

1. Introduction

1. THE AIM OF THE BOOK

This book explores whether the European Commission's (the 'Commission') recent tax rulings¹ in relation to Member States' advance pricing arrangements (APAs)² reflect a genuine problem of illegal State aid under Article 107 of the Treaty on the Functioning of the European Union (TFEU) or whether the Commission is actually using the State aid rules to harmonise national tax systems in a manner that is contrary to the Treaty.

APAs were first developed in the US and then adopted by the Organisation for Economic Co-operation and Development (OECD) as one of several administrative mechanisms to reduce the high degree of legal uncertainty that is inherent in transfer pricing arrangements. The OECD term 'Advanced Pricing Arrangement' is intended to cover a wide range of administrative instruments that aim at certainty, each with their own rules. APAs (like other rulings) play a valuable role by avoiding disputes and preventing genuine double taxation. In particular, where tax authorities enter into multilateral APAs double taxation is more effectively avoided. More generally, a tax ruling system may be set up because taxpayers require support in their own assessments, or because there exists a desire to foster a level of cooperation between taxpayers and the taxation authorities, or because authorities view a rulings system as a means of identifying important information at an earlier stage. These justifications underpin the overarching notion that rulings can often,

¹ State aid SA.37667 (2015/C) (ex 20015/NN) – Belgium – *Excess profit tax ruling system in Belgium*; State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) – Ireland – *Alleged aid to Apple*; State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP) – Netherlands – *Alleged aid to Starbucks*; State aid SA.38375 (2014/NN) (ex 2014/CP) – Luxembourg – *Alleged aid to FFT*; State aid SA.38944 (2014/C) – Luxembourg – *Alleged aid to Amazon by way of a tax ruling*; State aid SA. 38945 (2014/c) – Luxembourg – *Alleged aid to McDonald's*; State aid SA.46470 (2017/C) (ex 2017/NN) – Netherlands – *Potential aid to IKEA*; State aid SA.44888 (2016/C) (ex 2016/NN) – Luxembourg – *Aid to GDF Suez*; State aid SA.22309 (2007/C) (ex 2007/NN) – Spain – *Spanish Goodwill*; State aid SA.44896 (2017/C) (ex 2017/NN) – United Kingdom – *Potential state aid scheme regarding UK CFC Group Financing Exemption*.

² APAs and tax rulings will be used interchangeably throughout this book.

through increased certainty and clarity, produce a better taxation environment, as acknowledged by the Commission in its Notice on the notion of State Aid Pursuant to Article 107(1) TFEU³ as well as in other guidance documents it issued in the past.⁴

One of the key dangers of State aid – and important for the questions this book addresses – is if Member States are allowed to give financial support, for example in the form of a favourable tax ruling, to undertakings as they see fit. This can often lead to measures being implemented to protect or boost certain sectors of Member States' national economies. This has a distortive effect on competition and can prejudice the interests of more efficient competitors in other Member States, which harms both economies and consumers. Without any form of State aid control, Member States could be tempted to enter into a wasteful subsidies race, with each Member State giving more and more support to its own national industries at the expense of the taxpayer. It is therefore essential to the effective running of the single market that undertakings are able to compete with each other on a level playing field and that Member States are not allowed to distort competition in this way. This is why the basic principle set out in the Treaty is that State aid is incompatible with the single market and therefore prohibited.

Since the Treaty of Rome came into force in 1958, Member States within the EU have retained the sovereign right – exclusive competence – within the area of direct taxation. Any new tax measure, which involves implementation by all Member States in the EU, requires unanimity between the Member States. Thus, it is important to distinguish between enforcing the State aid rules to (i) achieve a level playing field by ensuring that Member States are not selectively giving certain companies an economic advantage and (ii) implementing new principles into national tax law. Only the former is acceptable. If the Commission's interpretation of the State aid rules in recent decisions is being interpreted to allow the Commission to transpose the so-called arm's length principle (ALP) into national law and thereby invades Member States' exclusive competence over national tax law, it violates the rule of law. It is acknowledged by Professor McDaniel that '... failure to place special tax provisions under the state aid structure would create an enormous loophole in the

³ 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, OJ 2016/C 262/01 (Notice on the Notion of Aid), paras 170ff. Cf. Draft Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU, http://ec.europa.eu/competition/consultations/2014_state_aid_notion/draft_guidance_en.pdf, accessed 23 July 2018 (Draft Notice on the Notion of Aid), para 169.

⁴ Draft Notice on the Notion of Aid (n 3) paras 174–77.

state aid regime'.⁵ However, until this is a reality, we are faced with a situation where Member States have sovereignty in matters of direct taxation.

If foreign corporations can no longer rely on the national tax framework within the Member States in which they operate, because the Commission can at any given time impose a new principle into national law, they will have no legal certainty as it will be impossible for corporations to predict their expositor and risks. This is likely to deter foreign companies from operating in the EU, which would have serious consequences for investment, growth and prosperity in Europe.

This book does not look at tax in general but it would be difficult to discuss tax rulings without touching upon certain tax instruments. However, this book is not about tax and the author does not purport to be a specialist in tax. It is written by a competition lawyer from a competition and constitutional law angle rather than a tax angle.

