



**REPORT FOR THE HEARING**  
in Joined Cases E-17/10 and E-6/11

APPLICATION to the Court pursuant to Article 36 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice in the cases between

**The Principality of Liechtenstein** (Case E-17/10),  
**VTM Fundmanagement AG** (Case E-6/11)

and

**EFTA Surveillance Authority**

seeking the annulment of the EFTA Surveillance Authority's Decision No 416/10/COL of 3 November 2010 on the taxation of investment undertakings under the Liechtenstein Tax Act.

**I Introduction**

1. In each of these cases, the parties dispute whether special tax measures implemented by the Liechtenstein authorities from 1996 to 2006, regarding the taxation of investment companies, constitute State aid under Article 61(1) of the EEA Agreement. It is also disputed whether the aid qualifies as “existing aid” that is not subject to recovery. In the event that the tax regime is classified as new aid, the parties disagree on the extent to which legitimate expectations entertained by the beneficiaries of the alleged State aid prevent its recovery. Further, the applicants argue that ESA's Decision infringes the principles of legal certainty, homogeneity and equal treatment, and that it lacks adequate reasoning.

**II Facts and procedure**

2. On 3 May 1996, the Liechtenstein Act on Investment Undertakings (*Gesetz über Investmentunternehmen*) was adopted. This amended the 1961 Liechtenstein Tax Act (*Gesetz über die Landes- und Gemeindesteuern*), (hereinafter, “the Tax Act”). These legislative measures introduced changes to

the way investment undertakings were taxed with the aim of ensuring that they were taxed in the same way as domiciliary companies (*Sitzgesellschaften*).

3. Investment undertakings in Liechtenstein may take the form of either an (i) investment fund (*Anlagefonds*), or (ii) investment company (*Anlagegesellschaft*). Investment undertakings generate income from two categories of assets, namely from (i) assets managed by these undertakings on behalf of investors (frequently referred to as “managed assets”), and (ii) the assets belonging to that undertaking (frequently referred to as “own assets” or “fund direction”).

4. With the introduction of section 84(5) of the Tax Act in 1996, it was intended that investment undertakings should be taxed in the same way as domiciliary companies. As a result, just like domiciliary companies under section 84(1) of the Tax Act, they enjoyed full or partial tax exemptions. According to section 84(1) of the Tax Act, no income tax and only a reduced capital tax of 0.1% (instead of 0.2%) was to be applied. In accordance with section 85(2) of the Tax Act, this rate was reduced further to 0.04% for the capital of investment undertakings exceeding CHF 2 million. Furthermore, a coupon tax on the distribution of profits generated from the fund capital was also abolished.

5. By letter of 14 March 2007, ESA sent a request for information to the Liechtenstein authorities, regarding various tax derogations for certain forms of companies under the Tax Act. By a decision of 18 March 2009, ESA informed the Liechtenstein authorities that it had decided to initiate the formal investigation procedure provided for in Article 1(2) of Part I of Protocol 3 to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (“SCA”) with regard to the taxation of investment undertakings under the Tax Act. This decision was published in the Official Journal of the European Union and the EEA Supplement.<sup>1</sup> In the decision, ESA called on interested parties to submit comments and subsequently received such comments from interested parties. By a letter of 26 January 2010, ESA forwarded these comments to the Liechtenstein authorities, which responded by letters of 17 March 2010 and 16 July 2010.

6. By Decision No 416/10/COL of 3 November 2010 (“the Decision”), ESA found that aid measures implemented by the Liechtenstein authorities in favour of investment companies, which took the form of tax concessions on the own assets of investment companies from 1996 to 2006, constituted unlawful State aid which is incompatible with the EEA Agreement (“EEA”). ESA also ordered the Principality of Liechtenstein to repeal the measures and to recover the aid already granted.

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<sup>1</sup> Decision of the EFTA Surveillance Authority No 149/09/COL of 1 October 2009 was published in OJ 2009 C 236, p. 6 and EEA Supplement No 51 of 1 October 2009, p. 1.

7. In its Decision, ESA declared that the aid measures implemented by the Liechtenstein authorities in favour of investment companies, and which were repealed with effect from 30 June 2006, were not compatible with the functioning of the EEA Agreement within the meaning of Article 61(1) EEA (see Article 1 of the Decision). According to Article 2 of the Decision, the measures involved unlawful state aid, in view of the failure by the Liechtenstein authorities to comply with the requirement to notify ESA before implementing aid in accordance with Article 1(3) of Part I of Protocol 3. Under Article 3 of the Decision, the Liechtenstein authorities are required to take all necessary measures to recover from the beneficiaries the aid unlawfully made available to them from 15 March 1997 until the date on which the beneficiaries last benefited from the tax exemptions following their repeal in 2006.

8. Article 4 of the Decision requires the Principality of Liechtenstein to effect the recovery of the aid referred to in Article 1 without delay, and in any event by 3 March 2011. This recovery must be effected in accordance with the procedures of national law, provided they allow for the immediate and effective execution of the decision. The aid to be recovered shall include interest and compound interest from the date on which it was at the disposal of the beneficiaries until the date of its recovery. Interest shall be calculated on the basis of Article 9 of the Implementing Provisions Decision.

9. Case E-17/10 was registered at the Court on 22 December 2010, pursuant to an application by the Principality of Liechtenstein bringing an action under Article 36(1) SCA for full or partial annulment of the contested Decision.

10. Case E-6/11 was registered at the Court on 10 March 2011, pursuant to an application of 9 March 2011 by VTM Fundmanagement AG (hereinafter "VTM") under Article 36(2) SCA for full or partial annulment of the contested Decision. VTM is an investment fund management company formerly organised, prior to restructuring, as an investment company. VTM has provided investment fund management services in Liechtenstein since 2003.

11. By a decision of 11 October 2011 pursuant to Article 39 of the Rules of Procedure, and, having received observations from the parties, the Court joined the two cases for the purposes of the written and oral procedures.

12. ESA submitted a Statement of Defence in Case E-17/10, which was registered at the Court on 2 March 2011. The Reply from the Principality of Liechtenstein in Case E-17/10 was registered at the Court on 4 April 2011. ESA submitted a Statement of Defence in Case E-6/11, which was registered at the Court on 27 May 2011. VTM did not submit a reply.

