U.K. Delay in Renewing State Aid Waiver Possible Elsewhere in EU

by William Hoke

The U.K.'s belated announcement that EU state aid approval for an important employee benefit scheme would expire within days blindsided taxpayers and should serve as a cautionary tale for taxpayers and governments alike, practitioners say.

The U.K.'s enterprise management incentive (EMI) scheme, as originally approved by the European Commission in 2009, allowed small and medium-size companies to offer their employees options to acquire shares worth up to £120,000 at a predetermined price. If the value of the shares increases, employees can purchase them at the lower pre-agreed price. Under the EMI, employees don't have to pay income tax and National Insurance contributions on the gain, and their employers are exempt from making National Insurance contributions on the profit.

In its original approval, the commission blessed the scheme for EMI share options exercised through April 6, 2018. Two days before that expiration date, the U.K. government issued a notice saying the approval was about to lapse. "The government has, since last year, been following the process of applying to the European Commission for fresh approval and we await the commission's final response," the government said. "We won't receive this before 6 April 2018 and so those involved in the establishment of EMI schemes and [the] grant of EMI share options need to be aware that there will be a period between the lapse of the existing approval on 6 April and a decision by the EU Commission on a fresh approval. The government is working hard to ensure this period is as short as possible."

The government said any EMI share options issued from April 7 until the U.K. receives the commission's approval might not be eligible for the tax advantages previously available.

Karen Cooper, an employee benefits lawyer with Cooper Cavendish in the U.K., said that in requesting the original approval for the EMI measure, the U.K. informed the commission of the scheme in 2007 and only received approval in July 2009, after it supplied additional information that was requested in March 2009. "This hopefully illustrates the speed at which these things move," she said.

Cooper said taxpayers and practitioners have had "little or no visibility" on the government's attempt to secure reapproval for the scheme. "Given the confirmation that they started the process last year, I do not think it's a case of dropping the ball as such, but in view of the previous experience, it might have been prudent to start the process earlier," she said. "That said, as EMI has been granted approval in the past, it might be assumed that the process for reapproval is more straightforward and quicker to secure."

While the U.K. said that it "has, since last year, been following the process of applying for fresh approval," a commission spokeswoman told Tax Analysts that a formal request was made only last month. "The commission received a notification from the U.K. on this matter on March 20, 2018," she said. "We are working with the U.K. authorities in order to be able to take a decision as swiftly as possible in line with EU rules."

'Genuine Shock'

Cooper said the government should have informed taxpayers and advisers much sooner. "Effectively, there was two days' notice when the bulletin was published, which was insufficient for businesses in the process of making EMI grants to take action before the approval lapsed," she said. "I think there was a genuine shock and, given the lack of visibility on the government's approval process, it was something people did not see coming."

Philipp Werner, a state aid lawyer with Jones Day in Brussels, said an EU member state doesn't have an obligation under European law to tell beneficiaries of a scheme previously approved by the commission that the approval is about to lapse. "Normally, the legislation applies for the same period of time as the approval," he said. "As a matter of European law, companies are supposed to know the termination date."

Annabelle Lepièce, a state aid lawyer with CMS DeBacker, said member states occasionally wait until the last minute to request reapproval. "In a case I was involved in, the scheme [was] merely suspended for the time necessary to obtain the commission's approval, which took in that case around six months," she said. "Therefore, the undertakings concerned were not prejudiced, apart from a slight delay to obtain the public funds."

The failure to seek timely renewal of a state aid scheme sometimes occurs when there is a change in a member state's government or administration, Lepièce said. "But that is happening less and less due to state aid registers and annual state aid reports from the states to the commission that highlight the duration of the approved schemes," she said.

Werner said that if a member state wants to extend an existing scheme that is about to expire, it will have to provide a new notification and advise the commission whether the scheme has been modified. "The notification [for reapproval] will be reviewed the same way as the original," he said. "It normally takes two months, but can be extended by common agreement if questions come up. If it is more complicated, that might lead to a so called in-depth investigation that could take 18 months or so. Expecting the commission to clear things up in four weeks is very fast."

Cooper said that while she doesn't expect reapproval to be perfunctory, she would be surprised if the request were denied. "There have been some minor amendments to the legislation, but nothing which would change the key features of the scheme, and our domestic legislation for EMI tax breaks remains in force," she said. "The only possible widening of the scheme was a change made in 2014 to allow companies which are controlled by employee trusts to qualify. However, I would not see this as hugely significant."

Lepièce said it would be unusual for the commission not to respond promptly to a request to renew a state aid ruling for a scheme that had been previously approved. "Such extension or renewal of existing aids is usually a formality, unless there has been a change of European policy/guidelines, etc.," she said. "Nevertheless, it also depends on the timing and the quality of the notification of the member state concerned."

Lepièce said the commission's original approval of the EMI scheme was based on the Treaty on the Functioning of the European Union, and not on the general block exemption regulation, commission guidelines, or communications establishing the conditions for approval of state aid. "It is therefore not a common case based on general state aid guidelines," she said. "The commission has thus total freedom to adapt its former position and it can either refuse the renewal or impose modifications to the scheme it had adopted."

Retroactive Approval

While reapproval is expected, the issue of whether it will be retroactive is not quite as clear. Lepièce said that, in some cases, schemes for which state aid approval has lapsed are not suspended by member states, which she said is an infringement of European law. "Therefore, the aids are illegal but [are] declared compatible afterwards," she said. "The commission [will say it] regrets the lack of respect of the obligation of suspension, but it does not affect its position on the compatibility. I suppose the [British] government was maybe hoping the approval of the commission would have occurred prior to the end of the duration of the initial scheme."

Cooper said the commission's original approval of the scheme, which was implemented in 2000, was also done retroactively. "Interestingly, it did not specifically back-date approval to . . . 2000, but rather 'looked forward' to 2018," she said in an email. "Whether they will be willing to give retroactive approval to 6 April 2018 remains to be seen."

Werner said the issue of retroactivity could depend on how the request for approval is worded. "If the notification says, 'We want to do this as of April 7,' and the approval comes back after that date approving the notification that was submitted, then you can apply it retroactively because that's what was approved," Werner said.

While there have been comments that the U.K.'s expected departure from the EU could have contributed to possible confusion over applying for an extension of the state aid approval, Werner said London has been taking steps that anticipate the country remaining subject to EU state aid law, post-Brexit. He said the British government has indicated that it will hand over the power for enforcing those state aid rules to the U.K. Competition and Markets Authority, which recently appointed a senior director and a project director of state aid.

Cooper said the U.K. government is under significant pressure to secure commission approval as soon as possible. "Given the challenging political situation we are in with Europe currently, we cannot expect any favors in terms of a response," she said. "It is hard to gauge whether the situation is indicative of the general strain in relations between the U.K. and Europe at present." ■