2. THE CONUNDRUM OF THE COMMISSION'S TAX RULINGS

We got a problem! The Commission believes that certain companies are not paying their fair share of tax. It alleges that certain national tax administrations in the EU have concluded tax rulings with various integrated companies on their taxable profit resulting from their intra-group transactions that infringe Article 107 TFEU. State aid can arise where any relief from tax is financed by the State or granted through State resources and it confers an economic advantage on a selective undertaking/group, which distorts competition and affects inter-State trade. The Commission has held for some time that direct tax measures that favour particular sectors, discretionary rulings or decisions constitute aid if they depart from the general tax rules to the benefit of individual undertakings.⁶ However, it was not until its opening decisions in *Fiat* and *Starbucks* on 11 June 2014 that it started taking enforcement action against individual tax rulings regarding transfer prices.⁷ Tax rulings play a valuable role by avoiding disputes and preventing genuine double taxation. In particular, where tax authorities enter into multilateral APAs double taxation is more effectively avoided. In the absence of harmonisation of Member States'

⁵ Paul R McDaniel, 'Impact of Trade Agreements on Tax Systems' (2002) 30 *Intertax* 1661–71.

⁶ Notice on the application of the state aid rules to measures relating to direct business taxation, OJ 98/C 384/03.

⁷ State aid SA.38375 (2014/NN) (ex 2014/CP) – Luxembourg – *Alleged aid to FFT*; State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP) – Netherlands – *Alleged aid to Starbucks*.

tax systems, double taxation can arise.⁸ The Commission's general view is '[t]ax rulings as such are perfectly legal'⁹ although competition Commissioner Vestager seems to have a different view. She is of the opinion that tax rulings 'are by nature selective'.¹⁰

Since 2013/2014, the Commission has focused its enforcement activity in the field of State aid control on advance tax rulings by national tax authorities.¹¹ The Commission commenced preliminary examination of specific advance transfer pricing rulings given by Luxembourg to Fiat and to Amazon; by the Netherlands to Starbucks; and of branch profits rulings given by Ireland to Apple.¹² Other decisions followed¹³ and some are still under investigation.¹⁴ These investigations fall under the Commission's broad priority of ensuring fairness and equality of the corporate tax system within the EU.¹⁵ They are linked to the widely held concern that multiple Member States appear to be using tax rulings as a means of allowing multinational corporations to take advantage of their tax systems (by providing opportunities for such corporations to reduce their overall tax burden) and that such practices may put other undertakings at an effective competitive disadvantage. To that extent, the

⁸ Case C-513/04 *Kerckhaert & Morres* [2006] ECLI:EU:C:2006:713.

⁹ European Commission, press release no. IP/16/2923 of 30 August 2016, State aid SA.38373 – *Apple*.

¹⁰ 'Tax avoidance and privacy in the digital age'. Transatlantic Citizens' dialogue in New York/Milan, 21 September 2016, at 24:30 minutes, http://ec.europa.eu/citizens-dialogues/italy/milano2/index_en.htm, accessed 26 July 2018.

¹¹ For an overview of the Commission's activity see 'State Aid: Tax Rulings', http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html, accessed 26 July 2018.

¹² State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP) – Netherlands – *Alleged aid to Starbucks*; State aid SA.38375 (2014/NN) (ex 2014/CP) – Luxembourg – *Alleged aid to FFT*; State aid SA.38944 (2014/C) – Luxembourg – *Alleged aid to Amazon by way of a tax ruling*; and State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) – Ireland – *Alleged aid to Apple*.

¹³ State aid SA.37667 (2015/C) (ex 20015/NN) – Belgium – *Excess profit tax ruling system in Belgium*; State aid SA.44888 (2016/C) (ex 2016/NN) – Luxembourg – *Aid to GDF Suez*; State aid SA.38945 (2014/C) – Luxembourg – *Alleged aid to McDonald's, Europe*.

¹⁴ State aid SA.46470 (2017/C) (ex 2017/NN) – Netherlands – *Potential aid to IKEA*; State aid SA.44896 (2017/C) (ex 2017/NN) – United Kingdom – *Potential state aid scheme regarding UK CFC Group Financing Exemption*.

¹⁵ Margrethe Vestager, 'Independence is non-negotiable', Chatham House Competition Policy Conference, London, 18 June 2015, http://ec.europa.eu/commission/2014-2019/vestager/Announcements/independence-non-negotiable_en, accessed 26 July 2018. For some further context, see Alec Burnside and Anne MacGregor, 'Enter Martha Vestager' (2015) 14(8) *Competition Law Insight* 10.

Commission's State aid investigations are aligned with the OECD/G20 Base Erosion and Profit Shifting (BEPS) project Action 5.¹⁶

The Commission's preliminary view in the cases mentioned was that the rulings constituted State aid incompatibility with the internal market as the rulings diverged from ALP and therefore provided the respective groups with a selective economic advantage. The Commission maintained this view in its final decisions in these cases and thereby used the EU State aid framework as a weapon against allegedly aggressive tax planning.¹⁷ While the Member States have exclusive competence within the area of direct taxation, they must exercise their sovereignty consistently with EU law.¹⁸ Similarly, while the Commission has the discretion to investigate whether certain tax rulings infringe Article 107 TFEU, the Commission does not have any powers of its own under the treaties to legislate on direct taxation. Thus, in order for the Commission to apply the ALP, 'it must be part of the reference framework, i.e. the national legal system at hand'.¹⁹ Furthermore, 'Member States should properly apply the at arm's length criterion when determining a proper transfer price, provided that this principle is embedded in domestic law to start with'.²⁰ Not all Member States have implemented the ALP in their domestic tax laws. Thus, the Commission has argued that the ALP it applies is inherent in Article 107(1) TFEU and therefore applies independently of whether the Member State in question has incorporated the ALP into its national legal system.²¹ The Commission justifies this position by reference to the *Forum 187* case.²² It also specifies that the ALP it applies is not equivalent to the ALP set out in the OECD Model Tax Convention, but is a general principle of equal treat-

¹⁶ OECD/G20 Base Erosion and Profit Shifting Project 'Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance' – ACTION 5: 2015 Final Report.

