# OPINION OF ADVOCATE GENERAL GEELHOED

delivered on 20 October 2005 [1]

## I — Introduction

1. By the present action brought under Article 230 EC, the Portuguese Republic seeks the annulment of the Commission Decision 2003/442/EC of 11 December 2002 (the 'Decision'), [2] insofar as it qualifies as State aid the tax reductions for residents of the Autonomous Region of the Azores (the 'Azores') that form part of Portugal's scheme adapting its national tax system to the specific characteristics of the Azores. In the alternative, the Portuguese Republic seeks the annulment of that part of the Decision declaring that the tax reductions for firms carrying on financial and intra-group service activities are incompatible with the common market.

2. This case raises an interesting question of the scope of Article 87(1) EC: namely, in what circumstances do variations in the national tax rate adopted solely for a designated geographical area of a Member State fall under the definition of State aid? The question acquires particular importance in the context of the current movements towards devolution of powers to certain Member State regions, including devolution of taxation powers; and raises once again the issue of the boundary between the State aid rules and Member States' — in principle exclusive — competence in direct taxation.

## II — Legal Framework

### A — *Community law*

3. 87(1) EC provides that,

'Save as otherwise provided in this Treaty, 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,

1 — Original language: English.

2 — OJ 2003 L 150, p. 52.

in so far as it affects trade between Member States, be incompatible with the common market'.

4. Article 87(3) EC sets out five circumstances in which State aid may, by way of derogation from the Article 87(1) EC prohibition, be considered to be compatible with the common market. Those relevant to the present case are:

— aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment (Article 87 (3)(a)); and

— aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest (Article 87(3)(c)).

5. The Commission has released two sets of guidelines pertinent to the present case: a Notice on the application of the State aid rules to measures relating to direct business taxation (the 'Notice on Direct Taxation'), adopted in 1998 in the context of the movement for coordinated action at Community level to tackle harmful tax competition; [3] and Guidelines on national regional aid (the 'Regional Aid Guidelines'), which lay down the framework for assessment of the compatibility with Community law of aid granted to regions. [4]

B — *Community rules for outermost regions*

6. A 299(2) EC provides,

'The provisions of this Treaty shall apply to the French overseas departments, the Azores, Madeira and the Canary Islands.

However, taking account of the structural social and economic situation of the French overseas departments, the Azores, Madeira

3 — OJ 1998 C 384, p. 3.
4 — OJ 1998 C 74, p. 9, as amended.

and the Canary Islands, which is compounded by their remoteness, insularity, small size, difficult topography and climate, economic dependence on a few products, the permanence and combination of which severely restrain their development, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, shall adopt specific measures aimed, in particular, at laying down the conditions of application of the present Treaty to those regions, including common policies.

The Council shall, when adopting the relevant measures referred to in the second subparagraph, take into account areas such as customs and trade policies, fiscal policy, free zones, agriculture and fisheries policies, conditions for supply of raw materials and essential consumer goods, State aids and conditions of access to structural funds and to horizontal Community programmes.

The Council shall adopt the measures referred to in the second subparagraph taking into account the special characteristics and constraints of the outermost regions without undermining the integrity and the coherence of the Community legal order, including the internal market and common policies'.

C — *Portuguese law*

7. The Portuguese constitution of 2 April 1976, as amended (the 'Portuguese Constitution') provides, in Article 6(2), that the archipelagos of the Azores and Madeira constitute autonomous regions with politico-administrative status and their own government bodies. Title VII of the third part of the Constitution contains a number of provisions governing the powers of these autonomous regions and their political and administrative bodies. [5] These include certain legislative, [6] regulatory, [7] political, [8] administrative and financial powers. [9]

8. Article 227(1)(j) of the Constitution provides that the autonomous regions shall receive their own tax revenue as well as part of the State tax revenue, as established by a principle of national solidarity. Article 227(1)(i) provides that the autonomous regions have the right to exercise their own fiscal competence, under the conditions laid down by the law, as well as the right to adapt national fiscal provisions to regional specifi-

5 — Articles 225-234 of the Constitution.
6 — Article 227(1)(a), (b), (c), and (i).
7 — Article 227(1)(d).
8 — Article 227(1)(g), (r) and (s).
9 — Article 227(1)(h), (j) to (q).

cities, under conditions to be provided in a framework law adopted by the Assembleia da Republica.

9. In furtherance of these provisions, by Law 13/98 of 24 February 1998 ('Law 13/98'), the Portuguese Republic established the regime and general principles of financial regional autonomy, regional tax revenue, regional public debt, and the adaptation of the national tax system to regional specificities. Article 4(1) of the Law provides for a principle of national solidarity that extends to the whole of the national territory and aims at assuring an appropriate level of public services and private activities on an equal basis. Article 5 of the Law specifies the principles of cooperation between the State and the autonomous regions. By Article 10, the autonomous regions have the right to certain elements of State fiscal revenue. Article 33(1) of Law 13/98 provides that the regional bodies have a number of tax competences, to be exercised by the regional legislative assembly, including the power to create and regulate taxes already in existence in the autonomous regions in conformity with Law 13/98, and the power to adapt State taxes to regional specificities within the limits set by law and in accordance with the rest of Law 13/98. Article 37(4) of Law 13/98 provides that the regional legislative assemblies can also, under conditions to be set out by law, reduce national corporation and income tax and VAT rates by up to 30%, as well as special taxes on consumption in accordance with legislation.

10. By regional legislative Decree No 2/99/A of 20 January 1999, as modified ('Decree 2/99/A'), the regional legislative assembly of the Azores approved for the territory of the Azores the regulation of the exercise of tax competences at regional level and the exercise of the power of adaptation of State taxes, as set out in Law 13/98. Articles 4 and 5 of this Decree provide for reduced rates of income and corporation tax applicable to all economic agents, whether natural or legal persons, insofar as they are subject to these taxes. These reductions were set at (a) 15% for 1999 and 20% from 1 January 2000 for income tax and (b) 30% for corporation tax.

## III — Factual background

11. By letter dated 5 January 2000, the Portuguese authorities notified the Commission of a scheme adapting the national tax system to the specific characteristics of the Azores. As the scheme was thought to have entered into force before being authorised by the Commission, and as the notification arrived late in response to a request for information from the Commission, it was entered in the register of non-notified aid.