### **III Forms of order sought by the parties**

13. The Principality of Liechtenstein and VTM claim that the Court should:

- (1) *annul EFTA Surveillance Authority's Decision No 416/10/COL of 3 November 2010 on the taxation of investment undertakings under the Liechtenstein Tax Act;*
- (2) *in the alternative, declare void Articles 3 and 4 of the EFTA Surveillance Authority's Decision No 416/10/COL of 3 November 2010 to the extent that they order the recovery of the aid referred to in Article 1 of that Decision; and*
- (3) *order the EFTA Surveillance Authority to pay the costs of the proceedings*

14. ESA contends that the Court should:

- (1) *dismiss the applications as unfounded;*
- (2) *order the applicants to pay the costs.*

15. The Commission submits that the applications should be dismissed as unfounded.

#### **IV Legal background**

##### *EEA law*

16. Article 61 EEA reads as follows:

*1. Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States 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 the Contracting Parties, be incompatible with the functioning of this Agreement.*

...

17. Article 62 EEA reads as follows:

*1. All existing systems of State aid in the territory of the Contracting Parties, as well as any plans to grant or alter State aid, shall be subject to constant review as to their compatibility with Article 61. This review shall be carried out:*

*... (b) as regards the EFTA States, by the EFTA Surveillance Authority according to the rules set out in an agreement between the EFTA States establishing the EFTA Surveillance Authority which is entrusted with the powers and functions laid down in Protocol 26.*

*2. With a view to ensuring a uniform surveillance in the field of State aid throughout the territory covered by this Agreement, the EC Commission and the*

*EFTA Surveillance Authority shall cooperate in accordance with the provisions set out in Protocol 27.*

18. Article 5 SCA reads as follows:

*1. The EFTA Surveillance Authority shall, in accordance with the provisions of this Agreement and the provisions of the EEA Agreement and in order to ensure the proper functioning of the EEA Agreement:*

*(a) ensure the fulfilment by the EFTA States of their obligations under the EEA Agreement and this Agreement;*

...

*(c) monitor the application of the EEA Agreement by the other Contracting Parties to that Agreement.*

*2. To this end, the EFTA Surveillance Authority shall:*

*(a) take decisions and other measures in cases provided for in this Agreement and in the EEA Agreement;*

*(b) formulate recommendations, deliver opinions and issue notices or guidelines on matters dealt with in the EEA Agreement, if that Agreement or the present Agreement expressly so provides or if the EFTA Surveillance Authority considers it necessary;*

...

*(d) carry out the functions which, through the application of Protocol 1 to the EEA Agreement, follow from the acts referred to in the Annexes to that Agreement, as specified in Protocol 1 to the present Agreement.*

19. Article 16 SCA reads as follows:

*Decisions of the EFTA Surveillance Authority shall state the reasons on which they are based.*

20. Article 24 SCA reads as follows:

*The EFTA Surveillance Authority shall, in accordance with Articles 49, 61 to 64 and 109 of, and Protocols 14, 26, 27, and Annexes XIII, section I(iv), and XV to, the EEA Agreement, as well as subject to the provisions contained in Protocol 3 to the present Agreement, give effect to the provisions of the EEA Agreement concerning State aid as well as ensure that those provisions are applied by the EFTA States.*

*In application of Article 5(2)(b), the EFTA Surveillance Authority shall, in particular, upon the entry into force of this Agreement, adopt acts corresponding to those listed in Annex I.*

21. The first and second paragraphs of Article 36 SCA read as follows:

*The EFTA Court shall have jurisdiction in actions brought by an EFTA State against a decision of the EFTA Surveillance Authority on grounds of lack of competence, infringement of an essential procedural requirement, or infringement of this Agreement, of the EEA Agreement or of any rule of law relating to their application, or misuse of powers.*

*Any natural or legal person may, under the same conditions, institute proceedings before the EFTA Court against a decision of the EFTA Surveillance Authority addressed to that person or against a decision addressed to another person, if it is of direct and individual concern to the former.*

22. Article 1 of Part I of Protocol 3 to the SCA, as amended by the Agreements amending Protocol 3 thereto, (“Protocol 3”) reads as follows:

*1. The EFTA Surveillance Authority shall, in cooperation with the EFTA States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the EEA Agreement.*

*2. If, after giving notice to the parties concerned to submit their comments, the EFTA Surveillance Authority finds that aid granted by an EFTA State or through EFTA State resources is not compatible with the functioning of the EEA Agreement having regard to Article 61 of the EEA Agreement, or that such aid is being misused, it shall decide that the EFTA State concerned shall abolish or alter such aid within a period of time to be determined by the Authority.*

...

*3. The EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the functioning of the EEA Agreement having regard to Article 61 of the EEA Agreement, it shall without delay initiate the procedure provided for in paragraph 2. The State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.*

23. Article 1 of Part II of Protocol 3 reads as follows:

*For the purpose of this Chapter:*

*(a) “aid” shall mean any measure fulfilling all the criteria laid down in Article 61(1) of the EEA Agreement;*

*(b) “existing aid” shall mean:*

*(i) all aid which existed prior to the entry into force of the EEA Agreement in the respective EFTA States, that is to say, aid schemes and individual aid which were put into effect before, and are still applicable after, the entry into force of the EEA Agreement;*

(ii) *authorised aid, that is to say, aid schemes and individual aid which have been authorised by the EFTA Surveillance Authority or, by common accord as laid down in Part I, Article 1 (2) subparagraph 3, by the EFTA States;*

(iii) *aid which is deemed to have been authorised pursuant to Article 4(6) of this Chapter or prior to this Chapter but in accordance with this procedure;*

(iv) *aid which is deemed to be existing aid pursuant to Article 15 of this Chapter;*

(v) *aid which is deemed to be an existing aid because it can be established that at the time it was put into effect it did not constitute an aid, and subsequently became an aid due to the evolution of the European Economic Area and without having been altered by the EFTA State. Where certain measures become aid following the liberalisation of an activity by EEA law, such measures shall not be considered as existing aid after the date fixed for liberalisation;*

(c) *“new aid” shall mean all aid, that is to say, aid schemes and individual aid, which is not existing aid, including alterations to existing aid;*

(d) *“aid scheme” shall mean any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount;*

...

