IV

*(Acts adopted before 1 December 2009 under the EC Treaty, the EU Treaty and the Euratom Treaty)*

# COMMISSION DECISION

## of 30 September 2009

## on aid scheme No C2/09 (ex N 221/08 and N 413/08) which Germany intends to grant to modernise the general conditions for capital investments

*(notified under document C(2009) 7387)*

**(only the German text is authentic)**

**(Text with EEA relevance)**

(2010/13/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] and having regard to their comments,

Whereas:

### 1. PROCEDURE

(1) By letter dated 30 April 2008, registered at the Commission on the same day, the German authorities notified the Commission of two measures relating to liability for trade tax and exemption from the restriction on loss carry forward (N 221/08), for the purpose of legal certainty. By letters dated 26 June and 23 October 2008 the Commission asked for additional information. Germany responded by letters dated 24 July and 21 November 2008, registered on the same day.

(2) By letter dated 22 August 2008, registered at the Commission on the same day, the German authorities notified the Commission of a third measure concerning tax benefits for private investors (N 413/08), for the purpose of legal certainty. A meeting between the German authorities and DG COMP took place on 9 October 2008. Germany then submitted additional information by letter dated 19 November 2008, registered on the same day.

(3) On 28 January 2009 the Commission initiated the formal investigation procedure for all three measures. The summary of the decision was published in the Official Journal on 14 March 2009 [2]. The German authorities submitted their observations in a letter dated 3 March 2009, registered on the same day. Third parties submitted their comments in letters dated 9 and 14 April 2009, registered on the same day. Germany was informed of these comments on 23 April 2009 and submitted its response thereto in a letter dated 22 May 2009, registered on the same day.

### 2. DESCRIPTION

#### 2.1. Objective of the measures and budget

(4) The notifications relate to three tax measures and include two definitions of beneficiaries. All measures have been incorporated into the Bill to Modernise the General Conditions for Capital Investments (*Gesetz zur Modernisierung der Rahmenbedingungen für Kapitalbeteiligungen,* hereinafter 'MoRaKG'). These measures have the common objective of facilitating the provision of private venture capital to a specific group of companies, defined as 'target enterprises' (hereinafter TE).

(5) The first measure (registered under N 221/08) aims to facilitate the provision of risk capital by applying specific eligibility criteria for 'venture capital companies' (hereinafter VCC) to be exempted from the *liability for trade tax* (*Gewerbesteuerpflicht*). Germany estimates the annual tax loss from this measure at EUR 90 million.

(6) The second measure (also registered under N 221/08) mitigates the restrictive anti-abuse rules on loss deduction, allowing TEs to *carry forward the losses* if a VCC acquires their shares. Germany estimates the annual tax loss from this measure at EUR 385 million.

[1] OJ C 60, 14.3.2009, p. 9.

[2] See footnote 1.

(7) Under the third measure (registered under N 413/08), natural persons investing in TEs (hereinafter also referred to as 'private investors') are entitled to *income tax benefits* in the case of capital gains on divestures. Although the tax advantage is granted directly to the private investors, TEs may benefit indirectly from this measure in that they receive more investment. Germany estimates the annual tax loss from this measure at EUR 30 million.

### 2.2. **Beneficiaries of the measures**

(8) The beneficiaries of the three tax measures in the MoRaKG are VCCs and TEs as defined by the MoRaKG and private investors, mostly business angels, as follows:

| | Trade tax measure | Exemption from the prohibition on loss carry forward | Income tax benefit |
|---|---|---|---|
| VCCs | Directly | Indirectly | No |
| TEs | No | Directly | Indirectly |
| Individuals | No | No | Directly |

(9) VCCs are companies which are recognised as such by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht — BaFin*) and which are not simultaneously registered as an equity investment company ([3]) (*Unternehmensbeteiligungsgesellschaft*). Further criteria for qualification as a VCC are as follows:

— their articles of association must have as their object the acquisition, holding, management and sale of venture capital participations. 70 % of the total assets managed by VCCs must be equity holdings in TEs,

— they must have their legal domicile (*Sitz*) and their corporate management (*Geschäftsleitung*) in Germany,

— their initial capital (*Grundkapital*) or the contributions made by their members under the company's memorandum of association must amount to no less than EUR 1 million,

— they must have at least two managers, who must be trustworthy and suitably qualified to manage a VCC.

(10) TEs must be incorporated enterprises (*Kapitalgesellschaft*) and fulfil the following conditions:

— they must have their legal domicile and corporate management in a State that is a contracting party to the Agreement on the European Economic Area,

— at the time when the participation is acquired by a VCC, they must have owner's equity of not more than EUR 20 million,

— they must have been set up not more than ten years before the time when the participation is acquired by a VCC,

— at the time when the participation is acquired by a VCC, they must not have had any securities (*Wertpapiere*) admitted to or traded on an organised market or an equivalent market.

(11) The measure does not elaborate on the definition of a TE as regards the definition of firms in difficulty ([4]).

### 2.3. **Trade tax**

#### 2.3.1. *Background*

(12) German trade tax (*Gewerbesteuer*) is raised by local authorities with respect to economic activities carried out by permanent business establishments on the territory of a community/municipality. The idea is that these permanent business establishments should contribute to the cost of the local infrastructure they use. Trade tax has to be paid by all undertakings, irrespective of their legal status, if they are engaged in trading activities (*gewerblich tätig*) in the sense of trade tax and income tax law. Incorporated firms (*Kapitalgesellschaften*) are always considered to be engaged in trading activities. For partnerships (*Personengesellschaft*), a distinction is made with regard to their activity: if an undertaking is a partnership and it carries out exclusively asset management activities (*vermögensverwaltend*), it is not subject to trade tax. On the other hand, partnerships which are engaged in trading activities are subject to trade tax.

([3]) Equity investment companies are registered with the competent Supreme Federal State Authority *(Oberste Landesbehörde)*. Under this registration, such companies may engage in all types of private equity investments.

([4]) Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ C 244, 1.10.2004, p. 2).