¹⁷ Other jurisdictions used in tax planning strategies outside the EU are Bermuda, Bahamas, Cayman Islands, Panama, Hong Kong and Singapore.

¹⁸ Case C-403/03 *Schempp* [2005] ECLI:EU:C:2005:446, para 19.

¹⁹ Directorate General for Internal Policies, EU State aid law and national tax rulings. IP/A/TAXE/2015-02, [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/563453/IPOL_IDA\(2015\)563453_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/563453/IPOL_IDA(2015)563453_EN.pdf), accessed 26 July 2018, 12.

²⁰ *ibid*, 13.

²¹ Commission Decision of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple, para 257, Commission Decision of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks, para 264, Commission Decision of 11 January 2016 on the Excess Profit Exemption State aid scheme SA.37667 (2015/C) (ex 2015/NN) implemented by Belgium, para 150.

²² Joined Cases C-182/03 and C-217/03 *Belgium v Commission* [2006] ECLI:EU:C:2006:416 (*Forum 187*).

ment.²³ The Commission is adopting its own version of the ALP (hereafter ‘the Commission ALP’) and arguing that it is inherent in Article 107 TFEU. Linking the ALP to Article 107 TFEU rather than the OECD will allow the Commission to transpose the Commission ALP into national law of Member States’ direct taxation law for the purpose of State aid. It will also allow the Commission to replace the ALP already imbedded in some domestic tax law with the Commission ALP. This is constitutionally troubling. It would be an overreach of the Commission’s competence and violate the rule of law. As said, the Commission has the discretion to investigate whether national tax administrations issue tax rulings that infringe Article 107 TFEU²⁴ but it cannot use this discretion to gain competence in an area of law where the Member States have exclusive competence.

The Commission’s lack of competence means that transposing principles such as the Commission ALP into national tax law must be done through Articles 113–115 TFEU.²⁵ However, competition law promotes ‘integration through law’ by allowing the Commission not merely to tackle barriers to trade, but to dictate detailed prescriptions in policy areas falling outside the remit of EU competences. This blurs the boundaries between ‘negative’ and ‘positive’ integration.²⁶ What is more, unlike the free movement provisions, which only allow a certain degree of negative integration, competition law can be strategically employed to impose far-reaching ‘remedies’ to perceived competition law problems, effectively achieving ‘harmonisation through the back door’.²⁷ At the same time, the Commission’s strategic use of competition law provisions allows it to override the political obstacles that often hinder attempts to adopt secondary legislation, especially in policy areas such as taxation, where the EU treaties require unanimity. State aid is controlled by the Commission and European Courts (the General Court and the Court of Justice

²³ Commission Decision of 21 October 2015 on State aid SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat, para 228.

²⁴ Case C-30/59 *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community* [1961] ECLI:EU:C:1961:2; Case C-173/73 *Italy v Commission* [1974] ECLI:EU:C:1974:71 (*Italy v Commission*).

²⁵ The EU has certain prerogatives in relation to indirect taxation, as explicitly provided in Article 113 TFEU, which allow the EU to adopt regulation in regard to indirect taxation, and Article 115 TFEU, which allows the Council (acting unanimously) to issue directives for the approximation of laws, regulations and administrative provisions.

²⁶ Fritz W Scharpf, ‘The Asymmetry of European Integration, or Why the EU Cannot Be a “Social Market Economy”’ (2010) 8 *Socio-Economic Review* 211, 11.

²⁷ Term borrowed from Sacha Garben, ‘Confronting the Competence Conundrum: Democratising the European Union through an Expansion of its Legislative Powers’ (2015) 35 *Oxford Journal of Legal Studies* 55, 67–70.

of the European Union) over Member State fiscal decision making. However, if this is happening without any significant legislative check, it is problematic, in particular because the original limiting principle of effect on competition and trade has largely vanished to irrelevance. The *Fiat*, *Starbucks* and *Apple* decisions are on appeal. Thus, it is up to the General Court to conduct a proper judicial review and exercise the power available to it, rather than deferring it to the Commission by giving it a huge margin of appreciation. A weak judicial review of the Commission's decisions does not comply with the 'access to a fair trial' in Article 6(1) of the European Convention on Human Rights.

I have written a number of articles arguing that the Commission has a weak legal case in these decisions as it is overstepping its remit by adopting a novel interpretation of the State aid rule to achieve an outcome within the area of tax, which would be hard to achieve through the legislative route.²⁸ Whether or not the Commission has a weak legal case is for the European Courts to decide but it is difficult to condemn the Commission's endeavours to achieve a publicly desirable result, namely to get companies to pay their fair share of tax and contribute to the proper functioning of the societies in which they operate, if, indeed, they are not already doing that. The conundrum lies within the Commission's constitutionally troubling extension of the EU legal framework in its pursuit to get the Member States to adopt certain principles into national tax law.

