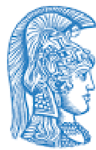

LAW SCHOOL

POSTGRADUATE PROGRAM: LL.M. in International and European Law
SPECIALIZATION: European Law
ACADEMIC YEAR: 2021-2022

POSTGRADUATE THESIS
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Tax rulings in the light of the EU State Aid rules

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Athens, October 2022

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Keywords: EU law; State aid; Tax administration; Tax authorities; Transparency; Tax Rulings; Tax Competition; Selectivity; Economic advantage; Article 107 TFEU;

INTRODUCTION

In November 2014, the "LuxLeaks" scandal comes to light. The media of twenty-six countries publish the confidential agreements that the Luxembourg tax authorities had been signing with hundreds of multinationals. These agreements, also known as tax rulings, are legal practices in principle, in which a company requests in advance the tax conditions of a certain country. The investigation revealed that such tax decisions artificially reduced the tax burden on companies, resulting in massive tax evasion by large corporations, and under the acquiescence of the country's tax authorities.

In a context of recent crisis, in which countless citizens saw their tax burden increased due to the economic austerity programs implemented in several eurozone countries, the indignation of public opinion was not long in coming. In fact, according to the **OECD**[1] revenue statistics back in those years, which correspond to the period from 2007 to 2014, income from Corporation Tax fell from 3.6% to 2.8% of Gross Domestic Product (GDP), while income from Personal Income Tax increased by 0.1% of GDP (from 8.8% to 8.9%).

The disclosure of government agreements with certain multinational companies, not only in the Grand Duchy, but in several European countries, highlighted the need for reforms in the area of taxation. The lack of harmonization of national legislations, among other factors, favors the aggressive tax planning strategies of companies, which take advantage of discrepancies and inconsistencies between different systems to artificially shift profits to places of zero or low taxation.

The fact that certain corporations can drastically reduce their level of taxation has been the subject of concern by the civil class. Organizations and governments have become aware of the situation, and legal actions have been taken both at European and global level.

The eradication of tax avoidance and evasion, the fight against harmful tax competition and the promotion of greater cooperation between tax administrations to guarantee control and combat fraud are currently framed as priority objectives in European tax policy. The effective control of State aid as well as tax rulings plays a fundamental role in achieving these ends.

Furthermore, the Organization for Economic Cooperation and Development (OECD) has launched an ambitious international taxation project to eliminate the erosion of tax bases and the transfer of profits to other jurisdictions (BEPS), promoted by the G-20 and some of the main emerging countries (BRICS).

The object of this thesis is, therefore, the analysis of the regulation of tax rulings in the light of the European regulations on state aid – the Union legislation, the requirements

[1] Information available in: OECD, Revenue Statistics 2015, OECD Publishing. Viewed December 3, 2015

for the Commission to declare a tax ruling an illegal aid – and the possible harmful and beneficial effects of rulings. All this without ceasing to consider the current problem caused, in particular, by the bad practices of some multinationals, which in recent years have taken refuge in the granting of tax agreements in their favor, with the aim of avoiding and / or lowering their tax burden, as well as the recent initiatives that, at international and European level, are being addressed to limit these harmful tax practices.

In conclusion, the purpose of this work is to shed light on a field conditioned by its great relevance, and that especially in recent years is being examined by governments, public pressure and experts in taxation.

Part I Tax Rulings and Harmful Tax Competition

Chapter 1. Tax Rulings and Tax Competition between Member States

State aid constitutes one of the fundamental pillars of the common market and of European taxation, insofar as in that they avoid the granting of aid that implies an advantageous situation to certain companies. The course and functioning of the EU are based on market policies open and free competition which, at the same time, by virtue of Articles 101 to 109 TFEU, act as fundamental principles of the Union legislation.

In order to analyze the regulation of State aid at European level, it should be borne in mind that the TFEU does not provide a clear definition of State aid[2]. While, Article 107.1 of the TFEU requires the fulfillment of four requirements for a measure of a Member State to be qualified as the State aid described, and, therefore, incompatible with European law (unless the Treaties stipulate otherwise). If we delve into the selective nature referred to in Article 107.1 of the TFEU, it is concluded that the concession must involve discrimination against an enterprise or group of companies, being necessary to qualify a measure as selective with respect to its beneficiaries, the existence of an economic benefit that certain companies could not have obtained without state intervention.

In this part, it is worth alluding to the Altmark judgment of the CJEU[3], which represents a turning point in the criteria of identification of State aid, the main issue in the dispute being the complaint to the Magdeburg government of the granting of transport licenses and subsidies to Altmark. As a result of this ruling, the so-called "Altmark Criteria", and compliance with which implies the qualification of an aid as compensation and not as State aid: the specificity in the attribution, the pre-definition of the criteria for calculating compensation, the prohibition of overcompensation and the efficient

[2] Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01)

[3] C-280/00 - Altmark Trans and Regierungspräsidium Magdeburg, Judgment of the Court of 24 July 2003.

weighting of compensation as an alternative to the selection through a recruitment procedure. However, to the general rule of article 107.1 TFEU, the exception of Articles 107.2 and 107.3 TFEU should be added, which stipulates that certain aid intended to promote the development of an economic activity without reversing the conditions of the exchanges affecting this to the common interest, may be considered compatible or suitable to be declared compatible.

The CJEU[4] ruled on the term of State Aid[5]. In this sense, it extends the application of Article 107 TFEU to any type of provision of a MS who intends to reduce the taxes that a company usually pays. It's not that obvious that it should be clarified that the assumption that a concession does not fit into the concept of state aid of Article 107 TFEU does not imply that the aid is considered legal, since all aid must be analyzed in accordance with the rules and regulations concerning. And, pursuant to Article 108 TFEU, it has the European Commission the exclusive power to qualify a compatible State aid or incompatible with the internal market. In addition to this function, the Commission has also the power to propose the necessary measures required for the functioning of the interior market.

Regarding the competitive level that is externalized between the different States, in the field of tax market, it is required to allude to the illegal character in which the Tax Rulings may end up incurring, thus resulting in a clear example of a practice of unfair tax competition. On numerous occasions, international doctrine has the qualification of the State aid regulations as an instrument of it is a secret that aims to eliminate disloyalty at the fiscal level. However, the achievement of this objective is not always achieved, due to the unfair tax competition as very present and international problem. The OECD therefore considers that the effect of this illegal practice would affect every state in one way or another.

In 1997, the States that are part of the EU unanimously adopted a package of measures[6] with the aim of ending unfair tax competition, in which included the proposal for the development of a Code of Conduct[7], the proposal for the development of a Directive

[4] Case 30-59 De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community. Judgment of the Court of 23 February 1961.

[5] In this judgment, the Court clarified that *'' The concept of aid is nevertheless wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore, being subsidies in the strict meaning of the word, are similar in character and have the same effect.''*

[6] Opinion of the Economic and Social Committee on ''Taxation in the European Union - Report on the development of tax systems'' (97/C 296/09) *OJ C 296, 29.9.1997*

[7] EU Code of Conduct of 1997 – Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy, 98/C 2/01

on taxation[8], as well as the proposal for a Directive on the tax treatment[9] of royalties and interests of European source. The Code of Conduct of 1997 is a significant element, concluded by MS to curb harmful tax competition. Though not binding, this Code consists of an agreement among MS to curb harmful tax practices. It distinguishes between "good" and "bad" tax competition and also aims at avoiding a race to the bottom, which would be disruptive for the whole system. Doing so, MS defined what could be considered harmful (*unfair*) tax competition and possible measures falling within this definition, hence those contrary to fair competition (i.e. those providing a significantly lower effective level of taxation) arising from national legislation, regulations, or other practices. According to all of them, what is intended is that the aid granted by the State comply with certain particularities so that they do not acquire the illegal character of state aid prohibited by the TFEU.

If we appeal to the requirements stipulated in Article 107.1 TFEU, which must be met in order for a State aid to be considered contrary to the regulations of the European Union, it follows that the selective aspect required is closely related with the Tax Rulings, and that can be appreciated even in those cases in which for the application of a certain tax measure, some general and objective criteria have been used, which are very usual to take place in the States in which the Tax Administration has the power to delimit the criteria for the award of State aid.

Given this situation, it seems that, the Tax Rulings, on certain occasions, can be framed within the assumption described above, as we can estimate for the following reasons. In general terms, the case that a tax ruling can be reached by any taxpayer who urges it and provided that it is in equal conditions than the rest who have obtained it, does not present any problem.

On the contrary, if one proceeds to the same practice, but without getting to deepen the profile of the taxpayer to whom such tax assistance is to be granted, instantly, an assumption could be made in which a selective advantage is appreciated. Indeed, it is essential to understand the function of the composition of the Tax Rulings, thus achieving detect possible occurrences of illegal aid.

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[8] Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation http://data.europa.eu/eli/dir/2014/107/oj

[9] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States http://data.europa.eu/eli/dir/2003/49/oj

1.1. Sovereignty and Direct Taxation

The limits to aid control: fiscal sovereignty.

The application of the principles of direct effect and primacy ensure that, in most cases, the granting of State aid by the Member States it is adequately controlled. However, this application is not always obvious or simple, a situation that is especially sensitive in the field of tax averages:

Can State aid rules limit the fiscal sovereignty of the Member States by preventing them from adopting tax measures that may fall within the scope of the article 107 TFEU? Does the finding that the EU can impose indirect tax harmonization imply an affirmative answer?

To be able to answer correctly, it is necessary to start from an elementary basis: the Member States of the Union are sovereign to decide their fiscal policy[10]- meaning that they retain exclusive competence - and yet such a tax policy has to comply with European competition and, more specifically, state aid regulations.

In effect, MSs are free to decide which tax policy to apply to companies operating in their territory as long as the State aid regulations are not violated.

So, as the European Commission (hereinafter EC) itself indicates, in the summer of 2013 **the Commission decided[11] to create a working team with the aim of investigating the eventual favorable treatment of some undertakings by the MS, mainly through tax rulings.** In this way it is clear the Commission's intention to verify the tax rulings that the MS apply to the large multinational undertakings.

On the other hand, although in the same line of argument, the Commission itself admits that '' The State aid rules are not suited either to address problems of lack of harmonization at the EU level, such as differences in the corporate tax rates between Member States, if they apply to all enterprises. Sometimes, there may be other possibilities to address this, for example if minimum levels of taxation or environmental standards have been agreed upon at European level, and if that minimum is not respected, the Commission can start an infringement procedure to force the Member State to respect the agreed minimum. '' [12]. The essence of the matter can be clearly seen here: the EC will only come in to assess the tax decisions taken by MS when they are selective. Indeed, the underlying problem is the following: even if the Member States

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[10] Art. 5.2 TEU ''Under the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States.''

[11] European Commission, Competition Policy ''Tax Rulings'' https://competition-policy.ec.europa.eu/state-aid/tax-rulings_en

[12] European Commission on *State aid control in the growing European Union, https://ec.europa.eu/competition/publications/cpn/5_state_aid.pdf*

are sovereign to decide what tax treatment they give to companies in their country, they cannot use that tool to violate the State aid regulations.

Let's look at it with an example.
Let's imagine that there are two MSs with a similar tax rate of corporate taxation. The one decides that, in order to get many undertakings to settle in its territory and, thus, collect more taxes, the percentage of the tax rate in respect to your neighboring Member State is going to be reduced ten percent more. Many undertakings will abandon the second MS to choose where there is a more favorable tax treatment. So far there is nothing illegal or that the EC can do, since it is a matter of mere competitive dynamics in the tax field, despite the fact that there is an economic advantage attributable to a MS and that it affects the internal market.

It is at this point, however, where the element of selectivity becomes critical: to the extent the MS that lowers the corporate tax in a generalized way to all companies that are taxed in its territory, we will be facing a general measure, which is not selective and, therefore, does not fall within the scope of State aid. However, if the decision to reduce the corporate tax rate is done in such a way that the largest companies, with complex and transnational corporate structures, pay a tax much more reduced to the generalized, the average tax rate acquires a selective element that places it within the scope of Article 107 of the TFEU. **This is the problem that appears with tax rulings**: a MS changes the corporate tax and dictates tax rulings under it that grant a selective advantage to many undertakings (this is roughly the simplified situation of the Apple case, which we will see in depth later). Again, the key element is the selectivity of the measure.

The permanent question about whether the EU intends to harmonize the taxation of companies through state aid arises for several reasons. At first, because the control of tax rulings in the field of State aid implies an interference by the EU in the tax policy of the Member States, at least indirectly. Thus, the fact about the qualification of a tax ruling as advantageous and selective is still a position of the Commission - certainly within the scope of its competences - on an exclusive competence of the Member States. Secondly, this position - the fact that the EC is competent to order the modification of that measure if it contravenes the aid regulations – can lead, logically a priori, to the criticism about a possible invasion of exclusive competences of the Member States by the Commission.

