:

— From 1993 reinvested capital gains received preferential tax treatment, provided they derived from tangible fixed assets or shares held by holding companies (SGPS) ([5]). In such cases reinvestment of the proceeds leads to their exclusion from taxable profit.

— This situation changed from 2001 ([6]). A positive balance between capital gains and capital losses was taxable as follows: when the proceeds were reinvested in the year they were realised, one fifth of the proceeds were taxable in the year they were realised and a further fifth in each of the following four years.

— From 2002 half of the capital gains became taxable, even if they were reinvested ([7]).

— In 2003 the situation changed again: SGPS (and risk capital companies, SCR) enjoyed total tax exemption of capital gains realised on shares they held, provided they held them for not less than one year ([8]).

(12) The Portuguese authorities argue that the tax relief legislation merely applies to public-sector undertakings the same rules of capital gains taxation and tax neutrality as have applied to private companies engaged in corporate restructuring since the 1988 tax reform and the establishment of corporate income tax, *Imposto sobre o Rendimento das Pessoas Colectivas* (IRC).

(13) The Portuguese authorities further argue that under Portuguese tax relief legislation reinvested capital gains receive preferential tax treatment, provided they derive from tangible fixed assets or shares held by holding companies. In such cases, reinvestment of the proceeds leads to their exclusion from taxable profit, something which is an integral part of the Portuguese tax system.

(14) Article 25 EBF also excludes from the taxable base for IRC capital gains realised by 100 % state-owned companies and companies controlled by them. It only extends to such bodies the tax treatment applicable to the capital gains reinvested by holding companies and to corporate restructuring operations carried out by other private companies. Eligible companies therefore derive no financial advantage when they are involved in privatisation, reorganisation or restructuring operations.

(15) According to the Portuguese authorities, the intention behind Article 25 EBF was precisely to avoid making privatisations and corporate restructuring operations in the public sector conditional on the involvement of a public holding company, thus facilitating the State's role as shareholder.

(16) The Portuguese authorities affirm that Article 25 EBF contains no provision which creates an exceptional system of taxation of capital gains compared with the ordinary system. Its application confers no additional advantage on beneficiary companies involved in reorganisation or restructuring operations.

(17) The Portuguese authorities also notified their intention of repealing Article 25 EBF. So, once it was repealed, every restructuring or privatising operation involving a public company would be treated under Portugal's ordinary tax relief system applicable to private enterprises.

(18) With regard to recovery the Portuguese authorities argued that: (a) only four transactions had benefited from the scheme, and in any case a private company would have obtained the same tax advantages by setting up a holding company and reinvesting the amount in financial assets; and (b) three of the four transactions had already been approved by the management of the Caixa Geral de Depósitos (CGD) with a view to privatisation (creation of an SGPS), given that at the time Article 25 EBF had not yet been adopted. Therefore, given that no financial advantage was granted to the public undertakings, the Portuguese authorities deny that there is anything to recover.

(19) The four transactions that benefited from the scheme are:

— The sale by Mundial Confiança (MC), an insurance subsidiary of the Portuguese financial institution CGD, of its holding (5,46 %) in *Crédito Predial Português* (CPP) to *Banco Santander Central Hispano* (BSCH) on 5 April 2000. The capital gain realised by MC was EUR 9,3 million.

— The sale by *Banco Pinto & Sotto Mayor* (BPSM), controlled by CGD at the time of the transaction, of its holding (94,38 %) in *Banco Totta & Açores* (BTA) and

([5]) Article 7(2) of Decree-Law 495/88 of 30 December 1988 and EBF Article 31(2) implemented Article 44 (now 45) of the *Código do Imposto sobre o Rendimento das Pessoas Colectivas* (CIRC).

([6]) Law 30-G/2000 of 29 December 2000.

([7]) Law 109-B/2001 of 27 December 2001.

([8]) Under Article 31(2) EBF, in the revised wording introduced by Law 32-B/2002 of 30 December 2002 approving the state budget for 2003: 'capital gains and capital losses realised by SGPSs or SCRs through conveyance in return for payment, whatever the grounds of the transaction, of shares in capital which they hold, provided they have held them for a period of not less than one year, plus the financial charges incurred in acquiring them, shall not count towards the taxable profits of such companies'.

its holding (7,09 %) in CPP to BSCH on 7 April 2000. The capital gain realised by BPSM was estimated at EUR 310 million.