Creeping competence is not a new phenomenon in the EU. When more and more nation states began to morph into a union of Member States in the 1980s, more and more powers were transferred to the EU in a dilution of sovereignty that not everyone supported. What is particularly grave about the creeping competence within the area of direct taxation is that it is happening within an area of law where the Member States retain sole sovereignty. The Commission's creep into the Member States' exclusive competences endangers the fundamental principle laid down in the European treaties that the EU shall respect Member States' 'national identities' and 'essential state functions'.²⁹ Raising revenue and deciding how to spread the tax burden are 'essential state functions' par excellence.

²⁸ Liza Lovdahl Gormsen, 'EU State Aid Law and Transfer Pricing: A Critical Introduction to a New Saga' (2016) 7 *Journal of European Competition Law & Practice* 369; Liza Lovdahl Gormsen and Clement Mifsud-Bonnici, 'Legitimate Expectation of Consistent Interpretation of EU State aid Law: Recovery in State Aid Cases Involving Advanced Pricing Agreements on Tax' (2017) 8 *Journal of European Competition Law & Practice* 423; Liza Lovdahl Gormsen, 'State Aid and Direct Taxation and the Big Eruption between the US and the EU' (2017) 62 *Antitrust Bulletin* 348.

²⁹ Treaty on European Union, OJ 2012/C 326/13 (TEU), Art. 4(2).

State aid in its current form is unique to the EU.³⁰ It is highly contentious both internationally and within the EU. Almost all of the Commission's recent tax decisions have been appealed not only by the company in question, but also by the involved Member States challenging the Commission's – in their view – opaque and novel interpretation of Article 107 TFEU. This view has been echoed internationally, in particular by the US, where arguments vary from the encroachment on Member States' sovereign powers in relation to direct taxation matters to alleged discriminatory treatment of US multinationals.³¹ Former Secretary of the US Treasury, Jacob Lew, formally expressed concerns that the Commission 'appears to be adopting an entirely new legal theory and applying it retroactively in a broad and sweeping manner'.³² Furthermore, the US believes the Commission's enforcement actions are inconsistent with, and likely contrary to, the BEPS project and appear to be targeting US companies disproportionately.³³ Competition Commissioner Vestager's response to Jacob Lew has been that the Commission's 'investigations into tax rulings is based on firm legal ground'.³⁴

3. ARTICLE 107 TFEU AND THE CONCEPT OF STATE AID

The Treaty does not provide a detailed definition of the concept of State aid but State aid rules can be found in Articles 107 to 109 TFEU.³⁵ They form part of the same chapter on the Rules of Competition in the Treaty as Articles 101 and

³⁰ Only Ukraine and to a lesser extent Turkey tolerate it in their free trade agreements (FTAs) with the EU.

³¹ Letter from Congressman Boustany to David O'Sullivan of 18 December 2015. See extract of the letter at <https://www.orbitax.com/news/archive.php/U.S.-Congressmen-Promises-Tax-R-16297>, accessed 26 July 2018.

³² Letter from Jacob J Lew to Jean-Claude Juncker of 11 February 2016. The concerns raised in the letter can be found in the US Treasury's white paper on the European Commission's recent State aid investigations of transfer pricing rulings, <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/White-Paper-State-Aid.pdf>, accessed 26 July 2018.

³³ *ibid.*

³⁴ Letter from Commissioner Magrethe Vestager to Jacob J Lew of 29 February 2016, <http://static.politico.com/cf/ba/b7725d194d84a1df018c28160048/margrethe-vestager-letter-to-secty-lew-on-eu-tax-investigations.pdf>, accessed 26 July 2018.

³⁵ See Conor Quigley, *European State Aid Law and Policy* (3rd edn, Hart Publishing 2015); Erika Szyssczak, *Research Handbook of State Aid Law* (1st edn, Edward Elgar Publishing 2011); Leigh Hancher, Tom Ottervanger and Piet Jan Slot, *EU State Aids* (4th edn, Sweet & Maxwell 2012); John Temple Lang, 'EU State Aid Rules – the Need for Substantive Reform' (2014) 13 *European State Aid Law Quarterly* 440.

102 TFEU, which are concerned with fair and equal competition. The State aid regime is designed to protect competition between undertakings from distortions of competition or intra-State trade that are generated by the Member States through the grant of measures favouring certain undertakings or goods at the expense of others. The rules are also intended to protect the internal market against segmentation through State aid while, at the same time, ensuring that there is no unjustified discrimination against foreign nationals or non-residents or forms of protectionism favouring domestic undertakings or capital. Yet the Commission made no reference to competition or the internal market in its recent tax rulings, but only mentioned a breach of Article 107 TFEU. Some believe this is because ‘the real motivation behind the Commission’s decisions is avoiding tax competition among Member States, not distortion of competition on given product markets’.³⁶ Thus, an outstanding question is what the relation between competition law and tax rulings is.

A measure which is State aid within the meaning of Article 107(1) TFEU may nevertheless be considered compatible with the single market if it falls within the scope of Article 107(2) or (3) TFEU as described below. In some circumstances, State aid is desirable and indeed necessary to achieve certain important objectives which would not be possible without State intervention. Thus, there needs to be a certain degree of flexibility, allowing Member States to give financial assistance to undertakings where necessary to achieve certain objectives.³⁷ However, the Commission plays a vital role in supervising and enforcing this process otherwise there would be significant potential for abuse if this discretion were left solely to Member States.