(f) *“unlawful aid” shall mean new aid put into effect in contravention of Article 1(3) in Part I;*

...

24. Article 14(1) of Part II of Protocol 3 reads as follows:

***Recovery of aid***

*1. Where negative decisions are taken in cases of unlawful aid, the EFTA Surveillance Authority shall decide that the EFTA State concerned shall take all necessary measures to recover the aid from the beneficiary (hereinafter referred to as a “recovery decision”). The EFTA Surveillance Authority shall not require recovery of the aid if this would be contrary to a general principle of EEA law.*

...

25. Article 15 of Part II of Protocol 3 reads as follows:

***Limitation period***

*1. The powers of the EFTA Surveillance Authority to recover aid shall be subject to a limitation period of ten years.*

*2. The limitation period shall begin on the day on which the unlawful aid is awarded to the beneficiary either as individual aid or as aid under an aid scheme. Any action taken by the EFTA Surveillance Authority or by an EFTA State, acting at the request of the EFTA Surveillance Authority, with regard to the unlawful aid shall interrupt the limitation period. Each interruption shall start time running afresh. The limitation period shall be suspended for as long as the decision of the EFTA Surveillance Authority is the subject of proceedings pending before the EFTA Court.*

*3. Any aid with regard to which the limitation period has expired, shall be deemed to be existing aid.*

26. Article 17 of Part II of Protocol 3 reads as follows:

***Cooperation pursuant to Article 1(1) in Part I***

*1. The EFTA Surveillance Authority shall obtain from the EFTA State concerned all necessary information for the review, in cooperation with the EFTA State, of existing aid schemes pursuant to Article 1(1) in Part I.*

*2. Where the EFTA Surveillance Authority considers that an existing aid scheme is not, or is no longer, compatible with the functioning of the EEA Agreement, it shall inform the EFTA State concerned of its preliminary view and give the EFTA State concerned the opportunity to submit its comments within a period of one month. In duly justified cases, the EFTA Surveillance Authority may extend this period.*

*National law*<sup>2</sup>

27. The Act of 3 May 1996 on the amendment of the Liechtenstein Tax Act (*Gesetz vom 3. Mai 1996 über die Abänderung des Steuergesetzes*, the “Tax Amendment Act 1996”) inserting a new section 84(5) into the Tax Act refers to the definition of investment undertakings given in section 2(1) of the 1996 Liechtenstein Act on Investment Undertakings (the “Investment Undertakings Act”). In that provision, investment undertakings are defined as “*assets raised from the public following public advertising for the purpose of a collective capital investment which are invested and managed for the collective account of the individual investors usually according to the principle of risk-spreading*”.

28. Under Liechtenstein law, an investment undertaking may choose the form of a collective trust, called an investment *fund* (see section 3(2) of the Investment Undertakings Act) or opt for the legal form of an investment *company* (see section 3(3) of the Investment Undertakings Act). In the case of an investment fund, the management of the fund is carried out by a separate entity, referred to as the “fund direction” (see section 39(2) of the Investment Undertakings Act).

29. The Liechtenstein Tax Act<sup>3</sup> comprises two kinds of taxes relating to legal entities, a business income tax (*Ertragssteuer*) and a capital tax (*Kapitalsteuer*). The legal entities liable to pay income tax in Liechtenstein are listed in section 73, points (a) to (f), of the Act, among which foreign companies operating a branch in Liechtenstein are made subject to the income and capital tax under section 73(e).

30. According to section 77(1) of the Tax Act, business income tax is assessed on the entire annual net income, which is defined as the entire revenues minus company expenditures, including write-offs and other provisions. Under section 79(2) of the Tax Act, the income tax rate depends on the ratio of net income to taxable capital and lies between the minimum level of 7.5% and the maximum level of 15%. This tax rate may be increased by certain percentage points, depending on the relation between dividends and taxable capital, as specified in section 79(3) of the Tax Act.

31. Under section 76(1) of the Tax Act, the basis for the capital tax is the paid-up capital stock, joint stock, share capital, or initial capital as well as the reserves of the company constituting company equity. According to section 76(1), capital tax is assessed at the end of a company’s business year. Pursuant to section 79(1) of the Tax Act, this is applied at a rate of 0.2%.

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<sup>2</sup> Translations of national provisions are unofficial and are based on translations contained in the documents of the case.

<sup>3</sup> The case before the Court is based on the Liechtenstein Tax Act of 1961, as amended with effect from 1 January 1998 (“the Tax Act”). In the meantime it has been replaced by the Liechtenstein Tax Act of 23 September 2010, which entered into force on 1 January 2011.

32. Section 5 of the Tax Act contains provisions on the coupon tax, which is levied on coupons under section 88a(1) of the Tax Act. The persons subject to the tax are further defined in section 88b to section 88e of the Tax Act. Pursuant to section 88a(1), coupon tax is levied on the coupons of securities (or documents equal to securities) issued by “a national”. According to section 88a(2), a person is regarded as a national if their place of residence, domicile or statutory seat is in Liechtenstein and, in the case of undertakings, where they are registered in the public register of Liechtenstein.

33. Under section 88d(1)(a) of the Tax Act, the coupon tax applies to companies the capital of which is divided into shares, for example, companies limited by shares and companies with limited liability. According to section 88h(1), it is levied at the rate of 4% on any distribution of dividends or profit shares (including distributions in the form of shares), see points (a) and (b) of section 88h(1).

34. Following the insertion of section 84(5) of the Tax Act in 1996, the assets managed by investment undertakings were taxed in the same way as domiciliary companies. According to the Tax Act, domiciliary companies are legal entities registered in the public register, which only have their seat or an office in Liechtenstein but do not exercise any commercial or business activity in Liechtenstein.

35. As domiciliary companies did not pay income tax, the assets managed by investment undertakings were also not subject to income tax. In addition, pursuant to section 84(1) of the Tax Act, only a reduced capital tax of 0.1% (instead of 0.2%) was applied. This rate was further reduced to 0.04% for the capital of investment undertakings in excess of CHF 2 million in accordance with section 85(2) of the Tax Act, as amended by the Tax Amendment Act 1996. The coupon tax on the distribution of profits generated from the fund capital was also abolished by virtue of Act No 88/1996.

