



JUDGMENT OF THE COURT

24 November 2005

(State aid - Failure of a Contracting Party to fulfil its obligations – Second subparagraph of Article 1(2) of Part I of Protocol 3 SCA – Validity of a decision by the EFTA Surveillance Authority – Termination of tax measures and recovery of aid - Absolute impossibility to implement a decision of the EFTA Surveillance Authority)

In Case E-2/05,

EFTA Surveillance Authority, represented by Niels Fenger, Director, Legal & Executive Affairs, and Bjørnar Alterskjær, Officer, Legal and Executive Affairs, acting as Agents, Rue Belliard 35, 1040 Brussels, Belgium,

Applicant,

v

The Republic of Iceland, represented by Finnur Þór Birgisson, First Secretary and Legal Officer, Ministry of Foreign Affairs of Iceland, acting as Agent, Rauðarárstígur 25, 150 Reykjavík, Iceland, assisted by Ingvi Már Pálsson, Legal Officer, Ministry of Finance,

Defendant,

APPLICATION for a declaration that the Republic of Iceland has failed to fulfil its obligations under points 2, 3 and 4 of the EFTA Surveillance Authority's Decision No. 21/04/COL of 25 February 2004 with regard to International Trading Companies,

THE COURT,

composed of: Carl Baudenbacher, President and Judge-Rapporteur, Per Tresselt and Stefán Már Stefánsson (ad hoc), Judges,

Registrar: Henning Harborg,

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having regard to the written pleadings of the parties and the written observations of the Commission of the European Communities, represented by Tibor Scharf, Member of its Legal Service, acting as Agent,

having regard to the Report for the Hearing,

having heard oral argument of the Applicant, represented by its Agent Bjørnar Alterskjær, the Defendant, represented by its Agent Finnur Þór Birgisson, and the Commission of the European Communities, represented by its Agent Tibor Scharf, at the hearing on 21 September 2005,

gives the following

Judgment

I Facts and procedure

- 1 By an application lodged at the Court on 10 February 2005, the Applicant brought an action under the second subparagraph of Article 1(2) of Part I of Protocol 3 on the functions and powers of the EFTA Surveillance Authority in the field of State aid to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (hereinafter “Protocol 3 SCA”) for a declaration that, by not having terminated State aid measures considered incompatible with the functioning of the EEA Agreement within the meaning of Article 61 EEA and not having taken all necessary measures to recover that aid from the beneficiaries within the time-limit set, the Republic of Iceland has failed to fulfil its obligations under points 2, 3 and 4 of the EFTA Surveillance Authority’s Decision No. 21/04/COL of 25 February 2004 with regard to International Trading Companies.
- 2 On 10 March 1999 the Icelandic Parliament adopted Act No 31/1999 on so-called International Trading Companies (hereinafter “ITCs”), laying down the terms and conditions for the registration and establishment in Iceland of a new type of limited liability company which engages predominantly in international trading activities. The Act was accompanied by Act No 29/1999 introducing amendments to various fiscal acts in respect of their application to ITCs. This legislative package allowed the ITCs to benefit from a lower corporate income tax than generally applicable to undertakings in Iceland, full exemption from payment of net wealth tax as well as a partial exemption from payment of stamp duty. The legislation was not notified to the Applicant.
- 3 When the Applicant became aware of the existence of the legislative package, it conducted a preliminary assessment and concluded that the special tax treatment of ITCs might constitute State aid within the meaning of Article 61(1) EEA. The Applicant opened the formal investigation procedure provided for in Article 1(2) of Part I of Protocol 3 SCA on 6 December 2001.

4 On 25 February 2004, the Applicant adopted Decision No. 21/04/COL (hereinafter “the Decision”), where it found that the tax measures in favour of ITCs constituted State aid according to Article 61(1) EEA and that the aid was unlawful on procedural grounds, as it had never been notified to the Applicant. Moreover, it concluded that the aid was incompatible with the EEA Agreement. Finally, the Applicant came to the conclusion that the aid was to be recovered from the beneficiaries as from the fiscal year 1999. The relevant operative part of the Decision reads as follows:

1. The tax measures in favour of ITCs enacted in Iceland with Act No. 31/1999 and Act No. 29/1999 and related legislation constitute state aid within the meaning of Article 61 of the EEA Agreement. The tax regime applicable to ITCs in Iceland is incompatible with the functioning of the EEA Agreement.

