

European Council formally adopted the Foreign Subsidy Regulation

16 December 2022

In brief

After the European Parliament's approval on 10 November, the Council formally adopted, on 28 November, the [regulation](#) on foreign subsidies ('FSR') that, in certain cases, are distorting the internal market (see also our previous [Tax Policy Alert](#) on the initial proposal). The FSR is likely to enter into force in December 2022 and will apply as of mid-2023.

The FSR is the latest instrument by which the European Commission aims to ensure a level playing field in the internal market and to execute its broader EU 2020 industrial policy.

In detail

Within the European Union, the Commission can already use the State aid and public procurement rules to scrutinise financial contributions by EU Member States to undertakings economically active in the European Union. Built upon the same mechanisms developed within the internal State aid and public procurement rules, the FSR now grants the Commission the power to redress the distortive effects of financial contributions granted directly or indirectly by non-EU countries which benefit undertakings economically active in the European Union. A foreign subsidy only exists if it confers a benefit specifically to one or more companies or industries. This requirement of specificity or selectivity is inspired by the State aid rules. The notion of a financial contribution under the FSR, which is also built upon the EU State aid concept, is broad.

Observation: A financial contribution does not only include subsidies but can take different forms, such as capital injections, grants, loans, loan guarantees, fiscal incentives, setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt-to-equity swaps or debt rescheduling and more. It may even include some routine tax exemptions and reliefs which, whilst they are clearly not 'subsidies,' may still need to be notified.

Observation: The Commission is required to have regard to the World Trade Organisation (WTO) non-discrimination rules. Accordingly, the FSR (applicable to non-EU subsidies) cannot be more restrictive than EU State aid provisions applicable to EU subsidies. Additionally, to the extent the distortion of competition is via the import of subsidised goods into the European Union, the WTO would address the matter.

In addition, to be in scope, the foreign subsidy must distort competition. A distortion shall be deemed to exist where a foreign subsidy is likely to improve the competitive position of an undertaking and it negatively affects competition in the internal market. A potential distortion will be assessed based on indicators, such as amount, nature, and purpose of the foreign subsidy. The Commission may conduct a balancing test in order to determine if any possible positive effects, broadly considered, outweigh the negative effects caused by the distortion of the internal market. This is similar to the current balancing test under the EU State aid rules. Subsidies of less than €4 million (over three consecutive years) to an undertaking are unlikely to be regarded as distorting competition. Please note that 'an undertaking' could also mean a group.

The FSR introduces three tools to assess distortion: two ex ante notification-based tools and an ex-officio power of investigation tool. More specifically, the FSR sets out an obligation for companies to notify:

- Concentrations where at least one of the merging companies, the acquired company or the joint venture generates an EU turnover of at least €500 million, and the transaction involves parties that have received foreign financial contributions from any number of non-EU countries of at least €50 million in the previous three years;
- Bids in public procurement procedures where the estimated contract value is at least €250 million and the bidder (or various group members or bid subcontractors or suppliers) was granted foreign financial contributions of at least €4 million per non-EU country in the previous three years.

Based on the FSR, parties will have to notify ex-ante financial contributions received from non-EU countries three years prior to concluding a concentration or a public procurement procedure above the relevant thresholds. Such a concentration cannot be completed, and an investigated bidder cannot be awarded the contract until cleared by the Commission. The FSR provides for redressive measures or commitments by the undertaking concerned. The Commission will take into account the balancing between the negative and positive effects when deciding whether to impose redressive measures or to accept commitments. The latter could include a repayment of the foreign subsidy by the undertaking to rectify the distortion, reduction of market presence, or divestment of certain assets. Breach of the notification obligation could lead to fines – imposed by the Commission – which may reach up to 10% of the aggregated turnover. Furthermore, the Commission can prohibit a subsidised concentration or the award of a public procurement contract to the subsidised bidder.

Observation: In practice, the €50 million financial contribution threshold is likely met when there is a concentration where at least one of the merging companies, the acquired company, or the joint venture generates EU turnover of at least €500 million. The notification requirement seems to relate to the concentrations that meet the threshold of turnover (€500 million) and financial contributions (€50 million) - although the notification details are yet to be determined and may specify a level of detail on financial contributions.

Observation: There will be an opportunity for undertakings to request pre-notification engagement with the Commission with the aim of receiving guidance from the Commission on whether the thresholds for (ex-ante) notification are met. The contacts mentioned below under 'legal business solutions' can be approached for this.

In addition to the two notification-based tools, the FSR grants the Commission a comprehensive ex-officio power of investigation for other market situations, if it suspects involvement of a distortive foreign subsidy. The Commission can also request ad-hoc notifications for smaller concentrations and public procurement procedures if it suspects the existence of distortive foreign subsidies.

Observation: Our expectation is that the measures will need to have settled in for a certain period of time and that the Commission will need to have gathered more knowledge before using the ex-officio power of investigation.

The Commission is required to produce guidance by entry into force and guidelines within three years of the measures coming into effect.

The takeaway

The FSR will enter into force twenty days after its publication in the Official Journal, which is expected to be in December 2022. The Regulation will become directly applicable across the European Union six months after entry into force (mid 2023). The notification obligations will start to apply nine months after entry into force (Q3 2023) and appear particularly onerous given the broad nature of financial contributions and the relatively low thresholds.

The FSR will increase the regulatory burden for businesses outside the European Union that wish to invest in or otherwise enter the EU internal market. Please note that EU undertakings active in non-EU countries that are granted foreign financial contributions are also within the scope of the FSR. Furthermore, the FSR could lead to increased scrutiny for mergers and acquisitions, and a prolonged public tender process, to name just some of the potential impacts. It is therefore important to assess whether the FSR impacts your situation and consider what further actions may be appropriate.

Let's talk

For a deeper discussion of how the FSR might affect your business, please contact:

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