36. Under the Tax Act, as amended in 1996, the fund direction of an investment fund (the management side of the fund) was fully liable to pay income, capital as well as coupon tax on its own income and capital. The fund direction had also been fully taxed prior to 1996 in accordance with section 84(2) of the Tax Act 1961.

37. In the case of investment companies, no distinction was made for tax purposes between the management company’s *own* assets and the *managed* assets. Consequently, investment companies’ own assets were also subject to the rules applying to domiciliary companies, in accordance with section 84(2) of the Tax Act. Accordingly, no income tax was levied on management activities or on the managed assets; capital tax was payable at 0.1% instead of 0.2% (and reduced further for any capital in excess of CHF 2 million in accordance with section 85(2) of the Tax Act); and, finally, no coupon tax was levied.

## **V Written procedure before the Court**

38. Written arguments have been received from the parties:

- the Principality of Liechtenstein, represented by Dr Andrea Entner-Koch, Director, EEA Coordination Unit, acting as Agent;
- VTM, represented by Dr Michael Sánchez Rydelski and Dr Hans-Michael Pott, Rechtsanwälte;
- ESA, represented by Xavier Lewis, Director, and Fiona M. Cloarec, Officer, Department of Legal & Executive Affairs, acting as Agents.

39. Pursuant to Article 20 of the Statute of the Court and Article 97 of the Rules of Procedure, written observations have been received from:

- the European Commission (“the Commission”), represented by Richard Lyal, legal adviser, and Carlos Urraca Caviedes, member of its Legal Service, acting as Agents.

## **VI Summary of the pleas in law and arguments**

40. The Principality of Liechtenstein and VTM, the applicants in cases E-17/10 and E-6/11, contend, first, that ESA did not correctly interpret and apply Article 61(1) EEA. In this regard, they submit that the exemption from income and coupon tax and the partial exemption from capital tax (the “tax measures”) were non-selective, general measures. The applicants argue further that the tax measures were in any event justified by the nature and general scheme of the Liechtenstein tax system.

41. Second, the applicants claim that ESA erred in ordering recovery. This plea is based on two limbs. First, the applicants argue that if the tax measures are classified as aid, this must be regarded as existing aid. Second, they contend that, by its Decision, ESA has violated the principles of legitimate expectations, legal certainty, homogeneity and equal treatment, all general principles of EEA law.

42. Finally, the applicants contend that the Decision lacks reasoning and therefore fails to satisfy Article 16 SCA.

### *Assessment under Article 61(1) EEA*

43. The applicants argue that in the Decision ESA incorrectly applied Article 61(1) EEA as, first, the tax measures were, in fact, non-selective, general measures, and second, if they were selective, they could be justified by the nature and general scheme of Liechtenstein tax law.

## Selectivity of measures

44. The applicants consider the tax measures not to confer a selective advantage. They maintain that ESA erroneously considered the capital of investment companies to be in a similar position to the capital of investment funds. As this is not the case, ESA's findings on this issue are erroneous.

45. The applicants argue, first, that investment companies and the fund direction of investment funds cannot be compared either as a matter of fact or law.

46. Liechtenstein points out that neither domiciliary companies nor assets managed by investment companies are subject to income tax. In its view, investment companies are comparable to domiciliary companies, registered as a legal person in Liechtenstein.

47. Liechtenstein and VTM assert that the income taxation borne by the fund direction is the consequence of the rule of Liechtenstein corporate law which requires an investment fund to be constituted in the legal form of a trust, comprised of two distinct legal persons. Investment funds thus cannot simultaneously hold and manage the fund. The economic activity of the fund direction as trustee is therefore subject to regular income tax and the fund direction does not benefit from the provision for domiciliary companies in section 84(1) of the Liechtenstein Tax Act as it is established as a public company and, therefore, commercially active in Liechtenstein.

48. VTM observes, first, that investors in investment companies own the capital of the investment company, whereas there is no such participation of investors in the capital of the fund direction of investment funds. The capital of the investors and the capital of an investment company are thus intrinsically linked, whereas the fund direction operates totally separately from the fund itself, which constitutes the capital of the investors. Second, VTM contends that once an investment fund is established, it can administer all types of asset class (securities, real estate and other assets) at the same time, whereas investment companies are only allowed to offer one class of asset. Investment companies are therefore restricted in their commercial activities.

49. VTM also observes that different tax treatment depending on the form of the investment undertaking is a common feature in certain EU Member States.<sup>4</sup>

50. Liechtenstein submits that the taxation of the investment fund does not confer an advantage within the meaning of Article 61(1) EEA on investment companies. It constitutes a disadvantage for investment funds and not a selective advantage for investment companies, which are treated just like any other

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<sup>4</sup> VTM cites the example of Luxembourg law which distinguishes for tax purposes between "undertakings for collective investment", "management companies", and "non-resident investors in Luxembourg investment funds".

domiciliary company. This disadvantage is inherent in the general system of corporate and tax law in Liechtenstein and, in practice, is outweighed by the advantages the investment fund bears for an investor. It observes that differences in taxation have not conferred any appreciable advantage on investment companies. It also claims that the exemption from coupon tax is open to any natural or legal person, regardless of sector or industry.

51. The applicants submit that the exemption from coupon tax does not constitute a selective measure.

52. On this point, the applicants observe that the coupon tax is a withholding tax. They submit that the real beneficiaries of this exemption are the shareholders of the investment companies. In the applicants' view, the fact that anyone can become a shareholder in an investment company should be taken to mean that the coupon tax exemption is a general measure which does not benefit specific undertakings.<sup>5</sup>

53. ESA contends that the measures in question are clearly selective. In ESA's view, the undertakings in the same legal and factual situation in this case are all those which pay the full income, capital and coupon taxes in Liechtenstein.<sup>6</sup> In comparison, investment companies in Liechtenstein receive a selective advantage. The Commission supports ESA's position and submits further that when analysing the selective character of a tax measure, only the differences that are relevant to the objective of the tax system in question can be taken into account. Therefore, the elements cited by the applicants as justifiable elements of difference are irrelevant.