— A share exchange between MC and BCP. MC sold its holding (53,05 %) in BPSM to BCP in exchange for approximately 10 % of BCP on 19 June 2000. The capital gain realised by MC was EUR 1 566,4 million.

— The capital gain from the sale of CGD's stake in the Brazilian bank ITAÚ SA, which took place between 2000 and 2003. The total capital gain realised by CGD was EUR 357,4 million.

(20) The first three transactions were decided following agreements between the Champalimaud Group and BSCH. To this end CGD and BSCH signed a contract on 11 November 1999 under which:

— BSCH bought António Champalimaud's holdings in the Champalimaud Group and then sold them to CGD.

— The holdings in BTA and CPP were sold to BSCH.

(21) The aim of restructuring the Champalimaud Group was to split up the banking and insurance activities in order to improve the efficiency of the Portuguese supervisory authorities (Banco de Portugal and Instituto de Seguros de Portugal).

(22) In the fourth case the divestiture was decided following a new agreement between CGD and Unibanco (União de Bancos Brasileiros *SA*).

(23) The objective of the measure in question was to ensure the fiscal neutrality of privatisation and restructuring operations involving wholly publicly owned companies and companies controlled by them.

(24) The Portuguese authorities, in their role of shareholder in CGD, sent on 18 October 2000 and 31 March 2000 letters signed by the Finance Minister authorising the transactions referred to above in accordance with the strategic guidelines.

V. ASSESSMENT OF THE MEASURE

V.1 Does the scheme constitute state aid?

(25) The Commission confirms the decision to open the formal procedure to decide whether the measure is state aid. Article 25 EBF, which exempts from corporation tax public undertakings' capital gains from privatisation and restructuring operations, constitutes a state aid scheme.

(26) The Court of Justice has consistently held that a measure whereby the public authorities grant certain undertakings a tax exemption which, although not involving a transfer of state resources, places the persons to whom the exemption applies in a more favourable financial position than other taxpayers constitutes state aid within the meaning of Article 87(1) of the Treaty ([9]).

State resources

(27) The measure provided for in Article 25 EBF uses state resources because it is based on the non-collection of corporation taxes which would normally be due to the State. The decision to forego this revenue fulfils the criterion for state resources.

Selective advantage

(28) Article 25 EBF, compared with the normal tax arrangements applicable to capital gains in Portugal, grants an advantage to the beneficiaries.

(29) The normal tax arrangments to be taken into consideration are those applicable to undertakings without distinction as to ownership (public-owned or not) or nature (holding or not).

(30) The normal tax arrangements are not those applicable exclusively to holding companies because the transactions covered by Article 25 EBF (restructuring operations) may involve both holding and non-holding companies.

(31) The preferential tax regime applicable to capital gains obtained by holdings in Portugal, became applicable from 1993. However, at the time the transactions in question took place this preferential treatment applied only if the proceeds realised were reinvested. This means that even by comparison with the arrangements applicable to holding companies, which were not the normal tax arrangements in Portugal, a selective advantage was accorded to wholly publicly owned companies and companies controlled by them.

(32) An exemption from capital gains tax puts the publicly owned companies which benefit from it at an advantage compared with other companies operating in the same economic sectors because these public companies enjoy an increased cash flow for running their business. Whatever the purpose of the measure may be, state aid is determined on the basis of effects and not objectives.

(33) The advantage is granted only to certain undertakings, namely undertakings that are wholly publicly owned and those controlled by them, undergoing privatisation or

([9]) Case C-6/97 *Italian Republic* v *Commission* [1999] ECR I-2981, paragraph 16.

restructuring operations that comply with government policy objectives. It excludes all other undertakings, including privately owned companies competing with the publicly owned beneficiaries. The Commission notice on the application of the state aid rules to measures relating to direct business taxation states that, when some public undertakings, for example, are exempt from company taxes, such rules, which accord preferential treatment to undertakings having the legal status of public undertaking and carrying out an economic activity, may constitute state aid within the meaning of Article 92 of the Treaty ([10]).