2. Iceland shall terminate the tax measures referred to in point 1.

3. Iceland shall take all necessary measures to recover from the beneficiary the aid referred to in point 1 and unlawfully made available to the beneficiary, deducting any repayment already made to the respective authorities.

Recovery shall be accomplished without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the decision. The aid to be recovered shall include interest from the date on which it was at the disposal of the beneficiary until the date of its recovery. Interest shall be calculated on the basis of the reference rate set by the Authority and shall be net of interest that has already been charged by the respective authorities.

4. Iceland shall inform the Authority, within two months of notification of this Decision, of the measures taken to comply with it.

5 The Defendant did not challenge the Decision before the Court pursuant to Article 36 SCA, nor did it inform the Applicant of any measures taken to comply with points 2 and 3 of the Decision within the time limit set forth in point 4.

6 By a letter dated 27 April 2004, the Defendant informed the Applicant that Act No 31/1999 on ITCs had been abolished with effect from 1 January 2004 and that no new operating licenses would be issued after 1 March 2004. ITCs already established had been granted a transition period and were allowed to continue to operate under the old rules until 1 January 2008.

7 By a letter dated 17 May 2004, the Applicant insisted that any aid granted to ITCs during the fiscal years 1999 to 2003 must be recovered. With regard to the fiscal years 2004 to 2007, the Applicant indicated that provided that a *de minimis* threshold were applied correctly and any other aid measures the beneficiary ITCs might receive were taken into account, Act No 133/2003, which abolished Act

31/1999, could constitute a sufficient measure of implementation as regards point 2 of the Decision.

- 8 By a letter dated 1 October 2004, the Defendant submitted a proposal for how to calculate the aid element as a prerequisite for recovery. It suggested that the *de minimis* rule could apply not only to tax advantages granted after the Decision, but also to the fiscal years 1999 to 2003. Furthermore, the Defendant argued that an estimation of the total tax burden of ITCs in past and future had to take into account the taxation of dividends in the hands of shareholders. On the basis of this method of calculation, there was, in the Defendant's view, no State aid involved in the period 1999-2002. In an alternative calculation, not including the taxation of dividends, a possible State aid element for the period 1999-2002 was found in one case, which concerned trade in fish, and therefore had to be considered as falling outside the scope of applicability of the EEA Agreement. As to the period from 2003 to 1 January 2008, the Defendant proposed to implement the Decision "by notifying the ITCs about the *de minimis* rule and by monitoring, with regular reports to the Authority, that the *de minimis* threshold shall under no circumstances be exceeded". Finally, the Defendant asked for continued cooperation with the Applicant regarding the implementation of the Decision.
- 9 By a letter dated 18 November 2004, the Applicant requested more information. In particular, the Defendant was asked to clarify how the application of the *de minimis* rule was to be regulated by law, since no reference to the *de minimis* rules could be found in the Act abolishing Act No 31/1999. The Applicant further stated that the suggestion to take into account the rules applying to taxation of dividends had already been rejected in the Decision. Moreover, the Applicant questioned the granting of a transition period to existing ITCs by the abolition act, and requested information on legal amendments proposed to the Icelandic Parliament for the complete and immediate abolition of the ITC scheme to the extent the scheme resulted in the granting of aid above the *de minimis* threshold. After the expiry of a deadline set to the Defendant, the Applicant filed the application at issue.

II Legal background

- 10 Article 3 EEA reads as follows:

The Contracting Parties shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Agreement.

They shall abstain from any measure which could jeopardize the attainment of the objectives of this Agreement.

Moreover, they shall facilitate cooperation within the framework of this Agreement.

- 11 The first and second subparagraphs of Article 1(2) of Part I of Protocol 3 SCA read as follows:

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.

If the EFTA State concerned does not comply with this decision within the prescribed time, the EFTA Surveillance Authority or any other interested EFTA State may, in derogation from Articles 31 and 32 of this Agreement, refer the matter to the EFTA Court directly.