State aid control is an *ex ante* system, in which measures must be notified under Article 108(3) TFEU prior to implementation. If a tax measure is considered aid, it should have been notified, according to the *ex ante* concept of control of new aids. The *ex ante* control is the basis while the *ex post* control is its derivative: the latter is related to respect for the notification obligation, respect for the Commission’s decisions and control of existing aid. Therefore, in the EU there exist both types of control but State aid law is based on the notification principle for new aids. This constitutes a difference as compared to the World Trade Organization (WTO) system, where there is no notification obligation. The WTO will be discussed in Chapter 6.

³⁶ Damien Neven, ‘State aid and tax ruling: is there really a competition issue?’ panel 3 at the 8th International Concurrences Review Conference, 26 June 2017.

³⁷ The definition of an ‘undertaking’ is a fluid concept but typically involves considering whether the organisation in question has a commercial purpose, is seeking to generate profits or does generate profits, or whether it has an exclusively social purpose.

For our discussion about State aid and corporate taxation, the relevant provision is Article 107 TFEU:

1. Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.
2. The following shall be compatible with the internal market:
 - a. aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
 - b. aid to make good the damage caused by natural disasters or exceptional occurrences;
 - c. aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point.
3. The following may be considered to be compatible with the internal market:
 - a. aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation;
 - b. aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
 - c. aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
 - d. aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;
 - e. such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

The relevant part of Article 107 TFEU is part 1, which prohibits State aid which is incompatible with the internal market. Not all State aid is automatically prohibited. Article 107(2) TFEU permits certain – although very limited – categories of aid that are considered compatible with the internal market. These are aid of a social nature granted to consumers provided there is no discrimination in relation to the origin of the products; aid to make good the damage caused by natural disasters or exceptional circumstances; and aid to

compensate for certain disadvantages caused by the reunification of Germany. As these are automatically compatible, the Commission's role is limited to assessing whether the measure in question is compliant with the requirements of Article 107(2) TFEU. These provisions are narrowly construed³⁸ and tax rulings do not fall within the scope of Article 107(2) TFEU. More pertinent to tax measures is Article 107(3) TFEU, which gives to the Commission discretion to approve certain broader categories of aid that may be declared compatible with the internal market. By contrast to Article 107(2) TFEU, these provisions are drafted much more widely, and this is where the Commission enjoys greater discretion. It is, however, for the Commission to decide whether or not the aid falls within the scope of Article 107(3) TFEU. If a Member State wants to introduce a new measure likely to entail State aid, it must notify it to the Commission under Article 108(3) TFEU prior to implementation. Pending a final decision from the Commission, a Member State is prohibited from implementing the aid.

If a Member State does not enforce an obligation to pay corporate tax, it may be considered a State aid and therefore prohibited if the measure under examination satisfies the following cumulative criteria:

1. it must confer an economic advantage on the beneficiary;³⁹
2. it must be granted by a Member State or through State resources;⁴⁰

³⁸ Case C-403/10 P *Mediaset SpA v European Commission* [2011] ECLI:EU:C:2011:533, para 81; Case T-268/06 *Olympiaki Aeroporia Ypiresies AE v Commission of the European Communities* [2008] ECLI:EU:T:2008:222, para 52.

³⁹ For example Case C-256/97 *Déménagements - Manutention Transport SA (DM)* [1999] ECLI:EU:C:1999:332 and Opinion of Advocate General Jacobs of 24 September 1998 to this case, para 31; C-39/94 *Syndicatfrançais de l'Express international (SFEI) and others v La Poste and Others* [1996] ECLI:EU:C:1996:285 and Opinion of Advocate General Jacobs of 14 December 1995 to this case, para 60; *Italy v Commission* (n 24) para 26; Case C-387/92 *Banco de Crédito Industrial SA, now Banco Exterior de España SA v Ayuntamiento de Valencia* [1994] ECLI:EU:C:1994:100, paras 12–13; Case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH*, and *Oberbundesanwalt im Bundesverwaltungsgericht* [2003] ECLI:EU:C:2003:415, para 83; Case T-157/01 *Danske Busvognmænd v Commission of the European Communities (Combus)* [2004] ECLI:EU:T:2004:76, para 57.

⁴⁰ For example Case T-214/95 *Het Vlaamse Gewest (Flemish Region) v Commission of the European Communities* [1998] ECLI:EU:T:1998:77; Case C-323/82 *SA Intermills v Commission of the European Communities* [1984] ECLI:EU:C:1984:345; Joined Cases C-296 and C-318/82 *Netherlands and Leeuwarder Papierwarenfabriek BV v Commission of the European Communities* [1985] ECLI:EU:C:1985:468; Case C-142/87 *Belgium v Commission of the European Communities (Tubemeuse)* [1990] ECLI:EU:C:1990:125; Case C-303/88 *Italy v Commission of the European Communities* [1991] ECLI:EU:C:1991:136; Case C-305/89 *Italy v Commission of the*

3. it must be selective (it must favour certain undertakings, the production of certain goods or the provision of certain services);⁴¹
4. there must be a (potential for) distortion of competition; and
5. there must be an effect (or potential effect) on trade between Member States.⁴²

