IV

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

COMMISSION DECISION

of 28 October 2009

on State aid C 10/07 (ex NN 13/07) implemented by Hungary for tax deductions for intra-group interest

(notified under document C(2009) 8130)

(Only the Hungarian text is authentic)

(Text with EEA relevance)

(2010/95/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:

I. PROCEDURE

(1) As of January 2003, the Hungarian authorities introduced new provisions for the favourable taxation of net interest income between affiliated companies belonging to the same group. The measure was not notified to the European Commission. By letter dated 19 November 2004, the Commission requested information from the Hungarian authorities which was provided on 14 December 2004.

(2) On 21 March 2007, the Commission informed the Republic of Hungary that it had decided to initiate the procedure laid down in Article 88(2) in respect of the scheme. After two extensions of the deadline, the Republic of Hungary replied by letter dated 20 June 2007.

(3) The Commission Decision to initiate the formal investigation procedure was published in the *Official Journal of the European Union* [2] inviting interested parties to submit their observations. Comments were submitted by the American Chamber of Commerce in Hungary on 20 July 2007, by the Netherlands on 26 July 2007 and by MOL Plc on 26 July 2007. These comments were forwarded to the Republic of Hungary, which replied by e-mail dated 6 September 2007.

(4) By letter dated 12 February 2008, the Commission requested additional information from the Hungarian authorities. Answers were provided by submissions dated 28 April 2008, 19 June 2008 and 13 October 2008.

(5) By letter dated 24 June 2009, the Hungarian authorities informed the Commission of their intention to abolish the scheme as from 1 January 2010.

(6) On 29 June 2009 the Hungarian Parliament passed the 2010 tax law changes, including the elimination of the 50 percent corporate income tax deduction rule on intra-group financing income. The law was published in the Hungarian Gazette on 9 July 2009.

(7) The Hungarian authorities submitted further information by e-mail dated 1 October 2009.

[1] OJ C 142, 27.6.2007, p. 12.

[2] See footnote 1.

II. DETAILED DESCRIPTION OF THE MEASURE

(8) The measure provides for the possibility to deduct from the tax base in Hungary 50 % of the amount of the net interest received from affiliated companies, which is the balance of interest received from affiliated companies less the interest paid to affiliated companies ([3]). Consequently, only half of the net interest received is taxed, while in the normal application of the tax system the whole amount would have to be taxed. On the level of the affiliated company paying the net interest, 50 % of the amount of the net interest paid is added to the tax base ([4]). Hence, instead of a full deduction of the net interest paid under the normal tax system, companies deduct only half of this amount from their tax base. The scheme applies only to the interest received from and paid to affiliated companies.

(9) An affiliated company is defined as ([5])

(a) a company in which the taxpayer has directly or indirectly a majority interest;

(b) a company that has directly or indirectly a majority interest in the taxpayer;

(c) any other company if a third company has directly or indirectly a majority interest in both the taxpayer and such other company;

(d) a foreign company and its permanent establishment in Hungary, the permanent establishment in Hungary of a foreign company and a person with which it has a relationship as defined above in points (a)-(c).

The term 'majority interest' shall also include the situation in which any party has the right to appoint or dismiss the majority of the executive officers and supervisory board members. Furthermore, when establishing whether a majority interest exists, the voting rights of close relatives shall be taken into account jointly.

Maximum deductible amount

(10) The total amount of special deductions, including the intra-group interest deduction, is capped at 50 % of the profits before taxes ([6]).

Opt-out possibility

(11) A taxpayer may decide on a yearly basis whether to apply the scheme or whether to opt out. Should a company with a net interest paid opt out, it does not have to increase its tax base in the manner described above and may apply the normal tax regime by a full deduction of the interest paid, provided that it notifies all of its affiliated companies (domestic and foreign) to which any interest was paid (or is payable) or from which any interest was received (or is due) ([7]). In this case, for the application of the measure, the affiliated companies do not take into account the interest received from or paid to this taxpayer when they compute their tax base with regard to interest payments ([8]).

(12) The Hungarian authorities do not enjoy any discretional rights, since the decision whether to apply or opt out from the application of the measure with regard to net interest paid is made by the affiliated company described in the paragraph above.

Beneficiaries

(13) The legislation applies to legal entities, European companies (SE), European cooperative societies (SCE), cooperatives and permanent establishments of foreign companies. The provision is not applicable to insurance companies, financial institutions, investment enterprises, or micro and small enterprises ([9]).

Legal basis

(14) The following provisions of Act LXXXI of 1996 on Corporate Tax and Dividend Tax form the legal basis of the measure: Article 7(1)(k), Article 7(14) and (16), Article 8(1)(k), Article 8(2), and Article 29/D(15).

([3]) For example, if a company receives interest of 100 from affiliated companies and pays interest of 60 to affiliated companies, the balance is 40, which is the net interest received.

([4]) If a company receives interest of 100 from affiliated companies, while it pays interest of 160 to affiliated companies, the balance is 60, which is the net interest paid.

([5]) Article 4(23) of Act LXXXI of 1996 on Corporate Tax and Dividend Tax.

([6]) Article 7(14) of the Act LXXXI of 1996 on Corporate Tax and Dividend Tax.

([7]) Article 29/D(15) of the Act LXXXI of 1996 on Corporate Tax and Dividend Tax.

([8]) If a company A receives interest from two affiliated companies, 50 from company B and 60 from company C, and if company B applies the opt-out and chooses not to increase its tax base, then company A can only use the interest of 60 received from company C for the application of the measure. Consequently, company A will be fully taxable with regard to the 50 interest received from company B, while it will be taxable only for half of the amount of 60 received from company C.

([9]) A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. A micro enterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million.

(15) The current legislation contains certain modifications in terms of eligible beneficiaries compared to the original provisions of the measure, those modifications having entered into force on 1 January 2003. In the original legislation the scope of the beneficiaries did not include European companies and European cooperative societies, as Hungary was not yet a member of the European Union. The statute of the European Company came into force on 8 October 2004 and the statute of the European Cooperative Society was adopted on 22 July 2003 and came into force on 16 August 2006. As venture capital companies can no longer be established in Hungary as of 1 June 2004, these companies also disappeared from the list of eligible companies.

Duration

(16) No limitation was initially provided for regarding the duration of the scheme. However, as noted above, the abolishment of the measure has been enacted by law as from 1 January 2010.

Budget

(17) Hungary provided the following figures as regards the effect of the measure on Hungarian budgetary resources:

in 1 000 HUF ([1])

Year	Balance of tax base correction (reducing/ increasing) items due to the measure	Measure's effect on taxation
2003	2 280 424	410 476
2004	4 478 141	716 503
2005	7 279 164	1 164 666
2006	125 992 638	20 158 822

([1]) Hungarian Forint — approximate exchange rate for the years concerned is HUF 250 for EUR 1.

(18) In total, the impact of the measure in the years concerned amounts to approximately HUF 24 billion (EUR 96 million) ([10]).

III. **GROUNDS FOR INITIATING THE PROCEDURE**

(19) In the Opening Decision, the Commission expressed its doubts that the scheme constitutes a general measure, since the benefit of the preferential tax treatment of intra-group interest payments is not equally available for all companies in Hungary.

([10]) No information has been provided by Hungary for the following years.

(20) As regards the existence of an economic advantage, the Commission was of the opinion that, at the level of an individual company belonging to a group, the scheme provides an advantage to undertakings that receive positive net interest from affiliated companies.

(21) At the level of the group taken as a whole, the Commission underlined that the scheme confers an advantage for cross-border situations with inbound interest, where the net interest-receiving company is based in Hungary and the net interest-paying company is non-resident.

