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COMMISSION DECISION

of 4.7.2016

**ON THE MEASURE
SA.41187 (2015/C) (ex 2015/NN)
implemented by Hungary
on the Health contribution of tobacco industry businesses**

(Text with EEA relevance)

(Only the Hungarian version is authentic)

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PUBLIC VERSION

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above¹ and having regard to their comments,

Whereas:

1. PROCEDURE

- (1) In March 2015, the Commission became aware of a new health contribution imposed by Hungary on tobacco industry businesses. By letter of 13 April 2015, the Commission sent an information request to Hungary on that measure, by which it also informed the Hungarian authorities that it would consider issuing a suspension injunction decision in accordance with Article 11(1) of Regulation (EC) No 659/1999².

¹ OJ C 277, 21.08.2015, p. 24

² Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 108 of the treaty on the functioning of the European Union (OJ L 083, 27.3.1999, p.1).

- (2) By letter of 12 May 2015, Hungary responded to that information request. Hungary did not, however, provide any comments on the possibility of the Commission issuing a suspension injunction.
- (3) On 15 July 2015, the Commission informed Hungary that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union (hereinafter: 'the Treaty') in respect of the health contribution imposed on tobacco industry businesses (the "Opening Decision"). The Commission also ordered the immediate suspension of the measure in the Opening Decision.
- (4) The Opening Decision was published in the *Official Journal of the European Union*³. By that decision, the Commission invited interested parties to submit their comments on the measure.
- (5) The Commission received comments from two interested parties. On 20 October 2015, the Commission forwarded those comments to Hungary, which was given the opportunity to react. Hungary did not react to those comments.

2. DETAILED DESCRIPTION OF THE MEASURE

- (6) On 16 December 2014, the Hungarian Parliament adopted Act XCIV of 2014 on the health contribution for the year 2015 of tobacco industry businesses ("the Act"). The Act imposes a tax, referred to as a "health contribution", which is levied on the annual turnover derived from the production and trade of tobacco products in Hungary and applies in addition to existing business taxes in Hungary, in particular, corporate income tax. The tax is levied on authorised warehouse keepers, importers, and registered traders of tobacco products. The stated purpose of the Act is to collect funds for the financing of the health system to increase the quality of health services.
- (7) The health contribution tax is due on the annual turnover generated in the year previous to the tax year derived from the production and trade of tobacco products in Hungary, on the condition that the turnover from these activities accounts for at least 50% of the total annual turnover generated by the undertaking. No deduction of costs is provided, apart from the cost of certain investments in the tax year. The health contribution tax is progressive in nature. The applicable contribution depends on the annual turnover of the taxpayer as follows:
 - For the part of the turnover below HUF 30 billion: 0.2% with a minimum of HUF 30 million
 - For the part of the turnover between HUF 30 billion and 60 billion: 2.5%
 - For the part of the turnover exceeding HUF 60 billion: 4.5%
- (8) Pursuant to Section 6(6) of the Act, the tax liability resulting from the health contribution tax can be reduced by up to 80% of the payable contribution if the company makes investments that comply with the definition set out in point (7) of Article 3(4) of the Act C of 2000 on Accounting⁴. The reduction is equal to the

³ Cf. footnote 1

⁴ In accordance with this Act, 'investment' shall include the purchase or creation of tangible assets, the production of tangible assets by one's own enterprise, the activity carried out in order to install or use the tangible asset purchased for its intended purpose until its installation or first normal use (transportation, customs clearance, intermediary activity, laying the foundations, installation and any activity related to the purchase of the tangible asset, including design, preparation, arrangement,

positive difference between 30% of the amount accounted for as an investment in the tax year and the amount of State or EU subsidy used for the implementation of the investment project.

- (9) The Act provides that a tax declaration has to be submitted by 30 June 2015 and that the health contribution tax has to be paid in 30 days following this deadline.
- (10) The Act entered into force on 1 February 2015 and, in its initial version, was supposed to apply on a temporary basis until 31 December 2015. On 24 June 2015, an amendment to the Act was published in the Hungarian Official Journal, which made the health contribution tax permanent.