First, the measure must confer an economic advantage. A measure confers an economic advantage if the financial situation of an undertaking is improved as a result of State intervention on terms differing from normal market conditions.⁴³ In particular, it is necessary to carry out a counterfactual analysis to verify the situation of the undertaking had the measure not been granted.⁴⁴ However, it is not necessary to carry out a full Articles 101 and 102 TFEU-type analysis to show that this is the case.⁴⁵ Moreover, an aid is characterised by reference to its effects rather than the cause or the objective of the State intervention.⁴⁶ Finally, the form of the measure – whether a positive economic advantage or a relief from economic burdens, such as a tax relief – is irrel-

European Communities [1991] ECLI:EU:C:1991:142; Case C-63/87 *Commission of the European Communities v Greece* [1988] ECLI:EU:C:1988:285; Case C-102/87 *France v Commission of the European Communities (Fonds industriel de modernisation)* [1988] ECLI:EU:C:1988:391; Joined Cases C-15/98 and C-105/99 *Italy and Sardegna Lines Servizi Marittimi della Sardegna SpA v Commission of the European Communities* [2000] ECLI:EU:C:2000:570.

⁴¹ For example, Case C-143/99 *Adria-Wien Pipeline GmbH and Wiertersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirektion für Kärnten* [2001] ECLI:EU:C:2001:598; Case T-55/99 *Confederación Española de Transporte de Mercancías (CETM) v Commission of the European Communities* [2000] ECLI:EU:T:2000:223; Case C-200/97 *EcotradeSrl v Altiforni e Ferriere di Servola SpA (AFS)* [1998] ECLI:EU:C:1998:579, para 36; Case C-290/87 *Netherlands v Commission of the European Communities (Fisheries quotas)* [1989] ECLI:EU:C:1989:362, paras 22–23; Case C-61/79 *Amministrazione delle finanze dello Stato v DenkvitalianaSrl* [1980] ECLI:EU:C:1980:100, para 31; Case T-260/97 *R Camar v Commission of the European Communities and Council* [1997] ECLI:EU:T:1997:194, para 62; Case T-399/11 *Banco Santander, SA and Santusa Holding, SL v European Commission* [2014] ECLI:EU:T:2014:938, para 35.

⁴² For example Joined Cases: T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to T-607/97, T-1/98, T-3/98 to T-6/98 and T-23/98 *Alzetta Mauro and Others v Commission of the European Communities* [2000] ECLI:EU:T:2000:151, para 81; Case T-288/97 *Regione Friuli Venezia Giulia v Commission of the European Communities* [2001] ECLI:EU:T:2001:115, para 41.

⁴³ Notice on the Notion of Aid (n 3) para 67.

⁴⁴ *Italy v Commission* (n 24) para 13.

⁴⁵ Case C-730/79 *Philip Morris* [1980] ECLI:EU:C:1980:209 (*Philip Morris*).

⁴⁶ *Italy v Commission* (n 24) para 13; Case C124/10 P *European Commission v EDF* [2014] ECLI:EU:C:2012:318, para 77.

evant.⁴⁷ The European Courts have developed a so-called ‘market economy operator test’ to verify whether transactions made by public bodies are carried out in line with normal market conditions. Depending on the quality of the Member State as a public investor, creditor or vendor, the market economy investor principle, private creditor test or private vendor test respectively will apply.⁴⁸ Within the framework of these tests, it is necessary to assess whether, in similar circumstances, a private operator of a comparable size operating in normal conditions of a market economy could have concluded a transaction on the same conditions.

Secondly, the measure must be granted by a Member State or through State resources. The wording in the Treaty is expressed disjunctively but the European Courts have held that this should be interpreted conjunctively.⁴⁹ Thus, it is necessary for State resources to be involved.⁵⁰ The concept of State aid covers all financial means by which public authorities may actually support undertakings, irrespective of whether or not those means are permanent assets of the public sector.⁵¹ State aid is a broad concept and it does not only include subsidies in the form of direct financial support. The Court of Justice of the European Union (CJEU) has from its early case law been of the opinion that:⁵²

[t]he 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.

The exemption from taxes has the effect of mitigating a charge that an undertaking would normally have to bear. It will directly result in a loss of revenue for the State as it has effectively foregone revenue it would otherwise have been entitled to collect. The measure is therefore granted by the State through State resources and is imputable to the State. There is no doubt that non-enforcement of an obligation to pay corporate taxation can be considered a State aid. Likewise if a tax ruling gives rise to a loss of State resources by reduction in the tax payable by the company in question, it results in loss of tax revenue, which would otherwise have been available to the Member State in question.

⁴⁷ Case C-280/00 *Altmark Trans* [2003] ECLI:EU:C:2003:415, para 84.

⁴⁸ Notice on the Notion of Aid (n 3) para 74.

⁴⁹ Case C-379/98 *Preussen Elektra* [2001] ECLI:EU:C:2001:160, paras 57–62.

⁵⁰ *ibid.*

⁵¹ Case C-482/99 *France v Commission* [2002] ECLI:EU:C:2002:294.

⁵² Case C-30/59 *Steenkolenmijnen v High Authority* [1961] ECLI:EU:C:1961:2; Joined Cases C-78/08 to C-80/08 *Paint Graphos* [2009] ECLI:EU:C:2009:417 para 61.