However, this criticism of the Commission could not be far from the truth. As we pointed out earlier, the EC itself admits that it does not seek to harmonize the regulation of the Member States through aid, but intends that the MS, in the name of the exclusive tax competence, tries to get the large multinationals settle in its territory through tax advantages that constitute state aid. It is very different for the Commission to control aid, whether it occurs in the field in which it occurs - obviously not in those in which it

is justified[13] - it is alleged that the EC intends to use a power it holds for other purposes, which it would be an obvious diversion of power.

In conclusion, the EC does not seem to intend a stealthy or covert harmonization of the tax legislation of the MS, not even in their treatment of large multinational corporations.

1.2. General concept

" For the purposes of these guidelines a ruling is any advice, information or undertaking provided by, or on behalf of, the government or the tax authority of a Member State, or any territorial or administrative subdivisions thereof, to a taxpayer or group of taxpayers concerning their tax situation and on which they are entitled to rely"[14].

The tax rulings are all those arrangements that encompass some type of agreement between the tax authority of a State and an undertaking, whose objective is that the authority transfers to the undertakings a specific interpretation of the tax rules that will be applicable. The EU[15] institutions point out that, by virtue of such arrangements, ''Tax rulings take a position on the divide between public and private law, a vertical and horizontal relationship, the public and individual interest. The tax administration explains how it will exercise its tax power in the particular situation of the taxpayer before or after the transaction took place or before or after the filing of the tax return.''

Thus, based on this notion of tax rulings, these resolutions can be classified in several ways, depending on the moment they are issued, the formal requirements they have or the effects they deploy. For the purposes of this work, it is interesting to highlight the so-called "Advance Pricing Agreements" (APA).

APAs are agreements between taxpayers and the tax authorities of the States to provide certainty, in advance, on the transfer pricing methodology[16], that is, to know ''how 'arm's-length profits' will be set for related party transactions where uncertainty justifies an advance ruling to ascertain whether certain intra-group transactions are priced at arm's length.'' [17]

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[13] Art. 107 par. 2 TFEU

[14] Code of Conduct: guidelines on the conditions and rules for the issuance of tax rulings – standard requirements for good practice by Member States, Report to the Council, FISC 202, ECOFIN 1092, Brussels, 28 November 2016

[15] 'Tax rulings' in the EU Member States, Directorate General for internal policies, Policy Department A: economic and scientific policy, November 2015

[16] European Commission, Statistics on APAs and MAPs in the EU, https://taxation-customs.ec.europa.eu/taxation-1/statistics-apas-and-maps-eu_en

[17] Par. 169. Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, (2016/C 262/01), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2016.262.01.0001.01.ENG&toc=OJ%3AC%3A2016%3A262%3AFULL

This type of agreement is characterized by three notes: its object, who requests it and the moment at which it is dictated.

First of all, the object of these arrangements is the transfer prices to be applied for a certain period of time and, more specifically, to the analysis of an appropriate method to calculate them according to certain principles. Before moving on, there is a need to clarify the significance of the intragroup transactions and why this project insists on these details.

A company's taxable profit results from the difference between income - arising from sales or other income - and expenses. Among the deductible costs are the amounts paid for the goods and services purchased. When a company buys goods or services from an independent seller or borrows money from a bank, there is not much debate about the reliability of the prices agreed upon.

However, this is not the case for transactions between companies of the same group. These enterprises are part of a wider group that exhibits economic and administrative unity with the main characteristic being the exercise of central control over the members of the group.

Because of the special relationship between the associated enterprises, the prices of the transactions between them are not determined under the conditions of the free market, that is, they are not formed on the basis of supply and demand. This means that groups have the ability to define them at will. Thus, however, there is a risk of using intragroup pricing in order to manipulate the financial results of the individual units of the group in order to reduce the overall tax burden of the group. In fact, when the different units of the group are located in different states – i.e., multinational groups - intragroup pricing determines the distribution of taxable income between the states involved.[18]

Secondly, the initiative of these tax rulings is pointed out by companies, private entities, which request clarifications from the tax administration.[19] This is because the company is the main - although, of course, not the only one - interested in obtaining that tax resolution. In this sense, such a request can be addressed to the tax authority of one State, which is labeled as unilateral APA; to the tax authorities of two States, which is identified as bilateral APA or, in short, to the tax authorities of several States, which can be classified as multilateral. One thing is as usual as the other. However, the larger the business groups are and the more countries they operate in, a bilateral or multilateral

[18] Andreas Tsourouflis, Transfer Pricing, Nomiki Bibliothiki 2010, p. 11 et seq.
[19] Company taxation: The European Commission proposes guidelines to avoid transfer pricing disputes, Brussels, 26 February 2007, https://ec.europa.eu/commission/presscorner/detail/d/IP_07_236

resolution is considered to provide greater legal certainty insofar as it implies greater cooperation between companies and tax authorities.

Thirdly, these are rulings that are issued prior to the moment, the transaction or activity, on which the rule is interpreted, takes place.

They are ex ante arrangements whose objective is simply to allow companies to know in advance which methodology the tax authority issuing the resolution will use to determine the tax impact of their transfer prices. Thus stated, it might seem that tax rulings are mere administrative actions aimed at providing clarifications on the application of a rule, so it is essential to understand its usefulness for companies.

1.3. Tax Rulings Benefits

From the mere reading of the previous paragraphs, the first - and most obvious - benefit of tax rulings can be extracted: legal certainty. Indeed, the most elementary of the benefits granted by tax agreement is that they allow companies to have the opinion of the tax authority on the fiscal impact that their operations will have. It allows companies to know in advance that during the following years - in which the tax ruling in question is in force -, with a quasi-absolute certainty, the taxes that will be required of them, depending on the operations they carry out, by fixing a certain methodology to their transfer prices.

Now, can the mere interpretation of the rule entail an advantage, since it affects the taxation of the company in question?

A priori there is no presumption, so the EC would have to prove that this interpretation is selective.

But this is not the only benefit, there are more[20]:

Avoid double taxation: the existence of bilateral or multilateral tax rulings allows large international companies to eliminate double taxation,

Company reputation: the company that actively seeks tax rulings and tries to obtain them in several countries presents an image of cooperation for the purposes of the tax authorities,

Less expenses: companies that have tax rulings will very predictably save all the expenses that could have been derived from audits and investigations by States.

[20] APA & MAP Country Guide 2019, CONNECTING THE DOTS OF INTERNATIONAL TAX CONTROVERSY, www.dlapiper.com Publications> 2019/03, (Tax insights | Topics | DLA Piper Global Law Firm)

In addition, the States that issue the rulings can also benefit from them, mainly for two reasons:

Cost savings: States that issue tax rulings through their tax authorities will save a lot of costs derived from investigations - which they will no longer have to do -, allowing to free up resources that in another situation they would have to focus on investigating companies, and

Reputation: States that are prone to issue tax rulings will be more attractive to companies, to the extent that they will have more certainty.

1.4. The Problem of Selectivity

Once the concept of tax rulings is understood, the problem of selective character arises. As it is clarified, when detailing the basic characteristics that define the concept of State aid, the selectivity of the measure is essential to determine if a tax resolution can be labeled as State aid in the terms of art. 107 TFEU. This is a consequence of the difficulty that exists in practice when it comes to demonstrating whether a tax ruling is separated from the general reference system of the specific tax.

The European Commission[21] itself indicates how the process should be to control whether a measure is selective.

The method pointed out is the so-called "three-step test":

First step: What is the reference system?

Step two: Is the measure in question an exception to such a system?

If the measure is not an exception to the system, it does not constitute State aid, otherwise it is necessary to proceed to the third step.

Third step: Is the measure justified within the reference system?

It is a question of determining whether, within the framework of the reference system, the exception has a harmonic fit or, on the contrary, it is completely outside.

In this way it can be checked whether a tax ruling protects a selective advantage to a given company. It can be seen better with an example. Let's imagine, in a very simplified way, that "Company A", with Italian origin and nationality, seeks to enter the Greek market. To do this, it addresses the Greek tax authority and asks it to interpret the rule that will be applicable. If the law says that companies have to be taxed at 20% for their profits, and the authority interprets, through the tax ruling - and this implies in fact or in law - that the rate that will be applicable to "Company A" will be less than

[21] Par. 128. Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, (2016/C 262/01), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2016.262.01.0001.01.ENG&toc=OJ%3AC%3A2016%3A262%3AFULL

20% (for accounting for its profits in a different way, for example), **a selective advantage is being granted.**

In this example, the three steps are clearly seen: firstly, the reference system is the rate generally applicable to companies (20%); secondly, interpreting through the tax ruling that the rate actually applicable to "Company A" will be less than 20% entails an exception to the reference system; and, thirdly, if that rate cannot be justified under any rule, State aid is being granted, in terms of art. 107 TFEU, to 'Company A'.

As we will see later in the Apple case, the burden of proof plays an essential role in demonstrating the selectivity of the measure. Thus, it is up to the EC to prove that the aid exists and that it is selective, thus having the burden of proving those first two steps, while it would already be the role of the Member State accused of granting an advantage to prove that such an advantage is an exception[22],[23] -step 3-, in the event that the EC managed to reliably and validly demonstrate the existence of selectivity.

This issue will be examined thoroughly in the next sections of this thesis.

Chapter 2: The Arm's Length Principle and the transfer pricing methods

2.1. The Arm's Length Principle

This is when the Arm's length principle comes into play. This principle aims to evaluate transactions as if they had occurred between independent parties, each seeking its maximum benefit.

Tax rulings (fully identified for the purposes of this analysis with the APA) normally identify the taxable amount that will be applied to companies based on certain benefits. These benefits, on the other hand, will be greatly influenced by the transfer prices that are applied to the intragroup transactions of large multinationals. Consequently, the problem we are facing here is that if the tax authorities support, as indicated by the EC[24], a profit attribution method based on transfer prices that are not close to market

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[22] Par. 141 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, (2016/C 262/01), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2016.262.01.0001.01.ENG&toc=OJ%3AC%3A2016%3A262%3AFULL

[23] See Judgment of the Court of Justice of 15 November 2011, *Commission and Spain* v *Government of Gibraltar and United Kingdom*, Joined Cases C-106/09 P and C-107/09 P, ECLI:EU:C:2011:732, paragraph 146; Judgment of the Court of Justice of 29 April 2004, *Netherlands* v *Commission*, C-159/01, ECLI:EU:C:2004:246, paragraph 43; Judgment of the Court of Justice of 6 September 2006, *Portugal* v *Commission*, C-88/03, ECLI:EU:C:2006:511.

[24] Par. 171. Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, (2016/C 262/01), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2016.262.01.0001.01.ENG&toc=OJ%3AC%3A2016%3A262%3AFULL Accordingly, a tax ruling which endorses a transfer pricing methodology for determining a corporate group entity's taxable profit that does not result in a reliable approximation of a market-

prices that can be comparable with the prices that other companies would pay under similar conditions, is offering a selective advantage to these companies.

Is this not simple enough? Yes, it could be characterized as simple, but in order to understand the selective advantage, the element of comparability is needed.

The problem is to know what is comparable, to know what the reference system of transfer prices is in order to be able to assess whether the measure in question departs from the usual practice or from MS. The EC cannot compare the tax treatment that multinational companies receive on their profits - with a high impact of their transfer prices - with those companies that do not have transfer prices: the situation it is not the same.

2.2. Transfer Pricing Methods

There are several methods that can be used to value the transfer pricing[25] both direct (comparable price method, increased cost method or resale price method) and indirect (net operating margin method or the method of the distribution of the result. The EC is inspired by the OECD TP Guidelines where five methods are described to approximate an arm's length pricing of transactions and profit allocation between companies of the same corporate group.

Transfer prices are those prices charged between associated companies and established in different countries for their intragroup transactions of goods and services.[26]

Consequently, ensuring that the profits and losses of multinational companies can be correctly assessed where they have occurred implies knowing how to assess, as close to reality as possible, the true economic impact of intragroup transactions and confirm that transfer prices reflect the economic reality of group companies. The setting of an intragroup transfer price is very relevant, since it is one of the criteria that will be considered when declaring a profit or loss, with the consequent fiscal significance.

Thus, the most widely adopted system internationally to tax corporate groups for their transfer prices is the so-called "Arm's length principle" which seeks to compare the

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based outcome in line with the arm's length principle confers a selective advantage upon its recipient. The search for a 'reliable approximation of a market- based outcome' means that any deviation from the best estimate of a market-based outcome must be limited and proportionate to the uncertainty inherent in the transfer pricing method chosen or the statistical tools employed for that approximation exercise.