3. THE FORMAL INVESTIGATION PROCEDURE

3.1. Grounds for initiating the formal investigation procedure

- (11) The Commission opened the formal investigation procedure because it reached the preliminary conclusion that the progressive structure of the health contribution (rates and turnover brackets) and the provisions on the reduction of the tax liability on the condition of making certain investments (hereafter collectively referred to as: “the contested measures”) constituted unlawful and incompatible State aid.
- (12) The Commission was of the opinion that the progressive tax rates laid down by the Act differentiate between undertakings based on their turnover and grant a selective advantage to undertakings with low turnover and thus smaller undertakings. The Commission was not convinced that undertakings with more significant turnover are able to influence the product market and generate higher negative smoking-related effects on health to such a degree that would justify the application of the progressive tax rates, as the Hungarian authorities had argued.
- (13) The Commission was equally of the opinion that the possibility to reduce a taxpayer’s tax liability on the condition of making investments grants a selective advantage to undertakings which have made such investments. The Commission further observed that the possibility to reduce the tax liability in the case of investment, which aims at increasing the production and trading capacity of the undertaking, appeared to be inconsistent with the stated objective of the health contribution tax, which is to create funds for the health system and increase the quality of health services given the fact that smoking plays a prominent role in the development of numerous diseases and significantly contributes to increased health expenses.
- (14) The Commission therefore reached the preliminary conclusion that the contested measures appeared to be neither justified by the nature or general scheme of the tax system nor compatible with the internal market.

3.2. Comments from interested parties

- (15) The Commission received comments from two interested parties who welcomed the Opening Decision and agreed with the Commission’s preliminary State aid assessment. They expressed their concerns about possible amendments to the Act and any other similar measures that might be adopted by the Hungarian authorities.

borrowing and insurance); investments shall also include activities resulting in the upgrading of an existing tangible asset, the change its purpose, its conversion or directly increasing its useful life or capacity, together with the other activities listed above and related to such activity.

- (16) One of the interested parties underlined that the reduction of the tax liability in case of certain investments would apply exclusively to investments in Hungary, since, according to Hungarian excise tax regulations, it is necessary for a company to be incorporated and have a seat of management in Hungary for that company to be licenced to sell or manufacture tobacco in Hungary. Therefore, the investments taken into account for the purposes of the Act are the investments made in Hungary either by domestically-owned Hungarian companies or by Hungarian resident subsidiaries of foreign multinationals.

3.3. Position of the Hungarian authorities

- (17) The Hungarian authorities do not agree with the findings of the Commission that the contested measures constitute State aid. In essence, they argue that the measures are not selective. Regarding the progressivity of the tax rates, the Hungarian authorities maintain that in the case of public burdens, the reference framework is specified by the tax base and the tax rate (including a system of progressive tax rates) jointly and that companies in the same factual situation are the ones whose turnover is the same. In this sense, under the progressive system of rates, applying tax brackets, the entities with the same projection tax base are subject to the same rate and the calculated amount of the tax is also identical. Therefore, in the view of the Hungarian authorities, the progressive system of tax rates does not create differentiation because companies in the same legal and factual situation are subject to the same tax rate, and thus is not selective.
- (18) Regarding the reduction of the tax liability in the case of investment, the Hungarian authorities argue that the Act does not distinguish according to the type or the value of the investment and no distinction is made between the operators carrying out an investment. The businesses implementing the same investment value are in the same legal and factual situation. They stress that the reduction does not apply exclusively to investments that are carried out in Hungary and that the value of all investments may be taken into consideration for the calculation. The Hungarian authorities further note that the calculation of the investment value is subject to the definition of investment and the calculation of the value of investment under the Accounting Act which is beyond the scope of the Act on the health contribution of tobacco industry businesses.

3.4. Comments from Hungary on interested parties' comments

- (19) Hungary did not react to the comments from the interested parties, which were forwarded to it by letter of 20 October 2015.