12. Following various requests for additional information from the Commission, in April 2002 it informed the Portuguese government

that, while it had no objections to the part of the scheme concerning reductions in the tax base and income tax credits, it had decided to initiate the procedure set out in Article 88(2) EC for that part of the scheme concerning reductions in the rates of income and corporation tax. The Commission received comments on this decision from the Portuguese government, as well as from the Regional Government of the Åland Islands, Finland, which supported the Portuguese position.

## IV — The contested Decision and procedure before the Court

### A — *The contested Decision*

13. In finding that that the tax reductions implemented in the Azores amounted to 'aid' within the meaning of Article 87(1) EC, the Commission began by recalling that a total or partial reduction in a firm's tax burden amounts to an 'advantage' in the meaning of Article 87(1) by relieving it from a charge normally borne from its budget. [10] This advantage is granted through 'State resources', as granting a tax reduction involves a loss of tax revenue. [11] Further, the Commission observed that, in view of the sectoral scope of the measures and insofar as at least some of the firms concerned will carry on an activity involving trade between Member States, the tax reduction affected competition and trade between Member States within the meaning of Article 87(1) EC.

14. On specificity, the Commission began by citing its Notice on Direct Taxation, which stated that, 'the Commission's decision-making practice so far shows that only measures whose scope extends to the entire territory of the State escape the specificity criterion laid down in Article 87(1) "and that" the Treaty itself qualifies as aid measures which are intended to promote the economic development of a region'. [12] As the tax reductions at issue applied only to firms taxed in the Azores, and not to firms economically active in other areas of Portugal, the Commission concluded that the advantage 'favoured' these undertakings within the meaning of Article 87(1) EC.

15. In support of this conclusion, the Commission reasoned as follows.

10 — Decision, point 24.

11 — Decision, point 24.

12 — Decision, point 24, quoting the Notice on Direct Taxation, point 17.

16. In the first place, as the selectivity criterion was based on a comparison between two groups of firms (those given the advantage and those not given the advantage), it could only be applied after defining a level of 'normal' taxation. In the Commission's view,

'In theory it follows both from the general scheme of the Treaty, which concerns aid granted by the State or through State resources, and from the fundamental role the central authorities of the Member States play in defining the political and economic environment in which firms operate, the measures they adopt, the services they provide and possibly the financial transfers they make, that the framework in which such a comparison should be made is the economy of the Member State. In this respect the text of the Treaty itself, which classifies measures intended to promote the economic development' of a particular region (Article 87(3)(a) and (c)) a State aid that may be considered to be compatible, indicates that benefits whose scope is limited to part of the territory of the State subject to the rules on aid may constitute selective benefits ... The settled practice of the Commission, confirmed by the Court of Justice, on the contrary consists of classifying as aid tax schemes applicable in particular regions or territories which are favourable in comparison to the general scheme of a Member State'. [13]

17. In the second place, the Commission stated that, in defining 'aid' for these purposes, a distinction based solely on the body that decides the measure – i.e., whether the authority is regional or central — would be unsatisfactory. In its view, such a distinction would compromise the objective nature of the concept of aid, which applies to all aid reducing the charges normally borne from the budget of one or more firms, regardless of its purpose, justification, objective or the status of the public authority that establishes it or whose budget bears the charge. The Commission added that, 'it should also be noted that the present Decision does not concern a mechanism that would allow all local authorities of a particular level (regions, districts or others) to introduce and levy local taxes with no reference at all to national taxation. On the contrary, the case in point involved a reduction applicable solely in the Azores in the rate of tax established by national legislation and applicable on the mainland of Portugal. Under the circumstances, the measure adopted by the regional authorities clearly constitutes a derogation from the national tax system'. [14]

13 — The Commission supported these statements by reference to a number of its own decisions, as well as the judgment of the Court of Justice in Case C-156/98 *Germany* v *Commission* [2000] ECR I-6857.

14 — Decision, point 31.

18. In the third place, because the reductions were not the result of applying proportionality or progressive taxation principles, but favoured firms in one region regardless of their financial situation, they could not be considered justified by the nature of the general scheme of the Portuguese tax system.

19. Having thus concluded that the tax reductions amounted to aid, and that this aid had been unlawfully implemented contrary to Article 88(3) EC, the Commission went on to examine whether this aid fell under any of the derogations provided for in the Treaty. In this regard, as the aid was continuous and had the objective of overcoming permanent structural handicaps resulting from the Azores' geographical position, it amounted to operating aid. As a result, it could be authorised only if its purpose was to offset the additional costs arising in the pursuit of economic activity from the handicaps identified in Article 299 (2) EC, in compliance with the national regional aid guidelines.

20. On this point, the Commission first recognised that, due to the reduced possibilities for firms to achieve economies of scale and increased costs resulting from its geographical location, the Azores region was 'effectively amongst the least developed in the European Union'. [15] In the Commission's view, however, a distinction should be made in this regard between the financial and non-financial sector.

21. As regards firms operating outside the financial sector, in the light of the study submitted to it by the Portuguese authorities, the Commission concluded that a reduction in corporation tax should allow these firms to improve their financial situation and thus contribute to regional development. [16] As a result, insofar as the tax reductions applied to such firms, the aid was compatible with the common market under the Article 87(3)(a) derogation. [17]

15 — Decision, point 36.

16 — The evidence contained in this study included: (a) Examination of a sample of 1083 firms subject to corporation tax, 100 of which were located in the Azores, which in Portugal's contention showed, under all the indicators used (namely, sales profitability, financial independence, overall solvency and return on equity) that firms located in Azores had substantially lower values than those located on the Portuguese mainland; (b) Evidence from an econometric study based on data relating to 1997 for the same sample of firms, in which it was found that, other things being equal, the profits of the firms located in the Azores were, on average, 33.6% lower than those of the other firms.

17 — The Commission noted that the Portuguese authorities had undertaken to notify the former in good time of any application of the scheme adapting the national tax system to the specific characteristics of the Azores beyond 31 December 2006, when the regional aid map would expire (Decision, point 38).

22. As regards firms operating in the financial sector, the Commission stated that income and corporation tax reductions were 'not justified by their contribution to regional development and that their level is not proportional to the handicaps they are intended to alleviate'. [18] As it was not in possession of quantified data enabling it to measure 'objective the level of the additional costs facing financial firms liable for tax in the Azores', the Commission concluded that, for financial firms, [19] the tax reductions did not qualify as permitted national regional aid under Article 87(3)(a) or any other derogation provided in the Treaty. In particular, due to its character as operating aid, it could not fall under the Article 87(3)(c) derogation. In the Commission's view, this assessment also applied to 'intra-group services' activities, [20] as such activities did not contribute sufficiently to regional development for them to fall within Article 87(3)(a).