[25] Par. 92. Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple (notified under document C(2017) 5605) http://data.europa.eu/eli/dec/2017/1283/oj

[26] Transfer pricing in the EU context, Taxation and Customs Union, https://taxation-customs.ec.europa.eu/transfer-pricing-eu-context_en

transfer prices carried out by multinational companies with the prices that independent companies should pay in an economic environment of perfect competition.[27]

This is the origin of the OECD, in its guide on transfer pricing.[28] While independent companies set their business and financial conditions by market forces, all those companies that are associated may not be directly affected by those market forces in the same way. And why is it important for multinational companies to reflect the arm's length principle in their transfer pricing? Because if they don't do it that way, the income that the group's enterprises receive can be distributed among them to be taxed for them where it is most beneficial to them, thus distorting the economic reality and also distorting the taxation that those same benefits should have.

This can be clearly seen with an example. Company" B " that is active in the sale of clothing, for example, is based in a state with very low taxes on its profits. Company B also operates in 5 other nearby countries through its subsidiaries. This company, what it can do with the aim of being taxed less or none is to pay to the parent company, as industrial property rights, for example, an amount almost equal to the profits obtained by the subsidiaries: it charges 100 in these 5 countries, but pays 98 for the industrial property of the clothes to the parent company, reducing its profits to 2. In this way, in the Member States that tax more, the company will hardly pay taxes since it has no profits and will pay them all from the parent company in that Member State where taxes on corporate benefits are low.

Profit shifting will be analyzed in the section of the case-law.

We can extract from the above the clear usefulness of the principle: it allows multinational undertakings to demonstrate that their transfer prices reflect the economic reality of transactions within the group and, for its part, allows States to make these companies tax for the economic activity developed within their borders, preventing companies from shifting their profits or losses to countries that are more beneficial to them.

The EC, for its part, has incorporated the principle when assessing the selectivity of means that could potentially constitute State aid in the field of tax rulings. In this regard, it points out that ‘’The arm's length principle the Commission applies in assessing transfer pricing rulings under the State aid rules is therefore an application of Article 107(1) of the Treaty, which prohibits unequal treatment in taxation of undertakings in a similar factual and legal situation. This principle binds the Member States and the

[27] Buendia Sierra, J.L. *Are the Tax Rulings Selective?* , King's College London, 20 June 2016

[28] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, https://doi.org/10.1787/tpg-2017-en

national tax rules are not excluded from its scope.''[29] This EC statement is very important for two reasons.

Firstly, the EC establishes that in matters of transfer pricing and tax rulings, its investigations will take as a reference system ''an ideal model that reflects the economic reality''[30], based on the principle of arm's length competition. This, put into practice and through a very simple example, means that, in that three-step analysis carried out by the EC to assess whether a measure is selective, the reference system implies that the group companies were independent companies. Consequently, if the difference that exists between the prices that two independent companies would pay for those goods and services differ greatly from those admitted by the tax ruling object of the analysis, the EC understands that there is selectivity in the measure and, therefore, if the other requirements are met, there is State aid.

Secondly, it is of great importance because the EC confirms that it follows such a principle in accordance with the aid regulations, deriving it from the direct interpretation of Article 107.1 TFEU, and not on the basis of the existence in the positive law of the Member State in question.

In short, the EC had been arguing that tax rulings implied a selective advantage when '' the administration applies a more 'favorable' tax treatment compared with other taxpayers in a similar factual and legal situation.''[31] This meant, in the field of transfer pricing, that a tax authority was granting an advantage if it supported, through a tax ruling, a methodology whose results do not approximate "market-based results" (arm's length principle).

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[29] Par.172 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, (2016/C 262/01), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2016.262.01.0001.01.ENG&toc=OJ%3AC%3A2016%3A262%3AFULL

[30] Buendia Sierra, J.L. *Are the Tax Rulings Selective?* , King's College London, 20 June 2016

[31] Par. 174 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, (2016/C 262/01)

Part II. The State Aid Rules against the Harmful Tax Competition

Chapter 1: Requirements of Art. 107 and how far can the prohibition go

The prohibition of State aid under EU Law results from paragraph 1 of Article 107 TFEU:

"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 favoring 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."

According to the case law of the CJEU a measure is qualified as State aid if each of the four cumulative criteria, on which this provision is based, is met. These criteria refer to the financing of the measure by the State or through State resources (first criterion), its conferring of an advantage on an undertaking (second criterion), the selectivity of that measure (third criterion), and the effect of the measure on trade between Member States and the distortion of competition resulting from that measure (fourth criterion).[32]
So, can a tax reduction or a tax exemption be qualified as state aid?

The answer is yes. According to case law and the judgments like the joined cases C-78/08 to C-80/08 and C-30/59[33], this issue has long been considered. As a result, the legal description of the taxable event can already trigger State aid.[34]

In tax provisions, one of the first characteristics we should put under scrutiny is the one of selectivity. The older case law of the CJEU placed the primary focus on the search for "normal taxation."[35] A measure was considered a state aid if it constituted an exemption to the general system of taxation. In the case of *EC and Spain v Gibraltar and U.K. (Joined Cases C-106/09P and C-107/09P*) the CJEU clarified that this is not the safest way.

If we don't include to the "normal taxation" the provision that is considered as an exemption, then is the same rule applied under the same scope? Under which criteria

[32] See the Joined Cases C-78/08 to C-80/08: Judgment of the Court (First Chamber) of 8 September 2011 (reference for a preliminary ruling from the Corte suprema di cassazione (Italy)) — Ministero dell'Economia e delle Finanze, Agenzia delle Entrate v Paint Graphos Soc. coop. arl (C-78/08), Adige Carni Soc. coop. arl, in liquidation v Agenzia delle Entrate, Ministero dell'Economia e delle Finanze (C-79/08), and Ministero delle Finanze v Michele Franchetto (C-80/08)

[33] De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community (C-30/59)

[34] See the Judgment of the Court (Third Chamber) of 22 December 2008. British Aggregates Association v Commission of the European Communities and United Kingdom. (Case C-487/06 P.)

[35] C. Micheau, 17 EC Tax Rev. 276 (2008), *Tax Selectivity in State Aid Review: A Debatable Case Practice*

could we find the exemption and the rule? According to the judgment *British Aggregates v Commission* (C-487/06 P), whether the legislator expressly designates one of the two provisions as the rule and the other as an exception cannot be of any relevance, since this depends either upon coincidences in drafting techniques, or upon the discretion of the legislator in deciding whether or not there is a "suspicion of State aid" based merely on which formulation the legislator may choose—and without changing the scope and the legal consequences of the two provisions.

In his opinion in the case *British Aggregates v Commission*, Advocate General Mengozzi, very helpfully summarized what the CJEU has already explained:

"With particular reference to State measures of a fiscal nature, the case-law shows […] that even measures which are selective, in that they differentiate between undertakings, may escape being classified as aid, if that differentiation is justified by the nature or structure of the tax regime of which they form part […]. It follows, according to the Court, that, in order to determine whether or not a measure is selective […] 'it is appropriate to examine whether, within the context of a particular legal system, that measure constitutes an advantage for certain undertakings by comparison with others which are in a comparable legal and factual situation."[36]

Comparability is the element that makes the difference. When individual undertakings are favored through the non-application of tax laws, the result is an unjustifiable, unequal treatment of what in essence are similar situations.

1.1 Are the Tax Rulings considered as State aid?

A ruling can only be considered a selective measure if it results in unequal treatment where certain undertakings or the production of certain goods are favored over others. This is the result in which we can lead to.

On the one hand, we could say that in the case of Tax rules, there is a lack of transparency[37] about the settlement that has been made. The tax authority cooperates with the taxpayer, and his activity is evaluated in advance. However, this does not fall under state aid legislation. Therefore, if the tax settlements are generally subject to tax secrecy, the fact that the anticipated settlement also remains secret cannot be regarded as a problematic, unequal treatment under State aid law.

In this case, we could say that, although this secrecy does not fall under the provisions on state aid, it does not mean that it does not confer an advantage over the competitors of the taxpayer concerned. Other taxpayers have virtually no opportunity to view the

[36] Par. 83 of the Opinion of Advocate General Mengozzi for the case *British Aggregates v Commission*
[37] Par. 22 of the Commission notice on the application of the State aid rules to measures relating to direct business taxation - C 384/3

tax records of others. It may be that similar competitors wish to have recourse to remedies and means based on competition law, but that cannot be the case because of the extreme secrecy under which tax ruling has been granted. This problem, however, does not arise because of rulings, but is primarily due to the tax assessment carried out under the protection of tax secrecy in several countries.

Hence those rulings which unlawfully favour taxpayers are definitely problematic under State aid law. But even in those cases, the problem is not the ruling but the arrangement behind the official decision which is made between the tax authority and the taxpayer to assess the taxable activity which is in breach of the law. How can we know that such an agreement will be limited to this object? it is very easy in the process and subsequently, the tax authority and the taxpayer to make an illegal agreement.

On the other hand, getting a tax ruling can be a financially significant advantage, especially considering the stability and the certainty it provides. In this case, does it fall under state aid legislation?

Taxpayers who do not have to wait for the tax assessment or for an even later tax audit, but who have already received binding assessments on controversial legal issues in advance, could occasionally benefit in the case of a sale of their undertaking or parts thereof. The binding ruling on otherwise controversial legal issues can alone enable the selling taxpayer to obtain a higher purchase price. The seller could bring into account the fact that the buyer of the undertaking is immune from lengthy disputes with the tax administration and does not have to live with the uncertainty of tax litigation risks, which may lead to a higher tax burden. Therefore, when the group of those taxpayers who can use a ruling is limited according to criteria which allow only certain undertakings to obtain a ruling, although others who are not entitled to get a ruling are in a similar situation, this can be regarded as an inadmissible State aid.

With reference to Article 107 of the TFEU, to which we alluded in previous chapters in order to determine whether or not Tax Rulings can be considered State aid, it should be stressed that the aforementioned Article does not contain a clear definition of the concept of State aid, nor does it include a list of aid declared incompatible, nor is there any Treaty or any rule of EU secondary law that stipulates a definition of State aid. However, Article 107 TFEU, which establishes a general principle of incompatibility with the internal market, it is possible to detach the origin and the effects that must occur for the constitution of a state aid. In this sense, we could affirm that the help of the state encompasses any economic-financial advantage granted by the State or through state funds to certain companies that falsify or threaten to falsify the competition, and that influence commercial transactions between the different Member States.

This definition of a broad concept of State aid has allowed both the Court and the EC to progressively delimit the limits of these fiscal measures. In addition to the general limits derived in domestic law from the principle of legality, the limits derived from EU law are incorporated, specifically, the qualification of certain agreements between the tax administration and the taxable person of a tax as State aid incompatible with European law.

1.2. Economic advantage granted by the State

Firstly, under Article 107(1) TFEU, State aid is understood to mean only advantages granted directly or indirectly through State funds.

If we examine, among others, the judgment of the CJEU[38], it follows that any rule that entails a reduction in the tax burden of a company may be constitutive of state aid, even though it does not imply a transfer of public resources, since the State would be giving up the tax revenues that it should have collected from usual way.

And with regard to the term State, it encompasses both the advantages granted directly by it and those provided through public or private bodies designated by the State.[39]

Secondly, for the constitution of State aid, it is required that it favors certain companies, thus granting them an economic advantage of a selective nature. It includes any economic benefit that the company would not have been able to produce in normal market conditions, without state intervention. Therefore, it should be clear that State aid must grant an economic advantage in such a way that, without its granting, the beneficiary companies would not have been able to obtain the same economic performance.

Although it is indifferent the form that the advantage in question takes, this means, if it does not have any importance if it is a subsidy, interest rebate, exemption from taxes or parafiscal fees, reduction of the taxable base, cancellation of the tax debt or any other measure with a similar effect, neither does the legal mean[40] used to arrange the aid. The advantages provided must be interpreted from an objective point of view, it being sufficient that the aid grants an economic improvement to the beneficiary compared to the rest of taxpayers who do not receive this aid, without it being necessary that the taxable person to whom the tax aid is directed positions himself above other companies in competitive terms.

[38] See the Judgment of the Court (Grand Chamber) of 17 November 2009. Presidente del Consiglio dei Ministri v Regione Sardegna. Case C-169/08.
[39] See Judgment of the Court of 12 December 1996. The Queen v Secretary of State for Trade and Industry, ex parte British Telecommunications plc. Case C-302/94.
[40] See Judgment of the Court (Sixth Chamber) of 17 June 1999. Kingdom of Belgium v Commission of the European Communities. Case C-75/97.

For the CJEU[41] and for the European Commission, an economic advantage is understood to be any situation in which the beneficiary perceives an economic value that the market would not have granted him, for which a comparison must be made between the tax burden after the application of State aid and that implied by general tax regulations. Thus, the European Commission considers that the economic advantage will take place at the moment when public funds are obtained outside normal market conditions. To qualify State aid incompatible with the principle of free competition and to the common market, it is decisive to confirm whether the economic advantage formed by a transfer of public resources follows the logic of the otherwise, the existence of State aid included within Article 107 TFEU will be assessed.

1.3 Selectivity and distortion of competition

Thirdly, the Court stresses the importance of the key terms 'selectivity' and 'distortion of competition' in the assessment of tax regimes, in view of the TFEU State aid Rules. The configuration of these concepts within the framework of European regulations is essential to specify the competences of the Member States in the field of tax measures. A priori, the European Courts agrees that, when there is selectivity, consequently, it leads to a distortion of competition.

However, case law considers that selectivity is an independent requirement, and its existence is sufficient to declare the existence of state aid. This has become so important that the absence of selectivity of tax aid has been fundamental in some resolutions. Example of this is the annulment of the Decision of the European Commission in the case involving Lico Leasing and Pymar, in which case, despite although the Court argued that the State aid scheme gave an advantage to the shipyards, being open to all investors, it was classified as non-selective. The judgment[42] was appealed, and finally, the opposite position was chosen, thus incurring the incompatibility arising from Article 107.1 of the TFEU. In 29th of September 2022, the very recent Advocate General’s Opinion in these Joined Cases proposes that the judgment of the General Court and the Commission's decision on the ‘Spanish tax leasing scheme’ should be partially annulled. Specifically, ‘’ AG Pritt Pikamäe takes the view, first, that the method used by the General Court to examine the selectivity of the STL system was correct. The grant of those tax benefits under the STL system was conditional on companies obtaining prior authorization for early depreciation, which was granted by the tax authorities under a wide discretionary power. That discretionary power, framed by vague and non-objective criteria, allowed the tax administration to determine the beneficiaries of early depreciation or the conditions of such depreciation, which makes it possible to consider that the selectivity criterion is satisfied.’’[43]

[41] See the Judgment of the Court of 11 July 1996. Syndicat français de l'Express international (SFEI) and others v La Poste and others. Case C-39/94.

[42] See the Judgment of the General Court (Seventh Chamber) of 17 December 2015. Kingdom of Spain and Others v European Commission. Cases T-515/13 and T-719/13

[43] Advocate General’s Opinion in Joined Cases C-649/20 P | Spain v Commission – C-658/20 P | Lico Leasing and Pequeños y Medianos Astilleros Sociedad de Reconversión v Commission – C-662/20 P | Caixabank, PRESS RELEASE No 164/22

Fourthly, with reference to the aforementioned distortion of competition, Article 107.1 TFEU stipulates as a requirement for the consideration of State aid that the measure affect trade between EU Member States, and that it distorts or threatens to distort tax competition. On the one hand, based on the judgment of the CJEU[44], it is understood that aid affects trade between States when it has the consequence that operators from other States access to the market, preserving or increasing the local supply.

Therefore, in order to determine whether the tax measure has an effect on trade between the Member States, it must be proved why the aid distorts or threatens to distort the competition and is likely to harm trade, on the basis of the predictable effects of the tax measure. On the other hand, according to the judgment of the CJEU[45], there is a distortion or threat of distorting competition at the moment when a State grants a financial advantage to a company in a sector liberalized where the competition exists or could exist.

Chapter 2: The distinction between the ''advantage'' and the ''selectivity'': How did European Commission use these criteria?

The purpose of this chapter is to analyze the application that the Commission has made of these concepts in relation to the measures adopted by the EU Member States in the form of advance tax decisions or tax rulings and the limits to the Commission's action in this area that have been raised both by the recent pronouncements of the court in some of the most relevant cases examined so far, as a part of the doctrine.

The requirement of selective advantage has traditionally been separated into two concepts: on the one hand, the advantage and on the other, its selective nature.

Although, as we say, both requirements have been analyzed separately by jurisprudence, in the analysis of tax rulings it is often difficult to completely separate them, as we will explain in detail in this chapter.

An advantage is any economic benefit granted to an enterprise that it could not have obtained under normal market conditions, that is, without state intervention[46]. In the tax field, the advantage can be granted by reducing the tax burden to which such an enterprise would normally be subject, in particular, by reducing the taxable base, the

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and Others v Commission

[44] See the Judgment of the Court (Ninth Chamber) of 15 January 2015. Birutė Šiba v Arūnas Devėnas. Request for a preliminary ruling from the Lietuvos Aukščiausiasis Teismas. Case C-537/13.

[45] See the Judgment of the Court of 26 September 2000. Commission of the European Communities v French Republic. Case C-225/98.

[46] Par. 66 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, (2016/C 262/01) '' An advantage, within the meaning of Article 107(1) of the Treaty, is any economic benefit which an undertaking could not have obtained under normal market conditions, that is to say in the absence of State intervention. '' and Judgment of the Court of Justice of 11 July 1996, *SFEI and Others*, C-39/94, par. 60; Judgment of the Court of Justice of 29 April 1999, *Spain* v *Commission*, C-342/96.

tax rate, or reducing in any way the tax burden as well as, for example, a postponement of the payment of the tax due[47].

On the contrary, the concept of selectivity implies that the State measure favors certain companies ‘’ over other undertakings which, in the light of the objective pursued by that regime, are in a comparable factual and legal situation and who accordingly suffer different treatment that can, in essence, be classified as discriminatory[48]. ‘’

It is in this context that the distinction that the CJEU has made between individual aid and aid schemes makes sense, which is particularly applicable in the field of tax rulings and aggressive tax planning[49]. The Court has established that the selectivity requirement differs depending on whether it applies to a general scheme or to individual aid. The examination of selectivity is essential in the context of aid schemes since, due to their scope of application, they can be - at least potentially - of general application, in which case they would not be selective. This is not the case with individual aid, as these are measures that are aimed at a single company, by virtue of its specific characteristics. In these cases, there can be little doubt that the measure cannot be of general application, so once it has been determined that it confers an advantage, it must be presumed that it is, by definition, selective in nature. In the words of the Court of Justice:

‘’ The requirement as to selectivity under Article 107(1) TFEU must be clearly distinguished from the concomitant detection of an economic advantage, in that, where the Commission has identified an advantage, understood in a broad sense, as arising directly or indirectly from a particular measure, it is also required to establish that that advantage specifically benefits one or more undertakings. It falls to the Commission to show that the measure, in particular, creates differences between undertakings which, with regard to the objective of the measure, are in a comparable situation. It is necessary therefore that the advantage be granted selectively and that it be liable to place certain undertakings in a more favourable situation than that of others.

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[47] Commission notice on the application of the State aid rules to measures relating to direct business taxation (98/C 384/03). ‘’ Firstly, the measure must confer on recipients an advantage which relieves them of charges that are normally borne from their budgets. The advantage may be provided through a reduction in the firm's tax burden in various ways, including: a) a reduction in the tax base (such as special deductions, special or accelerated depreciation arrangements or the entering of reserves on the balance sheet), b) a total or partial reduction in the amount of tax (such as exemption or a tax credit), c) deferment, cancellation or even special rescheduling of tax debt.’’

[48] Par. 54 Judgment Judgment of the Court (Grand Chamber) of 21 December 2016. *European Commission v World Duty Free Group SA and Others.* Case C-20/15 P.

[49] 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, Article 1(d) and 1(e) ‘’ ‘aid scheme’ means any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount; (e) ‘individual aid’ means aid that is not awarded on the basis of an aid scheme and notifiable awards of aid on the basis of an aid scheme;’’

However, a distinction must be made according to whether the measure in question is envisaged as a general scheme of aid or as individual aid. In the latter case, the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective. By contrast, when examining a general scheme of aid, it is necessary to identify whether the measure in question, notwithstanding the finding that it confers an advantage of general application, does so to the exclusive benefit of certain undertakings or certain sectors of activity ‘’ [50].

2.1. The concept of advantage in transfer pricing decisions and the Arm’s Length Principle

In its decisions, the Commission uses the arm's length principle as a parameter for determining the existence of an advantage. This is based on the CJEU in the case Forum 187[51]. This case concerns the Belgian tax regime for the coordination centers.

This system, which established certain exceptions to the common corporate tax regime, allowed the focal points to apply the so-called "cost plus" method (one of the transfer pricing methods proposed by the OECD) to determine their tax base.

According to this method, the taxable base of the coordination centers was fixed as a percentage of the amount of general and operating expenses incurred, from which personnel expenses, financial expenses and other taxes paid were excluded[52].

When determining whether this scheme conferred an advantage on its beneficiaries, the Court considered it necessary ‘’ to compare that regime with the ordinary tax system, based on the difference between profits and outgoings of an undertaking carrying on its activities in conditions of free competition. [53] ‘’

Applying this principle, the Court concluded that the exclusion of personnel and financial expenses from the costs used to determine taxable income conferred an economic advantage on the coordination centers, since it did not allow them to reach transfer prices ‘’ close to those which would be charged in conditions of free competition’’ and this since the excluded costs contributed in a preponderant way to

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[50] See the Judgment of the Court (Sixth Chamber) of 30 June 2016. Kingdom of Belgium v European Commission. Par. 48-49 Case C-270/15 P. and Judgment of 4 June 2015 in Commission v MOL. Par. 59-60 Case C-15/14 P.

[51] See the Judgment of the Court (Second Chamber) of 22 June 2006. Kingdom of Belgium (C-182/03) and Forum 187 ASBL (C-217/03) v Commission of the European Communities. Joined cases C-182/03 and C-217/03.

[52] Forum 187, par. 9

[53] Forum 187, par. 95

the generation of income of these companies, which provided services of a financial nature[54].

2.1.1. Amazon

This is the starting point of the examination of the requirement of economic advantage in decisions concerning Amazon, Apple, Fiat and Starbucks. These four decisions relate to tax rulings that determined the transfer prices applicable to intragroup transactions. The Commission's decisions are based on the premise that in the Member States in question (Luxembourg, Ireland and the Netherlands), corporation tax is, as a general rule, determined on the basis of the difference between the assets and liabilities of an undertaking operating in an environment of free competition. Therefore, by allowing the tax agreements analyzed in these decisions to apply transfer prices in intra-group transactions that did not correspond to ‘’ which would be charged in conditions of free competition between independent undertakings negotiating under comparable arm's length circumstances ‘’ [55], the Commission concluded that those agreements conferred an economic advantage on their beneficiaries.

As it is known, transfer prices are prices at which companies transfer goods and services to other group companies. The transfer prices, therefore, determine a portion of the income and expenses - and indirectly of the ‘’assets’’ and ‘’liabilities’’ - of the group companies, and therefore their taxable base[56].

The transfer prices must respect the arm's length principle, that is, they must be determined according to or on the basis of the prices that independent companies, without any corporate link, would have freely determined on the market. Only in this way, permanent memberships to corporate groups will have a tax burden equivalent to that of companies that sell or offer goods and services on the market, thus ensuring equal treatment between both categories. The determination of transfer prices is one of the main means that multinational companies have to distribute the group's profits between the different jurisdictions in which the group's companies are established. An incorrect determination of these prices could open the door to an undue transfer of profits (profit shifting) to jurisdictions with lower taxation, thus reducing the tax burden of the group as a whole.

These "improper" transfers of profit are the ones that underlie most of the decisions taken in matters of tax rulings. The Commission's decisions, however, regulate profit-shitting only indirectly. The examination of the existence of an advantage is not based on the benefit that the group as a whole derives from deriving part of its profits to low-

[54] Forum 187, par. 96
[55] Par. 222 Commission Decision (EU) 2016/2326 of 21 October 2015 on State aid SA.38375 (2014/C ex 2014/NN) *(hereinafter FIAT),* par. 402 Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) *(hereinafter Amazon),* par. 249 Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) *(hereinafter Apple),* par. 258 Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 *(hereinafter Starbucks)*
[56] Par. 11, 12 of the OECD Transfer Pricing Guidelines *for* Multinational Enterprise *and* Tax Administrations 2017

tax jurisdictions. And this is because, according to well-established case-law in the field of State aid, the examination of the advantage cannot take into account the treatment that the corporate group may receive in jurisdictions other than the Member State against which the aid file has been opened. The advantage is, in a more simple way, a purely national requirement, and should be limited to analyzing whether the company benefiting from the ruling obtains a more advantageous taxation by applying the transfer prices that the ruling sanctions in comparison with the taxation to which it would have been subjected applying what is considered the "general rule", that is, if its tax burden had been determined exclusively on the basis of income and expenses obtained on the market at arm's length, and this is completely independent of the advantage (or disadvantage) that these same transfer prices may imply for their taxation in other Member States.

Let us take a closer look at what this 'advantage' consists of in the transfer pricing decisions adopted by the Commission.

At Starbucks and Amazon, profit shifting would supposedly be obtained through an artificially high-cost setting. In both decisions, the taxable base of the beneficiary companies was reduced through deductible expenses, specifically the payment of royalties that these companies paid to other companies in the group for the use of intellectual property rights. The Commission considered that the tax rulings in question had made it possible to determine an inflated amount of these royalties, at a level higher than what would have been paid for the same rights on the market. This, in the Commission's view - and this was the basis for the proposal - was a departure from the general rule established by the tax regulations of the Netherlands and Luxembourg, according to which the taxable amount of a tax year is determined as a result of subtracting the deductible expenses incurred from the income generated in that year.

At Amazon, the ruling agreed by the Luxembourg tax administration established the method for calculating the taxable base of Amazon EU ("LuxOpCo"), an operational subsidiary of the Amazon group in this country that functioned as the group's headquarters in Europe for its online retail and service business operations through its web pages in the EU. The ruling authorized the use of one of the so-called "indirect" transfer pricing methods supported by the OECD, the transactional net margin method ("TNMM"). The difference between the profit actually obtained and the "market" or ordinary profit determined by applying the TNMM, is called the "residual" profit, and is considered the payment (deductible) that the company makes to another company of the group for the services provided. Thus, the TNMM determines "indirectly" the price of the intragroup transaction.

In the case of Amazon, the tax ruling considered LuxOpCo a company with operations of an ordinary nature and for this reason, through the application of the TNMM, it was allowed to be taxed for a profit corresponding to the 4-6% (the true number is actually confidential) of their operating expenses. The rest of the profits obtained by this company were considered the royalty paid to another company of the group, Amazon Europe Holding Technologies SCS ("LuxSCS"), not subject to taxation in

Luxembourg. The royalty thus represented more than 90% of the annual profit generated by LuxOpCo. The logic underlying this annual payment is that most of the profit generated by LuxOpCo should be attributed to the company that provides the intellectual property rights -LuxSCS - because it was the one that generated value in the group's operations.

The Commission's decision concludes that the amount of the royalty did not correspond to the economic reality of the functions that LuxOpCo and LuxSCS performed, and therefore did not faithfully reflect a market result in accordance with the arm's length principle[57].

LuxOpCo was the entity that made decisions and carried out activities related to Amazon's retail business in Europe[58], LuxSCS, on the other hand, was a "limited partnership" without employees, offices or commercial activity, which acted as an intermediary between LuxOpCo and other companies of the group based in the United States. As the owner of Amazon's intellectual property rights, LuxSCS received the royalty from LuxOpCo and transmitted it to the United States under a "cost sharing agreement"[59].

The General Court on Amazon[60]

In Amazon, the reasoning of the Court has much in common with the judgement in Apple. It is not only about the Commission's competence, but also to the focus on the burden of proof in State aid cases.

The judgment starts with the reasoning and the clarification that there is no doubt that the Commission has the competence to scrutinize tax rulings under art. 107 TFEU, and that this behavior does not encroach on Member States' fiscal autonomy[61].

The proof of (where the EC has the burden of proof) methodological error in the application of the arm's length principle is not enough[62]. In other words, "the Commission cannot simply assume that because the Member State acted in a seemingly arbitrary manner the outcome was wrong"[63]. There are three fundamental questions:

1) Which party should have been subject to the test in the application of the TNMM?

2) Did the Commission succeed in proving the existence of an advantage?

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[57] *Amazon, 9.2.1.1. Functional analysis of LuxSCS, 9.2.1.2. Functional analysis of LuxOpCo*
[58] *Amazon, 9.2.1.2. Functional analysis of LuxOpCo*
[59] '' A cost sharing agreement is a legal agreement between business entities where the expenses incurred by one entity are allocated to another entity, usually for taxation or accounting purposes. A cost sharing agreement can provide big tax advantages and is attractive to businesses because they can continue to operate on their own terms but share some of the most expensive costs of their business with another entity.'' From https://www.contractscounsel.com/t/us/cost-sharing-agreement
[60] See the judgment Joined cases T-816/17 and T-318/18 Luxembourg v Commission (hereinafter GC Amazon)
[61] GC Amazon, par. 113
[62] GC Amazon, par. 123
[63] A Lamadrid, ''The Fiat and Starbucks Judgements'' (25 September 2019) Chillin'Competition chillingcompetition.com.

3) Was the arm's length principle correctly applied?

LuxOpCo was the wrong choice as the party to be tested, since LuxSCS only performed very limited functions within the concerned transactions and was therefore the "less complex entity"[64]. LuxSCS was the one that had to be tested. Under these circumstances the Commission has to support its argument. On the contrary, the Court underlines that LuxSCS provided intangible assets with "unique and valuable" role that finds no external comparable on the market[65]. Furthermore, the Commission had to show that the functional analysis of the activities carried out by LuxSCS would have been easier[66].

In the second question, according to the par. 296 of the GC decision '' the Commission's calculation of LuxSCS's 'remuneration', on the basis that LuxSCS had to be the tested entity, is vitiated by numerous errors and cannot be regarded as sufficiently reliable or capable of achieving an arm's length outcome. Since the calculation method used by the Commission must be rejected, that method cannot serve as a basis for the Commission's finding that the royalty paid by LuxOpCo to LuxSCS should have been lower than the royalty actually received, pursuant to the tax ruling at issue, during the relevant period''.

As far as the third question is concerned, the functions performed by Lux SCS could not be considered as mere supply of "low value adding" services[67]. Therefore, the Commission's application of the arm's length principle led to an erroneous result in the determination of the net margin attributable to LuxSCS.

Apart from the above questions, the Court insists that the Commission is required to justify why it chose the specific methodology. Especially, the GC holds that the Commission should have examined better the choice of operating expenses as a profit level indicator while the Commission didn't prove that the total costs would be thw most appropriate profit level indicator and last but not least, there was no examination if LuxOpCo was the most appropriate profit level indicator as "administrator of a marketplace for third-party sellers" and "online retailer"[68].

Also, according to par. 587 '' the Commission found, at most, a methodological error in the calculation of LuxOpCo's remuneration, without succeeding in showing that that error had the effect of artificially reducing LuxOpCo's remuneration to such an extent that that level of remuneration could not have occurred under market conditions.''

Taking all of the above into consideration, the GC decided to annul Amazon Decision.

[64] *Amazon*, par. 549
[65] GC Amazon, par. 244
[66] GC Amazon, par. 250
[67] GC Amazon, par. 294-295
[68] GC Amazon, par. 546, 555-546

2.1.2 Starbucks

Starbucks is also concerned with the payment, which the Commission again considers to be inflated, of royalties from one operating company to another non-taxable group company. The operating company of the group was in this case Starbucks Manufacturing EMEA BV ("Starbucks Manufacturing" or SMBV), a company based in the Netherlands that distributed coffee and related products to the group's stores in Europe, the Middle West and Africa. The ruling allowed this company to reduce its tax base through a series of royalty payments paid to Alki Limited Partnership -a company resident in the United Kingdom -for the know-how for the roasting of coffee. Alki was a "transparent" limited partnership based in the United Kingdom, which was not taxed on royalties received either in the United Kingdom or in the Netherlands[69].

As in the case of Amazon, the ruling accepts again the application of the TNMM method for estimating the market remuneration of Starbucks Manufacturing for its contribution - supposedly frequent - to the Starbucks business[70]. This remuneration consisted of a reduced percentage of the profit actually generated by the company and recorded in its accounting. The fee paid to Alki was calculated in the tax ruling as the residual profit resulting from Starbucks Manufacturing after subtracting its remuneration or market profit for its supposed routine functions[71].

The Commission also considered in this case that the taxable profit of Starbucks Manufacturing determined under the ruling did not reflect a reliable approximation to what should be considered a market result in line with the arm's length principle. The Commission questioned whether the TNMM could be the most appropriate transfer pricing method for determining the market level of the fee, arguing for the application of the so-called Comparable Uncontrolled Price (CUP) method. This method is preferable in those situations where it is possible to estimate the remuneration of an intragroup transaction by its direct comparison with other comparable transactions that the same company carries out with third parties on the market. These transactions existed, according to the Commission, and would have allowed the Dutch tax administration to establish the royalty price by means of a comparison with the same[72]. In particular, the Commission notes in its decision that Starbucks Manufacturing has concluded several agreements with third parties for the roasting of coffee and that in those agreements no royalty payment was agreed for the alleged know-how. This allowed the Commission to conclude that, in application of the arm's length principle, no payment should have been made for this know-how to Alki[73]. The Commission also

[69] The "transparent" nature of these entities implies that the profits that Alki generated were subject to taxation at the level of its partners (resident partners) in the United States, and not at the level of the company.
[70] Press release. 21 October 2015. Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules.
[71] *Starbucks*, par. 52-61
[72] *Starbucks,* 9.2.3.3
[73] *Starbucks,* par. 286

considered that the price that Starbucks Manufacturing paid for raw coffee to another company of the group had been unreasonably increased from the year 2011[74].

The amount of the royalty and the price for the raw coffee reduced - in the Commission's opinion artificially - the taxable profit of Starbucks Manufacturing. This benefit has thus been derived both to Alki - which, as explained, was not subject to taxation for these revenues - and to the entity selling the raw coffee, a tax resident in Switzerland.

The General Court's position on Starbucks[75]

Following the appeal by the Netherlands and Starbucks, the General Court delivered its judgment on 24.9.2019.

As it has been pointed out above, the court seems to justify all the commission's methodological choices at legal level.

It then proceeded to check the merits of the arguments of the Commission's decision. The default pricing agreement adopted, as already mentioned, the transactional net margin method (TNMM), a methodological choice which the Commission considered to be incorrect. For its part, it applied the comparable uncontrolled price method (CUP) to calculate allowances in the light of the principle of equal distances. The court, however, held that the commission did not rely on any evidence to support the conclusion that this choice necessarily led to such a low result, since it did not compare the APA result with the result that would have been achieved had the CUP method been adopted. Therefore, the commission failed to demonstrate that the simple choice of the TNMM method in the present case granted SMBV a selective advantage.

The court then ruled on the commission's secondary argument that the rules for the application of the TNMM method, in the manner adopted by the agreement at issue, were incorrect, giving SMBV an advantage. Again, without denying the various errors identified by the commission in the application of the pricing method, the court considered that the commission had not sufficiently established its claims.

Consequently, the Commission's decision was annulled because it was unable to demonstrate, ''in the required legal measure''[76] that the Netherlands had derogated from the principle of equal distances and thus granted a selective advantage to its subsidiary Starbucks.

It is noteworthy that the Commission decided not to appeal the decision of the General Court. This move can be attributed, in particular, to the fact that its decision was annulled solely on the basis of fact. In the legal part of the case, which was the most

[74] *Starbucks,* par. 341
[75] See the Judgment in Cases T-760/15 Netherlands v Commission and T-636/16 Starbucks and Starbucks Manufacturing Emea v Commission. 24 September 2019
[76] Dimitrios Kyriazis, Apple: One Case to rule them all, Kluwer Tax Blog, 06/2020

controversial –and which is the only one the CJEU can consider - it was fully vindicated.

In fact, the General Court held, as is clear from its reasoning, that the Commission has the right to recognize a principle of equal distances as a criterion for assessing the existence of state aid, and that the commission's interpretation of Forum 187 was not elaborate[77].

2.1.3 Apple

In the case of Apple, the decision analyzed a tax ruling granted by the Irish administration that determined the taxable base of Apple Operations Europe (AOE) and Apple Sales International (ASI). Unlike Amazon or Starbucks, this case does not concern the distribution of profit between different group companies, but the internal distribution of AOE and ASI.

AOE and ASI were two companies incorporated in Ireland but neither of them was a tax resident in that country (or, in fact, in any other jurisdiction), ASI and AOE benefited from an existing regime in Ireland[78] that allowed companies established in Ireland not to pay tax if they were controlled and managed from outside the country and met another set of requirements. AOE and ASI operated through branches based in Ireland. However, the rulings questioned by the Commission allowed attributing almost all of the profits generated by both companies to their main headquarters ("head offices"), where the control and management activities were carried out through their boards of directors. These headquarters, however, had no tax residence in Ireland (or in any other jurisdiction), so ASI and AOE were effectively taxed in Ireland for the minimum portion of their profits that the ruling attributed to the branches in Ireland, despite the fact that it was in these branches that all their employees and tangible assets were located. This minimal portion of the profits generated by ASI and AOE remunerated what the tax agreements considered ‘’ordinary contribution’’ of the branches to the business of ASI and AOE[79].

The Commission considered that, in view of the functions carried out by the branches and the main headquarters, the internal distribution of profits erected by the rulings did not correspond to economic reality. The headquarters of ASI and AOE, in the opinion of the Commission, lacked operational capacity, since they had neither employees nor physical offices. According to the Commission, it was the branches located in Ireland that performed the functions, made the decisions and assumed the risks related to the operations of ASI and AOE, while the head offices were limited to taking decisions of

[77] Dimitrios Kyriazis, Why the EU Commission won’t appeal the Starbucks judgment, MNE Tax.com, 12/2019

[78] Taxes Consolidation Act (TCA) 1997, 2014

[79] Press release, 30 August 2016, *State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion,* ‘’ In 2011, for example, Apple Sales International recorded profits of US$ 22 billion but under the terms of the tax ruling only around €50 million were considered taxable in Ireland, leaving €15.95 billion of profits untaxed. ‘’

a purely administrative nature, related to the distribution of dividends and treasury management[80].

The Commission's Decision is based on the premise that a proper application of the arm's length principle should have led to the Irish branches and the head offices of ASI and AOE being treated as separate legal entities for profit-sharing purposes, as prescribed by the OECD[81]. When attributing the intellectual property rights that ASI and AOE use for their operations - under a Cost Sharing Agreement with Apple Inc. by paying an annual amount to the latter as a contribution to the cost of developing these rights - the risks associated with the activities carried out by both entities between the branches and the head offices of ASI and AOE, the Irish tax administration should have taken into account the functions actually carried out, the assets used and the risks assumed by the subsidiaries and by the headquarters. According to the Commission, the absence of all activity, employees and assets in the head offices should have led to an attribution of almost all profits to the branches. That is, the opposite result to that obtained when applying the rulings[82].

The issue of remuneration for Apple's intellectual property rights that ASI and AOE used in their activities is of particular relevance for the understanding of the Decision. The Commission does not dispute the payments made by ASI and AOE to Apple Inc for these rights under the Cost Sharing Agreement. It presumes that these payments - determined by Apple - constituted adequate remuneration to Apple Inc. for their contribution to the development of these rights. This aspect is essential to understand the position of the omission in relation to the accusation that most of the profits of ASI and AOE should not be taxed in Europe (Ireland), but in the United States, headquarters of Apple Inc., where the technology that Apple uses in its products and that ultimately determines its success in the market had been developed. The Commission considered that the part of the profits that remunerate the activity of Apple Inc was already estimated by Apple when calculating the payments under the Cost Sharing Agreement. The Commission's Decision concerns exclusively the remaining part of the profit, once Apple Inc has been remunerated[83].

The General Court's position on Apple[84]

Starting its lengthy judgment, the Court, following a claim by the applicants, concluded that the Commission's decision did not infringe the principle of fiscal autonomy of the states. In this context, it reiterated that, while direct taxation falls within the competence

[80] *Apple*, analyzed in 8.2.2.2
[81] *Apple*, analyzed in 8.2.2.2a
[82] Press release, 30 August 2016, *State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion,* ''… Therefore, sales profits of Apple Operation Europe should have been recorded with the Irish branch and taxed there. On this basis, the Commission concluded that the tax rulings issued by Ireland endorsed an artificial allocation of Apple Sales International and Apple Operations Europe's sales profits to their "head offices", where they were not taxed. ''
[83] *Apple,* par. 310-312
[84] See the Judgment of the General Court (Seventh Chamber, Extended Composition) of 15 July 2020. Ireland and Others v European Commission. Cases T-778/16 and T-892/16.

of member states, they should exercise it in accordance with the requirements of EU law, among which are the state aid rules.

Since the Commission is therefore responsible for ensuring that Article 107 TFEU is not infringed, it cannot be argued that it exceeded its powers in assessing the possible granting of favourable tax treatment to ASI and AOE by the Irish authorities through the adoption of the tax decisions at issue.

In carrying out this audit, the ‘normal’ system of taxation in Ireland plays a central role. This will provide the framework of reference to demonstrate whether the tax rulings allowed the Irish branches of Apple Group companies to reduce their attributable profits, by comparison with the tax treatment they would have received under the normal taxation rules in Ireland if the tax rulings at issue had not been issued.

Section 25 of the relevant Irish tax code (TCA 97) therefore states that ‘’non-resident companies carrying on their trade in Ireland through a branch are taxed, with regard to their trading income, only on the profits resulting from trade directly or indirectly attributable to that Irish branch.’’[85]

The court therefore concluded that the Commission is unjustifiably charged with unilaterally applying the substantive tax rules and actually carrying out tax harmonisation when comparing the value of the activity of the branches with that which corresponds to comparable situations in market conditions. This presupposes, of course, that account is taken of the activities, assets and risks that the branches concerned would bear if they were taxed under Section 25 of TCA 97. Only in this way does an analysis corresponding to the OECD proposed authentic approach take place.

In examining in more detail, the relevant question of determining the reference framework, the Court noted that this is substantially related to both the criterion of advantage and the criterion of selectivity.

Finally, it embraced the commission's view that the framework of reference was the common rules on taxation of corporate profits in Ireland, whose internal purpose is to tax the profits of all companies subject to tax within it, whether resident or not, whether vertically integrated or independent.

At the same time, it noted that according to the case-law, the rules forming the frame of reference are those to which the recipient of the measure considered to constitute state aid is subject. The tax rulings at issue therefore form part of Ireland's general corporate tax regime. But they are not entirely the reference system, as supported by multinational corporations.

It becomes obvious, therefore, that in order to calculate the tax liability of a company under the normal system, it is necessary to determine the amounts that would have been charged to it if it had transacted on the principle of equal distances.

[85] Cases T-778/16 and T-892/16, par. 113

However, the applicants claimed that this principle was not part of the Irish tax law[86]. In response - and to detour- the court of justice, without contesting that 'normal' taxation is determined in accordance with National Law, pointed out that if those national rules provide that branches of non-resident companies and companies considered to be resident are subject to taxation rules having a common purpose, as regards profits from commercial activity in Ireland, Article 107(1) TFEU entitles the Commission to verify whether the amount of profits attributed to the branch, by means of the tax decision, it corresponds to the amount of profits that would be attributed to the same activity under market conditions.

The Arm's length principle, that is, also applies in the present case, since it is the commission's tool for comparing the tax treatment of a different class of companies, which are, however, in the same legal position according to the purpose of the tax reference system, which is to tax all profits of companies.

By approving the commission's use of the principle of equal distances, the General Court has vindicated all its choices in law. Nevertheless, she annulled, in the end, her decision. The reason was the commission's incorrect application of this principle.

In its decision, the Commission concluded that all commercial profits of ASI and AOE from the exploitation of intellectual property rights should be attributed to the Irish branches of those companies, due to the lack of staff and physical presence of the two companies elsewhere.

The General Court, however, held that the Commission's application of the principle of equal distances was incorrect because the OECD methodology for determining the imputable income was not correctly applied, since the commission did not demonstrate that the branches had actually performed rights management functions.

It also found the commission's attempt to demonstrate that, through the TNMM methodology adopted in the tax rulings, an advantage was granted to the Apple group companies[87].

At the same time, while acknowledging that there were serious deficiencies in the information provided by Apple before the decisions were made in order to correctly calculate the profits attributed, the court ruled that it was not sufficient to simply identify methodological errors in the calculation of the profit attributable to branches[88]. The burden of full proof at this stage lies with the Commission.

The decision of the General Court in the Apple case is, at the moment, the main guide available to the parties concerned - both the Commission, as well as the tax advisors of multinational companies - to organize their next moves.

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[86] Indeed, the National Law of Ireland had not, until that moment, incorporated the arm's length principle. This is a fundamental difference between the Apple case and all the previous ones.

[87] Cases T-778/16 and T-892/16, par. 348-351

[88] Phedon Nicolaides, Taxation of Multinational Companies: The Apple Case- A Political Setback for the Commission, but a Victory on Principle, 07.2020

At the same time, however, it was made clear by the court that in its attempt to check the compatibility of tax rulings with state aid rules, the commission bears a very heavy burden of proof. The full proof which the court seems to require is difficult[89]. Especially when we refer to such technical issues as the correct application of a method of accounting for profits, in order to approach market conditions. It is characteristic that in all its judgments so far, the court has reiterated that intra-group transactions are not an exact science[90]. However, this does not help to determine the acceptable error range of a calculation method from a state aid perspective.

All controversial issues are expected – and should - be resolved by the CJEU, which this case has already reached following the commission's appellation[91].

The findings resulting from the General Court's judgments so far will be taken into account by the Commission and in its ongoing investigations in order to satisfy the court's requirements in terms of evidence, so that it can win cases on a substantive level.

2.1.4 Fiat

Finally, the Commission's Decision in FIAT concerns the tax arrangements of this company with the Luxembourg tax administration in relation to the taxation of the treasury management company of this group in the Duchy. Once again, the Commission considers that these agreements validated a methodology and tax burden that did not respect the arm's length principle. The company in question, Fiat Finance and Trade Ltd (FFT), provided treasury and financing services for the group's activities in Europe. The Commission considered that the rulings in question allowed the company to artificially reduce its tax bill by unjustifiably reducing its taxable base. Firstly, the capital that was used to estimate the company's profitability was significantly lower than the company's effective capital as it turned out from its accounting records[92]. In addition, the rate of return applied to capital was lower than it should have been applied as a result of a comparison with companies operating similar financing activities in the market[93].

[89] In Gibraltar (C-106/09 and 107/09), the tax system never worked and therefore did not, in practice, grant any advantage to a company. It was judged selective, on the basis of its possible consequences. Jerome Monsenego, Some observations on the Apple Case, Kluwer Tax Blog, 8.2020. This case-law is, of course, far from being regarded as settled, in view of the specific features of Gibraltar's corporate taxation system.
[90] DG COMPETITION WORKING PAPER ON STATE AID AND TAX RULINGS, High Level Forum on State Aid of 3 June 201
[91] Statement by Executive Vice-President Margrethe Vestager on the Commission's decision to appeal the General Court's judgment on the Apple tax State aid case in Ireland, Brussels, 25 September 2020
[92] *Fiat*, 7.2.2.5, 7.2.2.6, 7.2.2.7
[93] *Fiat*, 7.2.2.9.

The Commission's press release stressed that if conditions corresponding to those existing on the market had been applied, the company would have had to pay an amount for corporation tax twenty times higher than actually paid[94].

In short, in these four decisions the Commission assessed the existence of the advantage requirement for what it considered an unfair application of the arm's length principle. This incorrect application was allegedly carried out either by establishing royalty payments or artificially high prices (Starbucks and Amazon), by calculating an excessively low rate of return for the activities of one company (Fiat) or by an incorrect internal attribution of profit to the branches of two group companies (Apple).

It should be noted that in none of these cases is the combined tax burden of the group relevant to the Commission's reasoning. The examination of the advantage takes into account exclusively the tax burden of the beneficiary companies in the Member States that granted the rulings by comparing the tax burden resulting from the application of the rulings with that which would have resulted, if they had operated on the market according to the arm's length principle. The fact that the profit, that supposedly, would have been artificially reduced had been attributed to companies (or head offices in the case of Apple) with tax residence in jurisdictions with reduced or no taxation is completely irrelevant for the Commission despite the fact that - as is well known - this profit shifting is the purpose of international tax planning structures, as we will see in the GC Judgment.

In practice, it is the application of a deviation from the arm's length principle that results in profit shifting towards low or zero taxation jurisdictions. Even if that is not the reasoning followed by the Commission to demonstrate the advantage, that is ultimately the result in all cases: a (double) non-taxation of the group's profit.

However, there is another category of cases in which the Commission has taken a different approach to demonstrating the requirements of advantage and selectivity. These are cases in which there is no "diversion" of profits to other jurisdictions, but the absence of taxation within the group occurs within a single jurisdiction. These are the Belgian Excess Profit and Engie cases, we will address these cases in the section dedicated to selectivity, since the demonstration of advantage and selectivity in these matters are closely linked to each other.

[94] Press release. 21 October 2015. Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules. ‘’ The Commission's assessment showed that in the case of Fiat Finance and Trade, if the estimations of capital and remuneration applied had corresponded to market conditions, the taxable profits declared in Luxembourg would have been 20 times higher. ‘’

The General Court's position on Fiat[95]

The General Court ruled in its judgment of 24.9.2019 on the actions brought by Luxembourg and the FFT. It therefore adopted a rejection decision on the appeals, validating all the commission's interpretations on the merits at the legal level.

First of all, it recalled the settled case that, while direct taxation falls within the exclusive competence of the member states, the latter should exercise it in compliance with EU law. In this way, it confirmed the commission's right to assess the compatibility of tax decisions with competition rules, namely Article 107 (1) TFEU and the principles contained therein.

The wording of the judgment of the General Court seems to endorse the commission's view that the Arm's length principle is such a principle, since, according to the contested decision, it is a tool which makes it possible to establish an advantage in the context of the state aid analysis[96].

The General Court subsequently adopted the commission's view on the objective of Luxembourg's tax law. In other words, it considered that vertically integrated and autonomous companies are not distinguished in view of their inclusion in corporation tax. They are therefore in a comparable factual and legal situation with regard to the purpose of the state aid rules[97].

Proceeding to examine the two main conditions for proving the granting of state aid by a member state, namely the granting of an advantage and the selective nature of the tax decision, the court did not reject the commission's simultaneous examination of the fulfilment of the two criteria. It is sufficient, of course, from its decision to show that both are satisfied, which it considered to be the case in the present case.

It fully adopted the commission's reasoning that, on the basis of the method adopted in the pre-approval tax decision, a full competitive effect could not be achieved, since the tax burden on FFT was unduly reduced.

Finally, as regards the criterion of selectivity of the advantage granted to FFT, it pointed out the difference in terms of proof between a measure envisaged as a general Aid Scheme and a measure equivalent to individual aid[98]. It concluded that the tax decision at issue belonged to the second category, so since it considered the existence of an

[95] See the Judgment of the General Court (Seventh Chamber, Extended Composition) of 24 September 2019. Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission. Case T-755/15.
[96] However, the Court did not provide any definition that would demonstrate the material content of this principle, other than the general idea that some kind of similar pricing is required between independent and related companies.
[97] By adopting a reference system with such a range, it is easier for the Commission to demonstrate a derogation from the Arm's Length principle.
[98] Article 1(e) of the Regulation 2015/1589 '' 'individual aid' means aid that is not awarded on the basis of an aid scheme and notifiable awards of aid on the basis of an aid scheme. ''

advantage to be established, it approved the use of the presumption of selectivity on the part of the Commission[99].

This decision marked a clear victory for the commission-both in legal and factual terms - in the application of state aid rules to pre-authorization tax rulings granted by member states to multinational companies. The confirmation of the predominance of the commission's view as regards the legal aspect of these cases came in the judgment of the General Court in the Starbucks/Netherland[100], despite its essentially different outcome, due to the commission's inability, according to the court, to prove the granting of an advantage to Starbucks within the meaning of Article 107 (1) TFEU[101].

2.2. Selectivity: The presumption of selectivity in individual aid.

The Belgian Excess Profit and Engie cases

In the four matters analyzed above (Amazon, Starbucks, Apple and Fiat), the demonstration of the selectivity requirement is made from several perspectives. The main one is related to the distinction between general regimes and individual aid.

Indeed, to the extent that the tax subsidies analysed in these decisions are individual aid - insofar as their scope of application is limited to the companies benefiting from them - the Commission demonstrates the existence of selectivity by resorting to the presumption established by case law - among others in the MOL and World Duty Free judgments. According to this doctrine, if an individual measure grants an advantage, such an advantage must necessarily be considered selective, since no other company can benefit from it[102].

However, the Commission also proceeded in these decisions to demonstrate selectivity through the three-stage test, in which we have already referred to, proposed by case law for tax aid regimens[103]. This test is stated as follows: first, the Commission must identify a framework or reference system that applies to the generality of the taxable

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[99] *FIAT,* par. 218 ‘’ According to the Court, in the case of an individual aid measure, as opposed to a scheme, ‘the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective’ ‘’, also: Case C-15/14 P *Commission* v *MOL,* par. 60; Case T-385/12 *Orange* v *Commission* .

[100] Which was issued the same day.

[101] In December 16, 2021 — Case C-885/19 P Fiat Chrysler Finance Europe v Commission (“FFT appeal”) — Advocate General Priit Pikamäe recommends the Court of Justice of the European Union (CJEU) dismiss the FFT appeal in its entirety. In a nutshell, the FFT appeal is based on three main grounds. First, the fact that the EU General Court would have erred in law as regards the economic analysis of advantage for state aid purposes. Second, FFT argues that the General Court’s decision would be vitiated by an inconsistent and contradictory reasoning regarding the application of the arm’s-length standard. Third, and finally, the General Court would have infringed on the principle of legal certainty when endorsing an “ill-defined” arm’s-length standard, generating a presumption of selectivity that would have been applied to the tax ruling at issue.

[102] *FIAT,* par. 216-218; *Starbucks,* par. 252-254; *Apple,* par. 224; *Amazon,* par. 583-584

[103] *FIAT* par.*1*92; *Starbucks* par. 230; *Apple* par. 226; *Amazon* par. 585

persons; secondly, it analyzes to what extent the examined regime constitutes an exception to said reference system by establishing differences between economic operators which, having regard to the intrinsic objectives of the system, are in a situation comparable in fact and in law, in which case the measure is considered selective a priori; finally, in a third stage, the Member State may provide a justification for such a derogation based on the nature or the general economy of the reference system. In the absence of such justification, the measure is considered selective.

In the decisions of Amazon, Starbucks, Apple and Fiat, the Commission considered, when applying the first phase of the test, that the reference framework was the corporate tax system in Ireland, Luxembourg and the Netherlands[104].

As regards the second phase, the Commission found that under those tax systems all corporate taxpayers are in a comparable situation, in fact and in law. Thus, companies belonging to corporate groups and that conclude contracts with other companies of the same group would be in a comparable situation to companies that conclude contracts with third parties (not belonging to the group) taking into account the intrinsic objectives of the tax system in question. The fact that companies involved in transactions with other group companies are subject to provisions – the transfer pricing rules – that do not apply in the Commission's view, this is not a reason to consider the others to be incomparable, since the purpose of those provisions is precisely to ensure that the transfer prices applied reflect market conditions. In other words, the arm's length principle – by virtue of which transfer prices are applied – has no other objective than to ensure that the profit earned, on the one hand, by companies integrated into a group and concluding transactions with other group companies, and on the other hand by companies operating with third parties in the market is determined in the same way[105].

Thus, since the rules examined in these four decisions were separated from the principle of arm's length, they should be considered an exception to the reference system by establishing differences between economic operators who, in view of the intrinsic objectives of the system, were in a comparable situation in fact and in law, and therefore should be considered prima facie selective[106]. In other words, the reduction of the taxable base of the beneficiaries caused by the breach by the tax agreements of the arm's length principle constitutes at the same time the advantage and the repeal of the reference system in the three-stage test.

In a subsidiary line of reasoning, the Commission also considered in these proceedings a narrower system or frame of reference, composed exclusively of the taxable persons who are part of a corporate group and to which transfer pricing rules apply. In this narrow frame of reference, therefore, taxable persons to whom these rules do not apply,

[104] *Amazon,* par. 587; *Apple,* par. 245; *Starbucks,* par. 231
[105] *Fiat,* par. 210; *Starbucks,* par. 245; *Amazon,* par. 592
[106] *Amazon,* par. 9.3.2.1; *Apple,* par. 321; *Starbucks,* par. 9.2.3.

because they operate exclusively with third parties on the market, would not be considered comparable.

In any case, with this narrower frame of reference, the Commission's conclusion does not change. By deviating from the principle of arm's length competition – which constitutes the central element of the reference system – the rulings also constitute an exception or derogation from it, placing the beneficiaries in a more favorable situation than comparable companies, which are none other than those companies integrated into groups to which the arm's length principle[107] is correctly applied.

A similar reasoning is used by the Commission in Ireland when comparing resident companies and non-resident companies operating in Ireland through a permanent establishment. Both situations, according to the Commission, are comparable and are included in the same reference system[108]. For the Commission, the reference framework includes resident and non-resident taxpayers. The determination of the taxable base for the calculation of the tax burden is equivalent for resident companies (in which case the determination would be made with respect to their worldwide profits) than for the permanent establishment of a non-resident company (in this case only profits originating in Ireland are relevant)[109].

As we have mentioned above, there is another category of cases analyzed by the Commission that are not based on an erroneous application of the transfer pricing rules.

It is about the Belgian affairs Excess Profit and Engie.

2.2.1 Belgian Excess Profit

In Belgian Excess Profit[110], the reduction of the tax burden is not obtained by using transfer pricing to divert the profit to jurisdictions with reduced taxation, but by introducing a difference between the accounting profit of the company and its tax benefit. The excess profit regime consisted, in fact, in allowing the non-inclusion in the taxable base of the company of a part of the profit generated by it in its economic activities – and recorded in its accounting – without that non-inclusion being related – as in the transfer pricing matters analyzed above - with any payment to another company of the group for goods and services acquired.

In this case, the reduction of the taxable base is carried out through what is called a unilateral downward transfer pricing adjustment. The unilateral nature of these adjustments alludes precisely to the irrelevance of the other jurisdiction in order to achieve the desired tax savings.

The regime applied by the Belgian tax administration since 2005 allowed multinational companies to reduce their tax base through individual tax rulings that determined the

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[107] *Amazon,* par. 9.3.2.2; *Apple,* par. 8.2.3; *Starbucks,* par. 9.2.4.

[108] *Apple*, par. 236

[109] *Apple,* par. 237

[110] Commission Decision *(*EU*)* 2016/1699 *of* 11 January 2016 on the excess profit exemption State aid scheme SA.37667 – Belgian Excess Profit (hereinafter *Belgian Excess Profit*)

so-called "excess profit" or excess profit of each company, which was exempt from taxation. Conceptually, this excess profit did not correspond to the payment to another company of the group for services or goods acquired, but was justified by the supposed savings due to synergies and economies of scale inherent in the operations of multinational groups – which for so much would never be generated between companies not integrated into a group[111].

Leaving aside the determination of the amount of the exemption, which was obtained by a double application of the TNMM[112] method, the scheme in question was considered by the Commission to be an advantage because it constituted an exception or derogation from the reference system on the basis of two lines of argument.

In the first, the Commission argues that this scheme is derogatory in that it constitutes an exception to the general rule of the Belgian corporate tax system, according to which a company's tax base is calculated on the basis of its accounting profit. The exemption from excess profit consisted precisely in reducing the taxable profit below the trade profit reflected in its accounting.

The second line of argument was based on an incorrect application of the arm's length principle, basically considering that this principle and the transfer pricing rules should not be applied, since there was no intragroup transaction to put a price on. The exemption was to be considered contrary to the arm's length principle because it gave rise to a situation of double non-taxation[113]. According to the Commission, the arm's length principle allows the tax administration to make adjustments (upward) of the tax base of companies that do not respect this principle in their transfer prices. However, a downward adjustment that results in a reduction of the taxable base is only provided by the arm's length principle in those situations in which an upward adjustment has previously occurred in another jurisdiction, that is, provided that it is carried out symmetrically[114]. In these situations, the downward fiscal adjustment aims to avoid international double taxation of the same benefit. In the Belgian excess profit regime, the downward adjustment is, the Commission argues, unilateral and asymmetric in nature, since there was no transaction that could give rise to an upward adjustment in another jurisdiction. As there is no risk of double taxation, the Commission concludes that there was no justification for the unilateral reduction of the taxable base of companies subject to this regime[115].

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[111] *Belgian Excess Profit*, par 135-140

[112] *Belgian Excess Profit*, par. 155

[113] *Belgian Excess Profit*, par. 162-165.

[114] *Belgian Excess Profit,* par. 178, Commission approves and follows Article 9.2 OECD MODEL TAX CONVENTION

[115] *Belgian Excess Profit,* par. 171-181 and C-78/08 to C-80/08 *Paint Graphos,* par. 69.

The General Court's position on Belgian Excess Profit[116]

The General Court annulled the Commission's decision. In its decision, it accepted that the commission had committed a legal error by considering that the above scheme constituted a 'state aid scheme' within the meaning of Article 1(d) of the Regulation 2015/1589[117].

The Commission has therefore sought to demonstrate the existence of a whole tax scheme granting state aid, so that it does not have to analyse each tax decision separately, but that its entry under the scheme makes it appear to be unlawful[118].

In the judgment of the court, therefore, the commission failed in its task, since none of the cumulative conditions laid down in the above definition were proven. First of all, in this case, further enforcement measures were required, in addition to what was identified as the basis of the scheme at issue[119]. Second, the Belgian tax administration did not act in a binding capacity, but had effective discretion in examining applications for tax rulings for approval of the downward adjustment[120]. Finally, according to the Court, the beneficiary companies were not identified in a general and abstract manner, as required by the regulation, but were required to be specialised on the basis of further enforcement measures.

2.2.2 Engie

Another purely internal case of double non-taxation is Engie. This case concerns a 'hybrid' financing structure between Engie Group companies with tax residence in Luxembourg. Essentially, Engie financed the operations of two of its companies through a complex financial framework that allowed these companies to reduce their tax base almost to zero through deductible payments (comparable to interest payments). These payments subsequently arrived – through the intervention of intermediary companies and advance share purchase contracts – to the holding companies in the form of capital gains on shares that were exempt from the effect of the application of the participation exemption (which in Luxembourg applies both to dividends and to increases in the value of shares).

Thus, the profit generated by these two companies benefited from a double non-taxation: at the level of operating companies, the profit received the tax treatment of debt interest and therefore was not included in the tax base of the company. At the level

[116] See the Judgment of the General Court (Seventh Chamber, Extended Composition) of 14 February 2019. Kingdom of Belgium and Magnetrol International v European Commission. Cases T-131/16 and T-263/16

[117] According to this article '' 'aid scheme' means any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount.''

[118] Dimitrios Kyriazis, The Belgian Excess Profits Case- A State Aid Anti-Climax, Kluwer International Tax Blog, 5.3.2019

[119] *Cases T-131/16 and T-263/16*, par. 93-98

[120] *Cases T-131/16 and T-263/16*, par. 87 and par. 104

of holding companies, the same financial flow was considered capital, and again subject to an exemption[121]. This double treatment of financial flow – as debt and capital - was considered a selective advantage through two lines of arguments.

Both lines of argument apply the three-stage test and both take the same frame of reference: the Luxembourg corporate taxation system, although the exemption or repeal of it, is argued from two different and complementary perspectives.

In the first, the Commission argues that selective advantage occurs in holding companies. The thesis that defends is that the application by these holdings of the exemption of participations to a financial flow that has been previously deducted by the operating subsidiaries supposes an exception to the general rule in Luxembourgish law, according to which the dividends distributed – and possibly exempt in application of the exemption of participations – are included in the taxable base of the company that distributes them. From this point of view, the tax treatment of holding companies – argues the Commission - is more favorable than that which would have been received, for example, a holding company that financed its subsidiary through equity or debt, since in both cases the totality of the profit generated by the subsidiary would have been subject to taxation (although, depending on the instrument, at different times or in the hands of different entities). The complexity of the financing structure devised by Engie did not justify a derogation from the general principle. Or in other words, in view of the objective pursued by the Luxembourg tax regime, which is the taxation of profits generated for the taxable persons during the fiscal year, the different characteristics of the financing system used by Engie did not make it "not comparable" to simpler capital or debt financing structures[122].

In the second line of argument, the Commission considers the group as a whole to be the beneficiary of the advantage – and not necessarily the holding companies. In this case, the Commission argues that the tax treatment of Engie constitutes an advantage since, according to Luxembourg tax regulations, in any other intragroup financing transaction between companies situated in Luxembourg, the payment of remuneration for the granted financing in no case would lead to a reduction in the combined taxable base of the group, as was the case with the financing structures put into operation by Engie[123]. In both cases, the Commission considers that there has been no justification based on the nature or the general economy of the reference system, which was not even invoked by Luxembourg[124].

It is relevant that, despite the fact that the tax treatment of Engie was validated by different rulings granted by the Luxembourg tax administration, the Commission does not use in this case the presumption of selectivity that applies in the other cases of tax

In short, from the previous summarized so far, two types of cases can be defined:

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[121] *Engie,* par. 23-27
[122] *Engie,* section 6.2
[123] *Engie,* section 6.3
[124] *Engie,* sections 6.2.3 and 6.3.4

on the one hand, those of double international non-taxation, in which the alleged incorrect application of transfer pricing rules gives rise to profit shifting towards low-tax jurisdictions. In these cases, this incorrect application of the arm's length principle is considered by the Commission to be an individual measure, so once the advantage has been demonstrated, the presumption of selectivity applies (the three-stage test is applied only subsidiarily). On the other hand, the type of cases in which double taxation occurs without applying transfer pricing rules, in which the Commission applies the three-stage system of jurisprudence as the main line of argument for demonstrate the selectivity.

The General Court's on Engie[125]

At the beginning of its reasoning, like in the Amazon judgment, the Court reiterates that the Commission does not engage in any "harmonization in disguise" when assessing tax rulings under art. 107 TFEU.

The Court then, in order to examine the state origin of the aid, proceeds to distinguish between the concept of "advantage" and that one of "selectivity"; and the endorsement of an effect-based approach to the assessment of the aid.

As far as the first matter is concerned, in par. 241 of the GC Engine Judgment, there is a clarification about the fact that "In order to assess whether a measure is imputable to the State, it is necessary to examine whether the public authorities were involved in the adoption of that measure"[126]. The fundamental element that defines State origin is the fact that a public authority has been involved in the adoption of the concerned measure.

The second matter has to do with the well-known ''selective advantage''. Indeed, Engie and Luxembourg maintained that, given that the presence of an economic advantage and selectivity are two distinct requirements for a measure to constitute State aid, they should be separately analysed. If a preferential tax treatment was accorded to a certain undertaking, these two criteria should be examined, always in comparison with the treatment conferred by the law to other undertakings[127]. More specifically, the Court underlines that, as "the finding of a derogation from the provision on abuse of law simultaneously entails the grant of an advantage"[128], the Commission is not confusing the two criteria when observing that, in the absence of the tax ruling, the companies concerned would not have benefitted from the advantageous treatment that they received.

[125] Judgment of the General Court (Second Chamber, Extended Composition) of 12 May 2021. Grand Duchy of Luxembourg and Others v European Commission. Cases T-516/18 and T-525/18 (hereinafter GC Engie)
[126] See the judgment of the Court (Third Chamber) of 28 March 2019. Federal Republic of Germany v European Commission, par. 49, C-405/16 P
[127] GC Engie, par. 241, '' it is apparent from the Court's case-law that those two criteria may be examined together, as the 'third condition' laid down in Article 107(1) TFEU, relating to the existence of a 'selective advantage ''
[128] GC Engie, par. 250

For the last matter, the Court finds correct the way on which these criteria work. The economic substance of the concerned transaction rather than on the financial scheme adopted and the effect-based evaluation of the arrangement in order to determine its abusive nature. According to Gibraltar case[129], the Commission did not err in finding a derogation from the reference system (Luxembourg tax law) where the amounts exempted at the holdings' level were simultaneously deducted at the subsidiaries' level[130]. In fact, art. 107 TFEU defines that the aid itself is defined by its own effect [131]. And actually, this is the reason that the substantial violation concerns the combination of those provisions.

The novelty of the Engie case concerns the Luxembourg anti-avoidance rule. Once the abusive nature of the arrangement is demonstrated, the non-application of such a rule does indeed constitute a derogation from the reference tax system of Luxembourg law[132]. Moreover, as the Article 49 TFEU is concerned, by recalling the recent ruling of the CJEU, Beneficial Ownership Cases, "any finding that there is an abusive or fraudulent arrangement […] would also result in the fundamental freedoms guaranteed by the FEU Treaty being inapplicable"[133].

Therefore, in light of the above, the GC rejected the appeals and confirmed the Commission's decision.

2.2.3. McDonalds[134]

A separate case is the Commission's decision in the McDonald's case, the only one of those analysed, in which the Commission concluded that the ruling analysed did not constitute aid. This is a case of international double non-taxation, but unlike the previous ones, the Commission's analysis in the opening decision on the existence of a selective advantage was not based on double non-taxation per se, nor on transfer pricing regulations, but on the alleged incorrect application by Luxembourg of the double taxation treaty signed with the United States.

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[129] See the Joined cases C-106/09 P and C-107/09 P Commission and Spain v Government of Gibraltar and United Kingdom, par. 134: "the criteria forming the basis of assessment which are adopted by a tax system must also, in order to be capable of being recognised as conferring selective advantages, be such as to characterise the recipient undertakings, by virtue of the properties which are specific to them, as a privileged category, thus permitting such a regime to be described as favouring 'certain' undertakings". In that case, the Court held that the fact that a measure is in principle applicable to all corporations cannot itself exclude (de facto) selectivity ''

[130] GC Engie, par. 327 and 335.

[131] GC Engie, par. 351

[132] GC Engie, par. 472

[133] See the Joined cases C-115/16, C-118/16, C-119/16 and C-299/16 N Luxemburg 1 (hereinafter Danish Beneficial Ownership Cases) par. 177. In Engie the facts of the case concerned a wholly internal situation. Hence, the lack of a cross-border element prevented art. 49 TFEU from applying (GC Engie par. 474).

[134] European Commission (2015), 'State aid SA.38945 (2015/C) (ex 2015/NN) — Luxembourg: Alleged aid to McDonald's

Luxembourg applied to the subsidiary of McDonald's in Europe, based in the Grand Duchy, an exemption from corporation tax provided by the double taxation treaty signed with the United States, for those cases in which the exempt profit could be subject to taxation in the latter state. In this specific case, however, the exempt profit in Luxembourg was not subject to taxation in the United States, since the American branch to which the profit was attributable did not constitute a permanent establishment, according to the regulations of this country, resulting in a situation of double non-taxation.

Luxembourg and McDonald's argued that the tax administration could apply the exemption because the US branch is a permanent establishment according to Luxembourgish law, regardless of the consideration it received according to US regulations and without having to verify that the benefit was effectively subject to taxation in the United States. Ultimately, the Commission considered that this interpretation of the double taxation treaty was not necessarily incorrect even if it could lead – as in fact it did - to a situation of double non-taxation, and therefore declared the non-existence of aid [135].

Conclusions

The Commission's battle against aggressive tax planning through tax rulings has only just begun. Since 2013, the Commission has begun a detailed examination of aggressive tax practices, which, validated by administrations through binding decisions, are likely to give an advantage to certain multinationals, thus altering competition between Member States and the functioning of the internal market.

The practices examined by the Commission are of various kinds, but they mainly revolve around the application of transfer pricing rules in transactions between related entities, and how multinationals can, if the application of these rules is not correct, achieve a lower level of taxation in a Member State than it would have taken place in concurrence of market conditions.

So far, there have been numerous cases in which the Commission has found that the rulings of the Member States granted to certain taxpayers violated the principle of arm's length. However, for the time being, the General Court has annulled two of the Decisions in which it has conducted a substantive examination of the content.

[135] European Commission (2015), 'State aid SA.38945 (2015/C) (ex 2015/NN) — Luxembourg: Alleged aid to McDonald's, 3 December. *Par. 105*

Notwithstanding the fact that the CJEU has not yet ruled, some principles can be drawn from the judgments of the General Court on the fit of tax rulings in the control of State aid:

• The Commission has full competence, by virtue of the distribution of competences carried out by the TEU, to control the tax rulings approved by the tax authorities in the light of the prohibition of State aid. Therefore, this Commission control of the Member States' tax practices does not imply a harmonisation not permitted by the Treaty.

• There is no autonomous “arm's length principle” at EU level and no obligation to apply it outside national regulations. The control of a tax State aid still requires a comparison with a 'normal' level of taxation in that Member State, without it being understood that there is an independent concept of 'normal taxation' at Community level.

• The framework of reference for the examination of the normal level of taxation of a company is the Corporate tax system itself, not the more restricted framework of transfer pricing regulations.

• Consequently, although there is no specific rule covering the application of the arm's length principle in national legislation, if the general corporate tax regulations are designed to tax independent entities in the same way as those that are part of a group, the advantage requirement can be appreciated if the result of the ruling departs from an arm's length situation.

• The burden of proof is on the Commission.

The Commission must therefore be in a position to prove that the contested ruling reaches a situation incompatible with the arm's length principle. To this end, the difference between the result of the ruling and the profit that would have been obtained under market conditions must exceed the inaccuracies, inherent in the method applied to arrive at the market value. The finding of error and inconsistencies in the methods applied in the rulings is not enough, by itself, to conclude that an advantage has been granted.

Consequently, from the jurisprudence of the General Court to date, we can conclude that, in the litigation related to the tax rulings, the evidentiary elements will occupy a key place, the Commission having to prove conclusively that the disputed rulings approve taxation conditions that lead to a result incompatible with the principle of arm's length.

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