

## **State aid, selective fiscal measures and co-operatives: the prejudicial indictment to the Court of Justice**

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**Abstract** – The Court of Cassation with order n.325 of 2006, asked the European Commission for a series of information concerning the compatibility with the EU law about State Aid to analyze EU guidelines which aim at identifying a proper and unitary fiscal treatment for co-operatives of the member states. This request remained unanswered, so three orders of the Cassation followed in 2006 leaving, through the prejudicial indictment to the Court of Justice, not only to value the compatibility of the Italian provisions with state aid, but the possible abuse of the right in the choice of the type of co-operative, as well. So far, the answers from the Court of Justice haven't reached us yet, but on 8 July 2010 the conclusions of the Advocate-General at the Court of Justice were issued for the cases from C-78/08 to 80/08 concerning exactly the prejudicial questions put by the Court of Cassation.

**1. Introductory comment** – The event arises from the request of information the Supreme Court submitted to the EU Commission concerning the compatibility of tax concessions for co-operative societies with the EU guidelines in matter of State aid.

With order of 26 January 2006 n. 3525, the Supreme Court of Cassation, tax division, then asked the EU Commission for a series of information about the compatibility with the EU guidelines concerning State aid, of which 87 and following CEE treaty (from now on TFUE art. 107 and following), of tax concessions granted in Italy to co-operatives, in every field they operate.

This problem set out by the Court of Cassation had been the main topic of a political discussion arisen in the second half of 90s and particularly referred to the most important concessions of which co-operatives benefited from, that is intaxability (total) of the sums assigned to indivisible reserves, provided and disciplined by art. 12 of l. n. 904, 1977, in which the abrogation or a radical revision was requested, because it was believed, by those businesses which were not organized in co-operatives, to be a distorting factor of the competition. In that discussion entered the doctrine which supported the rationality of the relieving system, reserved by our system to the co-operative sector, in relation to the art. 45 of the Constitution from

whose interpretation would have derived the legitimate of non taxability provided by the aforementioned art. 12 of the l. n. 904, 1977

According to the Court of Cassation, as there are no specific precedents in the EU jurisprudence, to be able to issue a decision for the case which has been drawn to its own attention it is necessary to formulate a proper request to the EU so that to know if there have been either any other decisions issued or any investigation procedure has been started, or if any protest has been registered by competitors in relation to the different relieving systems of which co-operatives benefit from in Italy and in relation to their compatibility with EU guidelines concerning State aid. The Court, while formulating the request, applies what provided from the Commission communication 95/C/312 related to the cooperation between national judges and the Commission in relation to State aid.

The Court, after taking note of the difficulty to define the probable contrast between the national guidelines and the regulations which safeguard the competition, of which the one concerning State aid constitutes an essential part, applies a specific provision contained at point 235 part VI of the aforementioned Communication to request both explanations and assistance to the Commission itself.

**2. The requests of the Court of Cassation** – In the controversy submitted to its examination, the Supreme Court was asked to pronounce a decision on an inductive assessment in which the financial administration had disclaimed the mutual aid characteristic of a group of entrepreneurs who, according to the Court, used the co-operative form in the sole aim to access the fiscal concessions.

The EU Commission asked for more detailed information:

a) if the measures of tax concessions granted to co-operatives could be considered as State Aid;

b) which were the determinations the Commission took on tax concessions measures for co-operatives, in every field of activity (including banking);

c) which were the elements to consider in the evaluation of the compatibility with the regulations concerning State aid, of the effects produced in the internal law system ( in favour of co-operatives) which were overriding of the common EU and company law;

d) which were the elements in the light of which evacuate the compatibility of the regulations about State aid of a derogatory regulative system, in favour of co-operatives, that doesn't provide appropriate external control to check the existence of the necessary requirements to benefit from the concessions.

In the order of request of assistance to the EU Commission, the Court synthesizes the reference regulative outline related both to the tax

concessions provided by the law in force at the time of the event concerned, contained in Title III of D.P.R. 29 September 1973 n. 601 about the Discipline of Tax concessions, to which the submitted case refers to, and the subsequent modifications to the mentioned law. The Court in its order, also mentions the fiscal system of the refunds to the partners ( to study in depth the law please refer to the statement of M. Ingrosso Tax concessions and co-operatives in direct taxation in Italy §. 4 and following ).