23. By Article 3(1) of the Decision, Portugal was ordered to take all necessary measures to recover the aid made available from the income and corporation tax reductions implemented in Articles 4 and 5 of the Decree from firms carrying on financial or intra-group service activities. [21]

B — *Procedure before the Court*

24. On 24 February 2003, the Portuguese Republic lodged the present action for annulment. Pursuant to Article 93 of the Rules of Procedure, written submissions in intervention were subsequently lodged by the United Kingdom. A hearing was held on 6 September 2005, at which oral submissions were made by the Portuguese Republic, the Commission, the United Kingdom, and, pursuant to Article 93(7) of the Rules of Procedure, the Kingdom of Spain.

## V — Arguments of the Parties

A — *The Portuguese Republic*

25. The Portuguese Republic relies on three grounds in support of its application.

18 — Decision, point 39.

19 — As covered by section J (codes 65, 66 and 67) of the statistical classification of economic activities in the European Community (NACE Rev. 1.1).

20 — Activities the economic basis of which was to provide services to firms belonging to the same group, such as coordination, financial or distribution centres (as covered by section K, code 74, of the statistical classification of economic activities in the European Community (NACE Rev. 1.1)).

21 — The Commission added that a negative decision on an aid scheme did not prejudice the possibility that certain advantages granted under the scheme might, on its own merits, be considered as not being aid or as aid compatible with the common market: Decision, point 43.

26. First, the Portuguese Republic argues that the Decision is based on an error of law in its application of Article 87(1) EC, in two senses: first, in its application of the selectivity criterion; and second, in its failure to recognise that the tax reductions are justified by the nature and economy of the Portuguese tax system.

27. As to selectivity, in the Portuguese Republic's contention, the Commission's adoption of the whole of the Portuguese state as a framework for reference is erroneous. The tax reductions at issue result from the exercise of the competence of the Azores' regional legislative body and applied to all economic operators with tax residence in the region. As such, they do not 'favour certain undertakings or the production of certain goods'.

28. Moreover, these reductions result from the principles of redistribution contained in the Portuguese Constitution, which aims at correction of inequalities in economic development stemming from regional isolation, including in particular the principle of national solidarity contained in Article 4(1) of Law 13/98. The reductions thus are a result of the exercise of constitutional sovereignty and were motivated by precisely the factors set out in Article 299(2) EC, namely the geographical isolation, difficult climate and economic dependence of the Azores on a small number of products. The Portuguese Republic asks the Court to take this opportunity to establish the correct approach to such issues of selectivity in regional tax reductions, in order to eliminate the current uncertainty in the area.

29. As to the nature and economy of the Portuguese tax system, the Portuguese Republic emphasises that the tax reductions flow from Law 13/98, and the Constitution as a whole, which contain many references to the objective of redistribution and equality between the Portuguese mainland and the Azores. [22] Further, the Commission's argument that the tax reductions do not result from 'objective differences between taxpayers' is a fallacy: rather, all undertakings active in the Azores suffer from the same disadvantages, requiring a general tax reduction across all sectors in the Azores.

30. The Portuguese Republic's second ground of appeal is that the decision was in breach of Article 253 EC in failing sufficiently to motivate its findings that the tax reductions would appreciably distort competition and affect trade between Member States. Further, the Commission did not

22 — The Portuguese Republic refers in this regard to the econometric study it provided to the Commission, as well as a study of the Centre for European Policy Studies of 12 November 1999, to emphasise the special position of the Azores.

sufficiently identify the potential beneficiaries of the tax reduction, meaning that the effect of the measures on intra-Community trade could not satisfactorily be measured.

31. Third, the Portuguese Republic argues that the Commission committed a manifest error of appreciation in holding the tax reductions within the financial and intra-group service sectors to be incompatible with the common market. Financial undertakings such as banks, which tend to be larger than other undertakings active in the Azores, would also be affected by, for example, additional energy costs and the absence of technically qualified staff. As the Commission had been satisfied with estimating the additional costs resulting from the specific characteristics of the Azores on non-financial firms in the abstract, and not per sector, it should have extended this reasoning to financial firms also. In failing so to do, it infringed the principle of good administration, non-discrimination and proportionality.

B — *The Commission*

32. The Commission's principal arguments in defence are as follows.

33. First, on the alleged error of law in applying the selectivity criterion, the Commission refers to points 24–33 of the Decision. In particular, the Commission argues that the approach of taking a purely national point of reference in determining whether a measure is selective or not, was essentially approved by Advocate General Saggio in his opinion in the *Juntas Generales de Guipúzcoa* case.[23] In the Commission's view, as the tax reductions at issue favour undertakings subject to tax in the Azores, in comparison with other Portuguese undertakings, this is sufficient to qualify the reductions as selective for Article 87(1) EC purposes. This interpretation is, in the Commission's contention, required by the system of the Treaty itself. As a result, the fact that the reductions were adopted by a body other than the Portuguese State as such, is irrelevant: solely the effects of the measure, and not its form, can be taken into account in State aid assessment.

34. Furthermore, the Commission asserts that the nature of the autonomy granted to the Azores is in fact limited: the central Portuguese state continues to play a fundamental role in defining the economic framework within which undertakings operate. For example, undertakings active in the Azores nonetheless benefit from infrastructure financed by the central State and from a social security system maintained by the central State. In reality, thus, the tax advantages granted by the Azores result in

23 — Joined Cases C-400/97, C-401/97 and C-402/97 *Juntas Generales de Guipúzcoa et Diputación Foral de Guipúzcoa* [2000] ECR I-1073.

lower tax revenue within this region, which is in turn compensated for by the central State under the principle of national solidarity. The Commission emphasises that, as it stated in its Decision, in a case where all local authorities of the same level within a Member State's territory enjoyed the same power to impose and set the rate of certain taxes, this would not amount to selective granting of advantages within the meaning of Article 87(1) EC. On this point, in response to the intervention of the United Kingdom, the Commission observes that the present case can be distinguished from the situations in Scotland — where the Scottish Parliament's power to vary the tax rate applies to income, and not corporation, tax — and Northern Ireland.

