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Editorial

The State Aid Review against Aggressive Tax Planning: 'Always Look a Gift Horse in the Mouth'

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Since the early 1990s, the traditional concepts of income taxation have been under continuous pressure within the Union as in a never ending series of judgments the CJEU has ruled that the fundamental freedoms (Articles 45–66 TFEU) impose serious restrictions on the sovereignty of Member States to design their income tax rules. Although case law of the CJEU already in the 1990s indicated that the EU state aid rules (Articles 107–109 TFEU) may also seriously affect the tax sovereignty of the Member States, the full effect of the state aid prohibition on the design of corporate tax rules within the Union and their application and interpretation by the tax authorities was probably unclear for the majority of companies and their tax advisors before the summer of 2014.[1] Since then the question got a new impetus as a result of the formal investigations of the EU Commission's DG Comp into tax rulings (so-called *Advance Pricing Agreements* or *APAs*) obtained by *Apple* (Ireland), *Fiat* and *Amazon* (Luxembourg) and *Starbucks* (Netherlands) and the tax aid scheme of Belgium (so-called *excess profit regime*).

The actions of the DG Comp in the area of direct taxation are relatively recent. On the occasion of the Ecofin adopting in December 1997 the Code of Conduct to tackle harmful tax competition within the Union, the Commission announced in its 1998 Notice on the application of state aid rules to measures of direct taxation (hereinafter '*the 1998 Notice*'), that it would supplement the actions available under the Code of Conduct by means of '*the strict application of the aid rules concerned*'. According to the preamble to the 1998 Notice, '*account must also be taken, in the common interest, of the major repercussions which some aid granted through tax systems may have on the revenue of other Member States*'. Notwithstanding these firm statements, since 1991 the number of DG Comp investigations into direct tax measures of Member States has been fairly limited. According to the report of the TAXE Committee, only sixty-five investigations were carried out, of which seven concerned tax rulings and only ten originated from notifications by Member States.[2]

It is striking that the current investigations focus on the APA practice of only three (small) Member States and on an alleged aid scheme of one (small) Member State and that three of the four recipients of the APA's are US MNE's as are many of the beneficiaries of the alleged Belgian aid scheme. Many more Member States than Ireland, the Netherlands and Luxembourg issue advance rulings and APA's and it suffices to look at the Lux leaks-list of recipients of rulings to see that Luxembourg has provided an impressive number of rulings in transfer pricing and other areas of corporate tax law (some to competitors of the companies under investigation) that are currently left untouched. This criticism on the Commission's selection of cases may explain why it has requested in June 2015 individual rulings from not less than fifteen Member States. It remains to be seen whether the Commission has the resources to digest that information.[3]

A finding that impermissible state aid has been conferred on an undertaking has far reaching consequences, which are hard to explain to a beneficiary. The Member State, which is at the origin of the aid, must recover from the beneficiary the aid that was granted over the past ten years, plus compound interest and the amount so recovered goes into that Member State's own budget. However, the state aid review is based on a concept that still seems to be evolving in tax matters because the Commission and the Union Courts have continuously adjusted the analytical framework. It follows from past practice and case law that the key issue in fiscal state aid cases is the presence of a '*selective advantage*' and how one should distinguish such an advantage from general measures pursuing legitimate policy goals. In recent case law consensus seems to have been reached that a selective advantage exists if a tax

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[1] CJEU, 15 Mar. 1994, Banco Exterior, C-387/92.

[2] European Parliament, Special Committee on tax rulings and other measures similar in nature and effect (TAXE Committee), Draft Report, 20 Jul. 2015, § 51.

[3] In addition to this, the Commission ordered all Member States to submit their rulings issued between 2010 and 2013 and it opened a separate investigation into 165 rulings issued by Gibraltar (Press Releases IP/14/2742 and 1073).