Thirdly, the measure must confer a selective advantage on certain undertakings⁵³ engaged in economic activity or the production of certain goods. Selectivity can be either material, i.e. relating to a certain sector of the economy, or regional, i.e. relating to a certain geographical area. There is a three-stage test for material selectivity:⁵⁴ (i) it is necessary to determine a reference system – in tax cases, the reference framework is usually the general national legal tax system; (ii) it is necessary to consider whether the measure discriminates between undertakings which are in a comparable factual and legal situation, having regard to the objectives of the measure in question; and (iii) it is essential to understand whether such a derogation from the reference system in favour of the recipient undertakings is justified by the nature or general scheme of the system. In the *Adria-Wien* case,⁵⁵ an exemption from environmental taxes was found to be selective because it applied only to producers of goods and not services, and this could not be justified on environmental grounds because energy use by suppliers of goods and services is especially damaging to the environment. More recently, a similar measure in the *British Aggregates* case⁵⁶ was found to be disproportionate and was held to be selective.

Fourthly, the measure must distort or threaten to distort competition and affect trade between Member States. Where a measure distorts competition it usually also has the potential to affect trade between Member States. According to case law, those criteria are ‘inextricably linked’.⁵⁷ It has been argued in the literature that ‘the very notion of distortion of competition ... is quite ambiguous in economic terms’.⁵⁸ Moreover, and particularly with regard to tax measures, former chief economist of the Commission Damien Neven has argued that ‘it is dubious that tax rulings result in distortion of competition’ as ‘it has long been established that in the real world a reduction in the profit tax rate distorts neither prices nor investments, as long as investments can be

⁵³ Case T-216/15 *Dôvera zdravotná poisťovňa and others v Commission* [2018] ECLI:EU:T:2018:64.

⁵⁴ Case C-143/99 *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanz landesdirektion für Kärnten* [2001] ECLI:EU:C:2001:598.

⁵⁵ *ibid.*

⁵⁶ Case C487/06 P *British Aggregates Association v Commission* [2008] ECLI:EU:C:2008:757, paras 79–93.

⁵⁷ Joined Cases T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to T-607/97, T-1/98, T-3/98 to T-6/98, and T-23/98 *Alzetta Mauro and others v Commission* [2000] ECLI:EU:T:2000:151; *Italy v Commission* (n 24) paras 25, 44, 45.

⁵⁸ David Spector, ‘State Aids: Economic Analysis and Practice in the European Union’ in *Competition Policy in the EU: Fifty Years on from the Treaty of Rome* (Oxford University Press 2009) 185.

amortised and the cost of capital can be deducted'.⁵⁹ The difficulty of examining the effects on competition of tax measures has also been pointed out by David Spector, according to whom 'personalized tax rates' are occasionally superior to uniform ones.⁶⁰

The Commission's duties as regards demonstration of the effect on trade and thus distortion of competition were raised for the first time in the *Philip Morris* case.⁶¹ The applicant claimed that the effect on trade of the measure under review should be analysed on the basis of defining the relevant market, considering the pattern of the market, and analysing the effect of the aid on the relations between competitors.⁶² The Court rejected this proposal and, in view of the circumstances of the case, established a presumption of effect on trade in the following terms: 'when state financial aid strengthens the position of an undertaking compared with other undertakings competing in intra-community trade the latter must be regarded as affected by that aid'.⁶³ In a later case, *Leeuwarder*,⁶⁴ the Court annulled the Commission's decision for failure to state the reasons justifying why the aid in question had an effect on trade and distorted or threatened to distort competition.⁶⁵ The Court held:⁶⁶

even if in certain cases the very circumstances in which the aid is granted are sufficient to show that the aid is capable of affecting trade between Member States and of distorting or threatening to distort competition, the Commission must at least set out those circumstances in the statement of reasons for its decision.

Moreover, the Court said that the statement of reasons in the Commission's decision did not 'indicate that the Commission considered all the essential elements of fact or law which could have justified the granting of that exemption'.⁶⁷ Therefore, the distortion of competition and the effect on trade caused by an aid need to be justified. Despite this, the Court held in the *Boussac* case⁶⁸ that aid which 'reduced the costs which [the undertaking] would normally have incurred, distorts the conditions of competition'.⁶⁹ In the same vein, the Court

⁵⁹ Neven (n 36).

⁶⁰ Spector (n 58) 188.

⁶¹ *Philip Morris* (n 45).

⁶² *ibid*, para 9.

⁶³ *ibid*, para 11; Juan Jorge Piernas López, *The Concept of State Aid under EU Law: From Internal Market to Competition and Beyond* (Oxford University Press 2015) 189.

⁶⁴ Joined Cases C-296 and C-318/82 *Netherlands and Leeuwarder Papierwarenfabriek v Commission* [1985] ECLI:EU:C:1985:468.

⁶⁵ *ibid*, paras 22–30.

⁶⁶ *ibid*, para 24.

⁶⁷ *ibid*, para 25.

⁶⁸ Case C-301/87 *France v Commission* [1990] ECLI:EU:C:1990:67.

