

## *State Aid to the Madeira Free Trade Zone - A never ending story*

### **Commentary on the judgment of the General Court of 21 September 2022**

*João Miguel Batista*

#### **1. Judgment of the General Court of 21 September 2022**

The Madeira Free Trade Zone (MFZ)<sup>1</sup> – has been, since 1987, benefiting from a tax state aid scheme<sup>2</sup> which pursues an aim of regional development. Its most recently approved regime - known as Scheme III - initially raised some doubts to the European Commission, which have recently been confirmed through a General Court “GC” judgement.<sup>34</sup>

Having, first, serious concerns as to the application of the tax exemptions on income derived from activities actually and materially carried out in the Autonomous Region of Madeira and, second, as to the link between the amount of the aid and the creation or maintenance of jobs in the Autonomous Region of Madeira, the Commission adopted the decision - then appealed - in which it found that Scheme III was applied contrary to the provisions of the Commission's 2007 and 2013 Decision, being incompatible with the internal market - in breach of Articles 107 and 108(3) TFEU. Dissatisfied with that decision, the Portuguese Republic defends itself in court as follows:

- a) It contests the qualification of Scheme III as State aid within the meaning of Article 107 TFEU, arguing that it is not **selective** aid, which in any way distorts competition.
- b) It claims an infringement of Article 108 TFEU and Articles 21 and 23 of Regulation 2015/1589, in so far as Scheme III cannot be regarded as 'new aid' within the meaning of Article 1(c) of that Regulation;

---

<sup>1</sup> For further developments on the various regimes of the International Business Centre of Madeira, see BRUNA FURTADO MENDES DE ABREU, *Centro Internacional de Negócios da Madeira: um regime de tributação privilegiada*, or ANTÓNIO PRAGAL COLAÇO, *O Centro Internacional de Negócios da Madeira Como Paraíso Fiscal Ou Regime Fiscal Preferencial À Luz Dos Auxílios De Estado*, PhD Course 2009/2010, University of Lisbon, Law School.

<sup>2</sup> On the Community Regime of State Aid Applied to Tax Measures, see. TÂNIA LUÍSA FARINHA E FARIA, *Implicações Relevantes Do Regime Comunitário Dos Auxílios De Estado Na Política Tributária Dos Estados Membros*, Master in Tax Law, University of Lisbon, Law School.

<sup>3</sup> Allowing a decrease in corporate income tax (IRC), indexed to profits resulting from activities effectively and materially carried out in Madeira:

Making possible the reduction of municipal and local taxes, as well as of taxes related to the transfer of real estate used for the opening of companies in the Autonomous Region of Madeira - the latter would be determined based on the maximum limits of the beneficiaries' taxable base, such limits varying according to the number of jobs created by the beneficiary-employers in each financial year. In terms of scope, Scheme III was only available to activities listed in the 2007 Commission Decision, excluding, among others, some financial intermediation activities.

<sup>4</sup> Judgment of 21/09/2022 - Case T-95/21 Portugal v Commission.

- c) It identifies errors of factual law, taking the view that the Commission's decision does not provide the required statement of reasons, thereby jeopardising the principle of proportionality;
- d) It claims an infringement of the rights of the defence and of legal certainty since the Commission did not take into account a letter sent by the Portuguese Republic;
- e) Breaches of the principles of legal certainty, protection of reasonable expectations and sound administration: in so far as the contested decision ordered the Portuguese Republic to recover the aid declared unlawful and incompatible by the contested decision, it being manifestly impossible to recover that aid;

Considering the brief nature of this commentary, we will only address the issue of the order to repay illegal State aid and the argument that a failure to comply with such an obligation constitutes a breach of the structural principle of legal certainty and protection of reasonable expectations - as claimed by the Portuguese Republic.

## 2. The order to repay unlawful state aid

While maintaining its implacable stance on the effects on aid granted unlawfully, the GC reinforces that *'(...) the abolition of unlawful and incompatible aid by means of recovery is the logical consequence of the finding that such aid is incompatible. Indeed, the obligation of the State to abolish aid regarded by the Commission as being incompatible with the common market is designed to re-establish the previously existing situation so that the recipient forfeits the advantage which it had enjoyed over its competitors.'*<sup>5</sup>

This legal solution finds its echo in the meaning of state aid provided for in Article 101(7) of the TFEU, for which reason, CARLA MARCELINO states that *"For the purposes of applying the state aid regime, it is essential to demonstrate that the measure in question causes a negative effect on competition, affecting the regular mechanisms of the functioning of the market."*<sup>6</sup> The recovery of illegally granted state aid is the only way to eliminate these competition-distorting effects, with a view *"to restore the situation which existed before the aid was granted and to guarantee the practical effect (effet utile) of the standstill obligation."*<sup>7</sup>

## 3. Protection of Legitimate Expectations and Legal Certainty

*"The Portuguese Republic claims that recovery of the aid is contrary to the concept of the rule of law."*<sup>8</sup> for breach of the protection of reasonable expectations and legal certainty.

---

<sup>5</sup> Cf. paragraph 194 of the Judgement of 21/09/2022 - Proc. T-95/21, Portugal v. Commission.

