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State aid with a spotlight on the recent tax rulings

Is the Commission heading in the right direction?

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Abbreviation List

AG	Advocate General
Art.	Article
APA	Arm's Length Principle.
CJEU	Court of Justice of the European Union.
Commission notice	Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU EU.
Commission	European Commission.
EU	European Union.
EC	European Commission.
FS	Fiscal Sovereignty
QMV	Qualified Majority Voting
MNE	Multinational Enterprise.
OECD	Organisation for Economic Co-operation and Development.
TEU	Treaty of the European Union.
TFEU	Treaty of the Functioning of the European Union.
The Code	The Code of Conduct for business taxation
The Treaties	Treaty of the European Union and Treaty of the Functioning of the European Union.
U.S.	United States of America.

Keywords List :
State aid, The Commission, Member States, Fiscal Sovereignty, Arm's length principle, transfer pricing, direct taxation, taxes, TFEU, European Commission, Multinational Enterprise, Tax competition, Harmful tax competition, Organisation for Economic Co-operation and Development, Court of Justice of the European Union, Commission's Decisions; Amazon, Apple, Starbucks, Fiat.

Introduction

There has been, in the recent years, a new active European Commission dedicated at investigating certain tax rulings that were granted to multinational enterprises (MNEs) by the tax authorities of EU Member States, such as Belgium, Ireland, Luxembourg and The Netherlands. The European Commission, from 2014 onwards, has subjected several high clout multinational corporations (Apple, Starbucks, Amazon, Fiat, and others)[1] to formal state aid investigations. The pursuit of these investigations, in recent years, has led some MS to fiercely criticize the European Commission's state aid control efforts, accusing them of being excessively political, and used as a vehicle to try to harmonize tax provisions that are of exclusive competence of MS[2]. The EU commission's approach seems to be grounded on the ideal that tax design in the EU must safeguard and enhance EU initiatives that benefit the European spirit and goals.[3] In this context, there are two core grounds of debate in our thesis discussion. The first is the Member States' desire to maintain fiscal sovereignty, and the second is the EC's approach of targeting tax policies as a means of obtaining more autonomy from Member States.[4]

This paper presents an overview of EU state aid law and the Commission's competences in this area, as well as a critical analysis of the matter. Our specific focus will lie on the Commission's approach to state aid and whether case law has been broadening and overreaching the Commission's and EU's tax authority. We will, in particular, focus on a critical study of the EC rulings and the criticism they have been facing by different actors, as well as the Courts' reactions to the decisions and their interpretation of EU law. The purpose of this study is to examine the EC decisions from a political and legal standpoint. We will analyse the EC's approach to Article 107(1) TFEU and the reasons behind the Commission's arguments. We will also analyse this approach from the point of view of Member States and their sovereignty in relation to tax. In this thesis, we further propose to explore the interpretation of Article 107(1) TFEU, in the assessment of whether state aid rules have been breached. In this context, we will investigate the selectivity criterion and how it has been interpreted in recent tax judgements. In addition, we propose to conduct a critical examination of the Commission's interpretation of

[1] Commission Decision SA.38373 Apple; Commission Decision SA.38374 Starbucks; Commission Decision SA.38944 Amazon; Commission Decision SA.38375 Fiat.
[2] AUKE LEEN, A European tax. The Fiscal Sovereignty of the Member States vs. The Autonomy of the European Union. (2012), available at: https://scholarlypublications.universiteitleiden.nl/handle/1887/19409
[3] *Ibid.*
[4] *Ibid.*

selectivity and the advantage criterion as well as the matter of the EU arm's length principle and the implications of such principle.

In the end, we will discuss the interaction between the concept of fiscal sovereignty and the use of state aid regulation as a tool to combat tax competition within the European Union.[5] We will explore the main criticism regarding the Commission's decisions and explore the tensions between MS and the Commission on the established competences regarding taxation and its limits to direct taxes and state aid. Finally, we will bring to light the arguments the Commission applied in its recent decisions and try to discover the legal and political consequences of such approach.

All in all, the aim of this thesis will be to answer the following core question: *Bearing in mind the EU legal architecture and its core aims as defined by the Treaties, is the Commission heading in the "right direction" in its recent state aid tax rulings?*

Chapter 1- The issue of taxation in the framework of the internal market

1.1 Integration process & Taxation in the EU

In this thesis, as we have detailed above, we propose to discuss state aid with a spotlight on the recent tax rulings of the Commission. To understand state aid in the fiscal field, it seems fitting that in the beginning of our exploration, we analyse how does taxation fit in the framework of the European Union and its internal market goals. To understand any aspect in the EU legal system, we must be aware that the European Union has been through "*a historical long and complex process of integration"*.[6] To this extent, when understanding the role of taxation in the framework of the internal market, there are two important points to discuss: (i) the EU taxation legal framework[7]; and (ii) the integration process of the European Union.

