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Subject: State aid SA.46981 (2016/C) / ex (2016/N) – Poland - Flat rate sales tax in shipbuilding sector

Sir,

The Commission wishes to inform Poland that, having examined the information supplied by your authorities on the measure referred to above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union ("TFEU").

1. PROCEDURE

- (1) On 8 December 2016, Poland notified State aid in the form of a flat rate tax on sales in the shipbuilding sector.
- (2) The Commission requested additional information on 7 February 2017, 2 June 2017 and 21 September 2017, to which Poland replied on 4 April 2017, 21 July 2017 and 27 November 2017. In addition, the Commission has discussed the case with Poland during the country visit on 7 March 2017.

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2. DESCRIPTION OF THE MEASURE

- (3) The notified measure is provided for in the *Act on the stimulation of the shipbuilding industry and related industries* ("the Act").¹ It gives shipbuilding undertakings in Poland² an option to choose between (i) a 1% flat rate tax on the value of production sold and (ii) the generally applicable income taxes, that is to say, Corporate Income Tax (CIT, 19% on taxable income) or Personal Income Tax (PIT, 18% and 32% on taxable income for natural persons, or 19% for entrepreneurs). This option will not be available to other undertakings.
- (4) The flat rate tax is applicable to sales revenue from (i) the building of a new, complete and seaworthy ship or (ii) the conversion of a ship whose total value amounts to at least EUR 5 million or whose objective is to change the purpose of a ship or its drive. Revenue from other activities of a shipbuilding undertaking (if any) is subject to the standard CIT or PIT.
- (5) The flat rate tax is payable when the product is transferred or the service is rendered (i.e. when the building or conversion of a ship is completed), but no later than the day when the invoice is issued or the payment is fully settled. There is no obligation to pay tax on partial payments. In other words, payment of the flat rate tax is deferred until work is completed. By contrast, the payers of CIT and PIT are obliged to make advance payments every month (in some cases every quarter) and to settle the outstanding tax due after the end of each fiscal year.
- (6) The shipbuilding undertaking is subject to the flat rate tax for the period of three consecutive fiscal years (renewable). During the taxation period the form of taxation cannot be changed.
- (7) According to the notification the aid amount can be approximated at PLN 161.59 million (c. EUR 40 million), this being equal to the estimated tax revenue foregone due to the application of the flat rate tax during the period when the measure will be in place, that is to say from its approval by the Commission until 31 December 2026. According to Poland the precise aid amount cannot be determined in advance because it is not possible to estimate precisely the scale of a decrease in State revenues from CIT/PIT as it depends on factors that are not known at present (e.g. the rate of return on future production of individual taxpayers). This approximated aid amount does not take into account the benefit of tax deferment (see recital (5)).
- (8) Poland estimates that there are currently around 40 undertakings eligible to benefit from the notified measure.

¹ Official Journal of Laws of 2016, item 1206.

² According to Article 2(4) of the Act "shipbuilding undertaking" means (i) natural person, legal person or the limited joint stock partnership (*spółka komandytowo-akcyjna*) whose domicile or seat or management board respectively is in Poland or (ii) a partner in a civil law partnership (*spółka cywilna*), registered partnership (*spółka jawna*) and limited partnership (*spółka komandytowa*) whose seat or management board or domicile is in Poland or (iii) a foreign economic operator in the meaning of the Law on Freedom of Economic Activity (*Ustawa o swobodzie działalności gospodarczej*, Official Journal of Laws of 2015, item 584, as amended) who are engaged in Poland in the activity consisting in the building or the conversion of a ship. It follows that the beneficiary shipbuilding undertakings include natural persons subject to Personal Income Tax, who are engaged in the building or conversion of ships.

- (9) According to Poland the primary objective of the measure is sectorial development. Production of ships, which was a traditional specialty of Polish industry, has significantly declined. While in 2007 Polish shipyards produced 30 ships (with total capacity of 530.6 thousand gross tonnes, or GT), in 2014 they only produced 8 ships (with total capacity of 25.6 thousand GT). Poland considers that thanks to the introduction of the flat rate tax shipyards will be able to develop because a decrease in the real tax burden will leave them with more funds to finance their operations, develop their shipbuilding offer and thus enable them to win more orders.
- (10) Poland argues that the aid is necessary to ensure a level playing field for the Polish shipbuilding industry given the conditions of fierce and unfair competition on the international market, in particular from the East Asian shipyards which, in Poland's view, receive considerable State support.
- (11) Poland seems to imply that, apart from sectorial development, the aid may also contribute to the objectives related to research and development and protection of environment on the grounds that the measure is expected to promote mostly the building of new, innovative and environmentally-friendly vessels.