(13) The Federal Ministry of Finance issued a letter ([5]) (hereinafter letter of 2003) on the distinction between trading activities and asset management activities of venture capital funds and private equity funds (hereinafter VCF/PEF). On the basis of this letter, VCFs/PEFs are subject to trade tax if their activity is considered to be a trading activity. However, if they pursue only asset management, they are not subject to trade tax. This letter of 2003 is based on a judgment of the Federal Financial Court (BFH) of 25 July 2001 ([6]), according to which VCFs/PEFs do not pursue a trading activity where the following criteria are complied with:

— no use of bank loans/no acceptance of collateral,

— no extensive separate organisation to manage the fund portfolio, office use not more than what a large private fortune would require ([7]),

— no market exploitation using professional experience,

— no public offering/own-account trading,

— no short-term investment,

— no reinvestment of the proceeds of sale,

— no own commercial activity in portfolio companies (*eigenes unternehmerisches Tätigwerden in den Protfoliogesellschaften*),

— no commercial character or 'commercial infection' (*gewerbliche Infektion*) ([8]).

([5]) Income tax treatment of venture capital und private equity funds; delimitation of private fortune administration; BMF letter of 20 November 2003, Federal Fiscal Gazette (*Bundessteuerblatt — BStBl*), 2004, Part I, No 1, p. 40.

([6]) BStBl II 2001, p. 809.

([7]) The fund may not maintain an extensive separate organisation to manage the fund portfolio. If the fund operates a separate office, this is not harmful provided the office is not used more that what a large private fortune would require.

([8]) A commercial infection, referred to as income requalification (*Abfärbetheorie*), would occur, for instance, if an entity which is exempted from trade tax started an additional commercial activity, which in turn caused a contamination and resulted in the entire entity becoming liable to trade tax, even if the trading activity only represented a minor part of the overall activity.

(14) In substance, these criteria are intended to clarify the traditional distinction enshrined in German tax law between trading and non-trading activities of VCFs/PEFs. Asset management is seen as a non-trading activity. The distinction between trading and non-trading activities is very fine and the subject of numerous court decisions, inter alia, by the Federal Financial Court. As a general rule, VCFs or PEFs are engaged in trading activities whenever the trading of assets (short periods between purchasing and selling assets, such as securities) represents a significant part of their activities ([9]).

2.3.2. *Clarification on trade tax under the MoRaKG*

(15) According to the notification, Article 1 Section 19 of the MoRaKG includes a 'clarification' of the letter of 2003, and allegedly there is no substantial difference between the two.

(16) Under the above provision, VCCs in the legal form of a partnership which are engaged only in the acquisition, holding, management and sale of venture capital holdings and which have holdings only in incorporated companies shall be treated for income tax purposes as companies carrying out asset management activities. VCCs shall be deprived of their non-trading status especially where they engage in any of the following or similar activities:

— short-term sale of venture capital holdings and other holdings in companies with their legal domicile and corporate management in a State that is a contracting party to the Agreement on the European Economic Area,

— transactions involving money market instruments ([10]); transactions involving bank deposits with credit institutions having their legal domicile in a State that is a contracting party to the Agreement on the European Economic Area; transactions involving investment participations ([11]),

([9]) A trade activity is defined as an independent, lasting activity which is exercised with an aim for profit (not a hobby) and may be characterised as a participation in general economic transactions (which goes beyond services performed for family or friends) and is neither an agricultural activity nor a profession (lawyer, doctor, artist or teacher). Asset administration is defined as an activity which is characterised by the use of assets in the sense of collecting the benefits from intrinsic values which are to be maintained and where the exploitation of substantial assets by reallocation is not given definite priority. The characterisation as a trading activity or asset management is of particular importance for investments in securities or real estate. If there is trade income, all capital gains are taxable and also subject to trade tax. Where the activity is purely asset administration (*Vermögensverwaltung*), the income from the various sources is taxed, but a possible sale of the underlying source may be exempted from capital gains tax (and also from trade tax).

([10]) Within the meaning of Section 48 of the Investment Act.

([11]) Within the meaning of Section 50 of the Investment Act.

— advising a TE in which a VCC has a holding, granting loans and guarantees to a TE in which a VCC has a holding, taking out loans and issuing profit participation rights (*Genussrechte*) and bonds,

— reinvestment of proceeds from the sale of venture capital holdings and other holdings in companies having their legal domicile and centre of management in a State that is a contracting party to the Agreement on the European Economic Area,

— exploitation of a market using its professional experience.

(17) Acquiring and maintaining its own business premises and a proper business organisation shall not prevent a VCC from being considered to conduct asset management activities. The activities under recital 16 above may, however, be carried out by a subsidiary which is wholly owned by the VCC.

### 2.4. **Loss carry forward**

#### 2.4.1. *Introduction*

(18) The losses a company incurs in a tax year may normally be carried forward. This means that they may be offset against profits in future tax years. Loss carry forward enables those losses to be taken into account over the life cycle of a company. However, this can also lead to abuse in the form of 'shell companies' which are companies that have ceased their activities but are nevertheless sold since their loss carry forward represents a real value: purchasers of such shell companies benefit from an offsetting of future taxable profits and thus pay less tax depending on the applicable tax rate.

(19) Germany introduced anti-abuse measures regarding the trafficking of losses in the German Corporate Income Tax Act (hereinafter: CITA). The Company Tax Reform Continuation Law of 1997 stopped the trafficking of losses in the form of shell companies. Germany tightened the anti-abuse measures by means of the 2008 Company Taxation Reform Act (*Unternehmenssteuerreformgesetz 2008*). This Act has an impact on all changes in direct and indirect shareholding of more than 25 % within five years. The CITA provides for a pro-rata deduction of losses if, within a period of five years, more than 25 % of the subscribed capital, membership rights, participation rights or the right to vote directly or indirectly is transferred to an acquirer. Unused losses are not deductible at all if within five years more than 50 % of the subscribed capital or of the above rights are transferred directly or indirectly to an acquirer.

#### 2.4.2. *The MoRaKG*

(20) The MoRaKG would relax the loss carry forward rules for TEs acquired by VCCs, as it would enable TEs with a significantly modified ownership structure to carry forward losses which would otherwise lapse under the basic rule.