When discussing taxation in the EU framework, tax legislation takes on a special role as an important indicator of the idea of sovereignty and its tension with the powers of EU institutions.[8] Therefore, through the European tax legislation we can recognize fundamental

[5] *Ibid.*
[6] For a detailed discussion of this issue *see* PIETRO. BORIA, et al, *The role of Taxation in the EU Legal System,* in Taxation in European Union (Springer International Publishing Switzerland and G. Giappichelli Editore (2017).
[7] *See* PIETRO BORIA, Taxation in European Union (Springer International Publishing Switzerland and G. Giappicjelli Editore 2nd ed. 2017) p. 31 ("(…) it should be clear that taxation constitutes one of the most "intimate" attributes of sovereign power. ").
[8] *See* PIETRO BORIA, Taxation in European Union (Springer International Publishing Switzerland and G. Giappicjelli Editore 2nd ed. 2017) p. 31 ("Compared to the formative process of the European integration, the adjustment of tax legislation takes on a special importance as it is presented as one of the most important index detectors of the idea of sovereignty that is attributed to the EU institutions.").

principles involving the fiscal sovereignty of the European Union.[9] Moreover, when analysing the Treaties[10], we must highlight art. 113, 115, 191 and 192 of the TFEU, which concern tax-based own resources. Articles 113 and 115 TFEU concern the "*harmonisation of indirect and the approximation of direct taxes*"[11]. There is a clear difference in the involvement of the EU, when it comes to direct and indirect taxation. Article 113 focuses on indirect taxation, whereas 115 focuses on the area of direct taxation.[12]

Under Art. 113 TFEU, the Council can adopt provisions for the harmonisation of Member States rules in the area of indirect taxation, because these types of taxes can create barriers to "*the free movement of goods and the free supply of services within the internal market and create distortions of competition*".[13] However, this competence is limited to the extent of taxes that already exist in EU Member States.[14] This is because, regarding indirect taxes, harmonization is a tool, but only to ensure the functioning of the internal market.[15] This article requires a special legislative procedure of unanimity voting and consultation with the European Parliament. At this point, it is clear that article 113 grants to the EU a direct competence to harmonise indirect taxes when harmonisation is necessary in order to secure the functioning of the internal market. As a result, the EU has the authority to enact legislation that is binding to Member States. What we can see is that, unlike indirect taxes, in the field of direct taxes there is no clear mandate conferred to the EU to harmonise legislation.[16] The EU should only take initiative regarding harmonising direct taxes if there is a threat of market distortions. As far as Art.115 TFEU and direct taxation, the special legislative procedure is also required, (unanimity voting and consultation with the European Parliament and the Economic and Social Committee).[17] In this situations, Article 115 TFEU allows for the Council to: *"issue directives*

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[9] *See Ibid* p. 31.

[10] *See* Euro-lex, Consolidated version of the TFEU, under art. 113;114;115 (December 13, 2007), available at: http://data.europa.eu/eli/treaty/tfeu_2012/oj ; EUROPEAN COMMISSION, The Lisbon Treaty and tax legislation in the EU, available: https://ec.europa.eu/taxation_customs/lisbon-treaty-and-tax-legislation-eu_en

[11] *See* ALEXANDER KRENEK, MARGIT SCHRATZENSTALLER, *Tax-based Own Resources to Finance the EU Budget*, Intereconomics Volume 54, 2019 · Number 3 · pp. 171–177.

[12] *Ibid.*

[13] EUROPEAN COMMISSION, *The Lisbon Treaty and tax legislation in the EU*, available at: https://ec.europa.eu/taxation_customs/lisbon-treaty-and-tax-legislation-eu_en

[14] *See* ALEXANDER KRENEK, MARGIT SCHRATZENSTALLER, *Tax-based Own Resources to Finance the EU Budget*, Intereconomics Volume 54, 2019 · Number 3 · pp. 171–177.

[15] For a detailed discussion of this issue *see* ALEXANDER RUST & CLAIRE MICHEAU (eds), State Aid and Tax law, International Tax Conferences of the University of Luxemburg Vol. 3 (Kluwer law international BV, 2013), chapter 5.