3. ASSESSMENT OF THE MEASURE

3.1. Existence of State aid

- (12) As a preliminary matter, the Commission notes that Poland has notified the measure as State aid within the meaning of Article 107(1) TFEU. For the reasons set out below, the Commission agrees with Poland that the measure constitutes State aid.
- (13) Article 107(1) TFEU provides that any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.
- (14) It follows that, for a measure to be qualified as State aid within the meaning of Article 107(1) TFEU, the following cumulative³ criteria must be met: (i) it must be granted by the State or through State resources and must be imputable to the State; (ii) it must confer an advantage upon an undertaking; (iii) it must be selective, i.e. favour certain undertakings or the production of certain goods; and (iv) it must distort or threaten to distort competition and it must affect trade between Member States.⁴

State resources and imputability to the State

- (15) To constitute State aid, a measure must both be imputable to the State and financed through State resources.

³ See Case C-399/08 P *Commission v Deutsche Post* EU:C:2010:481, paragraph 38 and the case-law cited.

⁴ See Case C-399/08 P *Commission v Deutsche Post* EU:C:2010:481, paragraph 39 and the case-law cited.

- (16) Since the notified measure results from an Act of the Polish Parliament, it is clearly imputable to the Polish State.
- (17) As regards the measure's financing through State resources, the Court of Justice has consistently held that a measure by which the public authorities grant certain undertakings a tax exemption which, although not involving a positive transfer of State resources, places the persons to whom it applies in a more favourable financial situation than other taxpayers constitutes State aid⁵. The 1% flat tax rate to the undertakings' activities subject to the tax results in Poland waiving tax revenue it would otherwise have been entitled to collect from income on sales of newly-built and converted vessels.
- (18) What is more, the measure provides for the deferral of payment of the tax normally due. Indeed, the shipbuilding undertakings will not have to pay the tax on partial payments but only when the work is completed or when the invoice is issued or the payment is fully settled. The later payment of tax appears to place beneficiaries in a more favourable financial situation than other taxpayers who, under the general CIT/PIT rules, are obliged to pay advance tax every month or quarter. By allowing the deferral of the flat rate tax payment the Polish State foregoes additional financial revenues, i.e. interest that could have been generated had the tax been paid earlier.
- (19) By renouncing those revenues, the measure (including tax deferment) seems to give rise to a loss of State resources within the meaning of Article 107(1) TFEU⁶.

Advantage

- (20) According to the case law of the Union Courts, the notion of aid embraces not only positive benefits, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking.⁷ An advantage may be granted through different types of reduction in a company's tax burden and, in particular, through a reduction in the applicable tax rate, taxable base or in the amount of tax due.⁸ A measure that entails a reduction of a tax or a levy gives rise to an advantage because it places the undertakings to which it applies in a more favourable financial position than other taxpayers and results in a loss of income to the State.⁹
- (21) The present measure gives shipbuilding undertakings operating in Poland, which meet the criteria set out in the Act, an option to pay a 1% flat rate tax on the value of the production sold (i.e. revenue from the building or conversion of vessels) instead of the standard CIT/PIT rates on income. According to Poland analyses show that opting for the flat rate tax on the value of production sold will be financially beneficial for undertakings in case where profitability of a given

⁵ See Joined Cases C-106/09 P and C-107/09 P *Commission v. Government of Gibraltar and United Kingdom* EU:C:2011:732, paragraph 72 and the case-law cited therein.

⁶ See Case C-169/08 *Presidente del Consiglio dei Ministri* EU:C:2009:709, paragraph 58.

⁷ Case C-143/99 *Adria-Wien Pipeline* EU:C:2001:598, paragraph 38.

⁸ See Case C-66/02 *Italy v Commission* EU:C:2005:768, paragraph 78; Case C-222/04 *Cassa di Risparmio di Firenze and Others* EU:C:2006:8, paragraph 132; Case C-522/13 *Ministerio de Defensa and Navantia* EU:C:2014:2262, paragraphs 21 to 31.