(21) According to Article 4 of the MoRaKG, in the event of a direct acquisition by a VCC of a participation in a TE, the losses of the TE continue to be deductible to the extent of the hidden reserves of the TE taxable domestic assets. The same applies in the event of a direct acquisition from a non-VCC of a participation in a TE from a VCC, if:

— when the participation is acquired, the TE has equity of no more than EUR 20 million, or

— when the participation is acquired, the TE has equity of no more than EUR 100 million and the increase in equity in excess of EUR 20 million derives from annual profits in the four financial years preceding the sale,

— the period between the purchase and sale of the participation in the TE by the VCC is at least four years.

(22) Up to one fifth of the loss deductible may be deducted under the arrangements for the deduction of losses of the Income Tax Act in the year of acquisition; in each of the following four years this figure shall increase by a further fifth of the deductible loss.

### 2.5. **Tax benefits for private investors**

#### 2.5.1. *Introduction*

(23) The MoRaKG aims to encourage private investors such as business angels to invest in TEs by offering tax advantages for the profits derived from their investment.

(24) According to Article 1 Section 20 of the MoRaKG, the capital gains on the sale of shares in a TE shall be divided proportionally among the investors according to their participation. The resulting amount is taken into account for the income taxation of the private investors/business angels.

(25) The tax advantage would only take effect in the event of a realised capital gain. The participation of private investors/business angels in TEs must be between 3 % and 25 % at any moment within the preceding five years with a maximum holding time of ten years. Each private investor/business angel is entitled to tax-free profits of up to EUR 50 000 (EUR 200 000 times 0,25) per investment, which corresponds to the maximum participation of 25 %. Hence the maximum tax advantage per business angel and per investment is approximately EUR 22 500, according to Germany's calculations. The tax advantage would be proportionally reduced for profits above EUR 800 000 per investment, and fully disappear if total profits reached EUR 1 000 000.

## 3. DOUBTS EXPRESSED IN THE OPENING DECISION

(26) As set out in recital 3, the Commission decided on 28 January 2009 to initiate the formal investigation procedure (hereinafter opening decision). In the opening decision the Commission expressed its preliminary view that all three measures constitute State aid.

### 3.1. Existence of State aid in the trade tax measure

(27) On the basis of its comparison of the letter of 2003 with the 'clarification' in the MoRaKG, the Commission expressed doubts as to whether the German claim that the MoRaKG only creates a statutory 'clarification' of the letter of 2003 is correct as it seems that the law would provide certain tax advantages for the newly-created specific category of venture capital companies defined by the MoRaKG. Indeed, it seemed that the 'clarification' deviates from the letter of 2003, and may provide for less stringent criteria for certain VCCs to benefit from the trade tax exemption.

(28) On the basis of these doubts the Commission noted that the trade tax measure would favour certain VCCs over other investment companies which may pursue exactly the same or similar activities. Moreover, the exemption from trade tax would involve an annual tax loss estimated at around EUR 90 million, which may indicate that the MoRaKG does not merely 'clarify' the letter of 2003.

### 3.2. Existence of State aid in the loss carry forward measure

(29) In principle Germany has not excluded that the measure on loss carry forward is selective and hence favours TEs and VCCs. Germany claimed, however, that this is justified by the nature and logic of the German tax system. Since, according to Germany, the introduction of the general restriction on the exploitation of tax losses in 2008 hit the venture capital market particularly hard, the possibility of exploiting tax losses should continue to exist for this market, and thus the measure meets the criteria set out in the Commission Notice on the application of the State aid rules to measures relating to direct business taxation [12] (hereinafter Notice on Business Taxation).

(30) The Commission noted, however, that other investment companies (falling outside the scope of the VCC definition) should not be excluded, if the measure is justified by the nature and logic of the German tax system, since non-VCCs may also invest in TEs and should also benefit from the same right to exploit the losses. But this is not the case, as TEs co-owned by non-VCCs can only carry over their losses if the non-VCC has bought its participation from a VCC under the conditions described in recital 21.

(31) Germany also claimed that the measure does not affect trade between the Member States within the meaning of Article 87(1) of the EC Treaty, since it has an 'internal objective' which is compatible with the Notice on Business Taxation. The measure only represents an exception to a strict rule, of which there is no equivalent in other Member States; therefore the measure cannot have a cross-border effect on competition or trade.

(32) However, the Commission stressed that the beneficiaries of this measure could be involved in trading with other Member States and that therefore the measure could have an effect on trade. Moreover, in determining whether a tax measure grants a selective advantage to certain undertakings, one must look at the generally applicable system in the Member State concerned; the question of which rules should apply in other Member States is, in principle, irrelevant.

[12] OJ C 384, 10.12.1998, p. 3.

### 3.3. **Existence of State aid in the tax benefits to private investors**

(33) Germany claimed that the beneficiaries of this measure are natural persons and that therefore it does not constitute State aid. However, since the measure makes investments in certain companies (TEs) more appealing for investors, it may indirectly favour certain undertakings, namely TEs ([13]).

(34) The Commission therefore considered that the criteria of 'advantage' and 'selectivity' are met. Moreover, the implementation of the measure would involve an annual tax loss estimated at around EUR 30 million.

### 3.4. **Compatibility with the Community guidelines on State aid to promote risk capital investments in small and medium-sized enterprises**

(35) The Commission questioned the compatibility of the measures with the Community guidelines on State aid to promote risk capital investments in small and medium-sized enterprises ([14]) (hereinafter RC Guidelines), since the RC Guidelines provide that State aid in the form of risk capital cannot be granted to large enterprises ([15]), firms in difficulty and firms in the shipbuilding, coal and steel industry. In the case at hand, however, the above undertakings may benefit from the measures; therefore the scope of the measures (with regards to the beneficiaries) is not defined in compliance with the RC Guidelines.

(36) In addition, according to point 4.3 of the RC Guidelines, State aid must target a specific market failure for the existence of which there is sufficient evidence. Such evidence has not been submitted by Germany.

(37) Finally, the Commission also questioned whether the other requirements set out in Chapter 4 of the RC Guidelines were met. Furthermore, the Commission noted that restricting the tax advantage to VCCs investing in incorporated enterprises appeared to contradict the alleged objective of the measure, namely to promote the provision of risk capital to all companies that need it. Indeed, young innovative companies in need of risk capital might take legal forms other than that of incorporated companies. Hence, young innovative companies in the form of a partnership would not benefit from the measure.