4. ASSESSMENT OF THE AID

4.1. Presence of State aid within the meaning of Article 107(1) TFEU

- (20) According to Article 107(1) of the Treaty, *"save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market"*.
- (21) The qualification of a measure as aid within the meaning of this provision therefore requires the following cumulative conditions to be met: (i) the measure must be imputable to the State and financed through State resources; (ii) it must confer an advantage to its recipient; (iii) that advantage must be selective; and (iv) the measure

must distort or threaten to distort competition and affect trade between Member States.

4.1.1. *State resources and imputability to the State*

- (22) To constitute State aid, a measure must be financed through State resources and be imputable to a Member State.
- (23) Since the contested measures result from an Act of the Hungarian Parliament, it is clearly imputable to the Hungarian State.
- (24) As regards the measure's financing through State resources, where the result of a measure is that the State forgoes revenues which it would otherwise have to collect from an undertaking in normal circumstances, that condition is also fulfilled.⁵ In the present case, the Hungarian State waives resources it would otherwise have to collect from undertakings with a lower level of turnover (and thus smaller undertakings), if they had been subject to the same health contribution as undertakings with a higher level of turnover (and thus larger undertakings).

4.1.2. *Advantage*

- (25) According to the case-law of the Union Courts, the notion of aid embraces not only positive benefits, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking⁶. An advantage may be granted through different types of reduction in a company's tax burden and, in particular, through a reduction in the applicable tax rate, taxable base or in the amount of the tax due⁷. Although a tax reduction measure does not involve a positive transfer of resources from the State, it gives rise to an advantage by virtue of the fact that it places the undertakings to which it applies in a more favourable financial position than other taxpayers and results in a loss of income to the State⁸.
- (26) The Act lays down progressive rates of taxation that apply to the annual turnover derived from the production and trade of tobacco products in Hungary depending on the brackets into which an undertaking's turnover falls. The progressive character of those rates has the effect that the percentage of tax levied on an undertaking's turnover increases progressively depending on the number of brackets within which that turnover falls. This has the result that undertakings with low turnover (smaller undertakings) are taxed at a substantially lower average rate than undertakings with high turnover (larger undertakings). Being taxed at this substantially lower average tax rate mitigates the charges that undertakings with low turnover have to bear as compared to undertakings with high turnover and therefore constitutes an advantage

⁵ Case C-83/98 P *France v Ladbroke Racing Ltd and Commission* EU:C:2000:248 and EU:C:1999:577, paragraphs 48 to 51. Likewise, a measure allowing certain undertakings a tax reduction or to postpone payments of tax normally due can amount to State aid, see Joined Cases C-78/08 to C-80/08 *Paint Graphos and Others*, paragraph 46.

⁶ Case C-143/99 *Adria-Wien Pipeline*, EU: C: 2001:598, paragraph 38.

⁷ See Case C-66/02, *Italy v Commission*, EU: C: 2005:768, paragraph 78; Case C-222/04, *Cassa di Risparmio di Firenze and Others*, EU: C: 2006:8, paragraph 132; Case C-522/13, *Ministerio de Defensa and Navantia*, EU: C: 2014:2262, paragraphs 21 to 31. See also point 9 of the Commission notice on the application of the State aid rules to measures relating to direct business taxation OJ C 384, of 10.12.98, p. 3.

⁸ Joined Cases C-393/04 and C-41/05, *Air, Air Liquide Industries Belgium* EU: C: 2006:403 and EU: C: 2006:216, paragraph 30 and Case C-387/92 *Banco Exterior de España* EU: C: 1994:100,, paragraph 14.

to the benefit of smaller undertakings over larger undertakings for the purposes of Article 107(1) of the Treaty.

- (27) Similarly, the possibility to reduce an undertaking's tax liability under the Act by up to 80% in the case of investments carried out in the tax year constitutes an advantage for undertakings that have made such investments, since it reduces their tax base and thus their tax burden as compared to undertakings that cannot benefit from that reduction.