54. The Commission disagrees with Liechtenstein's submission that investment companies should be compared to domiciliary companies. In the Commission's view, the advantageous tax treatment granted to investment companies should be compared with the normal treatment under the system of taxation in Liechtenstein, under which companies pay full income, capital and coupon taxes. In this regard, Liechtenstein has not shown that investment companies are not in a comparable legal and factual situation with other companies or entities that are subject to normal taxation on revenues from their business activities. This is particularly clear in relation to investment funds which, unlike investment companies, are subject to normal taxation as regards their own assets (fund direction). No comparison can be made with domiciliary companies, that is, companies without any business activity in Liechtenstein, since fund management clearly constitutes an economic activity.

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<sup>5</sup> Reference is made to Commission Decision of 22 September 2004, State aid N 354/2004 – *Ireland Company Holding Regime*, OJ 2005 C 131, p. 10, and Commission Decision of 13 February 2008, State aid N 480/2007 – *Spain*.

<sup>6</sup> Reference is made to Case C-308/01 *Gil Insurance and Others* [2004] ECR I-477, paragraph 68, Case C-143/99 *Adria-Wien Pipeline* [2001] ECR I-8365, paragraph 41, and Case C-409/00 *Spain v Commission* [2003] ECR I-1487, paragraph 47.

55. ESA takes the view that the fact that Liechtenstein corporate law prevents investment funds from both holding and managing a fund is irrelevant for the purposes of assessing selectivity.<sup>7</sup>

56. As regards the reference made by VTM to the effect that differences in tax treatment exist in some EU Member States, ESA and the Commission submit that such differences are not relevant to the question whether different “investment vehicles” are in a comparable situation in the light of the objective of the Liechtenstein capital tax, income tax and coupon tax.

57. ESA, supported by the Commission, contests the submission that the exemption from coupon tax does not constitute a selective measure. ESA and the Commission maintain that an undertaking becomes more attractive on the market if the shareholders of that undertaking enjoy a certain benefit, and, therefore, the undertaking itself also benefits from the measure.<sup>8</sup> Furthermore, the Commission submits that if, for example, shareholders in companies operating in a certain sector of the economy were granted exemption from tax on dividends received from those companies, those companies would find it easier to raise capital, and it is almost self-evident that such a measure would constitute State aid.

58. ESA also submits that the fact that an extensive group of persons could have indirectly profited from the advantage enjoyed by a beneficiary undertaking of a selective aid measure cannot turn that (unlawful) selective aid measure into a (potentially permissible) general aid measure.

59. In addition, in ESA’s view, the State aid decisions of the Commission in *Ireland Company Holding Regime* (N 354/2004) and *Spain* (N 480/2007) are not relevant to the case at hand. It points out that these Decisions ruled on whether the undertakings that would benefit from the measure were part of a closed group, and hence the measure was selective, or whether the measure applied to an unlimited group of undertakings and thus general in nature. In ESA’s view, the assessment of selectivity in those decisions does not support the argument that a measure becomes non-selective where a theoretically unlimited group of persons could indirectly benefit from an advantage enjoyed by a beneficiary of a selective aid measure.

Measures are justified by the nature and general scheme of the Liechtenstein tax system

60. In the event that the Court takes the view that the contested tax measures must be classified as materially selective, the applicants submit that they do not

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<sup>7</sup> ESA refers to Case E-6/98 *Norway v ESA* [1999] EFTA Ct. Rep., p. 76, paragraph 34; Case 173/73 *Italy v Commission* [1974] ECR 709, paragraph 13; Case 310/85 *Deufil v Commission* [1987] ECR 901, paragraph 8; *Spain v Commission*, cited above, paragraph 46; Case C-56/93 *Belgium v Commission* [1996] ECR I-723, paragraph 79; and Case C-241/94 *France v Commission* [1996] ECR I-4551, paragraph 20.

<sup>8</sup> Reference is made to Case T-424/05 *Italy v Commission* [2009] ECR II-23, paragraphs 108-113, and the case-law cited therein.

constitute State aid since they are justified by the nature and general scheme of the Liechtenstein tax system.

61. Liechtenstein submits that its tax system concerning investment undertakings does not have discriminatory effects for any type of investment undertaking. The relevant provisions of Liechtenstein corporate and tax law apply uniformly to all investment companies throughout its territory and are inherent to the logic and objective conditions of the general legal system. In support of this submission, Liechtenstein relies on the EFTA State Aid Guidelines.

62. On the question of justification, Liechtenstein points out that all economic agents active in the business of managing funds are free to choose either form of investment undertaking (investment company or investment fund). Once a form has been chosen, the investment undertaking has to comply with Liechtenstein's corporate and tax laws. Since the discrimination associated with a particular legal form applies to all economic activities alike, no issue of State aid arises.

63. VTM argues that the Act of 21 December 1960 on investment companies, investment trusts and investment funds,<sup>9</sup> already established a distinction between two legal forms, namely, "investment trusts in the form of a public or limited company" (*Kapitalgesellschaften*), in other words, "investment companies", and "investment trusts in the narrow sense in the form of a trust" (*Anlagefonds*) in other words, "investment funds". Whereas investment companies consisted of a single legal entity, investment funds comprised two legal entities, namely the fund direction (*Fondsleitung*) and the fund capital (*Fondsvermögen*). Under the Tax Act of 30 January 1961,<sup>10</sup> the fund direction holding own resources of the investment fund was subject to regular income and capital tax.

64. VTM contends that the different tax treatment of fund directions and investment companies stems, as explained above, from the different legal form through which assets are managed and owned. Whereas investors own the capital of the investment company, there is no such participation of investors in the capital of the fund direction. VTM notes that the Liechtenstein Constitutional Court (*Staatsgerichtshof*) has ruled on whether the fund capital of an investment fund is independently subject to capital tax. In its reasoning, the Constitutional Court recognised the distinct legal structure of the investment fund as a trust and held that the fund capital must be treated in the same manner as the funds of holding companies (section 83 of the Tax Act) and domiciliary companies (section 84 of the Tax Act) in accordance with section 84(2) of the Tax Act and the principles of equality and equity of taxation.