(22) The Commission further explained that, in a cross-border situation with outbound interest, where the interest-receiving company is non-resident and the interest-paying company is Hungarian, the measure does not provide for an additional advantage. Similarly, in a domestic situation, i.e. where both companies are in Hungary, such an advantage does not in principle arise at the level of the group.

(23) As regards the selectivity criterion, the Commission noted firstly that insurance companies, financial institutions, investment enterprises and venture capital companies, as well as small enterprises, are *de jure* excluded from the scope of the measure. Secondly, at the level of the individual undertaking, only companies that are part of a group benefit from the lower taxation of net intra-group interest provided for by the scheme. Thirdly, at the level of the group, the scheme appears to be advantageous for cross-border situations with inbound interest, where the net interest-receiving company is Hungarian, while the net interest-paying company is non-resident. Fourthly, the opt-out possibility from the application of the scheme, which can be changed on a yearly basis, was an additional factor for considering that the measure is an exception from the tax system in Hungary.

(24) The Commission also had doubts that the above-mentioned exceptions were justified 'by the nature or general scheme' of the tax system, and therefore considered the measure to be incompatible with the common market.

(25) Finally, the Commission was of the opinion that the measure could not be considered existing aid as it does not fulfil any of the conditions set out in Annex IV.3 of the Act of Accession.

IV. COMMENTS FROM THE HUNGARIAN AUTHORITIES

Legal basis of the assessment

(26) The Hungarian authorities consider that owing to the lack of harmonisation at Community level in the field of direct taxation, the measure has to be assessed under the rules of the EC Treaty governing the approximation of laws according to Article 96 and 97 of the EC Treaty and not on the basis of the State aid rules. The Hungarian authorities refer to the case law of the European Court of Justice (ECJ), which stipulates that direct taxation falls within the competence of Member States but that Member States must exercise this competence consistently with Community law on direct taxation. In this context, Hungary argues that observance of the freedom of establishment influenced the characteristics of the measure to a large extent.

The objective of the measure

(27) The objective of the measure is that intra-group loan financing — providing for the optimal allocation of liquidity — could take place without taxation influencing business decisions on operation and financing.

(28) In contrast to the majority of other Member States, there is no group taxation in Hungary. Group taxation provides for the possibility to offset the loss of a (domestic) group member against the profit of another (domestic) group member in the same year. The budgetary resources do not permit the introduction of a full group taxation scheme. The Hungarian rule was therefore introduced as an alternative to group taxation, in order to reduce in part the competitive disadvantage compared to other Member States with a full group taxation scheme.

(29) By permitting the deduction of 50 % of the interest received and symmetrically — in order to reach the tax policy objective — an increase of its profits by 50 % of the interest paid to affiliated undertakings, the difference between equity and intra-group loan financing is reduced, as the dividend as remuneration for equity financing is tax exempt whereas interest is taxed for loan-financing.

(30) According to the Hungarian authorities, the measure represents a kind of partial group taxation, applied only to interest income. It is a generally applicable rule that does not favour any undertaking or the production of goods. Group taxation is a general feature of the tax system in certain Member States, and to the knowledge of the Hungarian authorities, the Commission has not contested its compatibility with the EC Treaty.

Existence of State aid under Article 87(1) of the EC Treaty

(31) The Hungarian authorities consider that the scheme in question does not constitute State aid within the meaning of Article 87(1) of the EC Treaty, as the criteria concerning (i) economic advantage, (ii) selectivity and (iii) State resources are not fulfilled.

Economic advantage

(32) According to the Opening Decision, the measure grants an advantage (i) at the level of the individual company owing to the possibility of deducting 50 % of the net interest income from the tax base, and (ii) at the level of the whole group when a Hungarian member of the group finances a group member abroad and receives interest income for which the 50 % deduction is also granted.

(33) The Hungarian authorities argue that the measure may provide an advantage to an individual company, but it provides a disadvantage to the other party of the loan transaction, and therefore it is symmetrical in purely domestic relations. It may provide an advantage also to the whole group, but this advantage is limited to a faster offsetting of interest losses of a group company against the interest income of the other, as in the case of other group taxation systems.

(34) The Hungarian authorities further argue that in cross-border situations, if the affiliated company receiving the intra-group loan and paying interest on it is based abroad, the advantage gained will depend on the tax rate applied in the Member State where this company is resident. The advantage is not due to the aid character of the Hungarian measure, but results merely from the difference between the tax rules of Member States, which cannot be taken into account in the assessment of the measure. If the foreign legislation was the same as the Hungarian legislation, the advantage identified by the Commission would no longer exist.

(35) Moreover, as stated in the Commission decision on International Financing Activities in the Netherlands ([11]), the existence of an advantage must be assessed within the framework of the State aid rules purely at national level. In this respect, Hungary observes that, in domestic situations, the measure does not distort competition and confers no advantage, as it is tax neutral.

([11]) Recital 82 of Commission Decision 2003/515/EC of 17 February 2003 on the State aid implemented by the Netherlands for international financing activities, (OJ L 180, 18.7.2003, p. 52).

(36) The Hungarian authorities do not agree with the Commission that the measure confers an advantage for cross-border transactions (with inbound interest). Hungary argues that the 16 % effective corporate tax rate may already be an incentive for groups to allocate activities in Hungary. A potential advantage is not a tax incentive for multinationals, but results from the freedom of establishment. This principle would have been infringed should the Hungarian authorities have excluded from the scope of the measure groups that have members outside Hungary.

(37) It is further argued that the measure helps groups to achieve a more efficient allocation of financial resources, similarly to the group taxation systems of other Member States. It is less lenient than tax consolidation systems, which allow the distribution of any type of loss within an administrative unity.

(38) If a measure is a generally applicable provision of the normal corporate taxation, it confers no advantage. The Hungarian authorities consider that this measure is a special group taxation arrangement which is as general as the group taxation system of any other Member State without favouring any undertakings or production of goods. To the knowledge of the Hungarian authorities, the Commission never contested the compatibility of other Member States' group taxation schemes with the EC Treaty. The system is an integral part of the general rules for the calculation of the tax base. Therefore it does not confer any economic advantage.

State resources

(39) First, Hungary is of the opinion that the measure is general and constitutes part of the tax system rules. Therefore no additional state resources are used, since the normal tax liabilities do not change.

(40) The Hungarian authorities also note that the Commission stated in the Opening Decision that the advantage of the measure at group level arises in cross-border situations when the interest-paying company abroad is taxed at an effective rate higher than 8 %. Such an advantage is not imputable to the Hungarian State, neither is it a loss from Hungarian State resources. The advantage is provided by the foreign state that allows the full deduction of interest paid. Therefore the potential advantage is not provided from Hungarian state resources precisely in cases where the Commission established the existence of such an advantage.

(41) In addition, the Hungarian authorities note that the corporate tax paid by the interest-receiving member of the group through the application of the measure constitutes revenue for the State which would probably not be obtained without the existence of the measure.

Selectivity

(42) The Hungarian authorities argue that the measure is part of the general rules on corporate taxation, therefore it is not selective.

(43) The Commission's statement that the beneficiaries are undertakings active in various economic sectors reinforces the Hungarian view that the measure is not selective. In each sector of the Hungarian economy there are undertakings (overall more than thousand) that apply the measure. The measure is applied also in sectors where typically multinational or large enterprises are not present (e.g. agriculture, education, catering).

(44) The Hungarian authorities point out that it cannot consider a measure to be selective if its application is not possible under the same terms for each taxpayer. From the point of view of the application of the measure, only companies belonging to groups are in a factually and legally comparable situation.