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measure derogates from a reference system in a way that it leads to a different treatment of undertakings that are – in light of the objective of the reference system – in a legally and factually similar position. Such a prima facie selective measure can still avoid state aid qualification if the unequal treatment is justified by the inner logic of the tax system. Objectives external to the tax regime (e.g., general economic or social policy goals) can, however, generally not serve as a justification. Moreover, the CJEU has further limited this justification by a proportionality-requirement in that no less distortive measures may be available and that the Member State should set up appropriate monitoring procedures.[4]

It follows that the determination of the reference framework is a crucial step in the state aid analysis. The wider the reference framework, the sooner a derogation thereof leads to an advantage that could be selective. Following the CJEU's decision in *Paint Graphos* and *Forum 187*, the Commission is of the view that in matters of corporate taxation, the reference framework is the general corporate tax system of the Member State concerned. Under such a system every company is liable to pay tax on its net accounting profit earned in a given year. In addition, according to the Commission companies that are part of multinational groups should be assessed on a tax base comparable to the profit that independent enterprises would have made. This is the application of the arm's-length principle following from Article 9 OECD Model Convention and further elaborated in the OECD Transfer Pricing Guidelines (hereinafter '*OECD TPG*')).[5] It is clear that any tax rule that provides for a full or partial exemption of the accounting profit or any interpretation of the OECD TPG that may derogate from the arm's-length principle, is susceptible of conferring a selective advantage. As such derogations cannot be justified by objectives that are external to the corporate tax system, the presence of impermissible state aid is imminent. The recent General Court's decision in *Banco Santander*[6] and the Opinion of AG Kokott in *Finanzamt Linz*[7] indicate, however, that the judiciary realizes that in matters of direct taxation state aid may become a too powerful tool that may have overkill effects. In her opinion, AG Kokott rightfully warns that a wide concept of state aid carries the inherent danger that the division of competences between the Member States and the Union (Articles 2–6 TFEU) and the division of internal competences between the Parliament, the Council and the Commission (Articles 12 and 17 TFEU) be jeopardized. As both cases are currently pending before the CJEU, it remains to be seen whether the CJEU will agree. Authors have also warned that the current investigations, most of them involving US MNEs, may not be in the long-term interest of the Union. If the Commission were to finally uphold that the APA's or the Belgian excess profit regime conferred state aid, full recovery orders could indeed seriously damage the economic relationships between the USA and the Union.[8]

The current investigations aim at striking down aggressive tax planning structures that may facilitate double non-taxation (see e.g., the deduction/non-inclusion rulings in *Starbucks* and *Amazon*, the Belgian excess profit regime). State aid review is, however, only concerned with the measures of one Member State.[9] Mismatches resulting from interpretation differences of the OECD TPG between two or more Member States or from qualification mismatches of financial instruments and legal entities are the result of disparities in the tax legislation of different Member States and are therefore, as a matter of principle, not suitable of being challenged by the State aid rules.

Because of certain press reports, the current investigations could give the impression that all rulings confer state aid on the taxpayer. However, that impression is wrong. Tax legislation is complex and makes increasingly use of vague and open norms, leaving room for discretion in their interpretation. When making investment decisions, corporate taxpayers seek legal certainty and advance clearance from the tax authorities on the application of the law. Rulings are very useful instruments to offer this certainty. However, because of the lack of any case law in tax matters, there is no conclusive guidance on when rulings or APAs confer impermissible state aid. The guidance provided so far by the Commission is not very helpful. In its 1998 Notice, the Commission distinguishes between interpretative rulings and derogatory rulings. An administrative decision that merely contains an interpretation of tax provisions without deviating from case law and practice does not give rise to a presumption of aid, while there is such a presumption if a decision departs from general tax rules and benefits individual undertakings.[10] Determining whether a tax ruling '*merely interprets*' or '*deviates from*' the normal

4 CJEU, 18 Jul. 2013, *P Oy*, C-6/12, § 19, CJEU, 8 Sep. 2011, *Paint Graphos*, joined cases C-78/08 to 80/08, § 49.

5 CJEU, 8 Sep. 2011, *Paint Graphos*, joined cases C-78/08 to 80/08 § 50; CJEU, 22 Jun. 2006, *Belgium and Forum 187 v. Commission*, C-182/03 and C-217/03 § 96.