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<sup>9</sup> *Gesetz über Kapitalanlagegesellschaften, Investment-Trusts und Anlagefonds vom 21. Dezember 1960*, Law Gazette 1961 No 1, as amended.

<sup>10</sup> *Gesetz vom 30. Januar 1961 über die Landes- und Gemeindesteuern (Steuergesetz)*, Law Gazette 1961 No 7, as amended.

65. According to VTM, the Constitutional Court thereby recognised the separate taxation of the fund capital as a legal entity distinct from the fund direction. This case-law formed the basis for Liechtenstein practice in connection with the taxation of investment undertakings prior to 1996. Hence, in the view of VTM, it follows from the above that the different tax treatment follows from the logic and general scheme of Liechtenstein tax law and is therefore not selective.

66. ESA and the Commission disagree with the applicants on these submissions. The Commission notes that, according to case-law, a measure which creates an exception to the application of the general tax system with regard to State aid may be justified by the nature and overall structure of the tax system if the State in question can show that a measure results directly from the basic or guiding principles of its tax system.<sup>11</sup> However, as justification based on these grounds constitutes an exception to the principle that State aid is prohibited, in the Commission's view, it must be interpreted strictly.<sup>12</sup>

67. ESA contends further that the tax concessions in favour of the management activities of investment companies do not result directly from the basic or guiding principles of the Liechtenstein tax system. ESA is of the view that there is nothing particular to Liechtenstein's general system of taxation that justifies these tax provisions yielding tax concessions for the own assets of investment companies, but full exposure to income, capital and coupon tax for the own assets of investment funds.

68. In addition, according to the Commission, the decision of the Liechtenstein authorities to repeal the tax measures in 2006 "to provide for non-discriminatory taxation of investment companies and investment funds" in effect amounts to an admission that the advantageous treatment granted to investment companies cannot result from the basic or guiding principles of the Liechtenstein tax system.

*Second plea in law - ESA erred when it ordered the recovery of the alleged aid*

69. The applicants argue that in ordering the recovery of the aid ESA erred in law on two grounds. First, the tax measures constitute existing aid. Second, the recovery violates the applicants' legitimate expectations, the principle of legal certainty, the homogeneity principle and the principle of equal treatment.

*Existing aid or new aid and recovery*

70. In the event that the Court upholds ESA's conclusion that the contested tax measures constitute State aid within the meaning of Article 61(1) EEA, the applicants contend that the measures qualify as "existing" aid.

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<sup>11</sup> Reference is made to Case C-88/03 *Portugal v Commission* [2006] ECR I-7115, paragraph 81.

<sup>12</sup> Reference is made to Joined Cases T-127/99, T-129/99 and T-148/99 *Diputación Foral de Álava and Others v Commission* [2002] ECR II-1275, paragraph 250.

71. VTM argues that the tax measures were already in force before the EEA Agreement took effect in Liechtenstein. Therefore, and having regard to the fact that these measures continued to apply after the EEA Agreement entered into force in Liechtenstein, they should be qualified as existing aid.

72. VTM claims that, under the Tax Act of 30 January 1961, the fund direction holding own resources of the investment fund was subject to income and capital tax, whereas investment companies were not subject to these taxes.

73. Liechtenstein and VTM claim that Liechtenstein practice concerning the taxation of investment undertakings prior to 1996 followed the 1984 ruling of the Constitutional Court, which recognised the separate taxation of the fund capital as a legal entity distinct from the fund direction. In their view, the Tax Amendment Act 1996 merely codifies the different treatment of investment funds and investment companies which had already been established.

74. Given this background, the applicants argue that, if the tax legislation in relation to investment undertakings were to be regarded as including measures qualifying as State aid, this simply reflects long-standing tax practice approved by the Constitutional Court.

75. Consequently, Liechtenstein submits that the contested tax measures did not constitute State aid when they were introduced, but became aid as a result of the evolution of EEA law. Therefore, Article 1(b)(v) of Part II of Protocol 3 is applicable to the disputed measures. According to that provision, aid is deemed to be an existing aid if it can be established that it did not constitute an aid at the time it was put into effect, but subsequently became aid due to the evolution of the EEA and without having been altered by the EFTA State concerned.

76. Liechtenstein contends that when the tax measures were introduced, taxation of investment companies was not considered to involve State aid. In this regard, Liechtenstein observes that prior to the publication of the Council of the European Union's Code of Conduct for business taxation<sup>13</sup> on 6 January 1998, and the subsequent Commission notice of 10 December 1998 on the application of the State aid rules to measures relating to direct business taxation,<sup>14</sup> no Commission decision had classified a taxation regime on investment companies as involving State aid.

77. ESA submits that the contested tax measures were introduced in 1996, after Liechtenstein had entered the EEA in 1995. Hence, the aid, as it is not existing aid within the meaning of Article 1(b) of Part II of Protocol 3, must be regarded as new aid in accordance with Article 1(c) of that provision.

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<sup>13</sup> Resolution on Code of Conduct for business taxation, Annex I to the Council Conclusions of the Ecofin Council meeting on 1 December 1997 concerning taxation policy, OJ 1998 C 2, p. 1.

<sup>14</sup> OJ 1998 C 384, p. 3.

78. In relation to the argument of the applicants that the contested tax provisions have only become State aid as a result of the “evolution of the common market”, ESA contends that the applicants have not shown how the criteria applied by ESA in assessing the tax measures concerned have changed since the measures were introduced into Liechtenstein law in 1996.

79. ESA also specifically submits that, even if a change of practice were to be established, the applicants have not shown how such a change of practice may be attributed to the “evolution of the EEA”, as required by Article 1(b)(v) of Part II of Protocol 3.<sup>15</sup>

#### *Legitimate expectations*

80. The applicants claim that, by ordering the recovery of the alleged aid as from 15 March 1997, ESA has violated the principle of legitimate expectations, which allows the beneficiary of unlawful aid to resist the recovery of the aid concerned on the basis that, due to certain behaviour on the part of public authorities, the beneficiary could not reasonably foresee that such recovery would be envisaged, let alone ordered.