[16] EUROPEAN COMMISSION, *The Lisbon Treaty and tax legislation in the EU*, available at: https://ec.europa.eu/taxation_customs/lisbon-treaty-and-tax-legislation-eu_en

[17] *See* HM GOVERNMENT, *Review of the Balance of Competences between the United Kingdom and the European Union: Taxation (July 2016), available at* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/224710/29010 87_Taxation_acc.pdfSite

for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market."[18] These directives are implemented by MS and result in the harmonisation of national tax provisions.[19] As a result, art. 115 is utilized as the legal basis for direct tax measures which are essential for the internal market to function. The general rule, under art. 113 and 115 TFEU, is of unanimity for a proposal of tax harmonization to be possible. The Economic and Financial Affairs Council (ECOFIN) is where Finance Ministers agree on tax measures. However, there are exceptions where QMV and co-decision are enough for there to be an agreement. Outside of ECOFIN, non-tax initiatives are decided by qualified majority under the standard legislative procedure.[20] Therefore, tax measures can be decided by QMV,[21] provided they are included in a non-tax proposal, and accordingly, will not be subject to the unanimity requirements of Art. 113 or 115 of the TFEU.

In this way, we see the particularity of the role of harmonization, and how it has been both the answer and the big issue when discussing European Taxation. Harmonization can be an answer due to its objective, for the establishment and functioning of the internal market, making essential the establishment of harmonised legislation[22]. Furthermore, EU legislation with harmonization can support the functioning of the internal market and at the same time respect public interests. This combination of objectives is necessary for a sustainable internal market. There is an aim to have tax compatibility at the EU level with Member States.[23] Consequently, it should be seen as a positive principle to support integration of national taxation systems.[24] However, the principle of harmonization also raises issues, especially in direct tax matters, calling into question the issue of fiscal sovereignty. The issue of direct taxation remains essentially a competence of Member States. Most EU legislation, on direct taxation, rather than adopting broader tax frameworks, has the goal of trying to remove tax obstacles within the internal market.[25] To this regard, as direct tax is a Member State competence, there is a general

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[18] Art. 115 TFEU.
[19] *See* ALEXANDER KRENEK, MARGIT SCHRATZENSTALLER, *Tax-based Own Resources to Finance the EU Budget*, Intereconomics Volume 54, 2019 · Number 3 · pp. 171–177.
[20] *Ibid.*
[21] *Ibid.*
[22] *See* PIETRO BORIA, Taxation in European Union (Springer International Publishing Switzerland and G. Giappicjelli Editore 2nd ed. 2017) p. 59 *et seq*.
[23] *See Ibid* p. 60.
[24] *See Ibid* p. 60.
[25] *See* HM GOVERNMENT, *Review of the Balance of Competences between the United Kingdom and the European Union: Taxation* (July 2016). https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/224710/2901087_Taxation_acc.pdfSite

acceptance that Member States are granted tax sovereignty and that this principle should not be called into question[26]. However, the exercise of this exclusive competence of MS must comply with EU law, therefore any measure that changes their taxation system should not go against the Treaties provisions.[27] Hence, the competence to legislate, that MS have in regard to direct tax is ultimately bounded by the objective of market integration.[28] Therefore, we need to understand my second remark, the fact that the internal market is the heart and ever-moving piece in the EU. We must be aware that European integration is the moving key and fundamental factor that keeps the EU dynamics strong and going[29]. Therefore, as BORIA observes, a community moved by economic unity[30] is at the core of the EU where economic interest becomes the first step of the political integration process.

On the other hand, integration comes with tension. The concepts of sovereignty and Member State power seem to be in a constant tension with the view of a further integration process. Professor J. H. WEILER in *Transformation of Europe* explored this idea.[31] To this extent, WEILER argues that there seems to exist a tension happening between the Member States and the EU institutions. Moreover, there is a balance of material and political costs, as well as benefits that the community conveys to Member States. It is argued that both parties are in constant tension, trying to explore the power dynamics between each other. Consequently, "*the community is accompanied by the strength of the member state"*[32] due *"to the unique legal political equilibrium of the Community structure."*[33] In this equilibrium there is a limitation of sovereignty of a MS. This translates to an abdication of the power to deal independently with issues of the four freedoms and entrusting the institution power to regulate the related matters by legislation.[34] Following this sensible conceptual framework, the issue of direct taxation in

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[26] *See* WOLFGANG SCHÖN, T*ax legislation and the notion of fiscal aid: a review of 5 years of European jurisprudence*, as in Richelle, I., Schön, W. & Traversa, E. (red.), State Aid Law and Business Taxation, Springer Berlin Heidelberg, 2016.