6 GC, 7 Nov. 2014, *Banco Santander*, T-399/11 and *Autogrill*, T-219/10. The cases concern a Spanish measure allowing companies to amortize goodwill on the acquisition of shares but only in non-Spanish companies. The GC found that the rule was not selective, holding that a derogation from the reference system and/or the requirement to fulfil certain conditions to enjoy the tax benefit, do not necessarily imply selectivity. It found that the rule aimed at a category of economic transactions (not a category of undertakings) and that undertakings must not a priori change their activities to benefit from it.

7 Opinion of 16 Apr. 2015, AG Kokott, *Finanzamt Linz*, C-66/14.

8 R. Luja, *Will the EU's State Aid Regime Survive BEPS?*, 3, B.T.R 379–389 (2015). According to the Financial Times of 13 Jul. 2015, Apple alone would be at risk for about USD 19 billion.

9 See e.g., Commission Decision 2009/809/EC on the Dutch groepsrentebox; CJEU, 11 Nov. 2004, C-73/03, *Commission v. Spain*; GC, 1 Jul. 2004, T-308/00, *Salzgitter*.

10 Commission Notice of 11 Nov. 1998 on the application of the State aid rules to measures relating to direct business taxation, § 22;

application of a tax provision can be complicated in practice, especially considering the fact that rulings are used to provide certainty where the '*normal application*' of the law is not obvious. In its draft Notice on state aid of 2014 the Commission itself recognizes that in the area of transfer pricing, the OECD's arm's-length principle leads to uncertainty and that APAs provide certainty as to its interpretation.[11] Together with the TAXE Committee, one can only hope that the current investigations will help the Commission to provide legal certainty. The Commission should establish: (i) more precise and effective guidelines on transfer pricing and other tax-related state aid matters and (ii) best practices, or even an EU framework, for the ruling systems of the Member States.[12] If it fails to do so, the Commission may become overwhelmed by notifications by Member States of the tax rulings that they plan to issue to taxpayers (application of Article 108(3) TFEU). The ruling practice within the Union may then effectively come to a standstill, something which is detrimental to the investment climate.

As mentioned earlier, the selectivity test in the state review requires as a first step the determination of a reference framework. Obviously such a framework must be composed of an enforceable rule or set of rules. In the opening decisions on the current investigations the Member States are blamed for having incorrectly applied the OECD TPG and as the rulings accordingly deviate from these TPG, the Commission asserts that a selective advantage is granted. Although the OECD TPG may have authoritative interpretation value, still they are non-binding soft law. The matter is different though if the OECD TPG are transposed into the domestic laws of the Member State concerned or the domestic transfer pricing rules are aligned to the OECD TPG. Yet, the OECD TPG allow for different transfer pricing methods and a range of different solutions may be arrived at depending upon the choice of the method, the choice of the comparables etc. Accordingly, even if two Member States apply the same method, both may retain different profit margins, rates of return etc. and none of those is necessarily wrong. Transfer pricing is not an exact science and if two countries disagree on the interpretation of the OECD's arm's-length standard, the parties may resort to the mutual agreement procedure or, within the Union, to the Arbitration Convention to settle the dispute. The Commission, however, seems to have its own interpretation of the OECD TPG that it substitutes for that of the Member State concerned. Although it may have to take some procedural hurdles, the OECD should have a say in these investigations and express its opinion as to whether or not the Member States have misapplied its TPG.[13] It is worrying that the Commission even substitutes the OECD's arm's-length principle with another – even vaguer – concept, i.e., that of the prudent independent market operator (hereinafter '*PIMO*').[14] The PIMO is a judicially developed concept that is used to identify state aid where economic activities are carried on by public authorities.[15] In such a case, it is necessary to assess whether in similar circumstances a private economic operator operating in normal conditions of a market economy could have prompted to make an investment, sale etc. under the same terms as the public body. Accordingly, the PIMO-test applies in a different context. Whereas the PIMO-test is applied to the economic activities carried on by a public authority, the Commission now uses it to assess economic activities of two or more private market operators. Admittedly, the PIMO-test has some similarity with the CUP-method under OECD TPG because it also requires a comparability analysis. To find out whether the transaction carried out by the public body is in line with market conditions, one has to compare it to the terms and conditions under which comparable transactions carried out by comparable private operators have taken place in comparable situations. However, the PIMO-test seems to be far less elaborated than the OECD's arm's-length test and not suitable to apply to the wide range of business transactions carried on by MNE's. It is striking that the Commission recognizes in its 2014 draft Notice on state aid of that the PIMO-test, just like the OECD Transfer Pricing methods, establishes a range of possibilities.[16] Hence, one test is replaced by another that suffers from the same deficiency, i.e., it does not offer legal certainty.