<sup>6</sup> Cf. CARLA MARCELINO, *The distortion of competition in state aid*, Scientific Master's Dissertation in Competition Law and Economic Regulation, 2018, available at: [https://repositorio.ul.pt/bitstream/10451/46824/1/ulf\\_d145306\\_tese.pdf](https://repositorio.ul.pt/bitstream/10451/46824/1/ulf_d145306_tese.pdf), p.57

<sup>7</sup> Cf. LUCYNE GHAZARIAN, *Recovery Of State Aid*, *European State Aid Law Quarterly*, Vol. 15, No. 2 (2016), pp. 228-234. In the *Lufthansa AG/FFH* case, the Court of Justice of the European Union stated that, *"To that end, national courts may decide to suspend the implementation of the measure in question and order the recovery of payments already made. They may also decide to order provisional measures in order to safeguard both the interests of the parties concerned and the effectiveness of the Commission's decision to initiate the formal examination procedure."*

<sup>8</sup> See paragraph 192 of the judgment of 21/09/2022 - Case T-95/21 Portugal v Commission

The General Court is right to hold that the argument that the principle of legal certainty and the protection of legitimate expectations have been infringed is unfounded when invoked by the Portuguese Republic, failing which the essential core provisions of Article 108 TFEU would be completely nullified. Since this (legitimate) expectation - as an aspect of legal certainty protected by European law - must be embodied in factual elements that amount to "*precise, unconditional and concordant assurances, but also in accordance with the applicable rules, capable of generating a legitimate expectation in the mind*". It is apparent from the matters of fact relied on that there has been no creation of legitimate expectations in the legal sphere of the Portuguese Republic, inferred, *inter alia*, from the proactive conduct of the European Commission.<sup>9</sup>

A different issue is the legitimate expectation created in the (private) legal sphere of the scheme's beneficiaries. A question arises: Can there be a legitimate expectation in the legal sphere of the ultimate beneficiaries of State aid - even if this is not the case for the Portuguese Republic - that allows an exception in the application of Article 16(1) of Regulation 2015/1589? Otherwise, can we draw from Article 16(1) of Regulation 2015/1589 immediate protection for the ultimate beneficiaries of an unlawful State aid scheme, with *the reservation on the protection of legitimate expectations* being extended to them in an immediately operative manner?

The answer seems to us to be negative. The legitimate expectations that individuals may have if they are relevant can be invoked against the Portuguese Republic and not against the European Commission. In other words, the protection of legitimate expectations is anchored in internal relations (i.e. in the relationship created between the national authorities which granted such benefits and their ultimate recipients and not in external, supranational relations). The idea that "*When aid is implemented without prior notification to the Commission and is therefore unlawful under Article 108(3) TFEU, the beneficiary of the aid cannot, at that moment, entertain a legitimate expectation that the aid was granted lawfully*" can only be seen from the perspective of European Law, and it is up to the various legal systems, when set up their systems of State Liability - a non-harmonised area - to attach importance to the expectation placed by individuals in the lawfulness of the benefits granted.<sup>10</sup>

## 2. Conclusion

Focusing on the possibility that the frustration of legitimate expectations may lead to a factor preventing the obligation to recover unlawfully granted State aid, we conclude with this brief comment, that the protection and frustration of the expectations of private individuals (beneficiaries) in good faith, can hardly be used as an argument in favour of eliminating the useful practical effect of the European Commission's decision. Such a fact is noted by the GC when, "*To admit such a possibility would in fact mean depriving the provisions of Articles 107 and 108 TFEU of any useful effect, in so far as the national*

---

<sup>9</sup> See paragraphs 206-212 of the judgment of 21/09/2022 - Case T-95/21 Portugal v Commission

<sup>10</sup> A legal entity which grants certain State aid may provide specific and unconditional guarantees to individuals to justify the legitimacy of their expectations.

*authorities could thus rely on their own unlawful conduct in order to nullify the effectiveness of the decisions taken by the Commission under those provisions."*<sup>11</sup>

Although the rule of law also protects legal certainty in terms of the principle of the protection of legitimate expectations, this will be intertwined in the relationship between the Member States and, in this case, the European Commission, meaning that the expectations placed in the latter by the beneficiaries will only be justified at the level of internal relations, within the legal-constitutional system (and, in a large majority of Member States, administrative law in the *broad sense*).

In the words of ALEXANDRE MAITROT DE LA MOTTE, "*the recovery procedure can, at the very least, lead to enriching the State. Because European law recognizes few rights for the taxpayers, the financial consequences of the State's infringement of Article 108 TFEU weigh heavily on companies that were supposed to be supported.*"<sup>12</sup> an avalanche of civil liability actions against the State is expected if an appeal against the GC's decision fails.

---

<sup>11</sup> Paragraph 196 of the Judgment of 21/09/2022 - Proc. T-95/21, Portugal v. Commission. The restrictive understanding when to these types of arguments had already appeared in case-law in the judgment of the Court of Justice (Grand Chamber) of 5 March 2019, Proc. No. C-349/17, when it was stated that "*Union law must be interpreted as meaning that the national authority cannot, when it grants aid by misapplying Regulation No 800/2008, engender in the beneficiary of that aid a legitimate expectation that it is lawful.*"

<sup>12</sup> Cf. ALEXANDRE MAITROT DE LA MOTTE, *The Recovery of the Illegal Fiscal State Aids: Tax Less to Tax More*, in *EC Tax Review*, p.75