How to Please Your Sweethearts When You Are Divorcing: The UK Government's Ability to Offer Incentives to Foreign Investors After Brexit

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This article explores the possible routes the UK government may take to continue attracting inward investment once it ceases to be a member of the European Union. In particular, it examines the compatibility of such measures with EU State aid and WTO anti-subsidy rules. By drawing on past experience and current bilateral relationships with third countries the article concludes that, even after "Brexit", the UK will likely be subject to State aid control. In light of the current global trend to combat tax avoidance, the UK may also find itself subject to stringent rules on corporation tax, narrowing its remit for attracting investment through advantageous tax measures.

I. Introduction

Nissan's recently announced intention to further commit to investing in its Sunderland plant in the United Kingdom has given rise to speculation in the media as to the precise nature of the UK government's commitments to the car manufacturer in particular and other foreign investors in general. Prior to the announcement Nissan CEO Carlos Ghosn had allegedly stated that the manufacturer would not invest in the plant unless it received assurances it would be compensated by the government for EU import tariffs arising as a result of a 'hard Brexit'.

It would not be appropriate to comment or pass judgment on the rumoured 'deal' of the UK government with Nissan, not least because the relevant communication remains undisclosed. The European Commission has reportedly asked the UK government to provide more information in relation to the assurances to Nissan, whilst reserving judgment on the compatibility of the government offer with EU law. It should also be borne in mind that other EU Member States, or local entities with the benevolent approval of central authorities, are also actively marketing the benefits of their own countries to companies currently still located in the UK. This applies especially to those Member States encouraging banks and insurance companies in the City of London to move their activities to other financial centres in Europe. Nevertheless, the current events relating to Nissan provide a good reason to discuss the UK's future

ability to offer favourable conditions for inward investments post-Brexit.

II. Possible Incentives for Inward Investments

Possible incentives for foreign investors in the United Kingdom could likely take shape in the following different forms:

1. The UK government seems to have all but ruled out direct compensation to individual companies or industry sectors to cover EU import tariffs. Instead, it appears the UK is seeking to pursue a negotiation strategy in its exit from the EU whereby the outcome would exclude the imposition of tariffs altogether, at least for certain sectors. It has been indicated that the UK would seek to ensure continued access to European markets without tariff barriers or other bureaucratic impediments. Taking the example of the car industry and the fact that it is maintained through an integrated supply chain across Europe, the UK government anticipates it will be relatively straightforward to find common ground and a mutually beneficial outcome with the EU. A possible incentive may

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therefore be a guarantee of a 'sector by sector' UK negotiating approach, or a sector membership of the customs union.

2. Other forms of financial remuneration remain at the disposal of the UK government, specifically in the form of independent funds allocated in competitive procedures. It is envisioned that such funds could be used to invest in workforce skills, infrastructure and R&D in particular. Where such commitments meet the criteria of the EU's General State Aid Block Exemptions¹ they should in principle not be further investigated by the Commission while the UK remains in the EU, and ultimately unlikely to pose any problems 'after the divorce'. However, as further outlined below, the specific provisions of the General Block Exemption Regulation² could significantly hinder such endeavours in the meantime.
3. Politically, the UK government has in recent years signalled a commitment to ensure maintenance of a supply chain made up of local SMEs by 'bringing the suppliers home' in order to stimulate regional development. This seems to reflect a general recent policy trend, and may bear some relation to the upcoming US administration policy to bring manufacturing jobs back into US territory.
4. Finally, the UK government has indicated its support for promoting investment in innovative research relating to e.g. the motor industry, namely electric and self-driving cars, and to remain on the 'leading edge of scientific development'.

While viable, none of these options present an entirely straight-forward route to securing inward investment. Negotiating sector-by-sector access to either the EU single market or the customs union is likely to prove tough, and the political and publicity difficulties of extending preferential treatment to one manufacturer or one industry over another cannot be underestimated. Similarly, any financial advantages bestowed on corporate beneficiaries are likely to increase the burden on public funds and the tax payer.

There are significant concerns regarding arrangements with individual companies from a legal perspective, too. As outlined below, these concerns will persist regardless of whether or not the UK is a member of the EU, the EEA or simply the WTO.

III. State Aid Concerns and Implications

The compatibility of any measures aimed at directly or indirectly compensating companies established in the UK for barriers to trade arising from Brexit or of investment incentives to such companies in general must be measured against EU State aid law, as well as EU and WTO anti-subsidy rules after Brexit.