### 3.5. **Compatibility with the common market**

(38) The Commission questioned the compatibility of the measures with the rules of the common market. In order to qualify as a VCC, an undertaking must have its legal domicile (*Sitz*) and its corporate management in Germany. It appears that certain undertakings, in particular permanent business establishments/branches and subsidiaries of EU and EEA companies with a legal domicile (*Sitz*) outside Germany, would not be eligible. This condition could hinder freedom of establishment within the meaning of Article 43 of the EC Treaty.

(39) Germany claims that companies with a legal domicile outside Germany cannot be supervised by BaFin and would enjoy an unjustified competitive advantage over German VCCs. But the Commission queried the idea that permanent business establishments of foreign companies registered in Germany, which are de facto in competition with VCCs, could not be supervised by other means. At that time, the Commission therefore came to the conclusion that there was no justification for excluding such undertakings from the scheme. This is why the Commission also doubted whether the measures at issue could be declared compatible with the common market.

## 4. **GERMANY'S COMMENTS ON THE OPENING DECISION**

(40) By letter dated 3 March 2009, Germany submitted its comments on the decision to initiate the procedure laid down in Article 88(2) of the EC Treaty. The comments concerned all three measures. In summary, Germany reiterated its view that those measures did not constitute State aid.

### 4.1. **Trade tax measure**

(41) Germany reiterated its view that the trade tax measure does not exempt companies from trade tax. Rather, it clarifies the distinction between trading and asset managing activities and thus has only declaratory value (*deklaratorische Bedeutung*). The final assessment of

([13]) The fact that a tax advantage to individuals investing in certain companies may represent aid to these companies has been confirmed by the Court (see Case C-156/98, *Germany* v *Commission*, [2000], ECR I-6857).

([14]) OJ C 194, 18.8.2006, p. 2.

([15]) The definition of a TE in the MoRaKG does not match the SME definition of the EU. For example, regarding the condition that a TE must have, at the time when the participation is acquired by a VCC, owner's equity of not more than EUR 20 million, the Commission notes the following: the balance sheet total equals the sum of the owner's equity and the liabilities. The liabilities normally represent a significantly higher amount than the owner's equity. Hence, the EUR 43 million balance sheet total threshold for SMEs is easily exceeded by TEs. Furthermore, the limit of 250 on headcount and EUR 50 million on turnover are not included in the TE definition.

whether a venture capital company is engaged in trading or asset managing activities is to be made in line with German supreme court precedents, which are summarised in the letter of 2003.

(42) As regards the estimated losses of EUR 90 million in tax revenue, Germany explained that it expects that the clarification of the MoRaKG will lead to fewer 'faulty' contractual arrangements (*verunglückte Vertragsgestaltungen*), in which the taxes are only due because of the contract's faulty arrangements.

### 4.2. **Loss carry forward measure**

(43) Germany reiterated its view that the rules on loss deduction at TE level are justified due to the nature and logic of the tax system, even if investment companies which fall outside the scope of the MoRaKG definition also invest in TEs.

(44) Germany argued that making a distinction between VCCs and other investment companies lies within the legislator's room for manoeuvre (*Gestaltungsspielraum*) as there are objective differences between VCCs and other investment companies. Accordingly, pursuant to paragraph 24 of the Notice on Business Taxation, a different treatment is justified.

(45) Furthermore, VCCs are in a special situation. As they typically invest in TEs with loss carry forward, the second measure is therefore not State aid but a compensation arrangement for the specific disadvantages (*Nachteilsausgleichsregelung*) of the current system with regards to the venture capital sector.

### 4.3. **Tax benefits for private investors**

(46) Germany considers that the tax benefit measure has no appreciable effect on trade between Member States, in particular as the tax benefit per investor is limited to EUR 22 500. In addition, those rules apply equally to TEs with legal domiciles in the other Member States, with no distinction between German TEs and TEs from other Member States.

(47) Germany also stresses that the direct beneficiaries are natural persons who are not covered by State aid rules. Furthermore, it underlines that due to the specific structure of the measure TEs are not granted any quantifiable advantage (*kein irgendwie quantifizierbarer Vorteil*), which in turn rules out any aid element in the measure.

(48) Germany states that the tax benefit is related to the disposal of the participation in the TE (*Veräußerungsvorgang*), and hence has no direct link to the investment.

### 4.4. **Infringement of the freedom of establishment**

(49) In Germany's opinion, the MoRaKG does not infringe freedom of establishment under Article 43 of the EC Treaty, as a restriction of the freedom of establishment would be justified if the legal domicile requirement afforded the only opportunity to ensure compliance with the legal conditions.

## 5. **COMMENTS BY THIRD PARTIES**

(50) In letters dated 9 April 2009 (*Bundesverband Deutscher Kapitalbeteilungsgesellschaften* — German Private Equity and Venture Capital Association e.V. (BVG)) and 14 April 2009 (*Biotechnologie-Industrie-Organisation Deutschland e.V.* (BIO) and *Business Angels Network* Deutschland e.V. (BAND)), three interested parties submitted their comments on the opening decision.

### 5.1. **Observations by third parties on trade tax**

(51) BVK stated that the introduction of legal criteria in the MoRaKG for the classification of a VCC as non-trading for tax purposes does not result in a tax incentive for VCCs. On the contrary, the MoRaKG will further contribute to uncertainty in the sector.

(52) According to BVK, the 'clarification' is not less stringent than the letter of 2003, as the Finance Committee of the German Bundestag took the view that the letter of 2003 also continues to apply alongside the MoRaKG ([16]). As a result, the general statements set out in Article 1 Section 19 of the MoRaKG are to be given concrete effect by means of the letter of 2003. Owing to this unsatisfactory regulatory technique, the criteria contained in the letter of 2003 also continue to apply to VCCs. Therefore, in the view of BVK, the loss in tax revenue, estimated by the Federal Government at approximately EUR 90 million, is difficult to substantiate.