The regulative excursus contained in the third part of the order highlights how the concessions for cooperation have been significantly reduced by the modifying interventions of 2002 and 2004. They confirmed the normative structure outlined by the third title of D.P.R. n. 601 of 1973 and subsequent provisions which provided further concessions, such as, for its particular relevance, must be first remembered the art. 12 of l. n. 904 of 1977, on which certain quantitative limitations have been operated, so that the concessions regulation is the one resulting from the institutive primary provisions and of those ones that operated the quantitative limitation.

In fact, for what concerns the substantial regulation of the concessions, there was a first reduction made by D.L. n. 63 of 2002 and, subsequently, of the L. n. 31 of 2004 (art. 1, par. 460-469).

According to the Court such concessions and subsequent modifications, can constitute State aid and be subject to the relative regulation. The Court particularly refers to the obligation of the prior notice, as per ECT art. 88 (now art. 108 TFUE), paragraph 3, to the Commission and to the control it has to carry out on the compatibility with the EU provisions about competition. The Court specifies in the aforementioned order, that the missed notice of measures constituting State aid would lead to the illegitimacy of the aids themselves with the subsequent obligation for the national Authority to collect the aids from the beneficiaries.

The same Court of Justice sanctioned many times that the abolition of an illegitimate aid through collection is the logical consequence of the assessment of its illegitimacy. Owing to the return of the aid, the beneficiary is deprived of the advantage benefited from, on the market in comparison with his competitors and the situation existing before the payment is re-established. Furthermore, in its order, the Court of Cassation underlines how the need to receive information from the Commission is strictly connected to the juridical force of the decisions of such institution about State aid. These decisions, as a matter of fact, are binding for the addressee State itself and its various authorities, including judicial branches and administrative agents. The decisions about aids of the Commission implicate not only the duty for the State to amend or eliminate the fiscal measures constituting aids ex art. 107

and following TFUE, but also the obligation for the national authority to cease to apply the law in contrast with what provided in the decisions themselves. This is also valid, as pointed out in the order under consideration addressed to the EU Commission, in a judgement such as the one of Cassation, in the sense that if the tax debt is contested to the finance Administration, the EU law must be applied.

Moreover, according to the Court of Cassation, to make eligible the fiscal measures in Italy for co-operatives, which are under the cognizance of the national judge by virtue of the direct enforceability as provided at the art. 107 and following TFUE, it is necessary to analyse the effect of such measures on the fiscal system, by making a comparison with the one concerning the normal corporate enterprises. Besides this, the Court also refers to the art. 45 first par. Cost. which provides a particular *favour* for co-operative system.

The Court, hence, having briefly reported the mechanisms of fiscal concessions provided by the national provisions in favour of co-operatives, quoted the constitutional rule of law that promotes the cooperation activity with the object of mutuality, asks for a clarifying intervention of the Commission.

The Court of Cassation asks the Commission to provide if tax concessions to co-operatives can be qualified as State aid. In addition, the Court states, between the lines, in the last part of the question, that the derogatory regulative system does not provide any proper external control on the effective existence of the necessary requirements to benefit from the tax concessions, influencing, not only a little, (in negative sense), the judgement of the Commission on the compatibility itself of the fiscal systems provided for the co-operatives.

Furthermore, the issue pointed out by the order n. 3525/2006 originated from a case that cannot certainly be simplifying of the whole co-operative sector; which presents some peculiarities that are very precise. In fact, there's a case of an association of entrepreneurs in the fishing industry that had adopted the co-operative scheme to benefit from the tax concessions provided for this kind of society and the financial administration required the application of the ordinary system of the business income, as they refused to recognize the business as a co-operative.

Anyway, the judges of the Court of Cassation, although the object of the trial was the collection of the tax concessions (as it had been assessed that it was not a co-operative), to reach the decision of the litigation thought it right to apply to the EU Commission.