(45) The fact that the measure necessarily has to be applied by undertakings which have at least one affiliated company seems to render the measure selective. However, the Hungarian authorities argue that a company providing intra-group loans is not in a comparable situation with a company providing loans to independent parties. The latter activity may only be pursued by an authorised financial institution as laid down in the Hungarian Act on credit institutions in line with the Banking Directive ([12]). Companies that finance third parties as their main activity cannot be compared to companies providing intra-group financing in order to optimally distribute liquidity within a group.

(46) Hungary refers to the Commission's 27th Report on Competition Policy of 1997 ([13]), which makes reference to a Dutch measure that reduced the payroll tax levied on employers engaged in research and development. The measure was not qualified as State aid, since it was not confined to a certain region, sector or undertaking and was provided on the basis of objective criteria.

1. De jure exceptions

(47) The Hungarian authorities consider that most general tax rules have exceptions from their scope of application which are based on economic policy considerations and are in line with the nature and general structure of the tax system.

([12]) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ L 177, 30.6.2006, p. 1).

([13]) http://ec.europa.eu/competition/annual_reports/rap97_en.html

(48) As to the exception concerning small companies, the Hungarian authorities note that (1) small companies typically do not provide intra-group financing, (2) the extension of the measure to them would require high administrative costs disproportionate to the potential advantages that they could effectively achieve, (3) the Hungarian Act on Corporate Tax provides for several tax benefits specifically designed for small companies. Hungary refers to the GIL case [14], where the Court supported the logic that different taxpayers can be treated on a different legal basis of the tax law.

(49) As regards the financial sector, Hungary further states that it did not intend to promote intra-group financing. Despite economic difficulties in Hungary, the companies concerned have operated with considerable profits, and the Hungarian government imposed special taxes on them rather than supporting them. In addition, these companies have special tax status, financial and accounting rules. In this regard, the Hungarian authorities also refer to paragraph 27 of the Commission notice on the application of the State aid rules to measures relating to direct business taxation [15]: 'Specific provisions that do not contain discretionary elements, allowing for example tax to be determined on a fixed basis (for example, in the agriculture or fisheries sectors), may be justified by the nature and general scheme of the system where, for example, they take account of specific accounting requirements or of the importance of land in assets which are specific to certain sectors; such provisions do not therefore constitute State aid (…)'.

(50) The Hungarian Government considers that extending the measure to financial service providers, insurance companies, investment companies and venture capital companies would precisely have constituted *de facto* selectivity as, given the special status of financial services providers (their activities typically/almost exclusively involve loan transactions performed using external resources), they would have obtained disproportionately large benefits in applying the measure.

2. Intra-group character

(51) As stated above, given the regulatory restrictions, non-financial firms may apply the measure only in relation to affiliated companies, since only authorised financial institutions are allowed to provide loans to independent parties. In addition, it must be noted that there are a number of rules in the tax systems of other Member States that are available only to corporate groups (e.g. group taxation).

(52) Therefore, according to the Hungarian authorities, the fact that the measure is not applicable to interest received from independent third parties in practice excludes only financial institutions from its scope of application owing to the stringent regulatory provisions for financial services, which, however, is justified by tax and economic policy considerations.

(53) The application of the Hungarian measure does not require that an undertaking should have activities in more than one Member State. According to Hungary, only companies belonging to the same corporate group are in a comparable legal and factual situation from the perspective of the application of the measure. Since all companies that are members of the group can apply the measure, it cannot be deemed selective. Hungary also notes that in practice, any company can be transformed into a corporate group. According to previous Commission practice, making a benefit subject to a certain shareholding is not a sufficient reason to consider a measure selective [16]. Special benefits provided to group companies cannot be considered to be selective because a group is not a sector or a function but merely a legal structure. Where a tax advantage is clearly applicable within a corporate group operating in any economic sector, it is a general measure and not a special advantage targeted at one specific sector.

3. Advantage from different foreign regulations

(54) The Commission takes the view that the measure selectively favours groups having at least one member outside Hungary. Hungary considers that such a situation does not constitute an advantage but merely an effect arising from the non-harmonised tax rules of different Member States, which is out of the control of the Hungarian state. As stated above, such an advantage is neither provided by Hungarian state resources nor imputable to Hungary. With respect to direct taxation, settled case law of the Court shows that residents and non-residents are not generally in a comparable situation.

4. Opt-out possibility on a yearly basis

(55) As regards the opt-out possibility, the Hungarian authorities note that such a feature would necessarily derive from the annual cycle of corporate taxation, together with other provisions of tax law. The actual choice as regards application of the measure is made neither by the Hungarian authorities nor by the beneficiary, but by an affiliated company where a tax disadvantage may arise.

[14] C-308/01 *GIL Insurance Ltd and Others* v *Commissioners of Customs and Excise* [2004] ECR I-4777.

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

[16] Commission Decision in Case N 354/04 — Ireland, Company Holding Regime (OJ C 131, 28.5.2005, p. 11).

The unlawful character of the measure, existing vs. new aid

(56) In the Opening Decision, the Commission concluded that the measure cannot be considered existing aid since it did not fulfil any of the three criteria set out in Annex IV.3 to the Act of Accession. However, the Hungarian authorities consider that this Annex does not cover all types of existing aid as set out in Article 1(b) in the procedural regulation. Annex IV.3 to the Act of Accession contains only provisions on aid put into effect and reviewed prior to the date of accession referred to in Article 1(b), (i) of the procedural regulation ([17]). However, the rules set forth in Article 1(b)(ii)-(v) of the Regulation should also be taken into account for the purpose of identifying existing aid which is not provided for by the Act of Accession. This interpretation is confirmed by Annex II to the Act of Accession which amends only Article 1(b)(i) of the Regulation. A different interpretation would question legal certainty and legitimate expectations and would lead to unequal treatment of Member States.

(57) In so far as the Commission maintains its position that the measure does not constitute existing aid on the basis of Article IV of the Act of Accession, the Hungarian authorities consider that it should be assessed pursuant to Article 1(b) of the Regulation and be qualified as existing aid, for two reasons.

(58) First, pursuant to Article 1(b)(v) of the procedural regulation, a measure which at the time of implementation did not constitute aid and subsequently became aid owing to the evolution of the common market and without having been altered by the Member State, is deemed to be existing aid. Hungary further refers to the Belgian Coordination Centres (BCC) case ([18]), which is to some extent similar to the measure, and in which the Commission considered in 1984 and 1987 that the BCC regime could not be regarded as State aid. Also according to the opinion given to a question by an MEP, the Commission considered that the BCC measure was not State aid and that similar measures of Member States also did not qualify as State aid ([19]). The Commission changed its opinion with regard to the BCC scheme only by its decision dated 17 February 2003, after the entry into force of the Hungarian measure.

(59) Hungary also confirmed, after verification with the competent department of the Hungarian Ministry of Finance, that the Hungarian State aid Monitoring Office (SAMO) had examined the measure in the summer of 2002, prior to its adoption. In the light of the applicable jurisprudence and the former Commission decision concerning the BCC scheme, the SAMO came to the conclusion that the measure at issue was not State aid and therefore did not submit the scheme to the Commission.

(60) In addition, the Hungarian authorities recall that the Commission requested information about the measure in a letter dated 19 November 2004 and Hungary responded on 8 December 2004. As Hungary did not receive any further questions or any form of official feedback from the Commission, it considers it had every reason to believe that the measure did not qualify as State aid, or if it did qualify as State aid, then it was existing State aid pursuant to Article 1(b)(v) of the Regulation.