(53) BVK expressly advocates uniform framework conditions for domestic and foreign private equity companies — in particular those from other EU Member States — and their domestic and foreign investors in Germany.

([16]) See the Opinion of the Bundestag Finance Committee, BT-Drucks. 16/9829, p. 5 *et seq.*: 'For the interpretation of the legal regulation, the previous order remains subsidiarily applicable' ('*zur Auslegung der gesetzlichen Regelung bleibe deshalb der bisherige Verwaltungserlass ergänzend anwendbar*').

(54) BIO argues that the MoRaKG does not provide venture capital companies with preferential exemption from trade tax. The MoRaKG is intended to lay down in law the already common practice, attested by the letter of 2003, of exempting asset management funds from trade tax.

### 5.2. **Observations by third parties on loss carry forward**

(55) BVK is of the opinion that the German legislature should treat both domestic and foreign venture capital and private equity companies in the same way as venture capital companies within the meaning of the MoRaKG. The BVK also takes the view that this objective can be achieved only by means of uniform legal and fiscal framework conditions for all private equity companies. BVK suggests that those venture capital companies which do not fall under the definition of the MoRaKG should be afforded the possibility of taking advantage of loss deduction in a non-discriminatory manner. BVK reiterates that the prohibition on loss deduction contained in the CITA greatly impedes the investments of venture capital and private equity companies.

(56) BIO Deutschland sees the MoRaKG as an improvement on the status quo as regards loss carry forward. BIO concentrates on loss carry forward and finds that the targeted mitigation of a disadvantage does not constitute aid. Since innovative SMEs in particular are disadvantaged by the existing loss deduction rules, the MoRaKG should be seen as a tax disadvantage compensation regulation (*Steuerbenachteiligungsausgleichsregelung*). BIO states that the MoRaKG makes it possible to distinguish capital investment companies which provide capital to the enterprise in a clear and necessary way.

### 5.3. **Observations by third parties on tax benefits to private investors**

(57) BVK welcomes the general objective of tax benefits for private investors set out in the MoRaKG. For BVK the tax benefit measure constitutes a reasonable incentive for individuals who invest in the high-risk sector of early-stage financing addressed in the MoRaKG.

(58) BAND stresses that such tax benefits for private persons investing in young companies are common and more generous in other Member States. BAND welcomes the introduction of tax benefits for private investors and hence welcomes the MoRaKG. At the same time, BAND expresses doubts as to whether the MoRaKG will have any appreciable incentive effect on business angels, given the rather low tax advantages which only materialise after a successful exit. BAND considers that due to the partial income procedure (*Teileinkünfteverfahren*), the maximum tax advantage per investor is around EUR 14 210 and not, as indicated by Germany, around EUR 22 500. BAND also considers that the indirect aid to TEs would in reality always be below the thresholds of the de minimis limit of EUR 200 000. The advantage would only occur, if at all, at the time of the exit of the investor.

(59) BIO finds that the maximum advantage granted to a private investor, which is conceivable only where specific conditions are met, is EUR 22 500. This amount is minimal, unconnected to the investment (resulting rather from the sale of holdings) and therefore not transferable to the TEs.

## 6. **GERMANY'S COMMENTS ON THE OBSERVATIONS BY THIRD PARTIES**

(60) By letter dated 22 May 2009 Germany reacted to the observations of the interested parties.

### 6.1. **Trade tax measure**

(61) Germany notes that despite its criticism of the MoRaKG, BVK confirms that the MoRaKG does not deviate from the law as regards the distinction between trading and asset management activities.

### 6.2. **Loss carry forward measure**

(62) Germany notes that BVK's proposal to extend the measure to the entire private equity sector would cause unjustified windfall profits (*ungerechtfertigte Mitnahmeeffekte*). In order to clearly target the measure, Germany decided in favour of the necessary differentiation.

(63) Germany underlines that BIO's arguments support its view that the MoRaKG provides for a coherent differentiation based on objective criteria in order to avoid an excessive exploitation of losses (*Verlustausnutzung*).

### 6.3. **Tax benefits for private investors**

(64) Germany considers that the comments by the interested parties support its view that the measure, being indirect and insignificant, profit oriented and aimed at TEs located anywhere in the EU, does not constitute State aid.

## 7. **ASSESSMENT**

### 7.1. **Existence of State aid**

#### 7.1.1. *Trade tax measure*

(65) The formal investigation procedure has not dispelled the doubts of the Commission concerning the alleged legal 'clarification' in the MoRaKG of the letter of 2003 with regard to the exemption from the liability for trade tax.

(66) Germany estimates that this measure will imply a yearly loss of tax revenue of EUR 90 million. It explains this loss by fewer 'faulty contractual arrangements'. The Commission does not find this justification convincing. It is indeed hard to believe that venture capital companies have such a bad knowledge of tax law that they cannot avoid such 'faulty contractual arrangements' and the corresponding tax liability. Furthermore, the Commission's view is clearly confirmed by third parties, as BVK finds that the MoRaKG will further contribute to uncertainty in the sector.

(67) In any case, the Commission notes that it is undisputed that the measure would imply a loss of State resources which would otherwise (in the previous situation) have accrued to the State. The Commission therefore concludes that the measure is granted from State resources.

(68) Regardless of the question of the compatibility of the 2003 letter with the nature and logic of the German tax system, which is irrelevant to the present case, the Commission noted in its opening decision that the MoRaKG appears to deviate from the letter, given that:

— VCCs may find investors through marketing to a wide public, while this is excluded in the letter of 2003,

— VCCs may have business premises and organise their activities in a 'business like' (*geschäftsmässig*) manner, while the letter of 2003 prevents them from having a 'substantial own organisation' and limits the number of employees and office use to what a 'large private fortune' (*privates Großvermögen*) would normally require,

— the MoRaKG does not explicitly exclude VCCs from having a commercial activity in portfolio companies, while the letter of 2003 does not allow 'commercial activity in portfolio companies' as stated in recital 13.