35. As to the argument that the reductions are justified by the nature and economy of the Portuguese tax system, the Commission argues that this could only be the case if the tax advantages at issue resulted from objective differences between taxpayers. In the present case, however, the reductions resulted from the economic characteristics of the region, which was a factor external to the tax system. The Commission adds that, in its view, where a Member State measure fulfils the other conditions for qualification as State aid, the burden is on the Member State to prove that the measure is justified by the nature and economy of the system.

36. Second, the Commission refutes the allegation that it failed to give adequate reasons for its conclusion that the reductions could affect inter-state trade and distort competition, with reference in particular to jurisprudence of the Court holding that the Commission is not obliged to enter into detail on these points in its decisions. [24] Rather, it suffices to show that, in the case of at least certain beneficiaries of a measure, the measure has an effect on trade.

37. Finally, as regards the alleged manifest error of appreciation and violation of the principles of good administration, equal treatment and proportionality, the Commission notes first that it enjoys a wide discretion in assessing the compatibility of State aids with the common market, due to the economic and social evaluations necessary for such assessment. Moreover, the Centre for European Policy Studies study relied on by the Portuguese Republic fails to

24 — Case C-310/99 *Italy* v *Commission* [2002] ECR I-2289; C-280/00 *Altmark Trans* [2003] ECR I-7747, paragraphs 77 to 81.

quantify the impact of increased costs per economic sector. [25] The Commission emphasises that, in assessing possible compatibility of aid with the common market on regional grounds, the burden rests on the Member State concerned to measure the amount of additional costs and to show the link existing with the factors listed in Article 299(2) EC, as well as the proportionality of the proposed aid measure to these costs.

C — *The United Kingdom and Spain*

38. The United Kingdom, intervening in support of the Portuguese Republic, concentrates its submissions on the selectivity issue. In rejecting the Commission's argument that the selectivity criterion in Article 87(1) EC is automatically satisfied if a tax reduction does not extend to the entire territory of a Member State, it contends that reduced tax rates introduced by devolved or autonomous regions which apply throughout their jurisdiction and are not sectorally specific will not always satisfy this criterion. In the United Kingdom's submission, the question of characterisation of a regional taxation system for state aid purposes raises broader regional autonomy issues of considerable constitutional importance. If the Commission's arguments were accepted, this could in the United Kingdom's view compromise its 'asymmetrical' constitutional settlement, in particular as regards the positions of Scotland (where the Scottish parliament has the power to vary the basic UK rate of income tax for taxpayers in Scotland by up to 3 pence in the pound, without any compensatory claw-back by or subsidy from central government); [26] and Northern Ireland (where the Northern Ireland assembly is empowered to impose taxes which are not substantially of the same character as taxes applying in the United Kingdom as a whole). [27]

39. The United Kingdom proposes that, in deciding whether regionally imposed tax rates lower than the national rate constitute State aid, the Commission ought to have had regard to the degree of autonomy of the infra-State authority that established the reduced tax rate, taking into account a number of factors, including whether the decision to reduce taxes is taken by a body elected by or otherwise democratically accountable to the people of the relevant region; and whether the financial consequences of the decision are borne by the region, without a linked and countervailing subsidy or contribution from other regions or from the centre.

25 — Establishing suitable strategies to improve sustainable development in the Portuguese ultraperipheral regions of Madeira and the Azores, Peter Ludlow, Vitor Martins and Jorge Núñez Ferrer, CEPS.

26 — Scotland Act 1998, s. 73.

27 — See Northern Ireland Act 1998 Ch. 47 s. 4(1) and Schedule 2(9); Northern Ireland Constitution Act 1973 Ch. 36 s. 2 and Schedule 2(B); Government of Ireland Act 1920 s. 21.

40. The Kingdom of Spain, also intervening in support of the Portuguese Republic, emphasises that devolution, where it exists, forms part of Member States' constitutional framework. To follow the Commission's arguments would disregard this constitutional structure, in particular as direct tax policy remains the exclusive competence of Member States.

## VI — Analysis

### A — *Do the contested tax reductions constitute State aid within the meaning of Article 87(1) EC?*

41. The bulk of the arguments put forward by the parties has, quite rightly, focused on the Portuguese Republic's first head of claim; that is, whether the tax reductions at issue fall within the scope of Article 87(1) EC.

42. More generally, this raises the following important question going beyond the instant case: What principles apply in assessing whether variations in national tax rates adopted solely for a designated geographical area of a Member State fall within the scope of the Community State aid rules?

43. The Court has never, in its jurisprudence to date, answered this question. [28] Yet, in my view, formulation of a 'test' or principles of assessment is indispensable here. This follows, first and foremost, from Member States' right to legal certainty in planning their own tax regimes. In particular, without a clear test defining when geographically limited tax variations fall under the scope of Article 87(1) EC, Member States cannot predict when they are subject to the Article 88(3) EC obligation to notify the Commission of planned tax variations prior to their implementation. I would recall that breach of this obligation of notification entails treatment of the measure under the regime for 'unlawful aid' as set out in Council Regulation (EC) No 659/1999. [29] The interests of legal certainty, and indeed effectiveness of the State aid rules, therefore require that Member States should be able to

28 — Advocate General Saggio, in his Opinion in Joined Cases C-400/97, C-401/97 and C-402/97 *Juntas Generales de Guipúzcoa et Diputación Foral de Guipúzcoa*, footnote 23 above, came closest to considering the issue. That case concerned compatibility with the Treaty of fiscal measures to aid investment and stimulate economic activity in the Basque Country, Spain. However, the Advocate General concluded that the provisions amounted to 'short-term measures which aim to improve the competitiveness of the companies to which they apply' (point 38), and thus did not formulate general principles for analysis of geographically-limited tax variations. The case was withdrawn before the Court could hand down a final judgment.

