

The FIAT Case and the Hidden Consequences

I INTRODUCTION

*Fiat*¹ is a state aid case involving the analysis of domestic tax rulings, state aid,² and the arm's length standard. It concerns the issues of whether the European Commission can establish a European Union (EU) arm's length standard as inspired in the OECD Guidelines and choose the adequate methods applicable to the specific case in light of the state aid rules.

On 8 November 2022, the Grand Chamber of the Court of Justice of the European Union (CJEU)³ annulled the General Court judgment⁴ and the European Commission decision that considered the tax ruling issued to Fiat by Luxembourg tax authorities as state aid incompatible with the internal market.⁵ The decision by the CJEU frustrates the Commission's attempts to apply an EU arm's length standard following the spirit of the Base Erosion and Profit Shifting (BEPS) Project.

With the CJEU decision, it can now be regretted that the anti-tax avoidance directive (ATAD)⁶ failed to take the opportunity to introduce such an EU arm's length standard. In contrast, the EU Member States' competence in determining the arm's length without EU law barriers can be praised as one

of the last frontiers for tax competition, not only within the Union, but also between the Union and third countries. In defence of the Court, it can be contended that international standards such as the arm's length cannot be converted into EU Law without harmonization and therefore cannot be directly applicable by Member States. This would lead to a wide margin of appreciation by the Commission.

2 THE COMMISSION'S VIEW

In the Fiat case, the Commission 'considered that the arm's length principle necessarily forms part of its assessment, under Article 107(1) TFEU, of tax measures granted to integrated companies, irrespective of whether a Member State has incorporated that principle into its national legal system'.⁷

The OECD listed five methods for approximating an arm's length pricing of transactions and profit allocation between integrated companies.⁸ The Commission departed from the OECD methods and claimed that

'only two of those methods were, in [its] view, relevant in the case at hand, namely the comparable uncontrolled price method and the transactional net margin method (recitals 88 and 89 of the decision at issue)'.⁹

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¹ Court of Justice of the European Union (CJEU): Joined cases C-885/19 P and C898/19 P, *Fiat Chrysler Finance Europe, Ireland, v. European Commission*, ECLI:EU:C:2022:859, <https://curia.europa.eu/juris/document/document.jsf?text=&docid=268045&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=183838>.

² According to Art. 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 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'.

³ The CJEU ruled on the appeals brought by *Fiat Chrysler Finance Europe, Ireland*, *supra* n. 1.

⁴ General Court (GC): Joined Cases T-755/15 and T-759/15, *Luxembourg and Fiat Chrysler Finance Europe v. Commission*, ECLI:EU:T:2019:670. See the comments on the decision of the GC: Peter J. Wattel, *Starbucks and Fiat: Arm's Length Competition Law*, 48 Intertax 119–121 (2020), <https://kluwerlawonline.com/journalarticle/Intertax/48.1/TAXI2020008>.

⁵ Commission Decision (EU) 2016/2326 of 21 Oct. 2015, on state aid SA.38375 (2014/C ex 2014/NN) – Luxembourg – Alleged state aid to Fiat (OJ 2016 L 351, at 1), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D2326&from=PL>.

⁶ Council Directive (EU) 2016/1164 of 12 Jul. 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 1–14 (19 Jul. 2016), <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L1164&from=EN>.

⁷ CJEU: Joined cases C-885/19 P and C898/19 P, *supra* n. 1, para. 19. Commission Decision (EU) 2016/2326, *supra* n. 5, at 17, 87. 'To the extent the Commission cites the OECD TP Guidelines in the present Decision, it does so because those guidelines are an existing manual in the area of transfer pricing that are the result of expert discussions in the context of the OECD and elaborate on techniques aimed to address common challenges of the application of the arm's length principle to concrete situations. The OECD TP Guidelines therefore provide useful guidance to tax administrations and multinational enterprises on the application of the arm's length principle. They also capture the international consensus on transfer pricing'.

⁸ Commission Decision (EU) 2016/2326, *supra* n. 5, at 17, 88; the traditional transaction methods (comparable uncontrolled price method, resale price method and cost plus method); and the transactional profit methods (transactional net margin and transaction profit split method): *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* 97–148 (2022), <https://doi.org/10.1787/0e655865-en>. https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2022_0e655865-en#page7.

