EU State Aid Enforcement: What Multinationals Need to Know

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In recent years, the European Commission (EC) has been actively enforcing European Union state aid violations, an area of law that is unique to Europe but has wide-ranging implications for multinationals with investments in the EU.

The EC's antitrust division, the Directorate-General for Competition, has investigated the alleged favorable tax arrangements enjoyed by several multinational companies in some EU member states. The EC's general theory in such cases is that certain EU national governments have breached EU state aid rules by offering these multinationals better tax treatment than other companies in those same countries, through tax rulings endorsing methods of cross-border profit allocation within their corporate groups that are not at arm's length (*i.e.*, do not reflect economic reality). In each of these cases, the EC has ordered the member state to recover the state aid (*i.e.*, the balance of unpaid taxes, plus interest). For example, in 2016 the EC ordered Ireland to recover up to €13 billion plus interest from Apple. The Netherlands, Luxembourg and Belgium also are in the EC's spotlight for the same type of conduct.

Investigations into alleged special tax deals are reminders that the EC should be reckoned with not only for its active merger control and antitrust enforcement but also for its powers under EU state aid rules, which can significantly affect the bottom line of companies active in EU markets.

What Is State Aid?

State aid is any measure originating from an EU member state (directly or, under certain conditions, through state-owned companies) that grants a company a selective economic advantage that distorts competition and affects trade among EU member states. State aid can be granted in the form of a subsidy but also through such measures as a capital injection, loan, tax advantage, reduction in social security contributions, purchase of goods and services, sale of land or other infrastructure, or privatization. However, these transactions are not automatically considered state aid: If the state is acting on commercial terms (*i.e.*, in the same way as a private market operator would), no state aid is deemed to have occurred.

EC Review of State Aid

A measure that qualifies as state aid isn't automatically unlawful. Rather, it must be vetted by the EC or otherwise meet a preapproved set of conditions that would exempt it from review. The EC reviews state aid measures for compatibility with the EU's internal market, following detailed compatibility criteria for practically every industry sector and type of measure. State aid that requires the EC's review may not be implemented prior to EC clearance (similar to the standstill obligation in the area of merger control). Aid granted in breach of the standstill obligation is illegal and may need to be recovered. The EC has the ability to order member states to recover illegal aid for violations dating back 10 years. Member states that do not comply can be sued by the EC in the European Court of Justice.

Key Considerations

State aid enforcement is a daily business reality in the EU. Companies navigating EU markets should therefore closely consider state aid rules in the following areas:

- **M&A in Europe.** When acquiring shares or assets of a company active in the EU, careful due diligence is warranted as to whether the target is benefiting from any state aid schemes and/or may have received illegal state aid in the past. For ongoing schemes, the acquirer should analyze whether the state aid is compatible with the single market and whether aid granted under the schemes post-closing will continue to be compatible. Exposure arising from past potentially illegal state aid may need to be assessed and reflected in the purchase price and/or contractual documentation. In share deals, state aid liability would transfer to the acquirer along with the legal entity that benefited from the aid. For asset deals, such liability would typically remain with the seller as long as the acquirer paid a "market price" for the assets. However, there are anti-circumvention rules whereby the EC may force the member state involved to nevertheless require recovery from the acquirer if recovery from the seller is unsuccessful.

- **Setting Up a Tax Structure in Europe.** Scrutinizing tax arrangements remains a key enforcement priority for the EC, and companies setting up a new tax structure in an EU market should conduct a detailed compliance check to avoid possible state aid violations. Tax arrangements may entail state aid regardless of whether a member state issues a tax ruling. State aid risk also is not limited to potential tax breaks granted to one specific company. For example, any tax regime that favors a certain sector over others (*e.g.*, tax break regimes tailored to research and development investments or to energy-intensive businesses) could involve state aid under certain circumstances.
- **Investing in New European Infrastructure.** EU member states are increasingly calling on private investors to build and operate infrastructure assets such as electricity generation, broadband internet, airports and port infrastructure. Investors should ensure that any government support provided in relation to such projects is in full compliance with state aid rules.
- **Conducting Transactions With EU Member States or With State-Owned Companies.** Any transaction with a member state or state-owned company (not only M&A and privatizations but also commercial transactions involving the sale of goods, services or land) that is not based on market terms may involve the grant of illegal state aid.

Conclusion

The EC is expected to continue to vigorously enforce its state aid rules across all industries and involving all types of state aid. Companies active in the EU should therefore pay close attention to state aid risk and the ongoing trend of state aid enforcement.