29 — OJ 1999 L 83, p 1.

know in advance the extent of this obligation via clear principles of assessment. [30]

1. When do geographically limited national tax rate variations amount to State aid?

(a) General principles

44. To be termed aid, a tax measure must satisfy the four criteria set out in Article 87(1) EC, namely:

— The measure must 'confer on recipients an advantage which relieves them of charges that are normally borne from their budgets'. [31] This requirement is clearly fulfilled where an undertaking is subject to a lower tax rate than would otherwise apply;

— This advantage must be 'granted by a Member State or through State resources'. As the Court held in *Germany* v *Commission*, this criterion is satisfied by tax reductions granted by regional authorities, leading to lower State revenue. [32]

— The measure must favour 'certain undertakings or the production of certain goods'; in other words, it must be selective. A measure will escape qualification as selective if the Member State can prove that the measure is justified by the 'nature or general scheme' of the system. [33]

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

45. In defining the extent to which Article 87(1) extends to geographically limited

30 — I would add that, aside from determining the incidence of the obligation to notify, the scope of the concept of aid has of course a further important practical implication; that is, where tax variations qualify as 'aid', the burden of proof shifts to the Member State to show that the aid satisfies the conditions for derogation under Article 87(3)(a) or (c), as set out in the Commission's Guidelines for Regional Aid.

31 — Notice on Direct Taxation, paragraph 9.

32 — See, for general tax reductions, Case C-143/99 *Adria Wien* [2001] ECR I-8365, paragraphs 38 and 39; and for regional tax reductions, Case 248/84 *Germany* v *Commission* [1987] ECR 4013: 'The fact that the aid programme was adopted by a state in a federation or by a regional authority and not by the federal or central power does not prevent the application of Article 92(1) of the Treaty if the relevant conditions are satisfied. In referring to "any aid granted by a Member State or through State resources in any form whatsoever", Article 92(1) is directed at all aid financed from public resources' (at paragraph 17).

33 — See Case 173/73 *Italy* v *Commission* [1974] ECR 709, and Notice on Direct Taxation, point 12.

variations in national tax rate, the rub lies in the concept of selectivity. The reason is evident. By definition, these variations are granted only to undertakings operating in a certain part of a Member State's territory. If, as is the Commission's position, we should in all cases take as the framework for reference the entire territory of the Member State, then prima facie all national tax variations limited to a geographic subsection of a Member State qualify as 'geographically' selective (in contrast to 'material' selectivity, where a measure favours undertakings in a certain industry or sector of the economy). In this case, the State aid rules may be applied to reduce distortions of competition.

46. If, however, we should in certain cases take as a reference point the geographic area in which the variations apply, such variations are not 'selective', because they apply to all undertakings operating within that area. In this case, the only Treaty instruments available to reduce distortions of competition are Article 94 EC, enabling harmonisation by unanimous consensus of Member State provisions directly affecting the establishment or functioning of the common market, [34] and the (seldom-used) Articles 96 and 97 EC, enabling consultation of Member States by the Commission and possible Council action to eliminate distortions of the conditions of competition within the common market resulting from Member State provisions.

47. The crucial question is thus the following: What should the point of comparison be in considering whether a geographically limited national tax rate variation 'favours certain undertakings or the production of certain goods' within the meaning of Article 87(1) EC?

(b) When are geographically limited national tax rate variations selective?

48. In tackling this question, we should first distinguish between an increase in national tax rate for a defined geographic area of a Member State, and a decrease in such a tax rate.

49. As regards an increase in national tax rate for a geographic area, presuming that an area comprises a minority of the Member

34 — Due to the difficulty of achieving unanimous consensus on proposed Community direction taxation legislation, very little harmonisation under this Article has yet taken place in this area.

State's total geographic territory, this constitutes what I have termed in my opinion in GIL Insurance an 'exceptional burden' imposed within that area, rather than the grant of aid to taxpayers falling under the general regime who are subject to a 'lower' tax rate.[35] As a result, for the reasons I explained in that opinion, such a situation does not fall under the State aid rules.

50. As regards reductions in national tax rate for a geographic area, however, we should distinguish between three different scenarios.

51. The first scenario is one in which the central government of a Member State unilaterally decides that the national tax rate should be reduced within a defined geographic area. Such a measure is clearly selective, as taken by a single body applying only to part of the geographical territory within its competence.

52. The second scenario is one where all local authorities at a particular level (regions, districts or others) have the autonomous power to set the tax rate for their geographical jurisdiction, whether with or without reference to a 'national' tax rate.

53. As is recognised by the Commission in the Decision and in its submissions, measures taken by a local authority pursuant to these powers that apply generally throughout its jurisdiction are not selective within the meaning of Article 87(1) EC — even if one authority adopts lower tax rates than all the rest. In such a case, where each local authority has freedom to set its tax rate independently of the central government, it makes no sense to take the whole Member State territory as a framework for comparison for selectivity purposes. To begin, it would be artificial to come up with an 'average national tax rate' against which to compare one region's tax rate: in reality, the tax rate would likely differ between each region. Yet the essence of selectivity in the direct tax field is that the tax measure should form an exception or derogation to the general tax system.[36] The idea of an 'exception' or 'derogation' makes conceptual sense only if one can establish a nation-wide 'rule' — which is impossible in a situation where

35 — Case C-308/01 *GIL Insurance*, Opinion of 18 September 2003, [2004] ECR I-4777.

36 — Thus, the Commission in its Notice on Direct Taxation states that, 'The main criterion in applying Article 92(1) to a tax measure is therefore that the measure provides in favour of certain undertakings in the Member State an exception to the application of the tax system. The common system applicable should thus first be determined'. Notice on Direct Taxation, point 16.

each local authority has autonomous power to set its own tax rates. [37]

54. This brings us to our third scenario: a tax rate lower than the national tax rate, decided upon by a local authority and applicable only within the territory of that local authority. Here, the crucial question is whether the lower tax rate results from a decision taken by a local authority that is truly autonomous from the central government of the Member State. Importantly, by 'truly autonomous' here I mean institutionally, procedurally and economically autonomous. That is to say:

— *Institutionally autonomous*: The decision must be taken by a local authority with its own constitutional, political and administrative status separate from that of the central government;

— *Procedurally autonomous*: The decision must be taken by the local authority pursuant to a procedure where the central government does not have any power to intervene directly in the procedure of setting the tax rate, and without any obligation on the part of the local authority to take the interest of the central state into account in setting the tax rate.