Under EU State aid rules, an assessment of an assurance given by the UK government to an investor will likely take account of the following: first, it will consider whether the UK government's assurance is merely a non-binding declaration of future intent or whether it actually constitutes a commitment to use public funds.

Second, the Commission will explore whether the promised measures would be permitted or not under the EU General Block Exemption Regulation. This may apply in particular to aid measures aimed at fostering investment in workers' skills, basic infrastructure and R&D. However, there are certain provisions in the Regulation which preclude even these measures from beneficial treatment. The Regulation only covers aid with an "*incentive effect*" which is only given where the beneficiary submits an application for aid before the relevant project or activity has even begun.³ Where manufacturers have already put in place projects such as workers' skills programmes without having applied for aid, accessing it now may become difficult.

Finally, where an arrangement amounts to compensation comparable to an export subsidy, this will clearly fall outside any Block Exemption, and would constitute State aid under both EU rules and a subsidy under WTO rules which could be met by countervailing measures. It should be noted that the UK government has assured that no arrangement of this nature has been made

According to the EU's current negotiating stance, it is impossible to imagine UK manufacturers maintaining access to the single market without government commitments to EU State aid discipline. This may, of course, ultimately depend on the balance of

1 European Commission, Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, OJ 2014 L 187/1 (General Block Exemption Regulation).

2 Ibid.

3 General Block Exemption Regulation (n 1), Article 6.

mutual concessions, in particular on the actual extent of market access effectively granted to the UK. The EU's past policy has not always been consistent in this regard.

For example, the Agreement on the European Economic Area (EEA) with the EFTA States Iceland, Liechtenstein and Norway contains a comprehensive State aid prohibition,⁴ as does the EU's Association Agreement with the Ukraine.⁵ The EU's Association Agreement with Israel deems public aid that may affect trade between the EU and Israel incompatible, and also provides for increased transparency by the contracting parties in the area of public aid.⁶ Agreements with other non-EU countries contain more or less fleeting references to a State aid prohibition, such as the Ankara Agreement with Turkey.⁷ In the case of Switzerland, the EU has imposed the State aid prohibition in the Free Trade Agreement of 1972⁸ and the Air Transport Agreement of 1999.⁹ Amongst other things, it makes any further integration in terms of trade with Switzerland conditional Switzerland's acceptance of State aid control.

The idea that the EU continues to assess the UK's subsidies post-Brexit in strict accordance with EU State aid rules may appear an improper extraterritorial assertion of EU law. However, the EU has had no qualms about persistently enforcing its State aid rules beyond EU Member States. In this context, it is interesting to consider what may be described as 'reverse' precedent relating to Austria's accession talks and State aid granted to Chrysler and Steyr-Daimler-Puch in the early 1990s. The Commission considered the aid intensity to be excessive (33% of the investment cost) for the region of Graz and attempted to convince the Austrian authorities to reduce the level of aid granted at a time when Austria was about to become an EU member. In 1992, the Commission effectively threatened Austria with the reintroduction of a 10% customs duty on importing multi-purpose vehicles, allegedly in accordance with the 1972 Free Trade Agreement. A compromise was finally struck to reduce the aid intensity by more than half and to repay any previous excess aid.¹⁰

Drawing on this experience, it would appear that the UK would only be able to avoid bilateral commitments to State aid control in a 'Full Divorce' scenario without any access to the single market. Even then, the UK would still be subject to the WTO Agreement on Subsidies and Countervailing Measures.¹¹ Should a member, pursuant to a WTO investigation and re-

port, continue to implement illegal subsidies, other members are allowed to introduce countervailing measures. A recent example of a WTO investigation concluding the violation of subsidy rules by way of tax cuts is the WTO panel's decision on Washington State's reduced business tax rate for Boeing, pursuant to a challenge filed by the EU in 2014.

Aside from direct compensation for tariffs or direct State aid for the purposes of stimulating investment, the UK government may also consider more discreet, indirect methods, such as adapting its taxation practice in order to achieve a favourable financial outcome, either for a company specifically or for an industry as a whole. The EU Code of Conduct on Business Taxation,¹² and further EU legislative acts on corporate taxation restrict the UK's room of manoeuvre in that regard, at least while the UK is still an EU member. Specifically, the Code of Conduct contains political commitments not to maintain rules for profit determination of a multinational group of companies that depart from internationally accepted principles, notably those of the OECD, and to ensure transparency regarding tax measures, in particular not to relax legal provisions at administrative level in a non-transparent way. The Commission's decisional practice has increasingly taken account of such principles in determining whether a reduction in tax liabilities constitutes illegal State aid, even though the Code of Conduct is not part of the State aid rules. Furthermore, the EU institutions have been very per-

4 Agreement on the European Economic Area, OJ 1994 L 1/3, Articles 61 – 64.

5 Association Agreement between the European Union and its Member States, of the one part, and Ukraine of the other part, OJ 2014 L 161/3, Articles 262 – 267.