The Commission should realize that a state aid investigation in the area of transfer pricing may be a zero sum game. If it is established that company A in Member State A has understated its profits on transactions with group company B in Member State B because company A benefited from an APA that derogated from the arm's-length principle, Member State A will be required to recover the aid from company A equal to the tax that it has forfeited on the understated profits. However, such profits may very well also have been included in the tax base of company B which has

Draft Commission Notice of 2014 on the notion of state aid pursuant to Art. 107(1) TFEU, § 174–175.

11 *Ibid.*, 2014, § 174.

12 European Parliament, Special Committee on tax rulings and other measures similar in nature and effect (TAXE Committee), Draft Report, 20 Jul. 2015, §§ 55 and 80.

13 K. Lenaerts, et al., *Procedural Law of the European Union*, 563 (2nd ed, Sweet & Maxwell 2010).

14 See §61 of the Commission's decision of 6 Feb. 2015, no. SA.38944-2015/C044/02 in *Amazon*: '*although as the Luxembourgish authorities rightfully argue, the OECD Guidelines provide some flexibility with respect to the application of the arm's length principle, that flexibility is limited by the principle that the remuneration arrived at should reflect what a prudent independent operator acting under normal market conditions would have accepted*'.

15 Draft Commission Notice of 2014 on the notion of state aid pursuant to Art. 107(1) TFEU, §§ 76–117.

16 Draft Commission Notice of 2014 on the notion of state aid pursuant to Art. 107(1) TFEU, § 103: *'Benchmarking often does not establish one "precise" reference value, but rather it establishes a range of possible values by assessing a set of comparable transactions'*.

paid tax thereon in Member State B. Hence, the state aid recovery results in international economic double taxation. Under the Arbitration Convention, B is allowed to request from Member State B's tax authorities a corresponding downward adjustment to avoid this double taxation.[17] The fact that the aid recovery in Member State A is effectuated through an administrative act ordering the repayment of an amount equal to the forfeited tax, rather than through a reassessment of company A's profits,[18] should not preclude such downward adjustment.

In view of the above, the state aid review should not be used as a means to achieve harmonization of corporate taxes in the Union or to address mismatches and the double non-taxation following from disparities in the tax legislations of two or more Member States. More efficient means are available to achieve these goals. In the first place they can be realized through the adoption of secondary Union legislation (such as the amended Parent/Subsidiary Directive to avoid hybrid mismatches, the adoption of the proposed Directive on the automatic exchange of rulings,[19] the adoption of CCCTB as relaunched by the Commission[20]) and in the second place through the various measures which Member States are expected to take to execute the different BEPS action plans. The state aid review should, in accordance with the initial intentions of the Commission of 1998, only be used to eradicate the most blatant harmful tax practices that are imputable to only one Member State.

17 If company B would not be established in the Union, a similar remedy is available if Member State A and the third State have entered into a tax treaty that follows Art. 9(2) OECD Model.

18 A recovery order covers the past ten years. A Member State may under its statute of limitations in tax matters be precluded to execute the order through a reassessment of taxes.

19 Council Proposal for Directive amending Directive 2011/16/EU as regards the mandatory automatic exchange of information in the field of taxation, 18 Mar. 2015 COM (2015) 135 final.

20 Communication from the Commission to the European Parliament and the Council, *A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*, 17 Jun. 2015 COM (2015) 302 final.