⁹ Joined Cases C-393/04 and C-41/05 *Air Liquide Industries Belgium* EU:C:2006:403, paragraph 30 and Case C-387/92 *Banco Exterior de España* EU:C:1994:100, paragraph 14.

building or conversion amounts to at least 6%. In other words, the amounts of tax paid by the beneficiaries of the measure will represent a lower share of their income (the normal tax base under CIT/PIT) than would be the case under the application of the normal CIT/PIT rules. The beneficiaries of the measure therefore will receive an advantage compared to undertakings the income of which is taxed according to the normal CIT/PIT rules.

- (22) As a result, the measure reduces the charges of its beneficiaries as compared to undertakings that are not subject thereto. Poland itself acknowledges that the measure is expected to bring an economic advantage to its beneficiaries in the total amount of PLN 161.59 million (see recital (7)). According to Poland's estimates the average value of the aid for an undertaking normally subject to CIT that would opt for the flat rate tax would amount to around PLN 430 000 p.a., while for a PIT payer it would be about PLN 40 000 p.a. Hence, this measure seems to confer an economic advantage to the undertakings subject to the flat rate tax to the detriment of undertakings subject to the normal CIT/PIT regime.
- (23) Similarly, the rules that allow a deferred payment of the flat rate tax reduce the financial cost for its payers as the amount due will remain available to them over a longer period of time than if they were subject to the normal tax regime. In other words the payers of the flat rate tax will benefit from a cash flow advantage. Those rules thereby seem to confer an additional economic advantage to shipbuilding undertakings that will opt for the measure.

Selectivity

- (24) A measure is selective if it favours certain undertakings or the production of certain goods within the meaning of Article 107(1) TFEU. For fiscal schemes the Court of Justice has established that the selectivity of the measures should in principle be assessed by means of a three-step analysis.¹⁰ First, the common or normal tax regime applicable in the Member State must be identified: "the system of reference". The reference system is composed of a consistent set of rules that generally apply – on the basis of objective criteria – to all undertakings falling within its scope as defined by its objective. Second, it should be determined whether a given measure involves a derogation from that system insofar as it differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. If the measure in question does not constitute a derogation from the reference system, it is not selective. If it does (and therefore is *prima facie* selective), it must be established, in the third step of the analysis, whether the derogatory measure is justified by the nature or the general scheme of the (reference) tax system. If a *prima facie* selective measure is justified by the nature or the general scheme of the system, it will not be considered selective and it will thus fall outside the scope of Article 107(1) TFEU.
- (25) At the same time, as the Court of Justice has specified¹¹, it is not always sufficient to confine the selectivity analysis to whether a measure derogates from the

¹⁰ See, for example, Case C-279/08 P *Commission v Netherlands (NOx)* [2011] ECR I-7671; Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365; Joined Cases C-78/08 to C-80/08, *Paint Graphos and others* [2011] ECR I-7611; Case C-308/01 *GIL Insurance* [2004] ECR I-4777.

¹¹ Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* EU:C:2011:732, para. 92.

reference system as defined by the Member State. It is also necessary to evaluate whether the boundaries of that system have been designed by the Member State in a consistent manner or, conversely, in a clearly arbitrary or biased way, so as to favour certain undertakings over others.

- (26) In substance, the selectivity analysis consists in determining whether the measure entails discrimination, in other words, whether the beneficiaries of the measure have received an advantage in comparison with other undertakings that find themselves in comparable legal and factual situation. The Court has ruled in case *World Duty Free*¹² that «*the assessment of that condition requires a determination whether, under a particular legal regime, a national measure is such as to favour 'certain undertakings or the production of certain goods' over other undertakings which, in the light of the objective pursued by that regime, are in a comparable factual and legal situation and who accordingly suffer different treatment that can, in essence, be classified as discriminatory.*». Then, if it is concluded that one or more undertakings benefit from an advantage compared to other undertakings that find themselves in a comparable legal and factual situation it should be determined whether that discrimination is justified by the nature and general scheme of the tax system of reference.