⁶⁹ *ibid*, paras 44, 50.

referred specifically to aid in form of tax relief in the *WAM* case. Indeed, it considered that the grant of such aid to some of its taxable persons ‘must be regarded as likely to have an effect on trade and, consequently, as meeting that condition, where those taxable persons perform an economic activity in the field of such trade or it is conceivable that they are in competition with operators established in other Member States’.⁷⁰ Although the Commission must ‘examine whether the aid at issue is liable to affect trade between Member States and to distort competition, giving information relevant to their likely effects in the contested decision’,⁷¹ it is not obliged to carry out an economic analysis of the actual situation of the relevant market or the patterns of the trade in question between Member States or to show the real effect of the aid at issue.⁷² This confirmed Advocate General Kokott’s earlier Opinion in *Presidente del Consiglio dei Ministri v Regione Sardegna*, where she made clear in relation to tax legislation that ‘it is always to be presumed that trade between Member State is affected where those favoured by such legislation perform an economic activity in the field of cross-border trade or where it is conceivable that they are in competition with operators established in other Member States’.⁷³ As a result, it seems that the presumption of distortion of competition and effect on trade, laid down in the *Philip Morris* case, still applies to cases of operating aid, and in particular to tax measures. Since distortion of competition is almost always assumed in tax cases and cases of operating aid, and the Commission does not have to carry out economic analysis when examining this criterion, the evidentiary requirements imposed on the Commission are relatively low.⁷⁴ Interestingly, David Spector considered this tendency to ‘forget’ both conditions to be an ‘expression of [the Commission’s] impulse to infringe on national governments’ sovereignty’.⁷⁵

The General Court has followed the case law of the CJEU by confirming that an in-depth analysis of the market is not necessary to fulfil the criteria of distortion of competition and effect on trade. For example, in *Italy v Commission*, the General Court held:⁷⁶

[T]he Commission was not obliged to show that competition was undermined ‘permanently’, or to carry out a more detailed investigation of the substantial impact of the measures at issue on the competitive position of the recipients, and even less

⁷⁰ Case C-494/06 P *Wam* [2009] ECLI:EU:C:2009:272, para 51.

⁷¹ *ibid*, para 57.

⁷² *ibid*, para 58.

⁷³ Opinion of Advocate General Kokott of 2 July 2009 in Case C-169/08 *Presidente del Consiglio dei Ministri v Regione Sardegna* [2009] ECLI:EU:C:2009:709.

⁷⁴ Piernas López (n 63) 207.

⁷⁵ Spector (n 58) 198.

⁷⁶ Case T-211/05 *Italy v Commission* [2009] ECLI:EU:T:2009:304, para 157.

so by viewing this in the context of their turnover. The case-law does not require the distortion of competition, or the threat of such distortion, and the effect on intra-Community trade to be significant or substantial.

The Commission is not even obliged to carry out an in-depth analysis when it is possible that some aid beneficiaries ‘could operate on markets which were only of national interest’.⁷⁷ In the *Alzetta* case, the General Court confirmed that ‘[t]he Commission merely needs to establish that the aid in question is of such a kind as to affect trade between Member States and threatens to distort competition. It does not have to define the market in question or analyse its structure and the ensuing competitive relationships.’⁷⁸

4. STRUCTURE OF THE BOOK

Given the focus on the current tax rulings considered under the State aid framework, Chapter 2 provides a short overview of some of the decisions in the tax rulings cases and the way in which the Commission has applied the criteria of Article 107 TFEU in these decisions. This chapter merely provides an understanding of the facts of the cases rather than an in-depth analysis. Chapter 3 will consider various aspects of the ALP and how it relates to the analysis of economic advantage and selectivity. Given distortion of competition and effect on trade are presumed once a selective advantage has been established, the analysis specifically focuses on how the Commission has conducted its analysis of economic advantage and selectivity. The latter is central to the debate, in particular in relation to tax rulings. It also looks at the Commission’s application of the principle. The ALP does not form part of all European Member States’ domestic tax laws. Thus, these Member States are not legally obliged to apply the principle unless it forms part of the EU legal order. Most companies rely on the ALP as set out in the OECD’s Transfer Pricing Guidelines, which are internationally accepted and provide detailed guidance on how to apply the principle. However, the Commission has been careful not to apply the ALP in the same way as the OECD. Instead, the Commission applies the ALP with reference to the *Forum 187* judgment. The chapter will carefully consider the link to this judgment to understand whether this is the best case to be used as a precedent for the ALP in legally very complex tax cases. It also looks at how the ALP has been applied in some internal market cases decided under Article 49 TFEU to understand whether there is a difference and the consequences of any differences. Chapter 4 looks at recovery and the Commission’s argument

⁷⁷ *ibid.*, para 159.

⁷⁸ Joined Cases T-298/97 and T-312/97 *Alzetta* [2000] ECLI:EU:T:2000:151, para 95.

that legal certainty is respected by the duty to notify. This includes a discussion of legal certainty and legitimate expectations. Chapter 5 considers the question of competence. A telling example of creeping competence is the current conflict between various Member States – notably Ireland, Luxembourg and the Netherlands – and the Commission over the application of the ALP in transfer pricing rulings. In this conflict, State aid policy clashes with direct taxation, which has remained a stronghold of national competence. This kind of clash is not uncommon and it is hard to deal with constitutionally. There are different models on how to deal with such clashes, for instance devolving power to the states or centralising power. The EU seems to favour the latter by allowing EU law to win in such clashes by virtue of the doctrine of supremacy, which constitutes the very basis for the interplay between national law and EU law. Maybe one solution is better than the other but it is a tough problem, which the State aid issue neatly illustrates. Chapter 6 examines the OECD and international practices within the area of tax rulings. The chapter tries to untangle the long-term effect that the recent tax ruling cases will have for the tax relationship between the US and the EU. It also considers the importance of international cooperation in the field of taxation. Chapter 7 considers the various possible ways forward. It looks at dialogue between the Commission and the Member States, regulation, arbitration, settlements and commitments.