(61) Second, Hungary argues that the measure is deemed to have been authorised based on Article 1(b)(iii) of the procedural regulation. It considers that if the measure had qualified as unlawful aid after the accession, the Commission's request for information of 2004 would qualify as the start of the investigation procedure. Hungary notes that under Article 4(5) of the Regulation the Commission's decisions must be taken within two months. Furthermore, according to Article 4(6) of the Regulation, where the Commission has not taken a decision within the above period, the aid is deemed to have been authorised by the Commission. According to Article 1(b)(iii) of the Regulation, aid which is deemed to have been authorised pursuant to Article 4(6) of the Regulation should be regarded as existing aid.

(62) Although the two months' deadline is not applicable in this procedure, the other obligation still prevails, i.e. the Commission is obliged to complete the examination. Based on settled case law of the Court, Hungary concludes that the Commission should have taken action to examine the State aid within a reasonable time. Hungary refers to the judgment of the Court of First Instance in Case T-190/00 ([20]), where the Court ruled that a 28-month period may be too long for a

([17]) Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty (OJ L 83, 27.3.1999, p. 1).

([18]) Commission Decision 2003/755/EC of 17 February 2003 on the aid scheme implemented by Belgium for coordination centres established in Belgium (OJ L 282, 30.10.2003, p. 25).

([19]) OJ C 63, 11.3.1991, p. 37.

([20]) Judgment of 27 November 2004 in Case T-190/00 *Regione Siciliana* v *Commission*, [2003] ECR II-5015, paragraph 136; see Case 120/73 *Gebrüder Lorenz GmbH* v *Germany et Land de Rhénanie-Palatinat* [1973] ECR-1471, paragraph 4.

preliminary investigation procedure if the Commission requested information only once from the Member State concerned. According to the Hungarian authorities, these principles should be applied *a fortiori* also in the preliminary investigation procedure, where the Commission examines only whether it has doubts as to the compatibility of the measure with Article 87 of the EC Treaty. Consequently, as the Commission failed to adopt a decision within a reasonable time — and having regard to the principles of legal certainty and good administration — even if the measure was deemed to be aid, it should be considered as existing aid pursuant to Article 1(b)(iii) of the Regulation.

The issue of recovery and potential transitional period for phasing out

(63) The Hungarian government argues that the Commission should refrain from the recovery of the potential aid, since it would be contrary to a general principle of Community law, namely the principle of legitimate expectations. Hungary refers to the case law which has consistently held that 'the right to rely on the principle of the protection of legitimate expectations extends to any person in a situation where a Community authority has caused him to entertain expectations which are justified.' ([21]) It also quotes the judgment of the Court in the Van den Bergh & Jürgens case ([22]), where the following test was applied to determine whether an expectation is justified: '…if a prudent and discriminating trader could have foreseen the adoption of a Community measure likely to affect his interests, he cannot plead that principle if the measure is adopted.' With reference to the Belgian Coordination Centres case, the Hungarian authorities argue that the Commission considered that system to be compatible in 1984 and 1987, and changed its decision only on 17 February 2003, after the Hungarian measure's entry into force. In addition, the Belgian Coordination Centres system was exclusively applicable to multinational companies, in contrast to the Hungarian measure which has a wider scope.

(64) The Hungarian authorities refer to the decision on the opening of the formal investigation procedure concerning Spain's corporation tax laws, where the Commission stated that it was based only on a preliminary assumption. In its final decision, the Commission stated that even the most cautious and well-informed parties could not have foreseen the measure being classed as State aid, and the parties could rightly claim legitimate expectations ([23]). In that case, the decision was taken more than four years after the request for information. In view of the fact that information was requested from Hungary on 19 November 2004, to which they gave a full reply on 8 December 2004, the Hungarian authorities consider that they could legitimately expect that the measure in question did not constitute State aid, in accordance with the Commission's position in Decision 2001/168/ECSC.

(65) Hungary points out that during that period the Council's Code of Conduct Group examined the measure and did not conclude that it constituted a harmful tax measure. In the light of the debates, the Commission as a member of this group could have requested further information from Hungary if it presumed that the measure qualified as.

(66) Hungary further argues that, according to the procedural regulation, before the opening of a formal investigation procedure, the Commission must discuss the compatibility of a provision with the Member State through a preliminary proceeding. It constitutes a violation of the procedural rules if the Commission commences a formal investigation pursuant to Article 88(2) of the EC Treaty without conducting a preliminary assessment under the Regulation and breaches the principle of cooperation in good faith laid down in Article 10 of the EC Treaty.

(67) The Hungarian authorities also argue that it follows from the established practice of the Commission that the protection of legitimate expectations also extends to Member States ([24]).

(68) Hungary also underlines that in certain decisions ([25]), in relation to legitimate expectation, the Commission referred to the similarities of the measures in question with the Belgian Coordination Centres (BCC) case which was originally considered compatible, and it therefore refrained from recovery.

(69) The Hungarian authorities conclude that 'neither Hungary nor Hungarian companies applying the measure could foresee — even if they exercised reasonable caution — that 4 years after the introduction of the Measure and 3 years after Hungary's accession to the EU the Commission would commence a procedure with respect to the Measure because it had doubts about its compatibility with Community law.'

([21]) Joined Cases C-182/03 and C-217/03 *Kingdom of Belgium and Forum 187* v *Commission* [2003] ECR I-6887, paragraph 147.

([22]) Case 265/85 Van *den Bergh en Jurgens BV et Van Dijk Food Products (Lopik) BV* v *Commission* [1987] ECR 1155, paragraph 44.

([23]) Paragraphs 27-28 of Commission Decision 2001/168/ECSC of 31 October 2000 on Spain's corporation tax laws (OJ L 60, 1.3.2001, p. 57).

([24]) Paragraph 43 of the English version, of Commission Decision 2003/512/EC of 5 September 2002 on the aid scheme implemented by Germany for Control and Coordination Centres, (OJ L 177, 16.7.2003, p. 17).

([25]) Commission Decision 2003/81/EC (OJ L 31, 6.2.2003, p. 26) and Commission Decision 2003/501/EC (OJ L 170, 9.7.2003, p. 20).

(70) Hungary underlines that an unfavourable decision of the Commission could lead to an immense number of lawsuits by taxpayers who have applied the measure for damages against Hungary and could reduce investors' confidence in the reliability of the economic transformation achieved so far by the country.

(71) Finally, Hungary argues that if the Commission decides that the measure is incompatible with Community law, it is necessary to set a transitional period during which the measure remains applicable at least for those companies that have been applying the measure so far. In the case *Kingdom of Belgium and Forum 187 ASBL v Commission* the Court held that in the absence of an overriding public interest, the Commission infringes a superior rule of law if it fails to establish transitional measures when repealing rules about which companies might have had legitimate expectations deriving from Community law ([26]).

(72) The Hungarian authorities therefore request that even in the event of a potential negative decision, on the basis of the principle of protection of legitimate expectation the Commission allow the application of the measure until the end of the fifth tax year following the year of the decision. This transitional period would be necessary for the taxpayers to prepare for the new circumstances resulting from the repeal of the measure. In this respect, Hungary notes that the Commission set a transitional period of almost 8 years in its decision relating to Dutch international financing activities for entities already applying the underlying Dutch rules ([27]).

Additional information provided by the Hungarian authorities

1. Justification by the nature or general scheme of the system

(73) In their reply to the Commission request for information dated 12 February 2008, the Hungarian authorities underline that 'should the Commission still hold that this measure is selective, the measure cannot in any case be considered to be State aid, because selectivity is justified by the nature or general scheme of the system'. The measure was introduced to diminish certain unfavourable effects that are attributable to the absence of group taxation in Hungary.