4.1.3. Selectivity

- (28) A measure is selective if it favours certain undertakings or the production of certain goods within the meaning of Article 107(1) of the Treaty. For fiscal schemes the Court of Justice has established that the selectivity of the measure should in principle be assessed by means of a three-step analysis.⁹ First, the common or normal tax regime applicable in the Member State is identified: "the reference system". Second, it should be determined whether a given measure constitutes a derogation from that system insofar as it differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. If the measure in question does not constitute a derogation from the reference system, it is not selective. If it does (and therefore is *prima facie* selective), it must be established, in the third step of the analysis, whether the derogatory measure is justified by the nature or the general scheme of the reference tax system¹⁰. If a *prima facie* selective measure is justified by the nature or the general scheme of the system, it will not be considered selective and it will thus fall outside the scope of Article 107(1) of the Treaty.

4.1.3.1. System of reference

- (29) In the present case, the reference system is the application of a special health contribution on undertakings in respect of the turnover they derive from the production and trade of tobacco products in Hungary. The Commission does not consider that the progressive rate structure of the health contribution can form a part of that reference system.
- (30) As the Court of Justice has specified¹¹, it is not always sufficient to confine the selectivity analysis to whether a measure derogates from the reference system as defined by the Member State. It is also necessary to evaluate whether the boundaries of that system have been designed by the Member State in a consistent manner or, conversely, in a clearly arbitrary or biased way, so as to favour certain undertakings over others. Otherwise, instead of laying down general rules applying to all undertakings from which a derogation is made for certain undertakings, the Member State could achieve the same result, side stepping the State aid rules, by adjusting and combining its rules in such a way that their very application results in a different

⁹ See, for example, Case C-279/08 P *Commission v Netherlands (NOx)* EU:C:2011:551; Case C-143/99 *Adria-Wien Pipeline* EU: C: 2001:598, Joined Cases C-78/08 to C-80/08, *Paint Graphos and others* EU:C:2011:550 and EU:C:2010:411, Case C-308/01 *GIL Insurance* EU:C:2004:252 and EU:C:2003:481.

¹⁰ Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384, 10.12.1998, p. 3–9

¹¹ Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* EU:C:2011:732.

burden for different undertakings.¹² It is particularly important to recall in that respect that the Court of Justice has consistently held that Article 107(1) of the Treaty does not distinguish between measures of State intervention by reference to their causes or their aims, but defines them in relation to their effects, and thus independently of the techniques used.¹³

- (31) Whereas the application of a flat tax levied on the annual turnover derived from the production and trade of tobacco products in Hungary is an appropriate means to collect funds for the financing of the health system, the progressive tax structure introduced by the Act appears deliberately designed by Hungary to favour certain undertakings over others. Under the progressive tax structure introduced under the Act, the undertakings subject to the tax are subject to different tax rates progressively increasing towards 4,5%, depending on the brackets into which their turnover falls. Consequently, a different average tax rate applies to undertakings subject to the health contribution depending on the level of their turnover (whether it surpasses the thresholds laid down by the Act).
- (32) Because each company is taxed at a different rate, it is not possible for the Commission to identify one single reference rate in the health contribution. Hungary also did not present any specific rate as the reference rate or “normal” rate and also did not explain why a higher rate would be justified by exceptional circumstances for undertakings with a high level of turnover, nor why lower rates should apply to undertakings with lower levels of turnover.
- (33) The effect of the progressive rate structure introduced by the Act is therefore that different undertakings pay different levels of taxation (expressed as a proportion of their overall annual turnover) depending on their size, since the amount of turnover achieved by an undertaking correlates to a certain extent with the size of that undertaking. However, the stated objective of the health contribution is to collect funds for the health care system and increase the quality of health services in Hungary in light of the fact that smoking plays a prominent role in the development of numerous diseases and significantly contributes to increased health expenses. The Commission considers that the progressive rate structure of the health contribution does not mirror the relationship between the generation of negative effects on health by the traders and producers of tobacco products and their turnover.
- (34) In light of that objective, the Commission considers all operators subject to the health contribution to be in a comparable legal and factual situation, regardless of their level of turnover, and Hungary has advanced no convincing justification to discriminate between those types of undertakings when it comes to levying the health contribution. The Commission refers, in this regard, to recitals 42 to 48 below Hungary has therefore deliberately designed the health contribution in such a manner so as to arbitrarily favour certain undertakings, namely those with a lower level of turnover (and thus smaller undertakings), and disadvantage others, namely larger undertakings.¹⁴

¹² Ibid, paragraph 92.