- 12 Article 7(6) and (7) of Part II of Protocol 3 SCA read as follows:

6. Decisions taken pursuant to paragraphs 2, 3, 4 and 5 shall be taken as soon as the doubts referred to in Article 4(4) of this Chapter have been removed. The EFTA Surveillance Authority shall as far as possible endeavour to adopt a decision within a period of 18 months from the opening of the procedure. This time limit may be extended by common agreement between the EFTA Surveillance Authority and the EFTA State concerned.

7. Once the time limit referred to in paragraph 6 has expired, and should the EFTA State concerned so request, the EFTA Surveillance Authority shall, within two months, take a decision on the basis of the information available to it. If appropriate, where the information provided is not sufficient to establish compatibility, the EFTA Surveillance Authority shall take a negative decision.

- 13 Paragraphs 1 and 2 of Article 2 (“De minimis aid”) of Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid (OJ L 10, 13.1.2001, p. 30), as adapted to and made part of the EEA Agreement in point 1e of Annex XV by Decision of the EEA Joint Committee No 88/2002 of 25 June 2002 (OJ L 266, 3.10.2002, p.56), read as follows:

1. Aid measures shall be deemed not to meet all the criteria of Article 61(1) of the EEA Agreement and shall therefore not fall under the notification requirement of Article 1(3) of Protocol 3 of the Surveillance and Court Agreement, if they fulfil the conditions laid down in paragraphs 2 and 3.

2. The total de minimis aid granted to any one enterprise shall not exceed EUR 100 000 over any period of three years. This ceiling shall apply irrespective of the form of the aid or the objective pursued.

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- 14 With a view to monitoring *de minimis* aid and to avoid the cumulation of several aid schemes, Article 3 of the *de minimis* Regulation sets out procedural requirements which the Contracting Party must comply with when granting *de minimis* aid.
 - 15 Reference is made to the Report for the Hearing for a more complete account of the legal framework, the facts, the procedure and the written observations submitted to the Court, which are mentioned or discussed hereinafter only in so far as necessary for the reasoning of the Court.

III Findings of the Court

General

- 16 The case before the Court is brought as an action under the second subparagraph of Article 1(2) of Part I of Protocol 3 SCA. Pursuant to this provision, the EFTA Surveillance Authority may directly bring a case to the Court where an EFTA State, within a period of time determined by the EFTA Surveillance Authority, fails to comply with a decision to abolish or alter aid incompatible with the functioning of the EEA Agreement. The provision must be read with Article 24 SCA, under which the EFTA Surveillance Authority shall give effect to the provisions of the EEA Agreement concerning State aid. In order to fulfil this task, the EFTA Surveillance Authority is given the power to ensure compliance of a Contracting Party with the obligation to terminate aid schemes contravening Article 61 EEA.
- 17 The Court notes at the outset that the Defendant did not challenge the Decision by way of an action under Article 36 SCA within the two months period laid down in the third paragraph of that provision. According to settled case law, a Contracting Party may no longer call into question the validity of a decision addressed to it once the time limit laid down in Article 36 SCA has expired. This finding is based in particular on the consideration that the periods within which applications must be lodged are intended to safeguard legal certainty by preventing decisions which involve legal effects from being called into question indefinitely (see, for comparison, Case C-188/92 *TWD Textilwerke Deggendorf* [1994] ECR I-833, paragraphs 15 and 16).
- 18 In this situation, the Defendant essentially puts forward four arguments in support of its submission that the application should be dismissed. First, the Defendant argues that the Decision must be deemed non-existent and that consequently there was no valid obligation to comply with. Second, the Defendant argues that legitimate expectations on the part of the beneficiaries preclude recovery. Third, the Defendant maintains that it has already fulfilled its obligations in accordance with the Decision. Fourth, the Defendant claims that recovery was absolutely impossible.