(69) The comments received during the formal investigation have not dispelled these doubts. Hence the Commission must conclude that the MoRaKG enlarges the potential group of beneficiaries who are not liable to trade tax as some VCCs which, under the letter of 2003, were liable to trade tax may possibly be exempt from trade tax under the MoRaKG. Therefore, the measure under examination grants a tax advantage to certain VCCs in that it allows them to carry out certain activities and still enjoy the tax liability exemption, unlike all other VCFs/PEFs, which are only subject to the letter of 2003 and would therefore become liable to tax if they carried out these activities.

(70) Moreover, the measure grants a selective advantage only to certain VCCs falling under the scope of the MoRaKG as compared to VCFs/PEFs. Indeed, VCCs benefit from this measure only if they comply with the definition set out in the MoRaKG. Hence VCFs/PEFs with less than 70 % of their total assets in equity holding in TEs may not benefit from the measure even if they carry out substantially identical activities. The same reasoning holds for VCFs/PEFs which do not have both their legal domicile and their corporate management in Germany. As a result, VCFs/PEFs that only have a permanent business establishment in Germany cannot benefit from the MoRaKG, even if they carry out exactly the same activities as VCCs.

(71) Therefore, only companies which belong to this limited group are relieved, by means of State resources, of a part of their operating costs (namely liability for a certain tax) which they would normally have to bear under the current legal framework. The beneficiaries of this advantage are essentially active in the provision of private equity and venture capital and are in competition with other providers established in Germany or other Member States. Consequently, this fiscal measure, by increasing the financial means available to the beneficiaries to carry out their activity, strengthens their position in relation to their competitors in the EU. The aid measure is therefore capable of affecting competition and trade between Member States.

(72) The Commission therefore concludes that the notified trade tax measure constitutes State aid to certain VCCs within the meaning of Article 87(1) of the EC Treaty.

7.1.2. *Loss deduction*

(73) As stated under point 4.2, Germany agrees in principle that the re-establishment of loss carry forward for VCCs investing in TEs is selective and favours TEs and VCCs. However, Germany argues that VCCs and TEs were differentiated in an acceptable and practical manner and that the distinction is justified by objective differences between taxable persons in compliance with paragraph 24 of the Notice on Business Taxation (which states that some differentiations in the tax system may be justified by objective differences between taxpayers), because the introduction of the general restriction on the exploitation of tax losses in 2008 hit the venture capital market particularly hard.

(74) First, the Commission emphasises that the measure is clearly linked to a loss of State resources and is therefore granted through State resources. This tax loss benefits TEs and VCCs since they are the beneficiaries of this measure. The more generous terms for tax deduction of loss carry forward which apply to TEs if they are acquired by VCCs constitute an economic advantage for these two groups of companies as it allows them to realise tax savings. Indeed, TEs benefit from loss carry forward since it enables them to offset a loss and thus pays less tax, which would otherwise be excluded by the anti-abuse rules. VCCs are also almost direct beneficiaries in the sense that other purchasers cannot benefit from the additional offsetting.

(75) As the tax saving is essentially only available if VCCs invest in TEs, the measure also favours TEs indirectly. Indeed, it constitutes an incentive for VCCs to invest in TEs rather than other companies that may be targeted by venture capital investors on the basis of purely economic considerations. TEs are thereby in a position to receive risk capital in amounts and under conditions that would not have been the case without the measure. The measure is thus capable of indirectly reinforcing the capital base of TEs.

(76) It also seems appropriate to reject Germany's argument according to which, even if it cannot be excluded that the definition of TEs covers firms in difficulty, this measure does not represents an advantage for such companies. Indeed, Germany argues that if a TE is in difficulty, it will not make profits that would offset its losses and could be taxed. So it is irrelevant whether or not such a firm can exploit the losses of earlier periods. As a result, according to Germany, the MoRaKG does not offer any advantage to firms in difficulty as defined by Community law. The Commission finds that this argument is not plausible, since an acquirer of a firm in difficulty or of a 'shell company' may in fact be particularly interested in the loss carry forward for tax purposes.

(77) These advantages are capable of affecting trade and competition. For VCCs, the Commission examined this requirement with regard to the trade tax rule in recital 71. With regard to TEs, the Commission notes that these companies can operate in any economic sector, including those that involve or could involve intra-Community trade. Therefore, the economic advantage granted to them is apt to affect competition and trade between Member States.

(78) Secondly, the Commission notes that the measure is undisputedly selective.

(79) Thirdly, the Commission finds that Germany has not succeeded in demonstrating that the measure is compatible with the nature and logic of the German tax system. Even if it were true that the venture capital market were particularly affected by the restriction on exploitation of tax losses and thus justified special treatment, the Commission finds that the distinction drawn up by Germany between taxpayers is not justified by this reasoning since only part of the venture capital sector is exempted from the prohibition on loss carry forward. If Germany's claims were correct, there would be no objective reason for non-VCCs not to benefit from the measure when they invest in the same TEs. However, non-VCCs only benefit from the measure in the rare case when they acquire a participation in a TE from a VCC. These views are also confirmed by BVK's comments in point 5.2.

(80) Moreover, the measure does not seem to comply with the nature and logic of the German tax system as Germany has not demonstrated why VCCs would be particularly affected by the restriction on the exploitation of tax losses when they invest in TEs and not when they carry out the same activity of providing capital to other companies such as partnerships which might also have difficulties in accessing risk capital (notably young innovative companies).

(81) The Commission notes furthermore that when Germany tightened the anti-abuse measures on loss carry forward by means of the 2008 Company Taxation Reform Act, as stated in point 2.4.1, it set out the new general tax regulation in this area. By allowing more generous terms for loss carry forward for a selected group of companies, these anti-abuse measures would be partly reversed; this does not seem to be justified by the nature and logic of the tax system in force since 2008.

(82) The Commission therefore concludes that the notified measure on loss carry forward constitutes State aid to TEs and VCCs within the meaning of Article 87(1) of the EC Treaty.

7.1.3. *Tax benefits for private investors*

(83) As stated under point 4.3, Germany claims that since the beneficiaries are natural persons, the measure cannot constitute State aid. Germany also claims that the measure has no verifiable and quantifiable advantage for TEs and hence has no impact on the price of shares. The tax amount saved by private investors is quite small and granted only in the event of a successful exit by the investor. Therefore, as Germany argues, the measure is likely to have only a limited incentive effect for individuals to invest in TEs. Hence it would also have a limited distortive effect on competition between TEs and non-TEs.