(34) The tax provisions of Article 25 EBF are *de jure* selective since they concern only certain companies (i.e. public companies or companies controlled by them). Moreover, the measure applied *de facto* exclusively to banking or insurance public undertakings or undertakings controlled by them. This is clear from the information provided by the Portuguese authorities.

(35) The Portuguese authorities deny that the measure is selective, arguing that the measure addresses public-sector entities as a category of undertakings, and is thus a general measure. This argument cannot, however, be accepted by the Commission for the following reasons.

(36) Firstly, there is no such concept as public-sector companies relevant for tax purposes as the companies that may potentially enjoy the advantage accorded by Article 25 EBF may in principle intervene on a wide variety of markets.

(37) Secondly, this measure does not identify any aspects specific to public companies compared with private ones. Private companies and foreign public companies with branches in Portugal may also engage in restructuring programmes. Their shareholders may decide to sell the companies, but would not be covered by the scheme.

(38) Thirdly, only a subsector of public undertakings is targeted by this measure: those which are in a process of privatisation or restructuring where such operations are recognized by the Finance Minister. This measure is selective even in respect of undertakings in the public sector, also because of the discretionary power enjoyed by the competent authority.

(39) Therefore, the Commission concludes that Article 25 EBF grants a selective advantage. The selectivity implied by the measure concerned is not justified by the nature and the structure of the Portuguese tax system.

Effect on trade and distortion of competition

(40) By enabling public companies undergoing privatisation or regulated restructuring to enjoy reductions in the tax on their capital gains, Article 25 EBF grants them an operating advantage and strengthens their position compared with other companies. In its assessment the Commission is not required to establish that the aid has a real effect on trade between Member States or that competition is actually being distorted, but only to examine whether that aid is liable to affect trade and distort competition ([11]). Where aid granted by a Member State strengthens the position of a company in relation to other companies competing in intra-Community trade, these other companies must be regarded as affected by that aid ([12]).

(41) What is more, all the identified beneficiaries of the scheme operate in the banking and insurance sectors, sectors that have been open to competition for many years. Progressive liberalisation has enhanced the competition that may already have resulted from the free movement of capital provided for in the EC Treaty.

(42) The effect on trade between Member States and the impact of the aid in terms of distortion of competition is particularly sensitive in these sectors ([13]).

(43) The aid scheme is therefore liable to affect this trade and distort competition.

Conclusion

(44) It follows from the above that the exceptional scheme provided for in Article 25 EBF, which exempts from corporation tax public undertakings' capital gains from privatisation operations and from restructuring processes, constitutes a scheme granting state aid within the meaning of Article 87(1) of the EC Treaty.

V.2 **Does the scheme constitute illegal aid?**

(45) Portugal has implemented the aid scheme without notification. Therefore, by unlawfully implementing Article 25 EBF, Portugal is in breach of Article 88(3) of the Treaty.

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

([11]) See for instance the judgment of the Court of Justice in Case C-372/97 *Italy* v *Commission* [2004] ECR I-3679, paragraph 44.

([12]) See Case 730/79 *Philip Morris Holland* v *Commission* [1980] ECR 2671 paragraph 11.

([13]) For the effect on trade and distortion of competition in the banking sector, see in particular the Court of Justice's judgment of 15 December 2005 in Case C-222/04 *Fondazioni bancarie*, paragraph 139 *et seq*., and the case law cited.

V.3 **Compatibility of the illegal aid scheme**

(46) The aid is not compatible with Article 87(2). It is not aid of a social nature, granted to individual consumers, nor aid to make good the damage caused by natural disasters or exceptional occurrences; nor is it aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany.

(47) The aid is applicable uniformly across the whole territory of Portugal, and therefore cannot be considered compatible with Article 87(3)(a) and (c), which covers the development of certain regions.

(48) The Commission considers that the operating aid concerned cannot be regarded as favouring the development of certain economic activities within the meaning of Article 87 (3)(c), notably because this provision requires that the aid 'not adversely affect trading conditions to an extent contrary to the common interest', a condition which the Commission deems not satisfied in this case. This aid does not meet any of the conditions of the rescue and restructuring guidelines in force when the aid was granted ([14]). It does not target any other horizontal objective of common interest. Finally, the fact that application is restricted to the financial sector does not change the conclusion of the assessment, especially since this sector is particularly sensitive to the effect on trade between Member States and the impact of this aid in terms of distortion of competition.