To this end they reconstructed the most relevant aspects of the fiscal system of co-operatives, with a generalized and wide reference to the relieving dispositions. It would have been desirable, especially in

relation to the different purposes of the system, to differentiate the actual derogations to the general taxability system, from the fiscal solutions or from those aimed at excluding double taxation (as it happens for agricultural co-operatives ex art. 10 of D.P.R. n. 601/1973), or destined to encourage the use of workforce (as in producers' and labour co-operatives ex art. 11 of D.P.R. n. 601/1973), or to favour the property reinforcement (as it happens for the non taxation of the incomes which go into the indivisible reserves ex art. 12 of Law n. 904/1977).

**3. The following orders of the Court of Cassation to the Court of Justice** – three further orders of the Cassation followed, n.3030, 3033 and 3031 of 8 February 2008 that submitted, through the prejudicial indictment to the Corte of Justice, not only the valuation of the compatibility of Italian provisions with the State aid, but also the possible abuse of the right to choose the type of co-operative.

As deducted from what we said up to this point, the Court of Cassation in the order 3525/2006 didn't consider the Commission's guideline concerning co-operatives. So, we mustn't be surprised at the fact that, with the three mentioned orders of prejudicial indictment to the Court of Justice, there has been a partial correction of the statement. The EU guidelines assume centrality in both the orders and the directive 2003/72, which was acknowledged by Italy with d. lgs. of 6 February 2007, n. 48 (Ingrosso M., Viviano M.R, "Co-operatives: compatibility of the tax concessions with the European law. § 2).

Particularly, the judges of the Cassation submit to the Court of Justice all those dispositions - which have been in our system for a long time - which, in different measure and at determined conditions, guarantee to such societies, various forms of abatement of the tax burden.

On this subject there's a question: if they take shape as "State aids" and if, when they can be considered as such, could anyway be "proportioned" to peculiar purposes (mutual) of the co-operatives; if, in this aim, it is necessary to regard to the single provision that is the co-operative taxation as a whole; let alone, where there's a negative response to such questions, if the use of the co-operative type for the sole purpose to benefit from the different tax system – so called "false cooperation" - integrates a form of "abuse of the law", in the acceptance assimilated by the EU jurisprudence. Moreover, the Cassation shows, in many occasions, to link the mentioned doubts also (and especially) to the inefficiency of the administrative control system, which, - it stated – besides presenting a number of "leaks", would have been further weakened by the recent company reform.

Beyond valuations as to this subject (configuration of State aid, proportionality, subsistence of "abuse of the law"), the orders under

examination appear to be extremely interesting as they show two more issues of method: an explicit one (the isolated or global valuation of the exemption tax provisions) and, above all an implicit one, that is the value to give to the (supposed) inefficiency of the administrative control in the inspection of both the compatibility with the EU regulation on State aid, and of the possible configuration of an “abuse of the law”.

It's easily understood the determining remark of the issues above; the individuation of the method of evaluation and the valuations strictly concerned to it, constitute in fact elements of very strict and reciprocal inter-connection: on one hand, a wrong method can lead to incorrect valuation of the case; on the other hand, an imprecise formulation of the problem can lead to adopt unsuitable methods of investigation (with all the consequences of the matter).

**3.1. An analysis of the questions of the orders** – The Cassation ask the CEE Court of Justice especially if the special tax regulation of co-operatives integrates a “State aid” and, if so, whether it could be considered “proportioned” to the peculiar modus operandi of co-operatives, that is the “mutual” management of the business.