Validity of the Decision

- 19 The Defendant argues that the Decision suffers from such serious and manifest defects that it must be deemed non-existent. The following reasons are given: First, the Applicant seriously breached procedural requirements and the principle of good administration in failing to adopt the Decision within the time limits prescribed in Protocol 3 SCA. Second, the Applicant also infringed the general principle of good administration by failing to provide proper advice on what means were available to contest the decision and the time limit available to initiate proceedings before the Court. The third defect, according to the Defendant, consists in the Applicant having manifestly exceeded its competence by requiring the Defendant to recover aid granted to activities that fall outside the scope of the EEA Agreement, namely the trading in goods such as fish excluded from the product coverage rules laid down in Article 8(3) EEA.
- 20 The Court recalls that the Defendant did not challenge the Decision before the Court within the time limit laid down in Article 36(3) SCA. In the absence of such an action, the Decision became definitive and binding for the Defendant, except to the extent the Decision was tainted by flaws of such gravity that it must be deemed non-existent.
- 21 The Court of Justice of the European Communities has made it clear that a finding of non-existence of a decision is reserved for quite extreme situations and must be restricted to measures which exhibit particularly serious and manifest defects of an obvious gravity (Case 15/85, *Consorzio Cooperative d'Abruzzo v Commission*, [1987] ECR 1005; Case C-137/92 P *BASF and others* [1994] ECR I-2555, paragraph 50). The Court shares this view and will therefore consider whether the Defendant's arguments could establish such an exceptional situation.
- 22 As to the argument that the length of the administrative procedure was excessive, the Court holds that rendering decisions within a reasonable time is part of good administration under EEA law. This general principle is, in the field of State aid, laid down in Article 7(6) and (7) of Part II of Protocol 3 SCA which entered into force on 28 August 2003. An excessive length of procedure may indeed render a decision unlawful. However, Article 36 SCA refers to such an infringement of an essential procedural requirement as one of the grounds on which judicial review is possible. In the case at hand, the time limit laid down in Article 36 SCA has expired. At any rate, the length of the procedure cannot be considered excessive in the circumstances.
- 23 The claim by the Defendant that the Applicant failed to comply with requirements of good administration by not advising of legal remedies available to challenge the Decision, and of the time limit applicable, is also unfounded. EEA law does not, in a case such as the one at hand, impose such a duty on the EFTA Surveillance Authority (see, for comparison, Case C-153/98 P *Guérin Automobiles v Commission* [1999] ECR, I-1441, paragraph 15).

- 24 Finally, the Defendant's argument that, by adopting a decision that covers, *inter alia*, aid granted to an undertaking operating in the trade of fish, the Applicant has exceeded its competences and thereby acted *ultra vires* is also unfounded. The Court notes that lack of competence is a ground on which a decision can be regarded as non-existent. However, where, as in the present case, a decision deals with a general aid scheme covering various activities, the possibility that a particular activity may fall outside the scope of the EEA Agreement cannot affect the legality of the decision as such. Consequently this argument must be rejected.
- 25 It follows from the above that the arguments put forward by the Defendant are not of such a kind as to permit the Decision to be considered as non-existent.

Legitimate expectations

- 26 The Defendant's allegation that the Applicant, by delaying its decision encroached upon the principle of protection of legitimate expectations on the part of the beneficiaries of the aid, constitutes a contention relating to the validity of the Decision, and could have been raised in support of an application under Article 36 SCA (see, for comparison, Case 52/83 *Commission v France* [1983] ECR 3707, paragraph 10). In any event, the Court recalls that a Contracting Party cannot plead legitimate expectations of beneficiaries in order to justify its own failure to comply with an order of the EFTA Surveillance Authority for the recovery of aid (Joined Cases E-5/04, E-6/04 and E-7/04 *Fesil and others*, judgment of 21 July 2005, at paragraph 171).