¹³ Case C-487/06 P *British Aggregates v Commission* EU:C:2008:757, paragraphs 85 and 89 and the case-law cited, and Case C-279/08 P *Commission v Netherlands (NOx)* EU:C:2011:551, paragraph 51

¹⁴ Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* EU:C:2011:732. See also, by way of analogy, Case C-385/12 *Hervis Sport- és Divatkereskedelmi Kft.* EU:C:2014:47, by which the Court of Justice held: “Articles 49 TFEU and 54 TFEU must be interpreted as precluding legislation of a Member State relating to tax on the turnover of store retail trade

- (35) The reference system is therefore selective by design in a way that is not justified in light of the objective of the health contribution, which is to collect funds for the Hungarian health system. Consequently, the appropriate reference system in the present case is the imposition of a health contribution on undertakings operating in Hungary based on their turnover, without the progressive rate structure being a part of that system.

4.1.3.2. Derogation from the system of reference

- (36) As a second step, it is necessary to determine whether the measure derogates from reference system in favour of certain undertakings which are in a similar factual and legal situation in light of the intrinsic objective of the system of reference
- (37) As explained in recital (31), the intrinsic objective of the health contribution tax is to fund the health care system and increase the quality of health care services in Hungary. As further explained in recital (34), all operators involved in the production and trade of tobacco products should be considered to be in a comparable legal and factual situation in light of that objective, regardless of their size and the level of their turnover.
- (38) The progressivity of the health contribution rate structure therefore creates a differentiation amongst undertakings carrying out the activity of production and trade of tobacco products in Hungary based on their size.
- (39) Indeed, due to the progressive character of the rates laid down by the Act, undertakings with turnover falling in lower brackets are subject to substantially lower taxation than undertakings with turnover falling in higher brackets. This has the result that undertakings with low turnover are subject to both substantially lower marginal tax rates and substantially lower average tax rates as compared to undertakings with high levels of turnover, and therefore to substantially lower taxation for the same activities. Hence, the Commission considers that the progressive rate structure introduced by the Act derogates from the reference system consisting of the imposition of a health contribution on all operators involved in the production and trade of tobacco products in Hungary in favour of undertakings with lower turnover.
- (40) Similarly, the possibility to reduce an undertaking's tax liability under the Act by up to 80 % in the case of investment differentiates between undertakings that have made investments and undertakings that have not made investments. However, in light of the intrinsic objective of the health contribution tax identified above, undertakings that have made investments and undertakings that have not made investments are in a comparable factual and legal situation, since the fact that an undertaking makes investments does nothing to reduce the negative externalities caused by smoking. Quite the contrary, the possibility to reduce an undertaking's tax liability in the case of investments, which aims at increasing the production and trading capacity of the undertaking, appears to be inconsistent with the intrinsic objective of the health contribution tax. Therefore, the Commission considers that the provisions of the Act

which obliges taxable legal persons constituting, within a group, 'linked undertakings' within the meaning of that legislation, to aggregate their turnover for the purpose of the application of a steeply progressive rate, and then to divide the resulting amount of tax among them in proportion to their actual turnover, if – and it is for the referring court to determine whether this is the case – the taxable persons covered by the highest band of the special tax are 'linked', in the majority of cases, to companies which have their registered office in another Member State."

providing for the reduction of the tax liability in the case of investment differentiate between undertakings that are in a comparable factual and legal situation in light of the intrinsic objective of the health contribution and thus creates a derogation from the system of reference.

- (41) Therefore, the Commission considers that the measures are *prima facie* selective.