Particularly, the judges of Cassation highlight that “... *it is about, to verify if a favourable tax system can be a means “proportioned” to the general interest purposes which the co-operative instrument mean to pursue. Applying the rules enunciated by a constant EU jurisprudence, it will be necessary, hence, to verify if the system in dispute: a) is suitable to realize the purpose; b) is necessary; e) is proportioned, and that is to say that it is not possible to pursue the purpose by a measure which is of minor type or intensity and continues: “It’s necessary... to establish if the judgement of proportionality must be carried out, besides the single relieving measures, on the concessions system as a whole, as well. This is because the presence of the co-operative on the reference market, through the offer of goods and services limited to some particular categories of consumers and with normal market conditions, can produce some distortions in the competition, which must be also valued in their totality.”* They then underline that “*it must be anyway cleared whether the requirement of the proportionality - as it was represented by the Commission- constitutes only a criterion the Commission adopted related to the judgement of the compatibility of the aid, to which it exclusively is owed, in other words if, presenting such characteristic, the tax concessions doesn’t constitutes ex definition an aid, and it isn’t, hence, subject to the procedure of verification as per art. 87 EU Treaty (now 107 TFUE), ...It seems appropriate, on this subject, to urge the EU Judge to issue a verdict about the application of the principle of the measures which can be*

*considered coherent with the tax system, that is to say, justifiable with the nature or the economy of the system, .... It is, in fact, a criterion (which would exclude at the root, as non-selective, the qualification of the measure as State aid) enunciated by the EU Commission in the communication 98/C 384/03 and recalled many times during the contentious session, but never in actual facts applied by the Court of Justice, whose jurisprudence showed a constant rigour towards those measures requiring selective economic benefits also for wide business categories, as it didn't recognised any relevance to a claimed coherence with the tax system considered as a whole."*

The "proportionality" which Cassation refers to, seems to be intended in the sense of "non speciality". The question is whether the tax exemption regulation (herein under examination) is coherent with the logic that founds the ordinary tax charging, as to that, it is to be regarded as mere adjustment dependent on the peculiar characteristics of co-operative.

It is known in fact, as regards to configuration of State aid through different forms of reduction of tax burden, not every "subtractive" treatment subjectively circumscribed (c.d. horizontal selectivity) must be considered a state aid, but only the one which constitutes an exception or derogation to the ordinary tax regulation, unless "not justified either by its own nature or by the system structure" (cp EU Court of Justice verdict 2 July 1974, case 173/73; verdict 17 June 1999, case C-75/97; verdict 5 October 1999, case C-251/97; verdict 8 November 2001, case C-143/99).

It is necessary, as underlined by the Court, to establish if the judgement of proportionality must be carried out, besides the single concessions measures, also on the assistance system considered as a whole. Now, to establish if an institution constitutes a derogation to a form of tax burden it is necessary to identify its function (reason) and compare it with the function (reason) of the ordinary tax burden. In addition, it must be said that a regulation which is structurally "special" isn't functionally "derogatory" (hence nevertheless relieving) if what distinguish it compared with the "common" regulation, appears mere corollary of the related application assumptions. In this specific case, today, once fixed the distinction between "co-operatives with prevalence of mutual aid" (CMP) and "co-operatives not with prevalence of mutual aid" (CMNP) - the former connoted by a compression of the subjective profit (non-distributivity of the dividends) and by a prevalence of mutual aid - the art. 223-duodecies, paragraph 6, transitory implementation dispositions of the civil code, subordinates to the qualification of CMP only the application of the "tax regulations if relieving type

provided by special laws”. (*amplius* M. Ingrosso “Tax concessions and co-operatives in the taxation of direct tax in Italy” §. 2).

From the above if it’s possible to deduce that not all the concessions to which the art. 223-duodecies, paragraph 6 refers to, subsisting the qualification of CMP, they resolve in tax treatments that aim at giving advantage to co-operatives instead of other businesses and not justified “by the logic and the structure of the system”.

Going on with the analysis the other stated issue is the value to give to the inefficacy of the supervision and control systems. The Court of Cassation shows to attribute the doubts about compatibility of co-operative taxability with the art. 107 TFUE also to the poor efficiency of the authority’s supervision with the result to let the “false co-operatives” obtain tax concessions.

In the orders above – although not in explicit words - the Cassation seems to be asking the Luxembourg judges whether the “non effectiveness” of the authority control procedure on the correct fruition of the tax regulation of co-operatives could “transform” the latter into a tax concessions (and probably, applying the further assumptions, in a “State aid”).