— *Economically autonomous*: The lower tax rate applicable within the region must not be cross-subsidised or financed by central government, so that the economic consequences of these reductions are borne by the region itself. [38] In such a situation, decisions on how and how much to tax its subjects lie at the core of the regional government's policy prerogative. Such decisions will directly influence the amount of government money spent on, e.g., public services and infrastructure. The regional government may, for example, prefer a 'tax and spend' approach, levying higher taxes and spending more on public services; or it may choose to lower taxes and have a leaner public sector. Where tax cuts are not cross-financed by central government, this policy decision in turn affects

37 — This premise is implicit in the Court's judgment in *Adria Wien* that, 'For the application of Article 92 of the Treaty ... [the] only question to be determined is whether, under a particular statutory scheme, a State measure is such as to favour certain undertakings or the production of certain goods within the meaning of Article 92(1) of the Treaty in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question'. My emphasis. Case C-143/99 *Adria Wien*, footnote 32 above.

38 — For example, according to the submissions of the United Kingdom, under the devolution of tax powers to Scotland set out in the Scotland Act 1998 and following a referendum on the matter, the Scottish Parliament has the power to reduce, or increase, the basic UK rate of income tax for taxpayers in Scotland by up to three pence in the pound. If this power is exercised, it attracts no compensatory claw-back by or subsidy from the UK central government. Scotland thus carries the financial 'risk' from any variation it chooses to implement in the tax rate.

the infrastructure and business environment in which undertakings resident in that region operate. Undertakings resident within and without the region are thus operating within different legal and economic frameworks which cannot be compared.

55. If all of these senses of autonomy exist when a local authority decides to institute a tax rate lower than the national rate, this decision cannot be classed as 'selective' for Article 87(1) EC purposes. In such cases, the basis of the Commission's position — that is, the 'fundamental role' of the Member State's central authorities 'in defining the political and economic environment in which firms operate' [39] — falls away.

56. If, however, one of these senses of autonomy is absent, the lower tax rate must in my view be classified as selective for Article 87(1) EC purposes.

57. The above summarises what I view as the essential principles in assessing whether regional tax reductions qualify as 'aid'. For the sake of completeness, however, it is useful to deal briefly with three arguments raised in the course of this procedure by the Commission.

58. The first is that the fact that a regional tax reduction will or could have the effect of distortion of competition within the Community is essentially sufficient for it to satisfy the selectivity criterion. [40] As I have already mentioned, however, the State aid rules are only one of a number of Treaty instruments empowering the Community to take measures towards reducing competitive distortion pursuant to Article 3(g) EC. While the State aid rules are aimed at selective aid measures, Articles 94 and 96-7 may be used to reduce distortions flowing from tax measures other than those covered by the State aid rules, as I have discussed in my opinions in *GIL Insurance* [41] and *Streekgewest Westelijk Noord-Brabant.* [42] The Commission's argument that the focus must be solely on whether or not a regional tax reduction has the effect of competitive distortion wrongly conflates the distinction between these conceptually separate instruments. [43]

39 — Decision, paragraph 26.

40 — The Commission relies in particular on Case 173/73 *Italy* v *Commission*, footnote 33 above, paragraph 13.

41 — Case C-308/01 *GIL Insurance*, footnote 35 above.

42 — Case C-174/02 *Streekgewest Westelijk Noord-Brabant*, Opinion of 4 March 2004 [2005] ECR I-85.

43 — In addition, as the United Kingdom observes, if the litmus test of the definition of 'aid' is simply competitive distortion, this would likewise capture the case of equal regional taxation powers granted to all local authorities of a particular level — which in the Commission's contention does not amount to aid.

59. A second argument brought by the Commission is that holding some regional tax reductions to fall outside Article 87(1) EC could encourage circumvention of the State aid rules by Member States' choosing to alter the internal organisation of taxation competence within their territories. [44] It should be clear from my explanation above, however, that a merely formal empowerment of regional authorities to act in the taxation sphere subject to conditions defined by central government, without the true autonomous decision-making that I describe above, would not be enough to remove a measure from the scope of Article 87(1) EC. The idea of going beyond the purely formal is itself supported by the phrase 'in any form whatsoever' in Article 87(1) EC and has been confirmed by the Court in, for example, *Italy* v *Commission*, [45] and most recently by Advocate General Saggio in the *Juntas Generales de Guipúzcoa* case. [46]

60. On the other hand, in a case where a local authority takes its decision with true autonomy (in the sense I have outlined) from the central government, there is no logical or doctrinal ground for distinguishing between 'symmetrical' devolution of tax powers — scenario two above, where each local authority has the same autonomous tax powers — and 'asymmetrical' devolution of tax powers — scenario three above, where some but not all local authorities have autonomous tax powers. As observed by the United Kingdom, the choice of which, if any, regions within a Member State should have such devolved tax-powers is evidently one of constitutional policy heavily dependent on the unique historical and economic circumstances of that region. As long as the tax rate decision is a truly autonomous one, it must fall outwith the State aid rules.

61. A final argument raised by the Commission against the possibility of regional tax reductions, in certain cases, falling outside the scope of Article 87(1), is that of legal certainty. The Commission emphasises that, as Article 87(1) sets the limits of which measures Member States must notify to the Commission for appraisal, Member States need to know in advance the precise extent of their obligation to notify.

62. On this point, I would observe that, while the goal of legal certainty is certainly a valid one, it cannot in itself justify extending the scope of Article 87(1) beyond its

44 — See the comment of Advocate General Saggio in Joined Cases C-400/97, C-401/97 and C-402/97 *Juntas Generales de Guipúzcoa et Diputación Foral de Guipúzcoa*, footnote 23 above, point 37.

45 — See Case 173/73 *Italy* v *Commission*, footnote 33 above, paragraph 13, where the Court dismissed Italy's argument that the alleged social objective of a reduction of social charges within the textile industry meant the reduction did not fall within what is now Article 87 EC, observing that, 'Article 92 does not distinguish between the measures of state intervention concerned by reference to their causes or aims but defines them in relation to their effects'.

46 — Joined Cases C-400/97, C-401/97 and C-402/97 *Juntas Generales de Guipúzcoa et Diputación Foral de Guipúzcoa*, footnote 23 above, point 37: 'the fact that the measures at issue were adopted by regional authorities with exclusive competence under national law is ... merely a matter of form, which is not sufficient to justify the preferential treatment reserved to companies which fall under the provincial laws'

purpose, which I have described above. Indeed, the definition of aid already includes an (as yet) amorphous concept, namely that of justification on the basis of the 'nature and economy of the system'.

63. Having set out what I view as the principles for application of the selectivity criterion to regional tax reductions, I turn now to apply these principles to the present case.