[27] *See* HM GOVERNMENT, *Review of the Balance of Competences between the United Kingdom and the European Union: Taxation* (July 2016). https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/224710/290108 7_Taxation_acc.pdf

[28] *See* ISABELLE RICHELLE; WOLFGANG SCHÖN & EDOARDO TRAVERSA (eds), State Aid and Business Taxation, MPI Studies in Tax Law and Public Finance Vol.6 (Springer 2016), p. 5.

[29] *See* European Union, The Schuman Declaration – 9 May 1950 (May 13, 2003), available at: https://europa.eu/european-union/about-eu/symbols/europe-day/schuman-declaration_en

[30] *See* PIETRO BORIA, Taxation in European Union (Springer International Publishing Switzerland and G. Giappicjelli Editore 2nd ed. 2017) p. 25.

[31] For a detailed discussion of this issue *see* J. H. Weiler, *The Transformation of Europe*, 100 YALE L.J. (1991), Available at: https://digitalcommons.law.yale.edu/ylj/vol100/iss8/5

[32] *Ibid*. p. 2429.

[33] *Ibid*. p. 2429.

[34] *See* PIETRO BORIA, Taxation in European Union (Springer International Publishing Switzerland and G. Giappicjelli Editore 2nd ed. 2017) p. 26.

the EU can be broken down to the fiscal sovereignty of a Member State and the equilibrium of the institutions[35]. This preservation of sovereignty around the taxation power in MS, poses tensions in the process of EU legislation.[36] One must never forget that when Member States join the EU, the concept of their sovereignty changes: the MS is no longer independent in the sense that it no longer just works towards itself, but towards the EU and the EU's goals. This balance of power comes with the need to support and align its focus on the integration process.[37] With respect to taxation policy, this tension gets particularly complex, when there is a goal of luring foreign investments and by doing so depriving other states of essential resources for economic development in a way which may be unfair, what is commonly referred to as "harmful tax competition".[38]

1.2 Sovereignty and Tax

In the context of our society dynamics, sovereignty is one important figure, where tax sovereignty is one of its fundamental elements. States are in principle free to exercise their tax sovereignty as they please. Tax sovereignty can be defined as the autonomous power to introduce and enforce a tax system, to positively levy taxes[39]. However, a State, and especially a Member State of the EU, does not exercise its tax sovereignty in a full independent way, since it is influenced by economic, political and legal considerations when designing its tax system.[40] Moreover, often in tax sovereignty the issue is also about the state's power to not tax, in order to be a competitor in the global economy.[41]

We can see the real implications where TS comes into play with the current tax rulings of the Commission[42] and the constant battle MS seem to be fighting to preserve their power to grant tax advantages to entities established in their MS. The dynamics of the MS and the EU institutions is quite complex, since in general MS co-operate with the EU regarding tax when it comes to taxes on consumption, for example, and even to allowing the EU sovereignty over

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[35] *Ibid*. p. 31.
[36] *See Ibid* at § 3.1.8 ("The preservation of a "strong" nucleus of sovereignty about the taxation power in each Member State poses, in fact, as a real contrast with the needs of non-discrimination and harmonization of national legislation, likely to lead to tensions in the axiological declination of EU legislation.").
[37] For a detailed discussion of this issue *see* J. H. Weiler, *The Transformation of Europe*, 100 YALE L.J. (1991).
[38] *See* CLAIRE MICHEAU , State Aid, Subsidy and Tax Incentives under EU and WTO Law, Series on International Taxation Vol.45 (Wolters Kluwer 2014), at $1.01, [2], [C].
[39] SMART, *what is tax sovereignty for?* (May 11, 2017), available at https://www.smart.uio.no/news/what-is-tax-sovereignty-for.html
[40] AUKE LEEN, *Eurotax and the Fiscal Sovereignty of the Member States*. Columbia Journal Of European Law, Online, 17(November 2010), 18-21, available at: from https://hdl.handle.net/1887/43338
[41] SMART, *what is tax sovereignty for?* (May 11, 2017), available at https://www.smart.uio.no/news/what-is-tax-sovereignty-for.html
[42] we will analyse the recent tax rulings further on chapter 4.

the definition of the tax base.[43] However, MS, or at least most MS, seem to wish that their competence to tax companies remains unchanged, without the intervention of the EC.[44] State sovereignty is a legal principle of public international law which can be defined as *"designed to protect a State's freedom of action and the self-determination of its people."*[45] There are different elements to characterise sovereignty, while it is common to focus on the following aspects: territory, people and government.[46] Other legal commentators define sovereignty as the State's obligation and duty to ensure the protection and welfare of its citizens, focused on obligations towards individuals.[47] Therefore, tax sovereignty is an important tool, since it allows states to maintain an organizing and decision-making function regarding" *the ability to control their tax policy; to better meet their functional duties; and to support democratic accountability and democratic legitimacy"*.[48] As a result, sovereign responsibilities go hand in hand with sovereign rights.