The profile at the art. 107 TFUE refers hence to the institution of assistance tax measures, so that the judgement about the subsistence of a “State aid” appears circumscribed at the legislation level. It concerns, always and in any case, a regulatory framework and not a real situation, that is a social or economical phenomenon (which is, exactly, the inefficacy if the control over co-operatives). It is true that to run into the violation of such prohibition it is necessary to consider the “actual effects” of the measure and its capability to alter the competition, but it must exclusively show on the basis of the derogatory and relieving regulations, apart from the efficiency or inefficiency of the authority system machinery in charge of its correct application. The fact that the supervision over the co-operatives is ineffective or not it is not relevant to the qualification as “State aid” of the regulation it is obliged to apply.

In short, the inefficiency of the supervision over the co-operatives doesn’t affect the qualification as “State aid” of the co-operative taxability (to this end only noticing the regulative result in the context of the system), but- by actually allowing the fruition of the exemption system as provided by the tax system itself, to those persons lacking in conditions to make use of it – it gets at violating the duty of the State to guarantee in real terms, the competitiveness of both internal and EU markets.

Two possible consequences can derive from the above: the application of sanctions towards the State from EU institutions and/or the obligation for the State to refund the probable loss (really) caused to

the competitors, unfairly damaged on the competitiveness owing to the omissions from the national authority machinery.

It must be added though, that nowadays the supervision over co-operatives has been the subject of a reorganization measure, which confirming compulsory ordinary and extra-ordinary inspections (now called revisions), modified the regulation, in order to assure more efficacy especially in the verification of the mutual requirements. Particularly, the reform of the co-operative law, provided that the prevailing condition must be documented by the governing directors and by the auditors in the balance sheet supplementary note (art. 2513, 1° paragraph, civil code), thus introducing, a new measure, which can be qualified, a broad sense, as supervising. (M. Ingrosso “Tax concessions and co-operatives in direct taxation in Italy” §. 2.2).

The last problems the Cassation put is if, set aside the possibility to qualify the tax concessions above as State aid, the use of the co-operative form, taking out the cases of fraud or simulation, it can be qualified as abuse of the law, when the use of such society is to reach the aim of tax saving. In particular the judges underline that “ *...in this case there is, ..., the problem whether having recourse to a type of society could be considered abuse of law, with subsequent non-opposability of the special taxation to the financial administration, beyond any hypothesis of fraud o simulation, when such use has intervened with the sole or main aim of achieving tax saving, that is without pursuing actual economic targets, so when the offer conditions of goods and services are the same as the ones offered by the normal corporate enterprises.* ”

The Court, eventually, explains that “*For what concerns the abuse of the law, whereto the practice would be considered abusive, the result would simply be the non-opposability of the co-operative legal form to the financial administration, which could require the observance of the applicable ordinary tax discipline*”.

**4. Conclusions** – It must be noticed that , in our code, before the company reform, the observance of fiscal requirements had contributed to unify the whole category of co-operatives that benefited from tax concessions. With the new reform, instead, the legislator (from civil law point of view) chose to allow tax - only to co-operatives with prevalence of mutual aid.

The limits of the effect of fiscal incentive became more restricted: with the company reform, those requirements that were considered elements from which deduce (presumptively) the existence of mutuality, became the qualifying elements of the civil law, and currently, nothing excludes that they can be used with the meaning and the interpretation with which they consolidated in the tax area.

At the presentation of the tax system of the co-operatives to the Court of Justice (and already presented to the Commission) it would have been appropriate, especially for a full valuation of the compatibility of tax exemption first, and next for tax abatement either on the sums or on the profits allocated in indivisible reserve, to underline how the capital strengthening assumes for co-operatives, compared to lucrative companies, such an importance to require a suitable taxability for both stimulating the capitalization of co-operatives, and compensating the strong limit imposed to the co-operator partners concerning the distribution of the profit and the access to the reserves. In fact, the reserves laid up with partial tax exemption (art. 1, par. 460, Financial Law 2005), differently from those of the joint-stock companies (with a different taxability), are not divisible among the partners. In case of dissolution or conversion of the co-operative they are devolved to mutual funds for the promotion and the development of the co-operation. This bond of non-distributivity is legal for prevalence of mutual aid co-operatives and statutory for the legal reserve of those with no prevailing mutuality.