(a) *System of reference*

- (27) The reference system is composed of a consistent set of rules that generally apply on the basis of objective criteria to all undertakings falling within its scope as defined by its objective.
- (28) In the present case, as regards the first component of the measure, namely the exemption of certain revenues of shipbuilding undertakings from the application of the normal CIT/PIT taxation rules and their replacement with the alternative rules, namely the application of the 1% flat rate tax on eligible sales, the Commission considers the reference system to be the general regime on CIT/PIT that applies in principle to all undertakings operating in Poland.
- (29) As regards the second component of the measure, namely the rules that allow the deferral of the payment of the tax, the Commission considers the reference system to be the general CIT/PIT regime and more specifically the rules applicable to the identification of taxable events, the timing of taxation and tax payment that apply under that general regime to all undertakings operating in Poland.
- (30) Whereas the reference system made of the standard CIT/PIT rules consists in the application of the CIT/PIT rate to a taxable income (meaning revenue minus deductible expenses), the measure in question would impose a rate upon the revenue generated out of eligible sales (without any deductions). This difference, however, does not affect the validity of the reference system since the measure is planned to introduce a derogation and alternative to the normal CIT/PIT rules (which will therefore not apply) for a group of selected undertakings so as to favour them. Moreover, this difference in the tax base does not affect the comparison with the system of reference and the establishment of an advantage (see recital (22)).

¹² Joined Cases C-20/15 P and C-21/15 P, *Commission/World Duty Free Group*, EU:C:2016:981, para. 54.

(31) The Commission considers that the 1% flat rate tax on eligible sales cannot form part of that reference system as it does not seem to respond to the same underlying logic – taxation based on the taxable income from economic activities – as CIT/PIT. And even if it was regarded as a part of the reference system (*quod non*), the boundaries of that system would be designed in a clearly arbitrary or biased way, so as to favour certain undertakings over others and that would in itself lead to the conclusion of selectivity (see recital (25)).

(b) Derogation from the system of reference

(32) As a second step, it is necessary to determine whether the measure derogates from the application of the rules of reference in favour of certain undertakings which are in a similar factual and legal situation in light of the intrinsic objective of the system of reference.

(33) In the present case, the intrinsic objective of the system of reference is to tax the income of economic operators. In particular, payers of CIT and PIT are charged on the income earned in a given fiscal year. The taxable income is calculated based on the difference between the total taxable revenue and tax deductible expenses. The current CIT rate is 19% and the PIT rates are 18% and 32% (progressive, depending on income) or 19% for entrepreneurs. CIT and PIT payers are obliged to pay advance tax every month or quarter. Before the adoption of the present measure, shipbuilding undertakings, in particular those who will become eligible for the flat rate tax according to Article 2(4) of the Act, did not enjoy any special tax treatment due to the nature of their economic activities. They were subject to the same general tax rules as all other economic operators obliged to pay CIT/PIT.

(34) The notified measure gives shipbuilding undertakings a special tax treatment consisting in an option to choose a 1% flat rate tax on the value of eligible sales (see recital (3)) instead of being subject to the applicable standard tax rates on income. In addition, in contrast to the standard CIT/PIT rules, the flat rate tax is not payable monthly or quarterly but only when the product is transferred or service is rendered (no later than the day when the invoice is issued or the payment is fully settled). As explained in recital (22), the measure is more favourable for its beneficiaries than the normal CIT/PIT regime.

(35) Hence, the Commission considers that the measure derogates from the reference system in favour of the shipbuilding undertakings.

(36) Therefore, at this stage, the Commission considers that the measure is *prima facie* selective.

(c) Justification

(37) A measure which derogates from the reference system is not selective if it is justified by the nature or general scheme of that system. This is the case where the selective treatment is the result of inherent mechanisms necessary for the functioning and effectiveness of the system¹³.

¹³ See for example Joined Cases C-78/08 to C-80/08 *Paint Graphos and others*, ECLI:EU:C:2011:550, para. 69

- (38) It is for the Member State to provide such justification.¹⁴ For this purpose, external policy objectives – such as regional, environmental or industrial policy objectives – cannot be relied upon by the Member States to justify the differentiated treatment of undertakings under a certain regime.
- (39) Poland has not provided any argument why the measure should be considered as justified by the nature or general scheme of that system. On the contrary, Poland has notified the measure as State aid.
- (40) Therefore, at this stage the Commission does not consider that the measure is justified by the nature and general scheme of the reference system and thus considers it to be selective.