(74) In this regard, Hungary indicated that the measure departs from the so-called 'classic' method of individual (i.e. non-consolidated) tax assessment to a much lesser degree than do frequently used group taxation schemes in other Member States. As a consequence, the Hungarian authorities argue that the measure aims to implement (in a special way) an established and frequently used modern income tax system.

(75) Hungary also referred to the two alternative forms of financing, namely equity and debt financing, and the resulting different tax treatment, and observed that in both cases the income is subject to the same tax rate (16 % and 4 % of surtax), but the taxable person is different (for dividends, it is the subsidiary, and for interest, it is the parent company that is liable to pay the tax).

2. Statistics about the application of the measure

(76) Hungary provided the Commission with statistical information concerning the application of the measure based on data reported in the tax returns in the 2003 to 2006 tax years and argued that the sectoral distribution of undertakings to which the measure is applied demonstrates that the measure is sectorally neutral.

(77) The Hungarian authorities also provided statistical information on the number of undertakings potentially applying the measure and those actually resorting to tax base correction. These figures indicate that in 2006, 8 181 undertakings ([28]) could potentially apply the measure, while 1738 actually applied it ([29]).

([26]) Joined Cases C-182/03 and C-217/03 *Kingdom of Belgium and Forum 187* v *Commission* [2003] ECR I-6887, paragraph 149.

([27]) Commission Decision 2003/515/EC of 17 February 2003 on the State aid implemented by the Netherlands for international financing activities (OJ L 180, 18.7.2003, p. 52).

([28]) The number of potential beneficiaries is based on a rough estimate as there is no data about the exact number of companies eligible to apply the measure, since tax authorities have no information about the number of taxpayers having affiliated companies. By undertakings potentially applying the measure, Hungary means every undertaking that is not a micro or small enterprise, a credit institution, an investment company or an insurance company, irrespective of whether it is an affiliated company or not.

([29]) In 2006 the total number of companies subject to the Act LXXXI of 1996 on Corporate Tax and Dividend Tax was 316 498.

Number of undertakings potentially applying the measure and undertakings actually resorting to tax base correction

	Year 2003		Year 2004		Year 2005		Year 2006	
	Number	%	Number	%	Number	%	Number	%
Number of undertakings potentially applying the measure	8 975	100,0 %	7 774	100,0 %	8 236	100,0 %	8 181	100,0 %
Number and ratio of undertakings actually resorting to tax base correction	1 198	13,3 %	1 532	19,7 %	1 573	19,1 %	1 738	21,2 %

(78) Hungary also presented the impact derived from the aggregate data relating to the 50 individual companies that received the highest amount of net intra-group interest. The effects calculated on the basis of the aggregate data relating to the 50 undertakings that achieved the highest tax base reduction owing to the measure are as follows ([30]):

in 1 000 HUF

Year	Tax base reduction owing to the measure	Measure's effect on taxation
2003	9 403 458	1 692 622
2004	25 747 203	4 119 552
2005	13 585 244	2 173 639
2006	118 790 256	19 006 441

V. **COMMENTS FROM INTERESTED PARTIES**

American Chamber of Commerce in Hungary

(79) The American Chamber of Commerce in Hungary (AmCham) considers that the measure constitutes a partial consolidation with respect to interest income. It is part of the normal system of taxation in Hungary. Any cross-border advantage is not caused by the Hungarian tax legislation but results from differences between the legislations of Member States. To exclude cross-border interest received or paid by a Hungarian company from the scope of the measure is contrary to the fundamental freedoms of the Treaty.

(80) Concerning the granting of aid through state resources, AmCham considers that in cross-border situations with inbound interest, the deduction of the interest is carried out by the affiliate located in the other country.

(81) With regard to the advantage, AmCham underlines that there is no deviation from the normal tax regime. Whether an advantage exists in a multinational scenario depends on the corporate income tax rate in the borrower's State; however, for the State aid investigation the advantage must be assessed purely at national level.

(82) Regarding selectivity, AmCham states that if the Commission determines that a tax provision could be selective on the basis set out in the Opening Decision, tax depreciation schedules, provisions related to personnel expenses and thin capitalisation rules, *inter alia*, would also come into the scope of State aid rules. The exclusion of small companies is justified by the nature and general scheme of Hungarian tax legislation (because SMEs are uniquely subject to equivalent tax provisions ([31]) and the measure would have a limited impact on them. Furthermore, extending the measure to financial services companies would disproportionately benefit them.

([30]) The data relating to the following years were not provided by the Hungarian authorities.

([31]) These benefits include extra amortization deductions on certain investments such as real estate, machinery, vehicles, and intellectual property; special allowances for certain employee salaries; and exemption from innovation tax.

(83) The legally and factually comparable companies are groups, since the measure is a method to partially consolidate the taxation of intra-group transactions.

(84) It is incorrect to argue that the measure is selective because it does not apply to single operating companies. In principle, it is possible for any undertaking to restructure and transform into a group. There is, however, no incentive for single member entities to so restructure, because intra-company interest is not subject to taxation. A potential advantage based on a multi-national scenario is not imputable to the measure, but to the difference between tax legislations of Member States. To consider the opt-out provision as giving rise to selectivity would call into question several other tax measures that have an element of choice.

(85) According to AmCham, Annex IV.3 of the Act of Accession concerns only pre-accession aid 'upon accession', which otherwise would be governed by Article 1(b)(i) of Council Regulation 659/1999 ([32]). The determination of existing aid also must consider the remaining provisions under Article 1(b). According to AmCham, if the measure was State aid, it would be existing aid under Article 1(b)(iii) and Article 1(b)(v) of Regulation (EC) No 659/1999. If the Commission should come to the incorrect conclusion that the measure constitutes unlawful and incompatible new aid, it should be prevented from taking a recovery decision. Taking into account legitimate expectations, the Commission should also accept a deadline until which the measure could apply unchanged.

MOL Plc.

(86) MOL Plc operates as the parent company of the MOL Group in Hungary. It has been applying the measure since its introduction in respect of intra-group financing transactions with 30 group members. The firm applies the measure mostly in domestic relations (at an amount of over HUF 10 billion), while to a significantly lower extent with group members abroad (at an amount of less than HUF 1 billion). This demonstrates that, in contrast to the Commission's assumption, the measure is not exclusively applied in order to gain intra-group tax advantage from international transactions.

(87) MOL Plc considers that the measure partially achieves the objective of consolidated or group taxation, a system which Hungary does not have. If consolidated or group taxation is accepted in several Member States, according to MOL it can legitimately be assumed that the present measure is not aid, in particular since its application does not lead to a lower tax liability at group level.

(88) The Commission would be wrong in saying that the measure confers a selective advantage. It is a general measure with limited exceptions applicable to any taxpayer irrespective of the field of activity. The fact that the measure is applicable to intra-group financing naturally presumes the existence of such transactions with affiliated companies, similarly to e.g. the situation where the deduction of depreciation from the tax base requires ownership of an appropriate asset.

(89) MOL Plc further argues that for the loan-provider company in Hungary it is irrelevant whether it provides financing abroad or in Hungary.

(90) To MOL Plc's knowledge, the Commission already examined the measure in December 2004. It would be unfair and contrary to legal practice in good faith to expect that Hungary and Hungarian taxpayers consider the measure as State aid in contrast to the Commission's earlier position on the measure. Recovery would be unfounded and especially unjust for groups. It would result in additional tax liabilities for certain group members, while companies that have ceased to exist or are now outside the group would receive a certain amount of tax back. MOL believes that such a correction would actually result in unfair tax advantages and disadvantages.