Breach of obligations under the Decision

- 27 The Defendant essentially argues that it had already abolished the aid scheme in question before the Decision was adopted. The Defendant further submits that Commission Regulation (EC) 69/2001 on the *de minimis* rule has been implemented into the Icelandic legal order. Even though a transition period was granted to existing ITCs when the special tax regime established for ITCs was abolished, the application of the *de minimis* rule provided a sufficient legal framework to ensure that no aid exceeding the *de minimis* threshold would be granted. Requiring further amendment of the Defendant's internal legislation in that regard would be disproportionate. As to the order for recovery, the Defendant maintains that no ITC engaged in activities falling within the scope of the EEA Agreement has been granted State aid exceeding the *de minimis* threshold and that there is therefore no aid to be recovered. The Defendant finally maintains that the Applicant has been informed of every step taken as regards the ITCs. The full notification of the measures taken under the Decision was impossible due to defects of the latter.
- 28 The Applicant contests that the mere act of monitoring that no ITC receives State aid exceeding the *de minimis* threshold would be sufficient to comply with the Decision. Rather, it would be necessary to change the abolishing act in order to ensure that no aid exceeding the *de minimis* threshold would result. As to the recovery of aid granted, the Applicant argues that the Defendant has not taken

any steps to examine whether any recipient would have to pay back unlawful aid under the *de minimis* rule, and has not given information to allow a conclusion to be drawn as to how much aid different recipients have received and continue to receive.

- 29 At the outset, the Court observes that the Decision contains a threefold obligation on the part of the Defendant, namely to terminate the tax measures, to take all necessary steps to recover from the beneficiaries the aid found incompatible with the functioning of the EEA Agreement, and to inform the Applicant, within two months of notification of the Decision, of the measures taken to comply with it.
- 30 By its first argument, the Defendant essentially asserts that due to the application of the *de minimis* rule no further action was warranted in order to terminate the tax measures within the meaning of the Decision.
- 31 In that respect, the Court notes that the expression “terminate” in the Decision must be understood to the effect that it obliged the Defendant to take legislative action which would have resulted in the effective elimination of the granting of aid henceforth, cf. the first subparagraph of Article 1(2) of Part I of Protocol 3 SCA. The legislative steps taken by the Defendant prior to the adoption of the Decision to preclude the establishment of new ITCs do not adequately fulfil this requirement. It appears that transitional arrangements will be practised, but these would not offer any guarantee that a *de minimis* ceiling would not be exceeded, nor that cumulation with other State aid would not occur.
- 32 By its second argument, the Defendant essentially states that recovery of aid granted in the past was not required, since no aid equivalent to an amount exceeding the *de minimis* threshold was granted to ITCs active in areas covered by the EEA Agreement.
- 33 In the proposed calculation submitted by letter dated 1 October 2004, the Defendant suggested two possible calculation methods. In a so-called “best case scenario”, an overall view of the regime applicable to ITCs, including disadvantages such as the special rules on withholding tax on dividends, led the Defendant to conclude that no aid above the *de minimis* threshold was granted. Under the so-called “worst case scenario”, which does not take into account alleged disadvantages in the tax regime for ITCs, the only company benefiting from State aid above the *de minimis* level until 2002 was an undertaking engaged in trade in fish allegedly falling outside the scope of the EEA Agreement.
- 34 The Court notes that according to point 3 of the Decision, which is binding on the Defendant, recovery shall be accomplished without delay and in accordance with the procedures of national law provided that they allow the immediate and effective execution of the decision. According to Point 4 of the Decision, the Defendant was obliged to inform the Applicant, within two months of notification of the Decision, of the measures taken to comply with it. Regardless of whether the calculation methods suggested by the Defendant are to be deemed adequate in order to comply with point 3, it suffices to note that the Defendant

took no action at all concerning recovery during the two months period, and submitted no information to the EFTA Surveillance Authority in accordance with point 4 of the Decision.

- 35 Based on the above, it must be concluded that the Defendant has not complied with the two months period of notification, nor has it complied with point 2 of the Decision. It thereby has infringed its duties under that Decision as well as under Article 3 EEA.

Impossibility of implementation

- 36 The Defendant asserts in the alternative that the Decision was so imprecise with regard to recovery that it was absolutely impossible to implement it. With regard to the three year rule laid down in the *de minimis* Regulation, the Defendant argues that it is impossible to initiate direct recovery actions against a company which has, for example, recently acquired its ITC license since it cannot be established whether there has in fact been granted any aid in excess of the *de minimis* threshold until after the end of each successive three-year period. Moreover, there is no reference in the Decision to the applicability of the *de minimis* rule regarding companies trading in fish. In particular, the Defendant states that the Decision did not specify clearly how any possible aid should be calculated. According to the Defendant, it is absolutely impossible to implement the Decision without further guidance and cooperation from the Applicant.