(49) Nor is the aid compatible with Article 87(3)(d) (aid to promote culture and heritage conservation) or (e) (such other categories of aid as may be specified by decision of the Council). Portugal has never invoked any of these derogations.

(50) Furthermore, the aid is not compatible with Article 87(3) (b). The aid cannot be considered a 'project of common European interest' since it will benefit the public undertakings of one Member State and not the Community as a whole and it will not promote a specific and well-defined project; nor does it 'remedy a serious disturbance in the economy of a Member State' since there is no evidence that, without the aid, the Portuguese economy would have suffered from a serious disturbance.

(51) In any case, apart from very general statements, Portugal has not specifically invoked any of the derogations of the Treaty.

([14]) Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 288, 9.10.1999, p. 2).

VI. **RECOVERY**

(52) According to Article 14 of Regulation (EC) No 659/1999, where negative decisions are taken in respect to unlawful aid, the Commission shall decide that the Member State concerned shall take all necessary measures to recover the aid from the beneficiary. However, the Commission may not require recovery of the aid if this would be contrary to a general principle of Community law.

(53) The Commission considers that, in the present case, there is no general principle of Community law which would impede recovery.

(54) The Portuguese authorities argue that the four transactions that benefited from the scheme would have been exempted from tax anyway under the Portuguese tax arrangements for holding companies. Moreover, three of the four transactions were already decided under the previous arrangements as Article 25 EBF had not yet been approved at the time. The Portuguese authorities therefore argue that no recovery should take place.

(55) According to ECJ case-law ([15]) and the Commission notice on business taxation ([16]), it is at the stage of recovery that re-establishing the status quo ante has to be considered in order to assess if an alternative tax treatment existed which, in the absence of unlawful aid and in accordance with domestic rules which are compatible with Community law, would have granted a similar advantage to the undertakings in question.

(56) The amount to be recovered in order to restore the previous situation is the difference between: (i) the total discounted advantage granted to the public undertakings or undertakings controlled by them resulting from the application of Article 25 EBF; and (ii) the 'normal' tax treatment which would have applied if the operations in question had been carried out without the aid measure. In the *Unicredito* case the ECJ states that it would not be right to determine the amounts to be repaid in the light of various operations which could have been implemented by the undertakings if they had not opted for the type of operation covered by the aid ([17]). In this context, the Commission must not to take into account the hypothetical choices which could have been made by the operators concerned, such as operations structured in other ways.

(57) Consequently, in order to assess the situation that would have prevailed if the operations in question had been carried out without the tax reduction, an analysis must be made of each of the transactions that benefited from

([15]) Case C-148/04 *Unicredito Italiano SpA*.

([16]) Commission notice on the application of the State aid rules to measures relating to direct business taxation (OJ C 384, 10.12.1998, p 3).

([17]) Paragraphs 113 to 119.

Article 25 EBF. In this case, such an analysis can be made on the basis of the information provided by the Portuguese authorities, without prejudice to a further assessment of each transaction on the basis of any further information available.

First two transactions

(58) The first transaction was MC's sale of its holding in CPP to BSCH on 5 April 2000. The second transaction was the sale by CDG-controlled BPSM of its holding in BTA plus its holding in CPP to BSCH on 7 April 2000.

(59) Since Article 25 EBF was not published at the time the sales were proposed, both transactions were planned and approved by the CGD management under the tax legislation applicable to holding companies (SGPS). The setting-up of the holding companies and the successive sales or swaps of shares would have resulted in a tax exemption for both transactions under the normal Portuguese tax arrangements. The Portuguese authorities have transmitted all the relevant documents to the Commission.

(60) Indeed, the choice of operators for the transactions in question was not at all accidental but the decisions had been already planned and approved by the managements of the groups concerned. The conditions for carrying out the transactions under the general tax legislation applicable to holding companies were also already met. The Portuguese authorities confirmed there was no need to obtain the prior approval of the tax authorities for such transactions.

(61) To conclude, the Commission considers that no recovery is necessary in these two cases. For these transactions there was no advantage in applying Article 25 EBF since, in view of the nature of the operation, MC and BPSM would have been exempted, even without this article, under the exemption arrangements for holding companies, which is the normal tax treatment under Portuguese legislation.