81. In this context, Liechtenstein submits that prior to the decision of the Commission on the Italian scheme for collective investments in transferable securities in 2005,<sup>16</sup> which might be regarded as comparable to the case at hand in certain respects, there were no decisions, whether of the Commission or ESA, which would have suggested that the taxation of investment companies might imply State aid.

82. In this regard, VTM observes that already in 1998 the Commission had adopted a notice on the application of the State aid rules to measures relating to direct business taxation and started to examine the tax schemes of Member States systematically in light of the State aid rule, inter alia, by opening simultaneous investigations into 11 schemes in 2001.

83. Although ESA adopted similar guidelines in 1999, VTM notes that it was not prompted to assess tax schemes in the EFTA States systematically in relation to the EEA Agreement. Thus, although the EEA Agreement requires ESA and the Commission to cooperate towards a homogeneous and coordinated enforcement of EEA law, ESA remained totally inactive. In VTM’s view, ESA’s delay in the case at hand constituted an implicit assurance that the tax measures did not qualify as State aid under Article 61(1) EEA.<sup>17</sup>

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<sup>15</sup> ESA refers to Joined Cases T-346/99, T-347/99 and T-348/99 *Territorio Histórico de Álava and Others v Commission* [2002] ECR II-4259, paragraph 84.

<sup>16</sup> Reference is made to Commission Decision of 6 September 2005 on the Italian scheme for collective investments in transferable securities, OJ 2006 L 268, p. 1.

<sup>17</sup> Reference is made to Case 223/85 *RSV v Commission* [1987] ECR 4617.

84. ESA disagrees with the arguments raised by the applicants. In ESA's view, it follows from the case-law of the Court and of the Union Courts that "precise assurances" must be given by an institution in order to establish legitimate expectations.<sup>18</sup> According to this case-law, moreover, the crucial question in determining whether there may have been a breach of the principle of legitimate expectations is whether the aid was granted further to a notification to ESA under Article 1(3) of Part I of Protocol 3.<sup>19</sup>

85. In light of this, ESA submits that the argument alleging a breach of the principle of legitimate expectations must be dismissed, as the aid measures were not notified to it under Article 1(3) of Part I of Protocol 3, and that it did not give any assurances of any kind to the applicants.

86. Regarding VTM's argument that ESA's delay constituted an implicit assurance, ESA submits that *RSV v Commission*, cited by VTM,<sup>20</sup> does not support that argument, as it is an exceptional case that turned on its own very specific facts. Moreover, the lapse in time in that case concerned the period between the notification of the aid to the Commission and the Commission decision on the notification,<sup>21</sup> whereas in the case at hand the aid measures were not even notified to ESA.

87. ESA also contests the applicants' assertion that it was unclear when the tax measures entered into force that they would constitute State aid. According to ESA, there is ample evidence to demonstrate that it was foreseeable in 1996 that tax measures such as those introduced could constitute unlawful State aid, as there were already decisions of ESA and judgments of the Court of Justice on that point.<sup>22</sup> In ESA's view, it is also clear from publicly-available records that the Liechtenstein authorities were aware at the time of Liechtenstein's entry to the EEA that, in principle, tax reductions constitute State aid within the meaning of Article 61(1) EEA and that, under certain circumstances, it may be necessary to notify Liechtenstein tax measures.

88. In response to VTM's arguments that it would be wrong to expect an assessment of the compatibility of the tax measures with the State aid rules so soon after the entry into force of the EEA Agreement in Liechtenstein in May 1995 and that VTM could not be expected to be informed about State aid, ESA observes that the obligations imposed by the EEA State aid regime entered into

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<sup>18</sup> Reference is made to Joined Cases E-4/10, E-6/10 and E-7/10 *Principality of Liechtenstein and Others v EFTA Surveillance Authority*, judgment of 10 May 2011, not yet reported, paragraph 143.

<sup>19</sup> *Ibid.*, paragraph 148.

<sup>20</sup> See footnote 17 above.

<sup>21</sup> Reference is made to Article 4(6) of Part II of Protocol 3, according to which a notified measure is considered authorised if ESA has not taken a decision within the two month period provided for to that effect.

<sup>22</sup> Reference is made to ESA Decision of 1 December 1994 (Decision No 213/94/COL), ESA Decision of 31 October 1995 (Decision No 106/95/COL) and ESA Decision of 14 May 1997 (Decision No 145/97/COL). Furthermore, ESA refers to Case 70/72 *Commission v Germany* [1973] ECR 813 and Case 173/73 *Italy v Commission*, cited above.

force in Liechtenstein on 1995. Thus, any aid granted after 1 May 1995 was subject to the notification obligation of Article 1(3) of Part I of Protocol 3. There was no derogation or transitional period in respect of this obligation that may now be invoked to justify the non-notification of the 1996 tax measures, or somehow substantiate a claim of legitimate expectations.

89. Moreover, ignorance of the State aid rules and the complex question of what constitutes State aid, cannot, in ESA's view, be regarded as exceptional circumstances of such a kind as to give rise to a legitimate expectation that the aid was lawful. Further, recipients of aid cannot, on grounds of their size, be relieved of the obligation to keep themselves informed of the rules of EEA law, as the practical effect of EEA law would thus be undermined.

90. The Commission essentially supports the arguments of ESA. However, it also notes that the reasoning of VTM, which is based on the idea that it was only at the end of the 1990s that the Commission started to systematically assess Member States' tax schemes in light of the State aid rules with the adoption in 1998 of the Commission notice on the application of the State aid rules to measures relating to direct business taxation, has already been rejected in case-law. In this regard, the Court of Justice observed that the fact that the Commission adopted the 1998 notice on tax aid does not imply any alteration of its criteria for the assessment of the tax systems of the Member States.<sup>23</sup>

*Principles of legal certainty, homogeneity and equal treatment*

91. Liechtenstein also argues that recovery of the alleged State aid constitutes a violation of the principles of legal certainty, homogeneity and equal treatment of economic operators. In this regard, Liechtenstein submits that when it joined the EEA in 1995 the *acquis communautaire* in relation to State aid did not qualify the taxation of investment companies as involving State aid. There were no changes or developments between 1995 and 1996 (the year in which the tax measures were introduced) which would have prompted Liechtenstein to reach a different conclusion. Hence, the assessment from the Community/EEA State aid law perspective of the tax regime governing investment companies under Liechtenstein law was far from foreseeable.