1.2.1 Member States and Sovereignty

Member States have gradually come to interpret the introduction of the EU own resources, which are "*a direct result of the existence of the EU and its policies"*[49], as a loss of part of their fiscal sovereignty.[50] This is especially so, since own resources are described as a source of finance independent of the Member States.[51] Hence, it is understandable how MS worry about their fiscal sovereignty. The Union is a dynamic system, where even though MS are no longer free to handle on their own every aspect of the Union's powers, in return they get the right to handle their individual and common problems collectively.[52] Again, to understand such a dynamic, we must recall that in the EU, sovereignty is limited by the goal of one internal market. Hence, national tax regimes should be in line with that goal in order to keep the guaranty of the market freedoms: free movement of goods, services, and capital.[53]

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[43] I*bid.*
[44] *See* CLAIRE MICHEAU , State Aid, Subsidy and Tax Incentives under EU and WTO Law, Series on International Taxation Vol.45 (Wolters Kluwer 2014), at §8.02, p.474-479.
[45] *See Ibid* p. 475.
[46] *See* DIANE M. RING. *"Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation."* Florida Tax Review 9, (2009): 555-596.
[47] *Ibid.*
[48] *Ibid.*
[49] AUKE LEEN, A European tax. The Fiscal Sovereignty of the Member States vs. The Autonomy of the European Union. (2012), p. 4, available at: https://scholarlypublications.universiteitleiden.nl/handle/1887/19409
[50] *Ibid.*
[51] *Ibid.*
[52] *See* AUKE LEEN, *A European tax. The Fiscal Sovereignty of the Member States vs. The Autonomy of the European Union.* (2012), available at: https://scholarlypublications.universiteitleiden.nl/handle/1887/19409
[53] *Ibid.*

1.2.2 The powers and limits of the EU

Since we are talking about taxes and how they can relate to competences at the level of the EU, we forcefully need to look further into the two principles that govern the Union competences: subsidiarity and proportionality.[54] In tax matters in the EU, the principles of subsidiarity and proportionality are the EU principles that manage the compliance of tax rules with EU law, and they should be applied as broadly as possible.[55] If we look into the treaties, what we can conclude is that action of the EU is dependent of the objective to pursue. What this entails is that the EU should only act if the objective or the final goal that is intended would be better achieved if it was tackled at the EU level.[56] It is then important, that the actions that are of the competence of the EU be in line with the objective that is being pursued. The prime objective according to which the Commission should guide its actions is to make sure it safeguards the internal market and ensures an open market with free competition. What is also important to keep in mind is that the Commission also regulates its action in accordance with the principle of subsidiarity.[57] The principle of subsidiary is a principle established in the treaties whose principal objective is, broad terms, to ensure that Member States preserve their national identities and powers.[58]

According to this principle, it is the Member States that in general have the competence to act in tax matters. The European Commission action is an exception, with the exception of the EU traditional own resources and other taxes in line with them. To safeguard this principle, it is important that its enforcement occurs both internally, enforced by EU institutions, and externally, through the MS's general control mechanisms.[59] As we have explored above, the process of integration in Europe has always been very attached to these ideas of sovereignty and of when to concede power. On the one hand, we have legal principles established in the treaties such as the principle of subsidiarity and conferral and the strict voting mechanism (unanimity) found on article 115 TFEU, that are of central importance in the context of direct taxes. On the other hand, we have a European Union that operates with the goal of creating a closer union and a fair internal market. These two non-coincident dynamics raise particularly

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[54] *See* AUKE LEEN, *A European tax. The Fiscal Sovereignty of the Member States vs. The Autonomy of the European Union.* (2012), available at: https://scholarlypublications.universiteitleiden.nl/handle/1887/19409
[55] *Ibid.*
[56] *See* HOELLER, PETER, M. LOUPPE AND P. VERGRIETE (1996), *" Fiscal Relations within the European Union ,* OECD Economics Department Working Papers, No. 163
[57] *See Ibid* "(…) In 1992, the European Council agreed on specific guidelines for the implementation of the subsidiarity (….)."
[58] *Ibid.*
[59] *See* AUKE LEEN, *A European tax. The Fiscal Sovereignty of the Member States vs. The Autonomy of the European Union.* (2012), available at: https://scholarlypublications.universiteitleiden.nl/handle/1887/19409

complex concerns regarding the European Union's future integration path.[60] Let's now delve into that.