Furthermore, the compression of the property interests of the partners implemented through the bond of indivisibility of the reserve, with structural profiles for those with prevalence of mutual aid and statutory for the legal reserve with non prevalence of mutual aid, has the purpose to allow the co-operatives to overcome those weaknesses for example, of capital variability (art. 2511 of Civil Code), of the free access of the partners (so called principle of the open door), which radically differentiate them from lucrative companies.

So far, the answers from the Court of Justice haven't reached us yet, but on 8 July 2010 the conclusions of the Advocate-General at the Court of Justice were issued for the cases from C-78/08 to 80/08 concerning exactly the prejudicial questions put by the Court of Cassation together with the orders above examined.

According to the Advocate-General at the Court of Justice the prejudicial indictments raise serious doubts about them being receivable.

It is particularly underlined that the concise formulation of the adjournment orders doesn't allow to get neither detailed information on the national system in object, nor the facts of the main cases and the Court wasn't given precise information about taxability of other forms of companies which are different from co-operatives, while such items are indispensable to the valuation of the comparability of the situations, which is intrinsic to the advantage and selectivity notions, fundamental elements of the State aid notion.

It also adds, that *"it appears even more uncertain the existence of a link between EU law and the cases submitted to the adjournment*

*judge. Concerning the subject and the nature of the main cases, it is difficult to understand with certainty how the answer given by the Court could be useful to the solution of the pending proceedings in front of the adjournment judge. In fact, the mentioned cases concern the validity of the controls carried out by the financial administration, while the questions refer to the probable qualification of the tax concessions in the light of the EU art. 87” (now 107 TFEU).*

For what concerns the problem of the supervision it then considers, such prejudicial question as a “deliberation” or a “comment” that can’t be considered a separate question.

Finally, for what concerns the last question, that is, the abuse of the law, it remarks that it is exclusively pertaining to the national sphere, hence, the Court is not competent to solve it.

From these premises, submitted to the Court, they should be defined totally unacceptable.

Nevertheless, if the Court shouldn’t decide to declare unacceptable the prejudicial adjournment, the Advocate-General suggests that the only prejudicial question to declare acceptable and on which the Court will have to issue its opinion could be the one referring to the possible presence of State aid, to be solved though stating that we are not in the presence of State aid, but of a mere favour tax system for producers’ and labour co-operatives, aimed at exempting the profit produced with the labour of the partners and placed in a wider tax system destined to the generality of these bodies. The tax regime of co-operatives can’t be considered as selective, according to the Advocate-General at the Court of Justice, if the participation of the shareholders or partners of a joint-stock company is a participation limited to the contribution of capital, typical of a co-operative is the mutual or exchange relationship. The difference of the fiscal treatment is founded on the difference of such relationships.

The Advocate-General starts from the assumption that State aid don’t include direct concessions only (effective services) as the subsidies and the contributions, but the indirect ones as well, such as the acknowledgment of concessions, tax reduction, or whatever, confirming that the exemption in favour of these mutual bodies doesn’t depict as an advantage in favour of co-operative, even if it must be always verified if, in the ambit of a precise juridical regime, the measure might represent an advantage of some businesses compared with other ones.

As a matter of fact, tax measures are, in that case, adapted and destined to particular juridical structures (co-operatives), as many times confirmed by the jurisprudence as well, justified in the application by the nature and the general structure of taxation and

differentiated on the basis of essential differences between the priority targets of lucrative companies, and to those of mutual societies. To have a complete analysis, it must be added that the Advocate-General, in the introductory part of the conclusions points out that “*whenever the Court would respond to the questions, that should be necessarily reformulated, the present proceeding would constitute an interesting opportunity of analysis of the significance of the notions of advantage and selectivity of national measures concerning taxation of co-operatives. In particular, there would be put the questions of the application of the justification criterion founded on the logic of the national regime and the analysis of the options taken into consideration by the Italian legislator in the ambit of the national system of direct tax*”.

Note:

DPR : decree of the President of the Republic

DL / d.lgs: law by decree

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