4.1.3.3. Justification

- (42) A measure which derogates from the reference system is not selective if it is justified by the nature or general scheme of that system. This is the case where it is the result of inherent mechanisms necessary for the functioning and effectiveness of the system¹⁵. It is for the Member State to provide such justification. For this purpose, external policy objectives – such as regional, environmental or industrial policy objectives – cannot be relied upon by the Member States to justify the differentiated treatment of undertakings under a certain regime.
- (43) The Hungarian authorities have argued that the health contribution is due on the manufacturing and trade of products causing health risk and is not linked to the profit of the economic operators, whereas the tax rate is adjusted to the load-bearing capacity of the taxable entities. In the view of the Hungarian authorities, the ability to pay and the degree of the risk generated by the undertakings are reflected by their market share and market leadership and, consequently, their price-orienting role rather than by their profitability. Profit, as the basis of the contribution, is the least suitable factor for the expression of the damage to health generated by the subjects of the contribution through their activity. Furthermore, in comparison with undertakings with low turnover, undertakings with more significant turnover and market share are much more able to influence the market of a product than the difference between their levels of turnover. Therefore, considering the objective of the contribution, this will also entail that an economic operator obtaining a higher turnover on the market of tobacco products will also generate exponentially higher negative smoking-related effects on health.
- (44) In the present case, given the substantial relative increments of the progressive tax rate, the Commission does not consider that ability to pay can serve as a guiding principle for turnover-based taxation. As opposed to taxes based on profit¹⁶, a turnover-based tax does not take into account costs incurred in the generation of that turnover. Therefore, in the absence of specific evidence to the contrary, it appears doubtful that the mere amount of turnover generated as such – irrespective of the costs incurred – reflects the ability to pay of the undertaking. Furthermore, the Commission is not convinced that, in comparison with undertakings with lower turnover, undertakings with more significant turnover are able to influence the product market and automatically generate higher negative smoking-related effects to such a degree that would justify the application of progressive tax rates in respect of turnover as adopted under the Act.

¹⁵ See for example Joined Cases C-78/08 to C-80/08 *Paint Graphos and others* EU:C:2011:550 and EU:C:2010:411, paragraph 69.

¹⁶ See Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384, 10.12.1998, para. 24. The statement on the redistributive purpose that can justify a progressive tax rate is explicitly only made as regards taxes on profits or (net) income, not as regards taxes on turnover.

- (45) In any event, the Commission considers that even if ability to pay and the negative effects on health might be considered to be inherent principles of the turnover-based health contribution, it would only justify a linear tax rate, unless it is shown that ability to pay and the generation of negative effects on health increase progressively with an increase of the turnover. The Commission considers that progressive rates for taxes on turnover can only be justified if the specific objective pursued by a tax indeed requires progressive rates i.e. for example, if it is shown that the externalities created by an activity that the tax is supposed to tackle also increase progressively. The pattern of the progressivity would also need to be justified. In particular, it would need to be explained why turnover over 60 billion has 22 times the effect on health of turnover below HUF 30 billion. No such justification was provided by Hungary.
- (46) The Commission is not convinced that the health damages caused by the manufacturing and trade of tobacco products would increase progressively with the turnover generated and according to the tax rate increments applicable under the measure. Furthermore, the condition that the turnover derived from the production and trade of tobacco products accounts for at least 50% of the total annual turnover generated by the undertaking to be subject to the health contribution also appears to contradict the justification of the tax progressivity based on the effects of tobacco products on health. In view of the tax objective, this requirement would mean that tobacco products marketed by companies whose turnover derived from the production and trade of tobacco products accounts for less than 50 % do not have negative effects on health like the products marketed by companies with a higher proportion of tobacco products in their turnover. This requirement therefore appears to be inconsistent with the alleged objective of the measure.
- (47) As regards the reduction of the tax liability in the case of investments, it cannot be justified by the nature and general scheme of the tax system either. The Commission considers the possibility to reduce the tax liability by up to 80 % in the case of investment to be inconsistent with the intrinsic objective of the health contribution tax. The objective of the health contribution tax is to create funds for the health system and increase the quality of health services given the fact that smoking plays an eminent role in the development of numerous diseases and significantly contributes to increased health expenses. Therefore, the Commission finds the possibility to reduce the tax liability in the case of investment, which aims at increasing the production and trading capacity of the undertaking, to be inconsistent with that objective, since, as already stated in recital (40), such investments would sooner increase the production and trading capacity of the undertaking and thus the negative externalities which the health contribution tax seeks to address. Furthermore, a contribution being based on the taxation of turnover should not take into account any costs.
- (48) Accordingly, the Commission does not consider the measures to be justified by the nature and general scheme of the tax system. The measures should therefore be considered to confer a selective advantage on tobacco undertakings with a lower level of turnover (and thus smaller undertakings) and to undertakings that have made investments eligible for a reduction of their tax liability under the health contribution tax.