2. Do the tax reductions in the present case constitute aid?

64. The Portuguese Republic confines its arguments on error of law in the application of Article 87(1) EC to the issues of selectivity and justification on the nature and scheme of the tax system. It is not therefore necessary to discuss here whether the tax reductions constituted an advantage granted from State resources that could distort competition.

65. I will deal first with the question whether the tax reductions satisfy the selectivity criterion according to the analysis I set out above.

66. In my view, the answer must be in the affirmative.

67. It is true that the Azores have been designated an 'autonomous region' by the Portuguese Constitution, with its own politico-administrative status and its own government bodies. Further, these bodies have the power to exercise its own fiscal competence as well as the right to adapt national fiscal provisions to regional specificities, these powers to be exercised under the conditions set out in Law 13/98 and Decree 2/99/A. As a result, it can be said that the decision resulting in the contested tax reductions was taken in an institutionally autonomous manner.

68. However, in my view this decision was not taken in circumstances amounting to true procedural and economic autonomy, within the meaning I describe above.

69. As regards procedural autonomy, the Portuguese Republic has, in its submissions, emphasised that the reductions constitute an application of the principles of redistribution to be found in the Portuguese Constitution, and in particular the principle of national solidarity of Article 4(1) of Law 13/98; that is, a principle of reciprocity extending to the whole national territory aimed at ensuring an

appropriate level of public services and private activities, to the exclusion of inequality. Article 5 of this Law specifies the principles of cooperation between the State and the autonomous regions with the aim of achieving national solidarity.

70. To my mind, the fact that the contested reductions were taken on the basis of such a national solidarity principle in itself negates the concept of true procedural autonomy in the sense I have outlined. Rather, the very idea of such a principle obliges regional and central government to cooperate in the furtherance of the cause of redistribution across the whole of the Portuguese territory.

71. Similarly, as to economic autonomy, Article 5 of Law 13/98 makes clear that, in the financial sphere, the principle of national solidarity requires budgetary transfers [47] and that the State should work with the authorities of the autonomous regions to achieve economic development and to correct inequalities. These principles are in turn further implemented by Article 10 of Law 13/98, which gives the autonomous regions the right to certain State fiscal revenue. Moreover, the Portuguese Republic has not shown (or attempted to show) that the Azores receive no countervailing funding from State finances to compensate for the lower tax revenue achieved as a result of the tax reductions. Indeed, this would be inconsistent with the rationale of the tax reductions, that is, the correction of inequalities in economic development stemming from regional isolation of the Azores: the achievement of this aim would likely be hindered, not helped, by reducing the corporation tax by 30% in the absence of countervailing compensation from the central Portuguese State.

72. In my view, therefore, the decision of the Azores' Regional Assembly to take the contested tax reductions was not made truly autonomously, for Article 87(1) EC purposes, from the central Portuguese government. As a result, the reductions must be qualified as selective, subject to potential justification on grounds of the nature and scheme of the tax system.

73. On this point, the Portuguese Republic argues that the tax reductions at issue are justified by the nature and general scheme of the tax system because the reductions result from the objectives of redistribution present in the Portuguese Constitution and their aim is to counteract the serious structural problems that undertakings operating in the Azores experience.

74. In this regard, although the limits of justification on the 'nature and general scheme' of a tax system have not been

47 — Article 5(2), Law 13/98

exhaustively defined by the Court or in the Commission's practice, the following points are clear.

75. First, the burden of proof of this justification lies on the Member State. [48]

76. Second, the essence of the justification is that the exceptions to the application of the tax system should 'derive directly from the basic or guiding principles of the tax system in the Member State concerned'. [49] In this respect, a distinction has been drawn between the 'external' objectives of a tax scheme – for example, social or regional objectives — which fall outside the scope of the justification, and the objectives 'inherent in the tax system itself' – for example, efficiency in tax collection and progressive taxation. [50] Evidently, therefore, the application of this test will differ according to the specific objectives of the particular tax system in question.

77. The Portuguese Republic has not, in my opinion, discharged the burden of proof of this justification here. Although, as with progressive taxation, the aim of the tax reductions in the Azores may be redistribution of income between richer and poorer regions, the method with which this has been achieved takes the form of a regional exception to the otherwise applicable general Portuguese tax system, rather than a specific use of general rules applicable across the national tax system. I refer by analogy to the judgment of the Court of First Instance in the *Diputación Foral de Álava* case, which concerned tax aid in the form of a reduction in the tax base for firms in certain Spanish provinces. [51] In rejecting applicants' argument that the provincial tax system had its basis in the Spanish constitution and was justified as necessary to attain the objectives of promoting investment and creating jobs, the Court observed that, 'the fact that the Basque authorities were granted certain powers in matters of taxation under the Spanish constitution does not mean that any and every tax concession they might be granted would be justified by the nature or structure of the tax system'. [52] In particular, 'an economic objective pursued by a measure cannot enable it to escape classification as State aid within the meaning of Article 87(1) EC ...'. [53]

78. Likewise, in the present case, the object of the tax reductions is, in the Portuguese Republic's own admission, essentially to compensate undertakings for the disadvantages flowing from the structural problems in

48 — Notice on Direct Taxation, point 23.

49 — Notice on Direct Taxation, point 16.

50 — Notice on Direct Taxation, point 26.

51 — Joined Cases T-346/99, T-347/99 and T-348/99 *Diputación Foral de Álava* [2002] ECR II-4259.

52 — Ibid., paragraph 62.

53 — Ibid., paragraph 63.

the Azores. While such an aim can validly be taken into account in assessing whether the aid falls under a derogation of Article 87(3) EC, it does not constitute a valid justification based on the nature and economy of the Portuguese tax system.

79. For these reasons, the Court should dismiss the Portuguese Republic's ground of appeal contesting the Commission's qualification of the contested tax reductions as State aid.

B — *Duty to give reasons*

80. The Portuguese Republic's second ground of appeal is that the Commission failed to give adequate reasons for its conclusion, in point 24, subparagraph 3, of the Decision, that the alleged aid would or could distort competition within the Community.