- 37 The Applicant maintains that doubts as to how the incompatible aid scheme could be changed in a way that would make it possible to continue it as a new *de minimis* scheme are not sufficient to prove that it was absolutely impossible to terminate the scheme and calculate the aid as basis for recovery. As the Defendant failed to take any steps to implement the Decision and inform the Applicant before the time limit had expired, the Defendant cannot claim impossibility.

- 38 The Court notes that, in its case law on infringement actions under the second subparagraph of Article 88(2) EC, the provision mirroring the second subparagraph of Article 1(2) of Part I of Protocol 3 SCA, the Court of Justice of the European Communities has consistently held that after a decision has become binding on a Member State, the only defence left in opposing an application by the Commission of the European Communities would be to plead that it was absolutely impossible to implement the decision properly (Case 52/84 *Commission v Belgium* [1986] ECR 89, paragraph 14). In particular, implementation may be impossible where the obligation imposed on a Contracting Party remains indeterminate (see, for comparison, Case 70/72 *Commission v Germany* [1973] ECR 813, paragraph 23).

- 39 An alleged lack of guidance in the Decision as to how to calculate the sums to be recovered, is, however, not sufficient to establish impossibility of its implementation. It is for the Defendant to substantiate an absolute impossibility of implementation. The Defendant has not provided the Court with any material

that would allow such a conclusion to be drawn. In itself, the fact that further guidance from the Applicant might have been useful for the calculation of the amount to be recovered does not mean that it was absolutely impossible to implement the recovery order.

- 40 The Defendant argues that the Applicant did not fulfil its duty of loyal cooperation under Article 3 EEA with respect to the implementation of the Decision. Therefore the Court should dismiss the action on the grounds of impossibility for the Defendant to act. The Court recalls that the EFTA Surveillance Authority is bound by that duty when giving effect to the provisions of the EEA Agreement concerning State aid (see, as regards cooperation under Article 1(1) of Part I of Protocol 3 SCA, Joined Cases E-5/04, E-6/04 and E-7/04, *Fesil and others*, paragraph 128). Furthermore, a Contracting Party is not prevented from reporting problems in implementing a decision to the Applicant, and to propose suitable amendments. This may be the case where the Contracting Party encounters unforeseeable or unforeseen difficulties or perceives consequences overlooked by the EFTA Surveillance Authority. In such instances, the Defendant may, *inter alia*, ask the Applicant for assistance, or an extension of the time limit set in the Decision may be requested. However, in the case at issue, neither were the alleged difficulties of that nature, nor was the time limit set by the Applicant unduly short. In addition, merely informing the EFTA Surveillance Authority of difficulties in implementing a decision will not suffice, if no steps have been taken to recover the aid at the same time (see, for comparison, Case C-183/91 *Commission v Hellenic Republic* [1993] ECR I-3131, paragraph 20).
- 41 It follows from the aforementioned that the Defendant's breach of its obligations under point 3 of the Decision and Article 3 EEA cannot be justified on grounds of absolute impossibility of recovery.

V Costs

- 42 Under Article 66(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. The Applicant has asked for the Defendant to be ordered to pay the costs. Since the latter has been unsuccessful in its defence, it must be ordered to do so. The costs incurred by the Commission of the European Communities are not recoverable.

On those grounds,

THE COURT

hereby:

- 1. Declares that by failing to terminate the tax scheme declared incompatible with the EEA Agreement by Decision No 21/04/COL of 25 February 2004, to recover the aid provided, and to inform the EFTA Surveillance Authority as required, the Republic of Iceland has failed to fulfil its obligations under points 2, 3 and 4 of the said decision.**
- 2. Orders the Republic of Iceland to pay the costs of the proceedings.**

Carl Baudenbacher

Per Tresselt

Stefán Már Stefánsson

Delivered in open court in Luxembourg on 24 November 2005.

Henning Harborg
Registrar

Carl Baudenbacher
President