

ECJ to Decide Fate of Gibraltar's Corporate Tax Regime

by Michael Castiel

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An oral hearing before the European Court of Justice was conducted on March 14 in a case dating back to 2004 that involves the government of Gibraltar and the European Commission. The two issues identified for adjudication by the ECJ are whether a new corporate tax regime proposed for adoption by Gibraltar to replace the existing exempt-company regime is in compliance with EU state aid rules and whether Gibraltar — which is regarded as part of the United Kingdom for purposes of some aspects of EU membership — retains fiscal independence from the United Kingdom and can have a tax regime separate from that of the United Kingdom. The ECJ has already received full written submissions from both sides, and the oral hearing is expected to be the final stage of the litigation.

Although it may be as long as three months before Gibraltar learns whether its tax case against the European Commission (joined cases T-211/04 and T-215/04) has been successful, the hearing of oral evidence has increased the optimism on the government's legal team. A ruling in Gibraltar's favor will open the door to a new tax structure that, it is widely believed, will see the application of an across-the-board company tax of about 10 percent.

Gibraltar had hoped the ECJ would hand down its decision within weeks — in time for the new tax structure to be incorporated in the budget for the 2007-2008 fiscal year that begins in July — but an unexpected intervention by Spain not only lengthened the oral proceeding, but will lengthen the deliberations of the five judges.

The introduction of the new tax structure could be delayed until the last minute, so if the decision is handed down in early June, there still will be time for the government to introduce proposals for the new corporate tax structure, which will compete favorably with those of other low-tax jurisdictions.

If Gibraltar gets the court's green light in time, the 2007 budget also is expected to significantly reduce Gibraltar's personal tax levels. If, however, a decision is not made in time for the budget, the government may have to reconsider its tax plans and postpone the introduction of new structures for another year.

Spain's intervention at the oral hearing focused on the issue of material selectivity, which relates to the form of the tax reform plan. Madrid apparently is concerned with the possible effect of any court ruling on tax regimes already operating in areas of Spain, such as the Basque homeland.

A favorable ruling also will remove much of the uncertainty that has affected Gibraltar's economy for almost three years, since the European Commission first intervened to claim that the United Kingdom and Gibraltar could not have different corporate tax regimes. Although Gibraltar's economy has continued to grow across the financial sector, efforts to capture new markets have been constrained by the ongoing uncertainty created by the EU actions.

The European Commission has argued that Gibraltar's new series of tax proposals, first mooted four years ago, infringe EU state aid rules. Both arguments were rejected by the U.K. and Gibraltar governments, but the commission's stance led Gibraltar to put on hold several planned tax changes and to scrap plans for a zero-tax regime that it was then believed would enhance Gibraltar's attraction for foreign investors.

However, Gibraltar's optimism was bolstered by a judgment (C-88/03) handed down by the ECJ last year that confirmed Portugal's right to make separate tax arrangements for the Azores without infringing EU state aid rules. (For the ECJ judgment in *Portugal v. European Commission* (C-88/03), see 2006 WTD 173-9 or Doc 2006-18627.)

Whereas the Azores is an integral, albeit autonomous part of the Portuguese state, Gibraltar is not part of the United Kingdom. And under Gibraltar's new constitution, which came into effect at the beginning of this year, Gibraltar has in effect a new, noncolonial relationship with the United Kingdom — a fact that was stressed in the oral evidence presented to the ECJ this week.

Those constitutional realities mean that although the arguments being fielded by the European Commission cannot be the same in both cases, in light of the ECJ's finding that Portugal has the right to make separate tax arrangements for the Azores without infringing EU state aid rules, it follows that the United Kingdom should also have that right in the far more clear-cut case of Gibraltar. Therefore, the judgment in *Portugal* paves the way for the introduction in Gibraltar of a new corporate tax code to replace the exempt company regime that is being phased out because it was found to be in violation of the EU state aid rules.

The *Portugal* ruling was raised during the oral hearing, the final stage of the lengthy litigation process. Under the EU court system, the exchange of written arguments is the core of the procedure, and Gibraltar believes it has submitted a substantial array of arguments. From the outset, it has stressed aspects of what is regarded as the "regionality" issue, pointing to the German system of Lander (states), which impose their own taxes that differ from those set by the federal government, and the Scottish Parliament and Welsh Assembly in the United Kingdom, which also have individual fiscal powers that differ from the tax regimes imposed by central governments.

The feeling in Gibraltar is that the ECJ will rule in favor of Gibraltar's ability to have its own tax regime independent of the United Kingdom. Nevertheless, it is anticipated that however the ECJ adjudicates the issue, Gibraltar will move to a system of low corporate tax rather than zero tax. ♦

♦ *Michael Castiel, partner, Hassans, Gibraltar*