81. I am not convinced by this argument. It is true that, as the Court has held, 'Even where the very circumstances in which the aid has been granted show that it is liable to affect trade between Member States and to distort or threaten to distort competition, the Commission must at least set out those circumstances in the statement of reasons for its decision'. [54] In my view, however, the Commission fulfilled this obligation in its Decision. In describing in detail in its Decision the nature and extent of the tax reductions, [55] as well as the geographical, economic and other conditions present in the Azores, [56] the Commission sufficiently set out the circumstances leading it to conclude that the reductions could distort competition and affect inter-state trade. In particular, in view of the wide sectoral scope (covering all economic agents, whether natural or legal persons, insofar as they are subject to tax in the Azores) and the substantial size (30% for corporation tax) of the tax reductions at issue, I do not find that the Commission exceeded its power in concluding from these circumstances that at least some of the firms concerned by the tax reduction carry on an activity involving trade between Member States, and that inter-state trade could be affected. [57]

54 — See Case 57/86 *Greece* v *Commission* [1988] ECR 2855, paragraph 15, and Joined Cases C-329/93, C-62/95, C-63/95 *Germany and Others* v *Commission* [1996] ECR I-5151, paragraph 52, and Case C-156/98 *Germany* v *Commission*, footnote 13 above, paragraph 98.

55 — See, for example, Decision, points 7 to 9.

56 — See, for example, Decision, points 36 to 37 (although this description was made in the context of assessing compatibility under Article 87(3)(a)).

57 — See also, the recent judgment of the Court in Case C-310/99 *Italy* v *Commission*, footnote 24 above, paragraphs 88 and 89. In that case, the Court concluded that the Commission's duty to give reasons for a finding of potential distortion of competition in a State aid decision was satisfied by an explanation in general terms that the measure gave an appreciable advantage to recipients in relation to their competitors and was likely to benefit in particular undertakings engaged in trade between Member States. In the Court's view, the Commission was 'not required to go into any more detail in that regard'.

82. I would add that the relatively small geographical size of the Azores is not conclusive here; as the Court has consistently held, 'the relatively small amount of aid, or the relatively small size of the undertaking which receives it, does not as such exclude the possibility that intra-Community trade might be affected'. [58]

83. The Portuguese Republic's second ground of argument should thus, in my opinion, be dismissed.

*C — Manifest error of appreciation in applying Article 87(3)(a) to financial and intra-group service sectors*

84. The Portuguese Republic's final head of appeal is that, in finding that the tax reductions did not qualify for derogation under Article 87(3)(a) insofar as they applied to the financial and intra-group services sectors, the Commission committed a manifest error of appreciation and infringed the principles of good administration, equal treatment and proportionality, contrary to Article 299(2) EC. In the Portuguese Republic's view, financial undertakings may be subject to precisely the same additional costs stemming from the geographic situation of the Azores, and thus should receive the same treatment.

85. In order to assess this argument, I would first recall that, in assessing whether a measure falls under one of the derogations to Article 87(1) EC, the Commission enjoys a wide margin of discretion due to the complex economic and social evaluations inherent in the decision. In its review of legality, the Court must therefore restrict itself to determining whether the Commission has exceeded the scope of its discretion by a distortion or manifest error of assessment of the facts or by misuse of powers or abuse of process. [59]

86. Bearing this in mind, I turn to consider the test for derogation under Article 87(3)(a). As set out in the Commission's Regional Aid Guidelines, operating aid — that is, aid aimed at reducing a firm's current expenses, which evidently includes tax reductions — is in principle prohibited. Exceptionally, however, such aid may be granted in regions eligible under the Article 87(3)(a) EC derogation 'provided that it is justified in terms of its contribution to regional development,

58 — Case C-310/99 *Italy* v *Commission*, footnote 24 above, paragraph 86; Joined Cases C-278/92, C-279/92 and C-280/92 *Spain* v *Commission* [1994] ECR I-4103, paragraph 42.

59 — See, for example, Case C-225/91 *Matra* v *Commision* [1993] ECR I-3203, paragraph 24.

and its nature and its level is proportional to the handicaps it seeks to alleviate'.[60] The Guidelines also specify that, in the outermost regions qualifying for exemption under Article 87(3)(a) and (c) EC, aid which is 'intended partly to offset additional transport costs may be authorised under special conditions'.[61] It is, however, for the Member State to prove the amount of additional costs caused by these factors.

87. In the present case, the Commission came to the conclusion to exclude the financial and intra-group services sectors from the derogation after recognising, in the context of Article 299(2) EC, that the small size of regional markets and geographic position of the Azores meant that the possibilities of achieving economies of scale were substantially limited for firms resident there, which were subject to significant additional costs as regards production and access to markets.[62] A considered analysis based on these factors indeed led the Commission to decide that non-financial firms fell within Article 87(3)(a) EC.

88. It is true that in taking this decision, as the Portuguese Republic points out, that the Commission was prepared to accept proof of additional costs for undertakings in the regional economy as a whole, without these costs being broken down by sector; in contrast, for the financial sector, the Commission insisted on 'quantified data enabling it to measure objectively the level of the additional costs facing financial firms liable for tax in the Azores' — which the Portuguese Republic was not able to provide.

89. I do not, however, consider this position to be a manifest error of appreciation on the Commission's part. As stated above, it is the Member State which bears the burden of proving that the impugned aid is justified and proportionate in comparison to the actual additional costs to which regional undertakings are subject. While the Commission may have decided to accept global cross-sector figures for non-financial sectors, in principle it was entitled to demand separate concrete proof of these costs for the financial sector –in particular as the econometric study provided by Portugal to prove these costs did not extend to the financial sector. The Portuguese Republic does not deny that it failed to provide such separate proof in the course of the Commission investigation.[63]

60 — Regional Aid Guidelines, paragraph 4.15.

61 — Regional Aid Guidelines, paragraph 4.16.

62 — Decision, point 36.

63 — See, Decision, point 18, 'The Portuguese authorities ... attributed the absence of firms from the financial sector among those in the basic sample merely to a lack of statistical data on the sector, accordingly acknowledging that it was not possible for them to demonstrate rigorously in relation to such activities that the tax reductions in question were, by their nature and level, such as to resolve the specific problems of the Azores'.

90. For these reasons, the Court should also dismiss the Portuguese Republic's third head of claim.

## VII — Conclusion

91. On these grounds, I am of the view that the Court should:

(1) Dismiss in its entirety the action for annulment of Commission Decision of 11 December 2002, on the part of the scheme adopting the national tax system to the specific characteristics of the Autonomous Region of the Azores which concerns reductions in the rates of income and corporation tax; and

(2) Order the parties to bear their own costs.