Potential distortion of competition and effect on intra-Union trade

- (41) According to Article 107(1) TFEU, to constitute State aid, a measure must distort or threaten to distort competition and have an effect on intra-Union trade.
- (42) A measure granted by the State is considered to distort or threaten to distort competition when it is liable to improve the competitive position of the recipient compared to other undertakings with which it competes.¹⁵ It is therefore sufficient that the aid allows the recipient to maintain a stronger competitive position than it would have had if the aid had not been provided.
- (43) Beneficiaries of the measure will pay less tax than they would have paid if they had been subject to the normal CIT/PIT regime. As a result they will have additional liquidity that they can use to finance their activities. This will clearly improve their competitive position when bidding for new orders as compared to competitors that will not benefit from the measure. Poland itself expects that the measure will induce beneficiaries to produce and sell more ships. It seems reasonable to consider that at least some of this increased production would come at the expense of competitors. In addition, the Court of Justice has consistently held that operating aid, such as the present measure, distorts competition (see recital (61)).
- (44) The shipbuilding market is open to competition from companies from other Member States (as well as third countries). Poland itself acknowledges that there is fierce competition on that market. Therefore the measure is likely to have an effect on competitors in other Member States.
- (45) Consequently, at this stage the Commission considers that the measure distorts or threatens to distort competition and affects trade between Member States.

Conclusion on the existence of aid

- (46) Since all the conditions laid down in Article 107(1) TFEU seem to be met, the Commission preliminarily concludes that the notified measure constitutes State aid within the meaning of that provision.

¹⁴ See e.g. Joined Cases C-20/15 P and C-21/15 P, *European Commission v World Duty Free Group SA and Others*, ECLI:EU:C:2016:981, para. 58.

¹⁵ See Judgment of the Court of Justice in *Phillip Morris Holland v Commission*, 730/79, EU:C:1980:209, paragraph 11.

3.2. Legality of the aid

- (47) Pursuant to Article 108(3) TFEU, Member States must notify any plans to grant or alter aid, and must not put the proposed measures into effect until the notification procedure has resulted in a final decision ("standstill obligation").
- (48) In line with Article 15 of the Act shipbuilding undertakings will be able to choose the flat rate tax when positive decision of the Commission is in force. Thus the standstill obligation has been respected.

3.3. Compatibility of the aid

- (49) Insofar as the measure constitutes State aid within the meaning of Article 107(1) TFEU, the Commission must assess whether that aid can be declared compatible with the internal market. According to Poland the notified aid is compatible with the internal market directly on the basis of Article 107(3)(c) TFEU.
- (50) The Commission notes that the notified aid, by nature of its objective, does not seem to fall within the scope of any existing guidelines or block exemption. In the past aid for the shipbuilding sector was covered by specific rules contained in the Framework on State Aid for Shipbuilding ("Shipbuilding Framework").¹⁶ However, this framework expired on 30 June 2014. As a result some of these rules were integrated in other sets of secondary legislation (e.g. in the field of R&D&I or regional aid), while others have disappeared.
- (51) In view of the above, the Commission must assess compatibility of the aid directly under Article 107(3)(c) TFEU on the basis of general assessment principles. For that purpose the Commission must examine whether the aid: (i) aims at a well-defined objective of common EU interest; (ii) is appropriately designed to address the policy objective concerned; (iii) is necessary and (iv) proportionate to the problem tackled; (v) has an incentive effect on the beneficiaries and (vi) does not unduly distort competition and affect trade among Member States so that the overall balance is positive.
- (52) Poland argues that the aid (i) serves the objective of sectorial development by aiming to ensure a level playing field against State-supported Asian shipyards; (ii) it is appropriate to achieve this objective as it encourages shipyards to embark on innovative and high-margin activities, whereas Asian producers specialise rather in cheaper and less advanced products; (iii) it is necessary, as without the aid Polish shipyards would not achieve the envisaged objective; (iv) it is proportionate, as the aid amount will be limited by market demand and production capacity; (v) it will induce shipyards to produce new and innovative vessels, which they would not do without the aid, and therefore it has an incentive effect; (vi) it has a limited impact on competition and trade as Poland has only a 1% share in the EU markets for building and conversion of vessels.

Objective of common interest

- (53) In the view of the Commission the primary objective of the aid, i.e. sectorial development, does not have a common EU dimension as the aid is to be granted

¹⁶ OJ C 364, 14.12.2011, p. 9.

only to shipbuilding undertakings located and operating in Poland and thus will not benefit shipbuilding sectors in other Member States. On the contrary, it may harm them by giving Polish shipyards undue economic advantage.

