Commission’s proposal to phase out tax benefits for exempt companies in Gibraltar: Strict limits on existing as well as new beneficiaries

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Description of the exempt companies scheme

Companies registered with the Gibraltar authorities under the 1967 Gibraltar exempt companies legislation are only subject to a fixed annual tax ranging between £225 and £300 (approximately €350 – €500). They are exempt from any further taxation in Gibraltar. Exempt companies may not conduct any trade or business within Gibraltar and no Gibraltarian or Gibraltar resident may have a beneficial interest in their shares.

The Exempt Companies scheme was classified as State aid as it fulfils the four relevant criteria set by article 87(1) of the EC Treaty. The exemption from tax grants them an advantage compared to companies subject to the generally applicable profit tax rate. This advantage is clearly selective, financed from State resources and is liable to distort trade and competition. The regime satisfies none of the criteria set out in Articles 87(2) and 87(3) of the EC Treaty under which State aid may be considered to be compatible with the common market.

The ‘Gibraltar Exempt Companies Scheme’ constitutes aid that existed before the United Kingdom’s accession to the European Communities in 1973. Therefore the Commission must follow the procedure provided for in Article 88(1) of the EC Treaty which includes proposing appropriate measures to phase it out. After the United Kingdom rejected the Commission’s first proposal for appropriate measures in November 2002, and the Commission adopted a final negative decision in March 2004 on the corporate tax reform in Gibraltar, which was supposed to replace the exempt companies scheme, the United Kingdom approached the Commission suggesting new terms of phasing out.

Following intensive negotiations, the Commission proposed a second set of measures in January 2005 that was unconditionally accepted by the United Kingdom on 18 February 2005. Consequently the last offshore regime in Gibraltar will be gradually phased out by the end of 2010.

Procedural aspects

Initially the Commission considered the exempt companies legislation as illegal aid and opened a formal investigation procedure following Article 6 of the Procedural Regulation (1). However, Gibraltar challenged that decision before the Court of First instance. In its judgement in joint Cases T-195/01 and T-207/01 (2) the Court ruled that the subsequent modifications introduced after the United Kingdom’s accession were, contrary to the Commission opinion, clearly separable from the original 1967 Gibraltar exempt companies legislation, which is thus to be treated as existing aid.

In November 2002 the Commission adopted a proposal for appropriate measures in which it suggested closing the scheme to new applicants within one month of acceptance and putting an end to the scheme before the end of 2005. The United Kingdom conditioned its acceptance of this proposal on, amongst other things, a positive Commission decision on the Gibraltar corporation tax reform (3). Since the acceptance was not unconditional, it amounted to a refusal. After the Commission adopted a final negative decision on the Gibraltar corporation tax reform in March 2004, the United Kingdom made new proposals concerning transitional arrangements for abolishing the scheme.

Procedural rules concerning existing aid measures require the Commission to propose appropriate measures to the Member State concerned, inviting it to amend or to abolish the scheme. When the Member State does not accept the proposal, the Commission may open the formal investigation procedure following Article 19(2) of the Procedural Regulation (4). The Commission can only order the amendment or abolition of the measure after such a formal investigation.

The Commission faced a choice of opening a formal investigation procedure or proposing new appropriate measures that would be accepted by the UK and enforceable from the day of their acceptance. The main disadvantage of the first approach would be that for more than a year, which is the usual duration of the formal investigation procedure, an unlimited number of new companies

(2) ECR II-2309 [2002].
(3) CPN 2004/2, p. 97.
(4) Ibid. footnote 1.
could legally enter the scheme. The Commission therefore chose to negotiate appropriate measures with the United Kingdom that would allow for a restricted number of new entrants but would at the same time immediately significantly limit the distortion of competition.

After intensive negotiations the United Kingdom proposed to the Commission a wording of the appropriate measures that gave satisfactory guarantees limiting the distortion of competition by Gibraltar exempt companies. Once this second proposal of appropriate measures was accepted by the United Kingdom on 18 February 2005, it became binding.

**Content and aim of the proposal**

The proposal for appropriate measures comprises an overall cap on the total number of all beneficiaries, a strict limitation on new entrants, restrictions imposed on existing beneficiaries as well as monitoring and publicity obligations.

Firstly, the total number of beneficiaries of the exempt companies scheme will be limited to 8,464. This was the actual number of companies at the end of 2003. This condition will prevent any possible quantitative expansion of the scheme.

Secondly, new entrants can only be admitted to the scheme until 30.6.2006. Furthermore, only a fraction of exempt companies leaving the scheme can be replaced by new entrants. In 2005 up to 60% of companies leaving the scheme can be replaced, subject to a maximum of 823 new admissions. In the first half of 2006 only 50% of companies leaving the scheme can be replaced, but not more than the number of new entrants in 2005. The benefits under the exempt companies scheme for these new entrants will cease on 31.12.2007. Given that for an existing scheme the new beneficiaries could not have been stopped from entering, the Commission was mainly concerned with limiting the distortion of competition to a minimum. The number of new entrants is limited to a fraction of the number of companies that leave the scheme. This proportion is further reduced for 2006. Thereby, it is ensured that the total number of beneficiaries will progressively diminish, especially taking into account the large number of exempt companies that are leaving the scheme every year.

Thirdly, beneficiaries existing before the date of acceptance of the scheme will continue to benefit until 31.12.2010. If they change legal or beneficial ownership or the field of their activities before 30.6.2006, they can benefit only until the end of 2007. However, if their legal or beneficial ownership or their field of activities changes after 30.6.2006, their benefits will cease immediately. The date for the definitive dismantling of the scheme follows Commission practice in other similar cases (1). On the other hand, this was the first time that a restriction on the change of ownership or activity of existing beneficiaries was imposed. The purpose was to prevent potential new companies from entering the scheme by the way of buying existing companies with exempt certificates. The Commission also aimed to stop the expansion of existing beneficiaries into new fields of activity after their exempt status has been confirmed until 2010. Therefore companies changing ownership or field of activity are to be treated as new entrants.

Finally, the UK was invited to issue a public statement announcing the changes to be made to Gibraltar’s legislation and report to the Commission about its compliance with the conditions set out in the proposal during the phasing out period.

**Conclusion**

This was the first time that the Commission introduced restrictions concerning the change of activity and of ownership of existing beneficiaries in a proposal for appropriate measures. This element prevents existing beneficiaries from extending the distortion of competition. At the same time imposing restrictions on existing beneficiaries contributes to a gradual phasing out of an existing incompatible measure since the beginning of the transition period.

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