Chapter 2- Integration mechanisms and state aid

2.1 Integration mechanisms in direct tax matters

When we are analysing direct taxation and the interest of the EU in this field, there are two main focuses of analysis that be identified. One is to avoid that certain tax rulings conferred according to domestic legislation can result in obstructions to the freedom of market competition. The other is to avoid an interference in the process of economic integration. [61] The aim of the internal market is to create an economic space that is unified, free of obstacles to enable free movements of capital, goods and people. This market must ensure that there is a level playing field between all actors. Member States in the European Union should not create certain advantages restricted to their national territory and by doing so causing disruption in competition.[62] Under this view, the essential point is to avoid that the freedoms of the internal market and the national legislation collide; and, at the same time, allow MS to maintain autonomy in their policies and decision-making regarding their internal taxation and economic decisions.[63]

The European treaties seem to be more in line with negative integration than measures of positive integration, focusing on an approach of restriction and limitation.[64] Negative integration relates more to economic values and the protection of economic interests. Whereas positive integration is more in line with positive values like social protection, and the correction of market failures.[65] As argued by BORIA, the EU taxation system has a negative dynamic, whereas the domestic taxation system is defined by a positive one.[66] The EU Taxation system focuses on a restrictive approach, trying to limit consequences that arise from national tax legislation. On the contrary, national tax legislation generally focuses on the promotion of a

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[60] *See* CLAIRE MICHEAU , State Aid, Subsidy and Tax Incentives under EU and WTO Law, Series on International Taxation Vol.45 (Wolters Kluwer 2014), at $1.01, [2], [C].
[61] *See* PIETRO BORIA,, Taxation in European Union (Springer International Publishing Switzerland and G. Giappicjelli Editore 2nd ed. 2017) p. 50-65.
[62] *Ibid.*
[63] *See Ibid.* p. 58.
[64] For further details *see* MICHAEL BLAUBERGER, *From Negative to Positive Integration? European State Aid Control Through Soft and Hard Law*; (April 2008).
[65] *See* GIANDOMENICO MAJONE, Dilemmas of European Integration: The Ambiguities and Pitfalls of Integration by Stealth (Oxford Scholarship Online: February 2006).
[66] *See* PIETRO BORIA, Taxation in European Union (Springer International Publishing Switzerland and G. Giappicjelli Editore 2nd ed. 2017) p. vi.

competitive and growth-friendly national economy. This restrictive attitude of the EU taxation system has the good functioning of the internal market as its constant goal.[67]

As a result, when we examine the market integration process, we see that the EU system is designed to contain rather than replace the Member States fiscal sovereignty. This is why in the European legal order there are mechanisms that limit the power of the MS.[68] To this extent, as observed by WATTEL[69], state aid rules[70], the Code of conduct, the free movement rights,[71] and the treaty provisions for market distorting disparities[72] are negative integration mechanisms.[73] We will analyse them and see their overlap ahead. As argued by WATTEL, direct taxation concerns negative integration, that allows for opportunities for healthy policy competition to be developed. Indeed, harmonization of direct taxes does not seem something that, at least at the current stage of European integration, MS are looking for.[74] Rather, Member States, or at least a majority of them, simply want to avoid competing with other MS in a policy race to the bottom. As a result, a system to prevent harmful tax competition needed to be devised.[75]

2.1.1 The Problem of harmful competition

Tax competition can be defined as "*the process by which countries seek to gain an advantage in attracting investments and manufacturing by reducing tax liabilities below those of countries competing for the same investment/manufacturing activities*".[76] Hence, when talking about tax competition, there are two dynamics in place. The first dynamic is the design of the tax system itself, its "black letter" law tax system; and, at another level, as a second sort of dynamic, we have the competition that takes place with regard to certain practices, like tax

[67] *Ibid.*
[68] *Ibid.*
[69] *See* WATTEL, P. *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition And Market Distorting Disparities*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016. p. 59-71.
[70] Arts. 107 and 108 TFEU.
[71] Arts. 28–37 and 45–65 TFEU.
[72] Arts. 116 and 117 TFEU.
[73] *See* WATTEL, P. *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition And Market Distorting Disparities*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016. p. 59-71.
[74] A clear example of this is the failure of the Common Consolidated Corporate Tax Base (CCCTB) project to flourish, despite the several trials of the European Commission and the many years of research and policy negotiation already invested in the project.
[75] *See* WATTEL, P. *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition And Market Distorting Disparities*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016. p. 60.
[76] *See* MCDANIEL P. R., Trade and Taxation, Brooklyn Journal of International Law, 26, 2001, p. 1635.