- (54) Poland refers to a number of EU documents that stress the importance of shipbuilding industry for the EU and its Member States. The Commission considers that the importance of a given sector, even if mentioned in the EU documents, is not sufficient to justify that it is in the EU interest to grant State aid to such a sector, let alone to grant it operating aid, like in the present case. Member States wishing to grant aid must demonstrate instead the pursued objective aims at increasing market efficiency and/or addressing equity problems.
- (55) Poland has not demonstrated the above and it does not seem to be the case. Markets seem to deliver an efficient allocation of resources as ships are produced in the EU without operating State aid. Such aid could even lead to inefficiency by contributing to overcapacity or discriminating against non-subsidised shipyards. Likewise, the notified aid does not seem to target any equity objectives as it is not designed to reduce inequalities between individuals or regions. This does not mean that aid for the shipbuilding industry is excluded. There are certain types of aid that are considered under EU State aid rules to contribute to the objectives of efficiency (e.g. R&D&I, training, environmental aid) and/or equity (e.g. regional aid, aid for the provision of general economic interest) and are thus allowed under the conditions set out in relevant secondary legislation. However, the notified aid at issue does not seem to fit under any of those categories.
- (56) Poland seems to consider that the aid may also serve, albeit indirectly, the objectives of environmental protection and research and development by incentivizing the building of new, innovative and environmentally-friendly vessels. In this respect, the Commission notes that while the aid might indeed have some limited and indirect impact on the environment or research and development, it would rather be a by-product of the measure than its intended outcome. It is clear that the primary purpose of the aid, as acknowledged by Poland, is to build and convert more ships, irrespective of their technological advancement or environmental impact. This is also confirmed by the very design of the measure, which targets the building and conversion of all types of ships, not just innovative or environmentally-friendly ones. In addition, there are specific forms of aid under EU law which are better-suited to promote the objectives concerned, such as R&D&I and environmental aid. However, Poland has decided not to use them because they would be insufficient to ensure the envisaged effects of the aid.

Appropriateness

- (57) First, Poland has not demonstrated, for instance through benchmarking or as a result of scenarios and a cost-benefit analysis, that the chosen measure is more appropriate to tackle the identified concerns and would cause less distortions of competition and trade than alternative policy tools (e.g. regulatory instruments, other forms of aid or financing on market terms).
- (58) Second, Poland has not justified why it considers that the measure will deliver the desired effect. It seems questionable that the relatively small savings expected from the application of the flat rate tax (less than 0.4% of total shipyards' forecasted revenue in 2017) would enable Polish shipyards to sell and convert

more ships, let alone to gain a sustainable competitive advantage over Asian competitors. Experience prompts to be cautious as much higher State support granted in the past did not ensure shipyards' long-term viability.

- (59) Third, Poland argues that the market environment has recently improved with a small but systematic increase of European shipyards' share in the world production. Whether this is the case or not, it has not justified why the aided shipyards would be able to benefit from this market opportunity.
- (60) The aid would also be contrary to the Commission's policy, which aims at eliminating sectorial aid to shipbuilding. Already in 2011, the Commission announced in the then applicable Shipbuilding Framework that "*In line with its policy to ensure enhanced transparency and simplification of State aid rules, the Commission aims, to the greatest extent possible, to eliminate the differences between the rules applicable to the shipbuilding industry and to other industrial sectors, by extending general horizontal provisions to the shipbuilding sector.*"
- (61) Finally, it seems that in the face of global overcapacity, reverting to operating aid would bring about rather negative than positive effects. This is also reflected in jurisprudence and State aid rules. The Court of Justice pointed out that "*in principle, operating aid, that is to say, 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*".¹⁷ Under State aid rules operating aid is in principle prohibited save for exceptional provisions (e.g. regional aid under certain conditions) which are not applicable to the present case. Indeed, sustainable competitiveness of shipyards seems more likely to be attained with aid that is targeted at innovation, efficiency or specialisation than with operating aid.

Need for State intervention

- (62) Poland has not demonstrated by way of comparison with credible alternative scenario(s) (e.g. private investment, market financing) that the expected effects would not have been achieved without State aid.
- (63) According to Poland the difficulties of Polish shipyards are not due to their inherent unprofitability but rather due to their insufficient liquidity. If this is true, i.e. if shipyards have a potential to be profitable, they should be able to raise the necessary liquidity on the market or to attract private capital investment, especially if the market outlook has improved, as claimed by Poland. Private shipyards, which account for a significant portion of the total sector's production in Poland, have been competitive without State support and managed to secure market financing. Some of them produce innovative and environmentally-friendly ships with LNG drive.
- (64) In addition, Poland justifies the need for State intervention by the loss of competitiveness of Polish shipyards in comparison with shipyards outside the EU in the segment of the production of fully-equipped vessels. Yet, the measure is envisaged not only for the production of fully-equipped vessels but also for conversion of ships and for the production of all types of vessels (irrespective of

¹⁷ Case C-156/98 *Federal Republic of Germany v Commission* [2000] ECR Page I-6857, para 30.

their specification and level of equipment). Poland has not justified the necessity of aid for conversion and for not fully-equipped vessels for which the aid is also envisaged.