4.1.4. *Distortion of competition and effect on intra-Union trade*

- (49) According to Article 107(1) of the Treaty, a measure must distort or threaten to distort competition and have an effect on intra-Union trade to constitute State aid. The measures apply to all undertakings deriving turnover from the production and trade of tobacco products in Hungary. The Hungarian tobacco industry is open to competition and characterised by the presence of operators from other Member States as well as from international operators, so that any aid in favour of certain industry operators is liable to affect intra-Union trade. To the extent the measures relieve undertakings with lower levels of turnover and undertakings making eligible investments from a tax liability they would otherwise have been obliged to pay, had they been subject to the same health contribution as undertakings with a high level of turnover and undertakings not making investments, the aid granted under those measures constitute operating aid in that it relieves those undertakings from a charge that they would normally have had to bear in their day-to-day management or normal activities. The Court of Justice has consistently held that operating aid distorts competition,¹⁷ so that any aid granted to those undertakings should be considered to distort or threaten to distort competition by strengthening their financial position on the markets on the Hungarian tobacco market. Consequently, the measures distort or threaten to distort competition and have an effect on intra-Union trade.

4.1.5. *Conclusion*

- (50) Since all the conditions laid down by Article 107(1) of the Treaty are met, the Commission considers that the health contribution tax on tobacco industry businesses laying down a progressive tax structure for tobacco businesses and the reduction of the tax liability on the condition of making certain investments constitutes State aid within the meaning of that provision.

4.2. **Compatibility of the aid with the internal market**

- (51) State aid shall be deemed compatible with the internal market if it falls within any of the categories listed in Article 107(2) of the Treaty¹⁸ and it may be deemed compatible with the internal market if it is found by the Commission to fall within any of the categories listed in Article 107(3) of the Treaty.¹⁹ However, it is the Member State granting the aid which bears the burden of proving that State aid granted by it is compatible with the internal market pursuant to Articles 107(2) or 107(3) of the Treaty.²⁰
- (52) The Commission notes that the Hungarian authorities did not provide arguments why the measures would be compatible with the internal market and that Hungary did not

¹⁷ Case C-172/03 *Heiser* EU:C:2005:130, paragraph 55 (emphasis added). See also Case C-494/06 P *Commission v. Italy and Wam* EU:C:2009:272, paragraph 54 and the case-law cited and C-271/13 P *Rousse Industry v Commission* EU:C:2014:175, paragraph 44. Joined Cases C-71/09 P, C-73/09 P and C-76/09 P *Comitato "Venezia vuole vivere" and Others v Commission* EU:C:2011:368, paragraph 136. See also Case C-156/98 *Germany v Commission* EU:C:2000:467, paragraph 30, and the case-law cited.

¹⁸ The exceptions provided for in Article 107(2) TFEU concern: (a) aid of a social character granted to individual consumers; (b) aid to make good the damage caused by natural disasters or exceptional occurrences; and (c) aid granted to certain areas of the Federal Republic of Germany.

¹⁹ The exceptions provided for in Article 107(3) TFEU concern: (a) aid to promote the development of certain areas; (b) aid for certain important projects of common European interest or to remedy a serious disturbance in the economy of the Member State; (c) aid to develop certain economic activities or areas; (d) aid to promote culture and heritage conservation; and (e) aid specified by a Council decision.