⁹ CJEU: Joined cases C-885/19 P and C898/19 P, *supra* n. 1, para. 13; Commission Decision (EU) 2016/2326, *supra* n. 5, at 17 88–89.

The Commission concluded that the reference system against which the contested ruling should be examined is the general Luxembourg corporate tax system in the form of the Luxembourg corporate income tax rules (IRC). According to the Commission, both types of companies – non-integrated and integrated companies – should be considered to be in a similar factual and legal situation.¹⁰ Thus, the Commission rejected the argument raised by Luxembourg and Fiat that ‘the reference system for determining whether the tax ruling at issue was selective had to be limited to undertakings subject to transfer pricing rules (recitals 193 to 215 of the decision at issue)’.^{11,12}

The Commission’s position in the *FIAT* case is in accordance with its subsequent notice (2016/C 262/01)¹³ on the notion of state aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (TFEU). This notice was issued in the aftermath of the BEPS Project and corresponding actions as well as the compatibility of tax rulings with Article 107(1) TFEU. In the notice, although acknowledging prior administrative rulings as a means to achieve tax certainty in individual cases,¹⁴ the Commission also stated that they should not be used as state aid.¹⁵

The Commission further announced the EU arm’s length standard based on a ‘reliable approximation of a market based outcome’.¹⁶ According to the Commission, the arm’s length principle ‘necessarily forms part’ of its assessment of tax measures granted to group companies in light of Article 107 (1) TFEU, ‘independently of whether a Member State has incorporated this principle into its national legal system and in what form’.¹⁷

3 THE DECISION BY THE CJEU

Contrary to the Commission’s position, in the *FIAT* case, the CJEU decided that the arm’s length standard is to be determined according to the Member States’ law, and that the OECD guidelines are external to the national system:

Parameters and rules external to the national tax system at issue cannot therefore be taken into account in the examination of the existence of a selective tax advantage within the meaning of Article 107(1) TFEU and for the purposes of establishing the tax burden that should normally be borne by an undertaking, unless there is express reference to them.¹⁸

It is furthermore mentioned by the Court that this results from the principle of legality:

it is only the national provisions that are relevant for the purposes of analysing whether particular transactions must be examined in the light of the arm’s length principle and, if so, whether or not transfer prices, which form the basis of a taxpayer’s taxable income and its allocation among the States concerned, deviate from an arm’s length outcome.¹⁹

This finding is an expression of the principle of legality of taxation, which forms part of the legal order of the EU as a general principle of law, requiring that any obligation to pay a tax and all the essential elements defining the substantive features thereof must be provided for by law, the taxable person having to be in a position to foresee and calculate the amount of tax due and determine the point at

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¹⁰ Commission Decision (EU) 2016/2326, *supra* n. 5, at 38, 209.

¹¹ CJEU: Joined cases C-885/19 P and C898/19 P, *supra* n. 1, at 4, 16. Commission Decision (EU) 2016/2326, *supra* n. 5, at 35–39.

¹² ‘[T]he Commission stated that whether a tax measure constitutes a derogation from the reference system would generally coincide with the identification of the advantage granted to the beneficiary under that measure. In its view, where a tax measure results in an unjustified reduction of the tax liability of a beneficiary who would otherwise be subject to a higher level of tax under the reference system, that reduction constitutes both the advantage granted by the tax measure and the derogation from the reference system. The Commission also noted that, according to the case-law, in the case of an individual measure, the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective’: CJEU: Joined cases C-885/19 P and C898/19 P, *supra* n. 1, at 4–5, 17; Commission Decision (EU) 2016/2326, *supra* n. 5, at 39, 218.

¹³ 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, JO C 262/1 (19 Jul. 2016), [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016XC0719\(05\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016XC0719(05)&from=EN).

¹⁴ ‘The function of a tax ruling is to establish in advance the application of the ordinary tax system to a particular case in view of its specific facts and circumstances. For reasons of legal certainty, many national tax authorities provide prior administrative rulings on how specific transactions will be treated fiscally. This may be done to establish in advance how the provisions of a bilateral tax treaty or national fiscal provisions will be applied to a particular case or 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’. Commission Notice on the Notion of State Aid, *supra* n. 13, at 36–37, para. 169.