Proportionality

- (65) Poland has not demonstrated that the aid is limited to the minimum necessary for the aided activity to be performed. In any case, the Commission notes that the aid amount is not limited by any quantitative cap. The amount of revenue foregone due to application of the 1% flat rate tax is only constrained by the value and profitability of the eligible sales. Poland itself admits that it is not possible to estimate precisely the scale of a decrease in State revenue from CIT/PIT. As the maximum aid amount is not fixed, the measure can result in a potentially unlimited operating aid.
- (66) Moreover, the aid amount approximated by Poland relates only to budget revenue foregone and does not include the additional benefit of the tax deferment (see recital (7)). As the flat rate tax is payable only when the building or conversion of a vessel is completed, in contrast to CIT/PIT which is paid monthly or quarterly, the beneficiaries of aid will *de facto* receive an interest-free tax credit, which can be used for financing their liquidity needs. Thus the total aid amount is even higher than approximated by Poland. In view of the above, the aid cannot be considered as proportionate.

Incentive effect

- (67) Poland argues that the aid will induce shipyards to produce innovative, fully-equipped and environmentally-friendly vessels and claims that in the absence of aid shipyards would have less of an incentive to build such vessels and would rather continue to produce partially-equipped and basic ships.
- (68) The Commission notes that Poland has not demonstrated how the introduction of the flat rate tax would make shipyards produce innovative and environmentally-friendly vessels. It seems that to be able to do that, shipyards would need not only additional liquidity but above all expertise. In addition, as mentioned in recital (56), the aid is available for the building and conversion of all types of ships, not only the innovative or environmentally-friendly ones. Finally, Poland has not sufficiently justified that shipyards would not take the expected action without the aid. As indicated in recital (63), private shipyards manage to produce innovative and environmentally-friendly ships without State support.

Effect on competition and trade

- (69) The introduction of the flat rate tax will reduce tax burden of benefitting shipyards and thus provide them with more funds to finance their operations and to compete for new orders (see recital (9)). The aid will be available only to shipyards located and operating in Poland. Competitors in Poland not eligible for the aid and shipyards in other Member States will have to finance their operations from their own resources. The measure will therefore put them at a competitive disadvantage as compared to Polish shipyards benefitting from the measure.
- (70) Poland estimates that the share of Polish shipyards in the building and conversion segments is not higher than 1% of the relevant European markets. Whereas this

does not appear significant, Poland also admits that there is fierce competition in the shipbuilding industry (see recital (10)). In this context, even a slight cost advantage can have a significant impact on demand. In addition, thanks to the aid Polish shipyards may be able to increase their market share in the future.

Conclusion on the compatibility of the aid

- (71) In view of the above, the measure does not seem to address any well-defined objective of common interest, is not appropriate to ensure the sustainable competitiveness of shipyards, does not seem necessary as private shipyards are able to compete without the aid, is not limited to the minimum necessary, does not have a sufficiently justified incentive effect and would distort competition and trade among Member States. In sum, the negative effects of the aid seem to outweigh by far any positive effects. Given that, the notified measure does not seem to be compatible with the internal market under Article 107(3)(c) TFEU.

4. CONCLUSION

- (72) Consequently, at this stage, the Commission has doubts on the compatibility of the notified aid with the internal market.

In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 108(2) TFEU, requests Poland to submit its comments and to provide all such information as may help to assess the measure, within one month of the date of receipt of this letter. Poland is also invited to explain whether natural persons, the payers of PIT, can indeed benefit from the notified measure, as appears from the Act, or whether they must first assume a corporate form, such as e.g. single entrepreneurs. It requests your authorities to forward a copy of this letter to the recipient of the aid immediately.

The Commission wishes to remind Poland that Article 108(3) TFEU has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.

The Commission warns Poland that it will inform interested parties by publishing this letter and a meaningful summary of it in the Official Journal of the European Union. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the Official Journal of the European Union and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: <http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission