BRUSSELS À JOUR

A Christmas (Tax) Break – 2nd Advent

Markus Roehrig and Joachim Hannes Burger report on the latest developments from the European capital of competition law.

After kicking off our four-part December issue last Monday with the most recent developments in the field of Cartels and leniency applications, it's time to turn towards State aid. This Monday, to continue our Advent series, we'll be talking about the ECJ's recent and widely-syndicated judgment regarding tax rulings. We know, this might not be the christmas present you hoped for, but we hope your loved ones will make up for this on 24 December. In the meantime, we suggest to head over to your local christmas market and digest the news with one or two cups of mulled wine (remember: drink responsibly!).

The 8 November 2022 judgment (Joined Cases C-885/19 P and C-898/19 P – *Fiat Chrysler Finance Europe v Commission*) granted the ECJ its first chance to weigh in on the Commission's controversial and much-discussed stance towards so-called tax rulings. At the core of this – and several other – disputes stands the question of taxation of multi-national companies and whether transfer pricing practices to reduce tax burdens amount to illegal State aid.

Tax rulings and State aid

But first, let's rewind a bit: What are tax rulings and why are they scrutinized under State aid rules? To begin with, it must be noted that multi-national companies and business groups often pay their taxes across a number of jurisdictions, each of them governed by separate and often diverging tax systems. In order to optimize their tax structure, multi-national companies often allocate profits to jurisdictions where lower corporate taxes are due, e.g. by way of transfer pricing agreements regarding intra-group trades. To that end, in various of these jurisdictions, tax authorities are willing to hand out specific letters (the so-called tax rulings) fitted to a company's specific business model and clarifying how the authority will treat intra-group transfer pricing agreements. Such tax rulings thus provide multi-national companies with comfort on the exact calculation

of their profits and the corporate taxes due. While such tax rulings are common practice and absolutely legal in nature, they may nonetheless violate State aid rules if the underlying methodology (e.g. to determine the transfer prices for intra-group trades) bears no economic justification and – as Commissioner Vestager puts it – merely allows to "*artificially reduce a company's tax burden*". In such cases, tax rulings grant the benefitting company an unduly edge over their competitors, which pay higher taxes on their respective profits.

So, particularly after the 2014 *Luxembourg Leaks* when several hundred tax rulings became known to the public, the Commission decided to open several in-depth investigations into tax rulings handed out by Luxembourg as well as other Member States. The list of subsequent decisions reads like a Who's Who of globally active business groups (e.g. Starbucks, Amazon, Fiat, McDonald's), including the maybe most (in)famous decision dealing with an Irish tax ruling in favor of Apple and concerning unpaid corporate taxes of EUR 14.3bn. As the issue of tax rulings and the individual cases raise a number of delicate questions (e.g. tax authority of Member States vs. the Commission's review, diverging assessment of the applicable national tax structures and the correct reference system), it is no surprise that most of these decisions were and are challenged before the Union courts.

While Apple succeeded to overturn it's decision – on grounds of an insufficient statement of reasons – before the General Court and is awaiting the ECJ's appeal judgment, one of the most pressing and consequential questions was answered in the ECJ's 8 November judgment regarding a tax ruling in favor of Fiat.

The ECJ's 8 November Judgment

Some ease of mind before we dive into the details: We are sparing you the ins and outs of tax law, but rather focus on the key takeaways from the ECJ's judgment and its implications for ongoing and future State aid cases concerning tax rulings.

The ECJ's 8 November judgment revolves around a decision from 2015, in which the Commission found that a tax ruling by Luxembourg's tax authorities setting out the calculation of a Fiat financing subsidiary's taxable profits amounted to unlawful State aid. In the decision, the Commission examined whether intra-group transfer prices applied to treasury and financing services and accepted in the tax ruling conferred a selective advantage on Fiat. To determine this, the Commission applied – as it did in other tax rulings cases – the so-called arm's length principle (the "**ALP**"). Under the ALP, a selective advantage arises if a tax ruling sets out a transfer price below or above the price that would normally be applied (at "arm's length") between independent companies in similar transactions, thereby minimizing the taxable profits and resulting in an artificial reduction of a company's tax burden. According to the Commission, that was the case for the transfer prices applied between Fiat's financing subsidiary and other Fiat group companies.

One of the key questions raised in this and other proceedings however is whether the ALP as applied by the Commission is the correct reference system to determine a selective advantage. Fiat, supported by Luxembourg and Ireland, argued that the Commission cannot apply an abstract ALP. Rather, an ALP is only binding to the extent the respective Member States incorporated that principle into domestic law.

In its 8 November judgment, the ECJ endorsed that view and found that the Commission's reasoning, which was upheld by the General Court, was vitiated by an error of law. The Commission has erred by using an abstract ALP (as for instance laid out in the OECD's Transfer Pricing Guidelines) as a reference framework instead of fully examining how and to which extent Luxembourg has incorporated an ALP of its own into its national tax system:

- In identifying the correct reference system, the ECJ held that only a national tax system and its interpretation must be taken into account and the Commission cannot transpose an abstract ALP on a given national tax system. This follows directly from the Member States' sovereignty in tax matters, under which they enjoy a broad discretion on how to implement an ALP and treat transfer pricing agreements thereunder. In other words: If a Member State has incorporated an ALP of some kind into its own legal order, the ALP and its interpretation under national law prevails over an abstract principle as applied by the Commission (e.g. the OECD Transfer Pricing Guidelines or other non-domestic standards). Consequently, tax rulings that comply with an ALP as incorporated into applicable national law do not confer a selective advantage.
- According to the ECJ, a tax ruling can therefore only constitute State aid in very exceptional circumstances. Insofar, leaving the door open slightly, the ECJ states that the Commission might apply a non-domestic, abstract ALP of its own only if "*the parameters laid down by national law are manifestly inconsistent with the objective of non-discriminatory taxation of all resident companies, whether integrated or not, pursued by the national tax system, by systematically leading to an undervaluation of the transfer prices applicable to integrated companies or to certain of them, such as finance companies, as compared to market prices for comparable transactions carried out by non-integrated companies*". In other words: If a Member State can show that the applicable ALP as incorporated into national law and a differentiated treatment of multi-national companies thereunder is justified in light of the objectives pursued by national law, the Commission cannot apply an ALP of its own (but would have to determine a selective advantage based on the parameters as laid down in national law).

The End of the Commission's Quest against Tax Rulings?

By and large, the judgment and its limitation of the ALP's application delivered a clear blow to the Commission's stance towards tax rulings. But does this mean that companies benefitting from tax rulings and Member States can now simply lean back or even begin to hand out more tax rulings? Perhaps not if you listen closely to Commissioner Vestager's

reaction immediately following the judgment: While admitting to a big loss for efforts directed at more tax fairness, a written statement specifically noted that the judgment "*confirmed that action by Member States in areas that are not subject to harmonization by EU law is not excluded from the scope of the Treaty provisions on the monitoring of State aid*" and that "*the EC is committed to continue using all the tools at its disposal to ensure that fair competition is not distorted in the single market through the grant by member states of illegal tax breaks to multinational companies*". And at a 01 December conference, Commissioner Vestager added that the Commission's "*enforcement should continue within the clarified limits of the courts that has given us*".

So the Commission seems determined to continue its quest against tax rulings, albeit it undoubtedly would need to spend a significant amount of time and resources to that end. This is all the more true now given that the requirements from the ECJ's recent judgment add on to the already extensive and evidence intensive work that has to be carried out to determine a selective advantage of tax rulings. So while this may not be the complete end of the Commission's fight against tax rulings, it will certainly slow it down and force the Commission to pick suitable cases carefully (i.e. cases in which jurisdictions have not – or not sufficiently – transposed the ALP into national law, as noted by the ECJ). On top of that, it is certainly not too far-fetched to describe the judgment as a game-changer with major implications for parallel pending cases, such as the highly anticipated appeal in the Apple case. So, the Commission's "corporate tax crusade", as Politico called it, promises to keep on delivering no matter what … stay tuned for more!

While we know that not everyone is a fan – be assured we are not either – of taxes, we nonetheless hope that you enjoyed our short excursion into the interplay of tax rulings and State aid. Make sure to come back next Monday, for our third instalment of our Advent series on competition law. In the meantime, keep working on that wishlist for Santa!

On our wishlist: If not done already, please follow us on LinkedIn for more updates on your favourite EU competition law topics.

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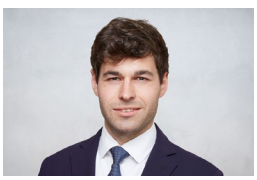

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