rulings, which grant certain tax advantages and lead to certain benefits, creating a difference between the situation at hand and the general level of taxation in the Member State concerned.[77]

Moreover, due to changes in the business and economic field, such as a growing digital economy, and the phenomenon of globalization that has allowed businesses to grow outside of their physical presence and countries' territory, we have seen tax competition intensified. This phenomenon has resulted in a clear struggle that Member States are facing in taxing the profits from economic activities conducted by multinational enterprises in their country.[78] There are still different views as to whether tax competition can be beneficial or not. At the national and EU levels, however, there has been a growing realization of the costs that tax competition imposes for the common good.[79] Market competition is in general seen as positive, having the ability to decrease prices and improve product and service quality. Under this view, regulatory competition is an important booster for the overall economy, used to foster growth, both regarding foreign capital and enterprises which operate on the territory of the interested State.[80]

2.1.2 State aid – a regulatory tool

Article 107 TFEU prohibits granting state aid, according to which, by favouring certain enterprises or certain products, a Member State may affect trade so as to distort or threaten the system of free competition.[81] Consequently, measures relating to direct taxation can be part of the scope of application of state aid [82], when there is a tax provision that has the objective of producing a benefit or relief to a national enterprise that can cause a distortion to competition.[83] Hence, the objective of the state aid rules is a crucial point to define. State aid provisions, have as a final objective, market integration. They aim to promote active competition policies, ensure undistorted free market and, thereby, strengthen the internal market.[84] As a result, the goal of state aid law is to correct competition distortions, making it a repressive policy field, rather than

[77] *See* VALÈRE MOUTARLIER, Reforming the Code of Conduct for Business Taxation in the New Tax Competition Environment, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016. p. 76.
[78] See CLAIRE MICHEAU , State Aid, Subsidy and Tax Incentives under EU and WTO Law, Series on International Taxation Vol.45 (Wolters Kluwer 2014) p. 36 *et seq.*
[79] *Ibid.*
[80] *Ibid.*
[81] The criterion of state aid will be analysed further on with more depth.
[82] *See* ALEXANDER RUST & CLAIRE MICHEAU (eds), State Aid and Tax law, International Tax Conferences of the University of Luxemburg Vol. 3 (Kluwer law international BV, 2013) p. 43; Commission Notice on the application of State aid rules to measures relating to direct taxation, (1988), p. 3.
[83] *See* PIETRO BORIA, Taxation in European Union (Springer International Publishing Switzerland and G. Giappicjelli Editore 2nd ed. 2017) p. 58.
[84] *See* CLAIRE MICHEAU , State Aid, Subsidy and Tax Incentives under EU and WTO Law, Series on International Taxation Vol.45 (Wolters Kluwer 2014) p. 36 *et seq.*

a proactive one.[85] Accordingly, state aid rather than trying to target and manage tax policy, it should repress the disproportionate impacts that tax provisions might cause in their individual application. Simply said, "*where that distortion is corrected, state aid law ends"*[86]. However, state aid as a regulatory tool causes concern of using state aid to indirectly supervise tax policies, and indirectly harmonize MS's tax rules at the EU level.[87] However, harmonization is neither the goal of state aid nor is it within the Commission's competencies according to the Treaties.[88] There is an institutional balance that needs to take place to safeguard the fine line between the two policy areas to protect tax law policy from the control of competition law and to ensure individual rights protection.[89]

As a result, it becomes appropriate to remark on the nature of state aid and how it should be viewed in the context of competition rules. Despite the fact that a regulatory framework has been established, the TFEU does not define the concept of competition. To this extent there are theories on state aid regulation being a tool to ensure fair competition[90]. On one perspective, one can argue that state aid regulation is about competition rules.[91] On another perspective, it may be claimed that state aid law is not covered by competition law because it does not need an economic analysis of the relevant market and its consequences.[92] To this extent, what we can argue is that state aid is a regulatory tool, because it allows for growth of the economy overall, while avoiding competition distortions caused by MS actions. State aid, although it does not directly regulate the behaviour of companies, has an impact on the position they have in the market by stopping measures of MS that can cause market distortions. Therefore, the goal of state aid is to stop enterprises from being given an unfair advantage due to MS aid.[93] Consequently, if the EU Commission uses state aid as a way to adjust legislative measures and define taxation for a whole sector, by going beyond an individual case, the aim of state aid