The Netherlands

(91) The Dutch government considers that the Commission should be consistent in the application of the four State aid criteria when it makes a choice between the individual and the group approach.

(92) As regards the individual company approach, the Netherlands acknowledge that there is an advantage from State resources for the company receiving intra-group interest. However, the measure is not selective, as the legally and factually comparable companies are those that receive group interest on balance in Hungary.

(93) With regard to the group level approach, the advantageous cross-border situation with inbound interest does not concern Hungarian state resources, nor is it a consequence of the Hungarian scheme. It is not selective, either, since the reference framework concerns companies that reside in the fiscal jurisdiction of Hungary.

(94) In the Dutch authorities' opinion, the opt-out possibility is of no consequence for the categories of companies the Commission deems will potentially benefit from the Hungarian scheme.

([32]) OJ L 83, 27.3.1999, p. 1.

(95) Finally, the Netherlands underline that disparities are inherent in the concurrent existence of non-harmonised tax systems. This is illustrated by the fact that the advantage in cross-border situations with inbound interest would still endure even if the Hungarian measure was abolished (in relation to countries having an effective corporate tax rate higher than the Hungarian 16 %).

VI. **REACTION FROM HUNGARY TO INTERESTED PARTIES' COMMENTS**

(96) The Hungarian authorities note that the observations and reasoning of interested parties are fully in line with the arguments put forward by Hungary. They also support the argument that, in the absence of harmonisation of direct tax legislation at EU level, the measure should assessed under Article 96 and 97 of the EC Treaty.

(97) Hungary underlines that it fully agrees with the analysis drawn up by interested parties that the measure does not meet the State aid criteria.

(98) The Hungarian authorities reiterate that alternatively the measure should qualify as existing aid, and, should the Commission decide that the measure constitute illegal State aid, recovery should not take place because the beneficiaries were acting in a good faith.

VII. **ASSESSMENT**

VII.1. **Existence of aid within the meaning of Article 87(1) of the EC Treaty**

(99) In order to ascertain whether the measure at hand constitutes aid within the meaning of Article 87(1) of the EC Treaty, the Commission has to assess whether the measure favours certain undertakings or the production of certain goods by granting an advantage that is of an economic nature, that such an advantage distorts or threatens to distort competition, that the advantage is granted through State resources and that the advantage is capable of affecting trade between Member States.

Selectivity of the measure: preliminary considerations

(100) To be considered State aid, a measure must be specific or selective in that it favours only certain undertakings or the production of certain goods.

(101) According to the applicable case-law, in order to determine whether a measure is selective, it must be examined whether, within the context of a particular legal system, that measure constitutes an advantage for certain undertakings in comparison with others in a comparable legal and factual situation ([33]). It may thus be that a taxation regime does not constitute State aid even though it does not correspond in all respects to the general system of corporate taxation of the Member State. The Court has also held on numerous occasions that Article 87(1) of the EC Treaty does not distinguish between the causes or the objectives of State aid, but defines them in relation to their effects ([34]). In particular, fiscal measures, which do not constitute an adaptation of the general system to particular characteristics of certain undertakings, but have been conceived as a means to improve their competitiveness, fall into the scope of Article 87(1) of the EC Treaty ([35]).

(102) The concept of State aid does not apply, however, to State support measures, which differentiate between undertakings where that differentiation arises from the nature or overall structure of the system of which they form part. As explained in the Commission's notice on the application of the State aid rules to measures relating to direct business taxation ('the fiscal notice') ([36]), some conditions may be justified by objective differences between taxpayers.

(103) As a preliminary, it should be clarified at which level (group or undertaking level) the assessment of the reference system should be made. In the Opening Decision ([37]), the Commission indicated its preliminary view that at the level of the individual company forming part of a group, the scheme provides an advantage to those undertakings that receive positive net interest from affiliated companies, since they can deduct 50 % of the amount from their taxable base. Inversely, at the level of the group taken as a whole, the Commission noted that the scheme confers an advantage for cross-border situations with inbound interest, i.e. where the net interest-receiving company is based in Hungary and the net interest-paying company is non-resident. While, in such a case, the receiving company is allowed to deduct 50 % of the net inbound interest from the taxable base (i.e. the interest income is effectively taxed at half of the 16 % corporate tax rate), the net interest-paying company is subject to the tax rules of its state of residence, and is in principle allowed to deduct 100 % of the net interest paid.

([33]) See, inter alia, Case C-487/06 *P British Aggregates* v *Commission* [2008] paragraph 82; Case C-409/00 *Spain* v *Commission* [2003] ECR I-1487, paragraph 47; Case C-88/03 *Portugal* v *Commission* [2006] ECR I-7115, paragraph 54; and Joined Cases C-428/06 to C-434/06 *UGT-Rioja and Others*, not yet published, paragraph 46.

([34]) See for instance Case C-56/93 *Belgium* v *Commission* [1996] ECR I-723, paragraph 79; Case C-241/94 *France* v *Commission* [1996] ECR I-4551, paragraph 20; Case C-75/97 *Belgium* v *Commission* [1999] ECR I-3671, paragraph 25; and Case C-409/00 *Spain* v *Commission* [2003] ECR I-10901, paragraph 46.

([35]) See for instance Case C-66/02 *Italy* v *Commission* [2005] ECR I-10901, paragraph 101.

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

([37]) See paragraphs (15) to (17) of the opening decision.

(104) The Commission notes that the measure in question relates to a specific operation (financing of related companies), and not to a consolidation operation at the level of the group. Any reduced tax level will be applied individually to companies on the basis of the balance of their interest revenues and payments. Even if financing decisions can indeed be expected to be taken in the best interest of the group as a whole, the analysis at the level of the group has no foundation in Hungarian tax law which does not include any tax consolidation system for groups. The Hungarian corporate income tax is levied on individual entities, not on groups.

(105) Therefore, the Commission is of the opinion that the assessment of the reference system should be made at the level of individual companies.

Analysis of the selective nature of the measure

(106) The Commission considers that for the taxation of specific types of revenues, it may be relevant to determine whether a regime covers broad categories of transactions in a non-discriminatory manner. Any discrimination that cannot be justified by objective differences between taxpayers may lead to a distortion of competition.

(107) This being said, it must be determined whether loan transactions between related companies can be objectively entitled to a reduced taxation rate. The Hungarian authorities, as well as the American Chamber of Commerce, argue that a company providing intra-group loans is not in a situation comparable to that of a company providing loans to independent parties. The latter activity could only be pursued by an authorised financial institution as laid down in the Hungarian Act on credit institutions in line with the Banking directive ([38]). Companies that finance third parties as their main activity should therefore not be compared to companies providing intra-group financing in order to optimally distribute liquidity within a group.

(108) According to the Hungarian authorities, the measure would have the effect of reducing the difference between equity and intra-group loan financing.

(109) The Commission is of the opinion that regardless of the existence of discrimination against specific sectors, the measure at stake will have the effect of reducing this arbitrage (in a domestic situation), as the taxation of intra-group interests will approximate to the taxation of intra-group dividends, thus reinforcing the technical neutrality of the fiscal system.

(110) In addition, as stand-alone companies that are not credit or financial institutions are in principle not engaged in the regular business of granting loans to independent parties, they are not discriminated against compared to related companies where loan transactions are concerned in the granting of loans to affiliated companies.