Third transaction

(62) The third transaction was the exchange of shares between MC and BCP described above.

(63) Thus the capital gains realised by MC from the swap of a majority shareholding in BPSM for shares accounting for about 10 % of the authorised capital of BCP, would be subject to the 'special system applicable to mergers, divisions, transfers of assets and share swaps' of Articles 67 to 72 CIRC. These articles implement Directive 90/434/EEC ([18]), which leaves the Member States no other possibility than to exempt the operation from taxation.

(64) What is certain is that by order of 14 November 2000 the Finance Minister decided to apply Article 25 EBF to this transaction. However, in this case there was no advantage in applying Article 25 EBF since the exemption imposed by the Community Directive and transposed by CIRC Article 71(1) is the normal tax treatment which, in the absence of unlawful aid and in accordance with domestic rules compatible with Community law, would have been granted for the operation actually carried out. Therefore, no recovery is necessary in this case either.

Fourth transaction

(65) The fourth and last transaction is the capital gain from the sale of CGD's stake in the Brazilian bank ITAÚ SA, which took place between 2000 and 2003. Unlike the other three transactions, this one is not related to agreements between the Champalimaud Group and BSCH.

(66) The complete sale took several transactions between 2000 and 2003. Although the Portuguese authorities argue that this transaction could have been done via a holding company, the fact is that doing it in this way in order to obtain a more favourable tax treatment than that offered by the ordinary system was not effectively planned. Therefore, in light of the *Unicredito* case, the Commission believes that applying the tax exemption for holding companies in this case would entail reconstructing past events on the basis of hypothetical elements. The Portuguese authorities did not provide enough detailed evidence on the different steps of the operation in question that would have led to tax neutrality, even if Article 25 EBF had not been applied.

(67) Therefore, the Portuguese authorities have not shown, at this stage, that the amount to be calculated by applying the effective tax rate to the capital gains actually realised (EUR 357,4 million) plus interest, should not be recovered.

VII. **CONCLUSION**

(68) The Commission finds that Portugal was in breach of Article 88(3) of the Treaty in implementing Article 25 of

([18]) Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (OJ L 225, 20.8.1990, p. 1). Article 8(1) lays down that: 'On a merger, division or exchange of shares, the allotment of securities representing the capital of the receiving or acquiring company to a shareholder of the transferring or acquired company in exchange for securities representing the capital of the latter company shall not, of itself, give rise to any taxation of the income, profits or capital gains of that shareholder'.

the Portuguese EBF. The aid scheme is incompatible with the common market and has to be repealed, as pledged by the Portuguese authorities.

(69) This Decision concerns the scheme as such and must be implemented immediately, including the recovery of aid granted under the scheme. However, it is without prejudice to the possibility that all or part of the aid granted in individual cases may be deemed compatible with the common market.

(70) The Portuguese authorities have shown that no recovery needs to be undertaken in the first three transactions. Therefore, on the basis of the information provided by the Portuguese authorities, and without prejudice to a further assessment of that transaction on the basis of any further information available, only the aid granted for the transaction relating to the capital gains from the sale of CGD's stake in the Brazilian bank ITAÚ S.A. has to be recovered,

HAS ADOPTED THIS DECISION:

Article 1

The state aid scheme implemented by Portugal under Article 25 EBF is incompatible with the common market.

Article 2

Portugal shall repeal the scheme referred to in Article 1.

Article 3

1. Portugal shall take all necessary measures to recover from the beneficiaries the aid referred to in Article 1 that was granted to them unlawfully.

2. Recovery shall be effected without delay and in accordance with the procedures of national law, provided that they allow the immediate and effective execution of this Decision.

3. The aid to be recovered shall bear interest from the date on which it was paid to the beneficiary until the date of its recovery.

4. Interest shall be calculated on the basis of the reference rate used for calculating the grant-equivalent of regional aid.

Article 4

Portugal shall inform the Commission within two months of notification of this Decision of the measures taken to comply with it. It will provide this information using the questionnaire in Annex I to this Decision.

Article 5

This Decision is addressed to the Portuguese Republic.

Done at Brussels, 4 July 2006.

For the Commission

Neelie KROES

Member of the Commission