(84) As stated under point 2.1, this measure implies a loss of State resources estimated by Germany at EUR 30 million per year. The measure is therefore granted through State resources.

(85) The measure in question provides individuals with tax incentives to invest in a selected group of enterprises (i.e. TEs) rather than in other companies that may be targeted by venture capital investors on the basis of purely economic considerations. TEs are thereby in a position to receive risk capital in amounts and under conditions that would not have been the case without the measure and under normal market conditions. The measure is thus capable of indirectly reinforcing the capital base of TEs. This analysis holds even if the fiscal advantage granted to investors is contingent on future profits and the amount is relatively limited, as underlined by Germany and third parties. Indeed, because of the nature of the measure it is extremely difficult to precisely quantify the advantage that TEs will receive ex ante ([17]). Consequently, it is impossible to conclude that the aid granted to TEs will always be de minimis. Moreover, the fact that a tax advantage to individuals investing in certain companies may involve aid to these companies, regardless of the magnitude of such advantages, has been confirmed by the Court ([18]).

(86) Therefore, the Commission concludes that the income tax benefit measure is selective and favours a limited number of companies by giving them better access to risk capital than under normal market conditions. This advantage is granted through State resources because it is basically the loss of tax revenues that creates the market incentive for private individuals to provide capital to TEs rather than to other enterprises that would normally have been targeted on the basis of the prospects of return on the investment that they offer.

(87) The extent to which this aid could affect competition and trade between Member States is set out in recital 77 above.

(88) The Commission therefore concludes that the modified income tax benefit measure constitutes State aid to TEs within the meaning of Article 87(1) of the EC Treaty.

7.2. **Compatibility with the State aid rules**

7.2.1. *Notification of the measure*

(89) By notifying the MoRaKG before implementing it, the German authorities fulfilled their obligations under Article 88(3) of the EC Treaty. Given that all the measures in the MoRaKG pursue a common objective of supporting the provision of private venture capital to companies, the Commission analysed their compatibility with the common market on the basis of the rules established in the RC Guidelines.

(90) The Commission also assessed the applicability of other State aid frameworks and regulations to the measures at hand, namely the Community framework for State aid for research and development and innovation ([19]), Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation) ([20]) (hereinafter GBER) and Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid ([21]). Unlike the measures under examination, these frameworks and regulations exclude from the scope of the aid firms in difficulty and firms in the shipbuilding, coal and steel industry and/or limit the aid to SMEs. In the light of the above the Commission is of the opinion that due to the scope of these frameworks and regulations, they are not applicable to the notified measures.

([17]) It is extremely difficult to establish ex ante the difference between the amount/conditions under which capital would have been available in the absence of the measure and the amount/conditions brought about by the measure.

([18]) Case C-156/98, *Germany* v *Commission*, [2000], ECR I-6857, point 64: 'As a preliminary point, it should be borne in mind that, as has been noted in paragraph 30 above, the aid scheme in issue must be regarded as granting operating aid to the recipient undertakings …'.

([19]) OJ C 323, 30.12.2006, p. 1.

([20]) OJ L 214, 9.8.2008, p. 3.

([21]) OJ L 379, 28.12.2006, p. 5.

7.2.2. *Trade tax measure*

(91) As stated in point 7.1.1, the trade tax measure constitutes State aid to VCCs. However, this measure does not explicitly provide incentives to VCCs to undertake risk capital investments, it merely enables them to have greater financial resources at their disposal, that they may use for any purpose (i.e. increased benefits distribution to their partners).

(92) Unlike the present measure, under the RC Guidelines, State aid in the form of risk capital cannot be granted to large enterprises, firms in difficulty or firms in the shipbuilding, coal and steel industry. The trade tax measure, on the other hand, could benefit such undertakings, especially large enterprises. Therefore, the scope of this measure is not compatible with the Guidelines.

(93) The measure cannot be considered to be compatible with Chapter 4 of the RC Guidelines because the specific conditions for the application of this Chapter are not fulfilled. For instance, Chapter 4 requires that the maximum level of investment tranches may not exceed EUR 1,5 million per beneficiary over a period of 12 months. The measure under examination does not contain such a ceiling. Moreover, the RC Guidelines also require that the measure be restricted to providing financing up to the expansion stage for small enterprises or up to the early stage for medium-sized enterprises. These provisions are not met because TEs can be large undertakings.

(94) The measure does not comply with the cumulation and reporting requirements set out in Chapter 6 and point 7.1 of the RC Guidelines.

(95) Finally, the Commission is not in a position to assess the measure's compatibility under Chapter 5 of the RC Guidelines. Indeed, according to the RC Guidelines, State aid must target a specific market failure for the existence of which there is sufficient evidence. Germany has not submitted any evidence that TEs are affected by a particular market failure.

(96) The Commission therefore concludes that the trade tax measure is not compatible with the common market.

7.2.3. *Loss deduction*

(97) As set out in point 7.1.2, the measure on loss carry forward constitutes State aid at VCC and TE level. The form of the aid measure is a fiscal incentive within the meaning of point 4.2(d) of the RC Guidelines.

(98) For the same reasons as highlighted above in recitals 92, 93, 94 and 95, the Commission cannot consider the present measure to be compatible with the common market as it meets neither the exclusion criteria of point 2.1 of the RC Guidelines, nor the cumulation and reporting requirements referred to in Chapter 6 and point 7.1 of the Guidelines, nor the conditions set out in Chapter 4 of the Guidelines; neither is there any evidence of a particular market failure affecting TEs and VCCs that would allow the Commission to launch a detailed assessment of the compatibility of these measures under Chapter 5 of the RC Guidelines.

(99) This measure does not exclude the purchase of existing shares (replacement capital) in TEs. Replacement finance is, however, excluded by the definition of venture capital in the RC Guidelines.

(100) Furthermore, the Commission notes that restricting the tax advantage to VCCs investing in incorporated enterprises appears to contradict the declared objective of the measure, namely to promote risk capital. Indeed, young innovative companies in need of risk capital might take legal forms other than that of incorporated companies. Hence, young innovative companies in the form of a partnership would not benefit from the measure.