(111) In terms of its effects, the advantage given to a company providing a loan to a related company cannot be considered as discriminatory, since a loan to a related company cannot be compared to a loan to an unrelated company. With respect to debt financing activities, related companies are not in a comparable legal and factual situation with unrelated companies. The reason is that related companies are not engaged in a merely commercial transaction, unlike unrelated companies, when they try to obtain loan or equity financing within the group. The parent and the subsidiary share the same interests, which is not the case of a commercial transaction with a third-party provider of finance, where each party tries to maximise its profits at the expense of the other.

(112) However, the Commission notes that the measure is not open to any company subject to corporate tax and receiving/paying interest in the context of intra-group relations. Although the measure does not include any limitation regarding the country in which the transaction is to take place, the Commission considers that the measure includes discriminating elements at three different levels.

1. Exclusion of the financial sector

(113) Hungary states that it did not intend to promote intra-group financing as these companies have operated with considerable profits. In addition, these companies have special tax status, financial and accounting rules.

(114) Hungary and the American Chamber of Commerce consider that extending the measure to financial service providers, insurance companies, investment companies and venture capital companies would precisely have constituted *de facto* selectivity as, given the special status of financial services providers, they would have obtained disproportionately large benefits when applying the measure.

([38]) Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ L 177, 30.6.2006, p. 1).

(115) In general, and as for any tax measure, it cannot be ruled out that group companies in specific sectors would benefit more from the measure because of the higher intensity of financial transactions in such sectors. This could indeed be the case of companies in the financial sector, which have lending as their main activity and which could easily increase lending to related companies as a result. However, this situation does not justify in itself the exclusion of the financial sector. Hungary could reach its objective of avoiding any abuse of the scheme by specific sectors or undertakings by a provision limiting the amount that can be taxed/deducted at a reduced rate. Furthermore, the Commission fiscal notice indicates that 'the fact that some firms or some sectors benefit more than others from some of these tax measures does not necessarily mean that they are caught by the competition rules governing State aid.'

2. Exclusion of small companies

(116) The Hungarian authorities argue that (1) small companies typically do not provide intra-group financing, (2) the extension of the measure to them would require high administrative costs disproportionate to the potential advantages that they could effectively achieve, (3) the Hungarian Act on Corporate Tax provides for several tax benefits specifically designed for small companies.

(117) The Commission notes that Hungary did not provide any data confirming that small Hungarian companies indeed do not provide or receive intra-group financing. It cannot therefore be ruled out that a significant number of small companies are organised in the form of a group and receive/pay interest in the context of their intra-group relations.

(118) In addition, the fact that small companies benefit from tax measures specifically designed for them is not relevant to the assessment of the selectivity of the measure.

3. Optional nature of the measure

(119) The optional nature of the measure allows the taxpayer to decide on a yearly basis whether to apply the measure or opt out. The Hungarian authorities point out that such a feature naturally derives from the annual cycle of corporate taxation, together with other provisions of tax law.

(120) The Commission considers, however, that such a feature has the effect of introducing differentiated treatment between group companies, as the measure does not apply to all group companies (with intra-group loan transactions) but only to those that have decided to opt in for the fiscal year concerned.

Justification by the nature and general scheme of the tax system

(121) In point 23 of its fiscal notice, the Commission indicates that 'the differential nature of some measures does not necessarily mean that they must be considered to be State aid. This is the case with measures whose economic rationale makes them necessary to the functioning and effectiveness of the tax system. However, it is up to the Member State to provide such justification.'

(122) According to the Hungarian authorities, the aim of the measure was to diminish certain unfavourable effects that are attributable to the absence of group taxation in Hungary. The measure departs from the 'classic' method of individual (i.e. non-consolidated) tax assessment to a much lesser degree than frequently-used group taxation schemes do in other Member States. As a consequence, the measure aims to implement (in a special way) an established and frequently used modern income tax system.

(123) The Commission observes, however, that the absence of tax consolidation systems for groups in Hungary does not justify the selective award of State aid to a limited number of companies. This principle was established in the Court of Justice judgment in Case 173/73 ([39]).

(124) Hungary also refers to the current different tax treatment of equity and debt and observes that in both cases the income is subject to the same tax rate but the taxable person is different (for dividends, it is the subsidiary, and for interest, it is the parent company).

(125) The Commission is of the opinion that the scheme in question has the effect of excluding several sectors from the benefit of reduced taxation and that it does not qualify as a simple technical measure aiming to shift part of the tax burden from the net interest-receiving company to the net interest-paying company.

(126) As to the exclusion of the financial sector, the Hungarian authorities also refer to paragraph 27 of the fiscal notice: 'Specific provisions that do not contain discretionary elements, allowing for example tax to be determined on a fixed basis (for example, in the agriculture or fisheries sectors), may be justified by the nature and general scheme of the system where, for example, they take account of specific accounting requirements or of the importance of land in assets which are specific to certain sectors; such provisions do not therefore constitute State aid (…)'.

([39]) Case 173/73 *Italy* v *Commission* [1974] ECR 709, paragraphs 22-33.

(127) The Commission notes, however, that the provisions referred to in paragraph 27 of the fiscal notice do not aim to increase or reduce the tax burden on specific sectors but rather to take into account specific features of the sectors in question, such as accounting requirements that could justify the implementation of simplification rules for the assessment of the taxable basis.

Conclusion on selectivity

(128) The differentiation between on the one hand the financial sector and small undertakings and on the other hand the other sectors, as well as the optional nature of the scheme, is not justified by the nature and general scheme of the Hungarian tax system.

(129) In this context, the Commission must conclude that the measure at stake is selective.

Economic advantage

(130) The Hungarian authorities argue that the measure may provide an advantage to an individual company, but it provides a disadvantage to the other party of the loan transaction, and therefore it is symmetrical in purely domestic relations.

(131) The Commission is, however, of the opinion that an advantage at the level of one company cannot be offset by the disadvantage at the level of another company, even if that company is part of the same group. The assessment whether there is an advantage has to be made at the level of the individual company, not of the group. In addition, it must be underlined that group companies can easily reorganise their financing activities and influence the outcome of the application of the measure.

(132) Besides, the Commission considers that the symmetry of the measure and its neutral impact at the level of the group is not sufficient to exclude the possibility of an advantage at the level of individual companies. Similarly, a lower taxation of interests by one entity of the group cannot be justified by a higher rate of taxation — due to a lower deductibility level of interests — in another one ([40]).

([40]) In this regard, it must be observed that, in its assessment of the tax regime for coordination centres established in Belgium (see Joined Cases C-182/03 and C-217/03, paragraphs 86 to 118), the Court of Justice considered that the flat-rate assessment of income under the cost-plus method constitutes an economic advantage for the purposes of Article 87 of the EC Treaty and that 'that analysis cannot be called into question either by the fact that the inclusion of the financial charges could, in some cases, lead to a tax base that was unduly high or by the scale of the tax burden that might be imposed on the group, nor can it be called into question by the fact that a centre may be taxed when it has not made any profits'. The Court further considered that the exemption from property tax in favour of coordination centres conferred an economic advantage on them and that 'the fact that only 5 % of the coordination centres benefit from it in practice, as all the others hold their buildings under lease, does not affect that assessment, since the choice between owning a building and leasing it is a matter entirely at the discretion of the centres.'

(133) It results from the jurisprudence referred to above that the fact that some group companies suffer a disadvantage does not call into question the existence of an advantage at the level of another company.

State resources

(134) In this case, the Commission takes the view that the advantage granted by the State through a lower tax (50 % reduction of the taxable amount) must be considered a loss of tax equivalent to consumption of State resources in the form of fiscal expenditure.