92. Moreover, in ordering the recovery of the alleged aid from the investment companies as from 15 March 1997, ESA accorded considerably less protection to legitimate expectations than beneficiaries would have enjoyed under identical circumstances in the European Union. Liechtenstein submits that, in creating such an imbalance in the interpretation and application of this general principle of law within the EEA, ESA has violated the homogeneity principle and the principle of equal treatment of economic operators in the EEA.

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<sup>23</sup> Reference is made to Joined Cases T-30/01 to T-32/01 and T-86/02 to T-88/02 *Territorio Histórico de Álava - Diputación Foral de Álava and Others v Commission* [2009] ECR II-2919, paragraphs 314-315.

*Lack of reasoning*

93. On a final point, the applicants submit that ESA did not provide adequate reasoning on essential parts of its contested Decision as required by Article 16 SCA and that also for that reason the contested Decision must be annulled.

94. Liechtenstein contends that this applies in particular to the assessment of selectivity in relation to the various tax measures at stake and the basis on which the recovery order is made. It asserts that ESA concludes only in general terms that the tax measures are selective, on the basis that they were granted only to investment undertakings which adopted the legal form of an investment company. Liechtenstein argues that, in doing so, ESA ignores the fact that the economic activities of investment funds and investment companies are exactly the same and that each undertaking in Liechtenstein carrying out such economic activity, each economic agent active in the business of managing funds, is, in principle, free to choose the appropriate legal form.

95. Moreover, Liechtenstein criticises the fact that, in concluding in such general terms that the tax relief is selective, ESA does not assess the characteristics of the various tax measures at stake. For example, one of these measures is a withholding tax (the coupon tax) which falls on the investor as the ultimate taxpayer but which is withheld at the level of the company. As any natural or legal person regardless of sector or industry can be a shareholder in an investment company the exemption from coupon tax may not be regarded as benefiting certain undertakings. However, according to Liechtenstein, ESA failed to assess this element.

96. With regard to the basis for the recovery order, Liechtenstein criticises the fact that ESA makes no attempt to explain why the disallowance of fiscal aid measures in Finland and Norway justifies denial of the legitimate expectations that investment undertakings in Liechtenstein held. In this respect, it notes that the Decision merely states that ESA's decisions in disallowing fiscal aid measures in Finland and Norway shortly before the implementation of the Liechtenstein Tax Act should have made it clear that tax measures favouring certain companies or groups of companies should be notified to ESA.

97. In VTM's view, ESA should have provided reasoning which explains why investment companies are deemed to have received State aid as a result of the coupon tax exemption when the beneficiaries of that exemption are the shareholders in an investment company and not the company itself. VTM argues that ESA has failed to provide any guidance on the calculation of the State aid element that investment companies are alleged to have enjoyed due to the coupon tax exemption and which is now subject to recovery.

98. ESA rejects the submissions of the applicants which maintain that the decision lacks reasoning both as a whole and in respect of the coupon tax

exemption. ESA contends that it assessed the tax measures as a scheme and assessed that scheme as a whole.

99. ESA asserts that, according to well-established case-law, it may assess the general features of the scheme to ascertain whether it involves State aid within the meaning of Article 61(1) EEA. It observes that settled case-law of the Union courts has established that, in the case of an aid scheme, the Commission may confine itself to examining the general characteristics of the scheme in question without it being required to examine each particular case in which it applies.<sup>24</sup> According to ESA, it analysed, in turn, each of the criteria contained in Article 61 EEA that determine whether a measure is compatible with the EEA Agreement or not.

100. According to ESA, the statement of reasons in the Decision set out in a clear and unequivocal fashion its reasoning. As a result, the applicants were able to ascertain how ESA applied EEA law to the tax measures and the reasons for its decision. Given that ESA set out the facts and legal considerations that had decisive importance in that context, in its view, the Decision fully meets the standard of reasoning required by the case-law of the Court and the Union Courts.

101. Furthermore, ESA takes the view that the argument advanced concerning the lack of reasoning in relation to the coupon tax exemption (that is, how the investment companies were regarded as receiving State aid when the shareholders were the beneficiaries) pertains to the substantive legality of the Decision. ESA submits that such a submission raises a question of *defective* reasoning and must be distinguished from a plea adducing *a lack* of reasoning. Accordingly, this argument should be dismissed.<sup>25</sup>

102. For completeness and to the extent that it is even necessary given that the reasoning required by case-law has been provided, ESA rejects the contention that it insufficiently reasoned its conclusion that the coupon tax constituted State aid. ESA avers that it set out the characteristics of the coupon tax in Part I, Section 3.1.2 of the Decision and its reasoning why this tax exemption constitutes a selective advantage is contained in part II, section 1.2.

103. As to VTM's argument that ESA failed to provide guidance on the calculation of the State aid element that the investment companies allegedly enjoyed due to the coupon tax exemption, ESA contends that this was not required of it. In any event, ESA submits that it would not have been difficult for VTM to calculate the State aid element to be recovered. VTM simply needed to calculate 4% of the value of the profits distributed to its shareholders during the

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<sup>24</sup> Reference is made to Case C-278/00 *Greece v Commission* [2004] ECR I-3997, paragraph 24, Case T-171/02 *Regione autonoma della Sardegna v Commission* [2005] ECR II-2123, paragraph 102, and *Norway v ESA*, cited above, paragraph 57.

<sup>25</sup> Reference is made to Case C-17/99 *France v Commission* [2001] ECR I-2481, paragraph 35, and Case C-159/01 *Netherlands v Commission* [2004] ECR I-4461.

period 1996-2006 (that is, the amount that would have been payable by the shareholders as tax had it not been for the coupon tax exemption). In ESA's view, this was not a difficult task, as was proved by the fact that the tax authorities in Liechtenstein, without any apparent difficulty, were able to determine the amount of unlawful State aid that each beneficiary had been granted and secure its repayment. The Commission supports the arguments of ESA in this regard.

Páll Hreinsson  
Judge-Rapporteur