²⁰ Case T-68/03 *Olympiaki Aeroporia Ypiresies v Commission* EU:T:2007:253 paragraph 34

comment on the doubts expressed in the Opening Decision as regards the compatibility of the measures. The Commission considers that none of the exceptions provided for in the aforementioned provisions of the Treaty apply, since the measures do not appear to aim to achieve any of the objectives listed in those provisions. Consequently, the measures cannot be declared compatible with the internal market.

4.3. Recovery of aid

- (53) The health contribution of tobacco industry businesses was never notified nor declared compatible with the internal market by the Commission. Since the progressive structure of the health contribution and the provisions on the reduction of the tax liability on the condition of making certain investments constitute State aid within the meaning of Article 107(1) of the Treaty and new aid within the meaning of Article 1(c) of Regulation No 2015/1589²¹ and have been put into effect in violation of the standstill obligation laid down in Article 108(3) of the Treaty, those measures also constitute unlawful aid within the meaning of Article 1(f) of Regulation No 2015/1589.
- (54) The consequence of the finding that the measures constitute unlawful and incompatible State aid is that the aid must be recovered from its recipients pursuant to Article 16 of Regulation (EU) No 2015/1589.
- (55) However, as a result of the suspension injunction issued by the Commission in the Opening Decision, Hungary confirmed it had suspended the implementation of the health contribution on tobacco businesses.
- (56) Therefore, no State aid has been effectively granted under the measures. For this reason, there is no need for recovery.

5. CONCLUSION

- (57) The Commission finds that the health contribution tax on tobacco industry businesses laying down a progressive tax structure for tobacco businesses and the reduction of the tax liability on the condition of making certain investments constitutes State aid within the meaning of Article 107(1) of the Treaty and that Hungary has unlawfully implemented the aid in question in breach of Article 108(3) of the Treaty.
- (58) This decision does not prejudice possible investigations on the compliance of the measures with the fundamental freedoms laid down in the Treaty, notably the freedom of establishment as guaranteed by Article 49 of the Treaty,

HAS ADOPTED THIS DECISION:

Article 1

The progressive tax rate structure for tobacco businesses and the provisions on the reduction of the tax liability on the condition of making certain investments introduced by Hungary through Act XCIV of 2014 on the health contribution of tobacco industry businesses constitute State aid that is incompatible with the internal market within the meaning of Article

²¹ Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (codification) (OJ L 248, 24.9.2015, p. 9).

107(1) of the Treaty on the Functioning of the European Union, which were unlawfully put into effect by Hungary in breach of Article 108(3) of that Treaty .

Article 2

Individual aid granted under the scheme referred to in Article 1 does not constitute aid if, at the time it is granted, it fulfils the conditions laid down by the regulation adopted pursuant to Article 2 of Regulation (EC) No 994/98²² or Regulation (EU) No 2015/1588²³ whichever is applicable at the time the aid is granted.

Article 3

Individual aid granted under the scheme referred to in Article 1 which, at the time it is granted, fulfils the conditions laid down by a Regulation adopted pursuant to Article 1 of Regulation (EC) No 994/98 repealed and replaced by Regulation (EU) No 2015/1588 or by any other approved aid scheme is compatible with the internal market, up to maximum aid intensities applicable to that type of aid.

Article 4

Hungary shall cancel all outstanding payments of aid under the scheme referred to in Article 1 with effect from the date of adoption of this Decision.

Article 5

Hungary shall ensure that this Decision is implemented within four months following the date of notification of this Decision.

Article 6

1. Within two months following notification of this Decision, Hungary shall submit a detailed description of the measures already taken and planned to comply with this Decision;
2. Hungary shall keep the Commission informed of the progress of the national measures taken to implement this Decision. It shall immediately submit, on simple request by the Commission, information on the measures already taken and planned to comply with this Decision.

Article 7

This Decision is addressed to Hungary.

²² Council Regulation (EC) No 994/98 of 7 May 1998 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to certain categories of horizontal State aid (OJ L 142, 14.5.1998, p.1).

²³ Regulation (EU) No 2015/1588 of 13 July 2015 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to certain categories of horizontal State aid (OJ L 248, 24.9.2015, p. 1).

Done at Brussels, 4.7.2016

For the Commission
Margrethe VESTAGER
Member of the Commission