Distortion of competition and effect on trade between Member States

(135) As the beneficiaries are undertakings active in various economic sectors in markets that are open to competition, it has the potential to distort competition between Member States and affect intra-Community trade.

(136) In principle, aid which is intended to release an undertaking from costs which it would normally have had to bear in its day-to-day management or normal activities distorts the conditions of competition ([41]). In addition, it has been ruled that any granting of aid to an undertaking exercising its activities in the Community market is liable to cause distortion of competition and affect trade between Member States ([42]).

(137) Consequently, without it being necessary to carry out an economic analysis of the current situation in the markets concerned ([43]) and in view of the fact that the tax scheme introduced by Hungary strengthens the position of the economic operators who benefit from it compared with other operators competing in intra-Community trade, the Commission considers that the scheme affects trade between Member States and distorts competition between those operators.

(138) In the light of all the above considerations, the Commission takes the view that the intra-group interest deduction provided for in Act LXXXI of 1996 on Corporate Tax and Dividend Tax constitutes aid within the meaning of Article 87(1) of the Treaty.

([41]) Case C-156/98 *Germany* v *Commission* [2000] ECR I-6857, paragraph 30, and the case law cited therein.

([42]) Case 730/79 *Philip Morris* v *Commission* [1980] ECR 2671, paragraphs 11 and 12.

([43]) Case C-372/97 *Italy* v *Commission* [2004] ECR I-3679, paragraphs 44 and 45, and, on the unlawfulness of the scheme at issue, paragraphs 153-155.

VII.2 **Classification of the scheme as unlawful or existing aid**

(139) Annex IV.3 of the Act of Accession provides that the following aid schemes and individual aid put into effect in Hungary before the date of accession and still applicable after that date must be regarded upon accession as existing aid within the meaning of Article 88(1) of the EC Treaty:

(a) aid measures put into effect before 10 December 1994;

(b) aid measures listed in the Appendix to Annex IV;

(c) aid measures which prior to the date of accession were assessed by the State aid monitoring authority of Hungary and found to be compatible with the *acquis*, and to which the Commission did not raise an objection on the ground of serious doubts as to the compatibility of the measure with the common market.

(140) Annex IV.3 further provides that all measures still applicable after the date of accession which constitute State aid and which do not fulfil the conditions set out above shall be considered as new aid upon accession for the purpose of the application of Article 88(3) of the EC Treaty.

(141) The measure at hand was not put in place before 10 December 1994; it was not listed in the Appendix to Annex IV.3 of the Act of Accession; and neither was it covered by the interim mechanism procedure upon accession.

(142) The Hungarian authorities and the American Chamber of Commerce consider that this Annex contains only provisions about aid put into effect and reviewed prior to the date of accession referred to in Article 1(b)(i) of the procedural regulation ([44]). As a consequence, the rules set forth in Article 1(b)(ii)-(v) of the Regulation should also be taken into account for the purpose of identifying existing aid.

(143) The Commission agrees with this interpretation of Annex IV to the Act of Accession. Such an interpretation is confirmed by the wording of Article 1(b)(i) of the procedural regulation. As a consequence, it considers that the existing character of the aid should be assessed pursuant to Article 1(b)(ii)-(v) of the procedural regulation.

(144) With respect to the application of Article 1(b)(ii) and (iii), the Commission does not agree with Hungary on the fact that the measure at stake was authorized by the Commission, since it was not notified pursuant to Article 88(3) of the EC Treaty and Article 2 of the procedural regulation.

([44]) Regulation (EC) No 659/1999.

(145) The Commission considers that Article 1(b)(iv) does not apply either as the aid granted under the scheme is not covered by the limitation period of ten years.

(146) As regards Article 1(b)(v), this provision does not apply as such in the case at hand, since it cannot be considered that at the time the intra-group interest scheme was put into effect it did not constitute aid and became aid owing to the evolution of the market.

(147) However, the Commission notes that the measure under examination bears some similarities to the Belgian Coordination Centre (BCC) scheme. In this respect, it is worth recalling the previous Commission decisions of 2 May 1984 ([45]) and 9 March 1987 where the Commission ruled that the Belgian scheme was not aid within the meaning of Article 87(1) of the EC Treaty.

(148) Similarly to the Belgian Coordination Centres scheme which was exclusively applicable to multinational companies, the Commission found on the basis of the data provided by the Hungarian authorities that the main beneficiaries of the scheme were also multinational companies. In addition the Hungarian scheme has other similarities with the Belgian scheme in that both of the measures concern the taxation of intra-group activities.

(149) As a consequence, the qualification as aid of this type of measure related to intra-group activities was not self-evident at the time it was put into effect.

(150) Hungary points out that the Hungarian State Aid Monitoring Office (SAMO) examined the measure in the summer of 2002, prior to its adoption. In the light of the applicable jurisprudence and the former Commission decision concerning the BCC scheme, the SAMO came to the conclusion that the measure at issue was not State aid and therefore did not submit the scheme to the Commission.

(151) Despite the fact that the measure did constitute State aid at the time it was implemented, the Commission considers that owing to the very specific circumstances of the case at hand, in particular the pre-accession context and the previous Commission decisions in 1984 and 1987 on the Belgian scheme, the Hungarian

([45]) Although this decision was not published, it was referred to in the 14th Competition Report and in an answer to a parliamentary question published in 1991 that the Commission had not lodged any objections to the scheme in question.

State Aid Monitoring Office had no reason to consider that the measure constituted aid within the meaning of Article 87(1) of the EC Treaty, especially since the measure was adopted before the Commission reconsidered its position on the Belgian scheme ([46]). It is therefore considered that there is a body of exceptional circumstances suggesting that the Hungarian authorities may have been misled in thinking that the measure did not constitute State aid in a pre-accession context. In such circumstances, at the time the measure was adopted, Hungary had valid reasons not to submit the measure to the Commission as provided for under the interim mechanism procedure laid down in Annex IV to the Act of Accession.

(152) The Commission further notes that following Hungary accession to the EU, neither the scope of the measure nor the importance of the advantage conferred were altered in a substantial way. It is true that, as mentioned in recital 14 of the present decision, some modifications were introduced. However, they mainly consisted in technical adaptations relating to either the inclusion of certain types of companies that did not exist in Hungary before accession (European companies and European cooperative societies), or the exclusions of certain other types of companies which were abolished (venture capital companies). The measure at stake was thus not substantially altered following Hungary's accession to the European Union, and must thus be considered as existing aid.

VIII. **CONCLUSION**

(153) Owing to the peculiarities of the case at hand and the pre-accession context described above, the intra-group interest scheme must be considered as an existing aid scheme by analogy to Article 1(b)(v) of Regulation (EC) No 659/1999.

(154) Since the procedure regarding existing aid schemes is laid down in Articles 17 to 19 of the same regulation, the present procedure initiated on 21 March 2007 is redundant.

(155) Since the Hungarian authorities already enacted the repeal of the scheme as from 1 January 2010, the Commission does not see the need to start the cooperation procedure provided for in Article 17 of the procedural regulation,

HAS ADOPTED THIS DECISION:

Article 1

The Commission decision of 21 March 2007 opening the procedure laid down in Article 88(2) of the EC Treaty in respect of the scheme implemented by Hungary for the taxation of intra-group interest is redundant, since the scheme in question must be considered as an existing aid scheme.

Article 2

This Decision is addressed to the Republic of Hungary.

Done at Brussels, 28 October 2009.

For the Commission
Neelie KROES
Member of the Commission

([46]) See footnote 19. It should be noted that in the case of existing aid, only final decisions of the Commission produce legal effects (see Case T-276/02 *Forum 187 asbl* v *Commission*).