¹⁵ ‘The grant of a tax ruling must, however, respect the State aid rules. Where a tax ruling endorses a result that does not reflect in a reliable manner what would result from a normal application of the ordinary tax system, that ruling may confer a selective advantage upon the addressee, in so far as that selective treatment results in a lowering of that addressee’s tax liability in the Member State as compared to companies in a similar factual and legal situation’: Commission Notice on the Notion of State Aid, *supra* n. 13, at 37, para. 170.

¹⁶ Commission Notice on the Notion of State Aid, *supra* n. 13, at 37, 171.

¹⁷ *Ibid.*, at 37, 172.

¹⁸ CJEU: Joined cases C-885/19 P and C898/19 P, *supra* n. 1, at 18, 96.

¹⁹ *Ibid.*

which it becomes payable (see, to that effect, judgment of 8 May 2019, *Związek Gmin Zagłębia Miedziowego*, C-566/17, EU:C:2019:390, paragraph 39).²⁰

4 CRITICAL NOTES

Whereas the reference to legality is meaningful, the legality argument by the CJEU in the *Fiat* case grants not only allocation of transfer pricing rights to the Member States but also the exercise of transfer pricing rights to the Member States (*as long as there is no explicit reference to the international standard in the domestic legislation*). A more favourable regime applicable to multinationals via transfer pricing rulings could only be prevented with the application of state aid rules, which would guarantee that the exercise of taxing rights complies with EU law.

Moreover, although tax rulings contribute to the foreseeability of taxes and legal certainty, it is not certain that rulings comply with the general principle of legality, i.e., the approval of tax rules by a parliament. The latter ensures equality, which is not necessarily the case of tax rulings. In the absence of explicit reference to the OECD guidelines by domestic legislation, there is a risk that rulings are exploited as an instrument to grant aid.

Although OECD contracting states are not bound by the OECD guidelines,²¹ they are encouraged to follow them.²² The OECD guidelines reflect the international consensus on transfer pricing and have ‘practical significance in the interpretation of issues related to transfer pricing’.²³ Guidelines could be understood as a subsequent practice in the application of the treaties (Article 31 (3) (b) of the Vienna Convention of the Law of Treaties).

The Court reference to the principle of legality is to be understood as a negative boundary to EU competence and similarly to corporate income tax rates, juridical double taxation, and the most favourable nation clause. In the absence of harmonization in the EU and if no reference is made to the international standards, the exercise of transfer pricing rights is under the competence of the Member States.

It is true that the application of the state aid regime to the arm’s length standard would grant a wide margin of appreciation to the Commission. However, it also implies that the OECD standards resulting from the recommendations in the BEPS actions can be at risk in the EU. Whereas the CJEU has developed an EU principle of abuse applicable to taxes that, by definition, is also vague, Member States could still explore disparities (double non-taxation) based on different concepts of the arm’s length standard. Issuing tax rulings on transfer pricing and addressing them to specific taxpayers (selectivity), can violate the principle of equal treatment in the Union and foster BEPS.

This is an unbalanced result: tax transparency requirements on taxpayers have been expanding,²⁴ taxpayers’ tax planning is increasingly classified as abuse²⁵ and, yet, at the same time, Member States could select some taxpayers and treat them more favourably using transfer pricing rules. They could also incentivize aggressive tax planning (double non-taxation) via favourable transfer pricing methods enacted by tax rulings. Is some tax competition via some state aid, after all, desirable?

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Notes

²⁰ *Ibid.*, at 18, 97.

²¹ *Ibid.*, at 18–19, 98 and 99.

²² See the *Commission Notice on the Notion of State Aid*, *supra* n. 13, at 84, fn. 43.

²³ General Court (GC): Joined Cases T-755/15 and T-759/15, *supra* n. 4, at 147.

²⁴ See e.g., Willemien Netjes & Dominik Freyer, *Tax Transparency Is Here to Stay: An Analysis of the Public CbCR Directive*, 50(8/9) Intertax 612–618 (2022).

²⁵ Robert Danon, Daniel Gutmann, Marggriet Lukkien, Guglielmo Maisto, Adolfo Martín Jiménez & Benjamin Malek, *The Prohibition of Abuse of Rights After the ECJ Danish Cases*, 49(6/7) Intertax 482–516 (2021).