(101) The Commission therefore concludes that measure on loss carry forward is not compatible with the common market.

7.2.4. *Tax benefits for private investors*

(102) As set out in point 7.1.3, the income tax benefit measure constitutes indirect State aid at TE level. Since the measure creates incentives for private investors to invest in TEs, it may favour risk capital investments pursuant to point 4.2(d) of the RC Guidelines.

(103) For the same reasons as highlighted above in recitals 92, 93, 94 and 95, the Commission cannot consider the present measure to be compatible with the common market as it meets neither the exclusion criteria of point 2.1 of the RC Guidelines, nor the cumulation and reporting requirements referred to in Chapter 6 and point 7.1 of the Guidelines, nor the conditions set out in Chapter 4 of the Guidelines; neither is there any evidence of a particular market failure affecting TEs and VCC that would allow the Commission to launch a detailed assessment of the compatibility of these measures under Chapter 5 of the RC Guidelines.

(104) Therefore, the Commission concludes that the income tax benefit measure as it stands cannot be considered compatible with the common market on the basis of the RC Guidelines. However, the measure should have only a limited distortive effect on competition between TEs and non-TEs given that the incentive granted to individuals for providing capital in favour of TEs is relatively limited and thus presumably the advantage granted to TEs will also be limited. Moreover, the measure is capable of having a general positive effect in the sense of stimulating the provision of risk capital to companies which may be in need of risk capital, on the basis of a proper economic assessment. Indeed, private investors will select the TEs at issue on the basis of the prospect of making a return on their investment. Therefore, the Commission finds that the measure may be adjusted to the requirements of the RC Guidelines by ensuring that the conditions in Article 3 below are met.

### 7.3. **Compatibility with the common market**

(105) The trade tax measure and the loss carry forward measure, which can favour VCCs, are in breach of common market rules, in particular with regard to freedom of establishment within the meaning of Article 43 of the EC Treaty (see point 3.5).

(106) According to Germany, the MoRaKG contains detailed rules relating to the structure and business activities of VCCs. These include in particular regulations concerning transaction types and the investment policy of VCCs, the question of their integration into group structures and the minimum denomination of investments in such companies. These regulations would apply to all VCCs. In the case of German permanent establishments of foreign investment companies, it is not possible to guarantee that the company as a whole will comply with the regulations. Merely limited recognition of the German permanent establishment would allow for the possibility of the rules being circumvented and therefore, de facto, invalidated. Financial market regulators monitor the undertakings within their own areas of responsibility according to their own national regulations, a significant proportion of which are harmonised with EU law. In the field of venture capital financing, however, the supervisory regulations are not harmonised with EU law in this way.

(107) The Commission's doubts have not been dispelled. First, EC and EEA companies with a legal domicile (Sitz) outside Germany and a permanent business establishment in Germany should in principle be eligible where they can show that they comply with the conditions set out in the aid schemes and with the rules relating to the structure and business activities of VCCs (assuming they are compatible with the EC Treaty). The argument that BaFin is not in a position to supervise these companies does not necessarily imply that they enjoy a competitive advantage over companies established in Germany, nor that they do not comply de facto with the conditions set out in the aid schemes and with the rules relating to the structure and business activities of VCCs. Therefore this argument is not sufficient per se to derogate from a fundamental rule of the EC Treaty.

(108) In summary, it would appear that Germany could achieve the same objective using less discriminatory means ([22]). Compliance with the conditions set out in the aid schemes could be verified, for instance, through a voluntary submission to an examination by the BaFin, through confirmations by the foreign supervisory authority or through independent audit reports. Germany should give foreign companies with a permanent establishment in Germany the possibility to prove that they comply with the conditions set out in the aid schemes and with the rules relating to the structure and business activities of VCCs.

(109) Therefore, the Commission finds that the trade tax measure and the loss carry forward measure are not compatible with the common market because they infringe freedom of establishment within the meaning of Article 43 of the EC Treaty.

([22]) For instance in State aid N 629/07 (OJ C 206, 1.9.2009, p. 1), the French authorities provided for the possibility of also granting aid to foreign investment structures equivalent to the French-based structures targeted by the aid under examination in that case. To the same effect, see State aid case N 36/09 (OJ C 186, 8.8.2009, p. 3).

## 8. **CONCLUSION**

(110) The Commission considers that the aid measure on trade tax liability for VCCs is not compatible with the EC Treaty.

(111) The Commission considers that the aid measure on loss carry forward for TEs acquired by VCCs is not compatible with the EC Treaty.

(112) The Commission considers that the measure on tax benefits for private investors can be made compatible with the EC Treaty subject to the conditions listed below in Article 3,

HAS ADOPTED THIS DECISION:

*Article 1*

The State aid schemes which Germany is planning to implement under Article 1 Section 19 and Article 4 of the Bill to Modernise the General Conditions for Capital Investments (MoRaKG) are incompatible with the common market.

These State aid schemes may therefore not be implemented.

*Article 2*

The State aid scheme which Germany is planning to implement under Article 1 Section 20 of the MoRaKG is compatible with the common market, subject to the conditions set out in Article 3.

*Article 3*

The State aid scheme under Article 1 Section 20 of the MoRaKG shall be adjusted so that the following conditions are met:

— the definition of target enterprises shall be limited to small and medium-sized enterprises (SMEs) as defined in Annex I to the General block exemption Regulation ([23]),

— the definition of target enterprises shall exclude companies in difficulties and companies from the shipbuilding, coal and steel industry,

— maximum investment tranches shall not exceed EUR 1,5 million per target SME over each period of twelve months and shall be restricted to seed, start-up and expansion financing,

— Germany shall develop a mechanism to ensure that the measure complies with the cumulation and reporting rules set out in Chapter 6 and point 7.1 of the RC Guidelines,

— the purchase of existing shares (replacement capital) in a target SME shall be excluded,

— there shall be no special requirements with regard to the legal form of the target enterprise.

*Article 4*

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

*Article 5*

This Decision is addressed to Federal Republic of Germany.

Done at Brussels, 30 September 2009.

*For the Commission*

Neelie KROES

*Member of the Commission*

([23]) See footnote 20.