6 Euro-Mediterranean Agreement establishing an association between the European Communities and their Member States, on the one part, and the State of Israel, of the other part, OJ 2000 L 147/3, Articles 36(1)(iii) and (3).

7 Decision No 1/95 of the EC-Turkey Association Council of 22 December 1995 on implementing the final phase of the Customs Union, OJ 1996 L 035/1, Article 33(3).

8 Agreement between the European Economic Community and the Swiss Confederation, OJ 1972 L 300/189.

9 Agreement between the European Community and the Swiss Confederation on Air Transport, OJ 2002 L 114/73.

10 See European Commission, Press Release IP/93/200, <http://europa.eu/rapid/press-release_IP-93-200_de.htm>, Last accessed on 29 November 2016.

11 World Trade Organisation, Agreement on Subsidies and Countervailing Measures, Article 3.

12 Code of Conduct for Business Taxation, Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy, 98/C 2/01.

sistent in their attempts to impose the Code's disciplines on non-EU countries.

The nature of financial advantages granted by the UK to certain undertakings in targeted industries could tap right into the controversy surrounding the Commission's recent 'tax rulings' cases concerning transfer pricing arrangements in corporate taxation. The Commission has increasingly deemed prior administrative tax rulings by national tax authorities to be an infringement of EU State aid laws where, through selective treatment, they enable the addressee's tax liability to be lowered as compared to companies in a similar factual and legal situation. The Commission's recently published Notice on the notion of State aid provides more detail on the authority's take on State aid through reduced tax liability as a result of transfer pricing arrangements. According to the Notice, this analysis is carried out with reference to the OECD's 'arm's length principle', meaning that transfer pricing arrangements between companies in the same corporate group should not differ from the arrangements made by a prudent independent operator acting under normal market conditions. Somewhat controversially, the Commission goes on to state that the arm's length principle is inherent to Article 107(1) TFEU, "*independently of whether a Member State has incorporated this principle into its national legal system and in what form*".¹³

Whilst this is in principle an internal debate to the EU, the Commission is clearly minded to push through its point of view in non-EU countries. The

case of Switzerland illustrates this point well. Following a tense dispute relating to certain Swiss corporation tax measures, the EU and Switzerland recently struck a mutual understanding.¹⁴ Although non-binding, the understanding sets out certain principles and mutual objectives. In particular, Switzerland confirmed its objective to reform its corporation tax system in such a way as to prevent different, or preferential fiscal treatment of domestic over foreign income ("ring-fencing"). Set out according to OECD principles, the reformed legislative package is currently pending popular approval by referendum, and is being closely monitored by the EU.

In any event, given that the Commission is, in part, drawing on and interpreting OECD rules on transfer pricing¹⁵ which "*capture the international consensus on transfer pricing*"¹⁶ the UK government may nonetheless have to consider the impact these rules could have on its discretion to come to specific arrangements with certain companies. In particular, the above-mentioned 'arm's length principle' in Article 9 of the OECD Model Tax Convention would continue to apply.

In addition the EU is keen to crack down on corporate tax avoidance. Given the wide territorial scope of measures such as the Council's Anti-Tax Avoidance Directive, the UK subsidiaries and permanent establishments of multi-national groups are unlikely to escape scrutiny entirely.

IV. Conclusion

In conclusion, the UK's policies for attracting and preserving inward investment will likely be subject to continuing close scrutiny by the EU, even after it ceases to be a member. The EU and the UK would do well to remember that the implications are more far-reaching than a mere bilateral affair and due to the potential for precedent, other countries are likely to keep a close eye on how the cake is cut.

13 European Commission, Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, OJ 2016 C 262/1, para. 172.

14 EU-Switzerland Joint Statement on company tax issues and on the way forward, 14 October 2014.

15 See OECD, *Aligning Transfer Pricing Outcome with Value Creation, Actions 8-10 – 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project* (OECD Publishing 2015).

16 *Notice on the notion of State aid* (n 13), [173].