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[85] *See* THOMAS JAEGER, *Tax Incentives Under State aid Law: A competition Law Perspective*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, (Springer 2016), p. 39-56.
[86] *Ibid* p. 44.
[87] *Ibid* p. 39-56.
[88] *Ibid.*
[89] *Ibid* p.40.
[90] For further discussion on this issue *see* CLAIRE MICHEAU , State Aid, Subsidy and Tax Incentives under EU and WTO Law, Series on International Taxation Vol.45 (Wolters Kluwer 2014) p. 38 *et seq.*
[91] *See Ibid* p. 38 *et seq,* at ("(…) State aid rules are actually competition rules. Despite the wording of the Treaty, competition law encompasses traditionally the following anti-competitive activities: restrictive trading agreements (Article 101 TFEU), abusive practises of undertakings holding a dominant position (Article 102 TFEU) and control of mergers with EU dimension. This traditional approach, which set aside State aid rules, is supported by a part of legal literature.").
[92] *See Ibid* p. 38 *et seq.* at ("In response to this criticism, two comments could be made. First, competition law cannot be reduced to consumer protection. Competition policy does not exclusively aim to protect consumer rights. This would otherwise challenge all the competition theories developed from economic, legal and political perspectives.").
[93] *Ibid* p.39.

would have been overstepped.[94] Thus, decisions concerning state aid that try to replace the lack of EU tax legislation risk going beyond the scope of the objective of state aid.[95]

2.1.3 State aid & the Code of Conduct

The Code of Conduct is an important instrument in the context of European direct taxation. The Code of Conduct for Business Taxation is a non-binding instrument that allows us to identify harmful tax competitive measures. As observed by WATTEL, the requirements to identify whether a measure is harmful to competition is a re-location test and a derogation test.[96] The fact is, tax measures can be both state aid and harmful tax competition measures.[97] Both mechanisms have the same goal in mind: to eliminate internal market distortions. However, state aid rules are legally binding, and it is an arena where the European Commission has the initiative. Whereas the Code of Conduct has simply political force[98]. The Code of Conduct Group is composed by experts from the members of the Council of the European Union, with the support of the Commission.[99] The Code aims at targeting harmful tax measures that are not covered by the state aid rules or free movement[100]. In general, it requires from Member States two types of actions: a *"standstill" (''refrain from introducing any new harmful tax measures in the future''*)[101] and a *''rollback''* (''*roll back existing tax measures that constitute harmful tax competition''*).[102] Therefore, what we can conclude is that excessive cross-border tax policy competition is the focus of The Code. Whereas, on the other hand, state aid primarily addresses positive discrimination within a single domestic market.[103] Regarding the effectiveness of The Code, it seems that there is a need for Member States to reorganize themselves within the Group, since tax planning has become more complicated and competition between Member

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[94] *Ibid.*
[95] *See* THOMAS JAEGER, *Tax Incentives Under State aid Law: A competition Law Perspective*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, (Springer 2016), p. 39-56.
[96] *See* WATTEL, P. *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition And Market Distorting Disparities*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016, p. 63.
[97] *See Ibid* at p. 69.
[98] EUROPEAN COMMISSION, *Harmful tax competition*, available at: https://ec.europa.eu/taxation_customs/harmful-tax-competition_en#:~:text=The%20Code%20of%20Conduct%20requires,Code%20(%22rollback%22).
[99] *See* WATTEL, P. *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition And Market Distorting Disparities*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016. p. 59-71.
[100] *Ibid.*
[101] EUROPEAN COMMISSION, *Harmful tax competition*, available at: https://ec.europa.eu/taxation_customs/harmful-tax-competition_en#:~:text=The%20Code%20of%20Conduct%20requires,Code%20(%22rollback%22)
[102] *Ibid.*
[103] *See* WATTEL, P. *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition And Market Distorting Disparities*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016. p. 69.

States has grown, and, thus, the Group's tools for ensuring fair tax competitiveness within the EU are becoming insufficient.[104] To this end, there is an overlap that has been brought to light, of using state aid in order to deal with certain measures that would be under the scope of The Code, which can be demonstrated with the recent novel approach of the Commission towards State aid with the large-scale investigations that we will discuss further on. Some of these rulings, as WATTEL argues, could have been dealt with within the Code of Conduct Group.

2.1.4 State aid & Market disparities

As observed by WATTEL, regarding unfair tax competition, Articles 116 and 117 TFEU would seem the legal instrument appropriate to deal with this type of measures. Unfair tax competition happens, when there are disparities between national tax legislations that can cause severe market distortions. In order to avoid market distortions, these fiscal disparities should be eliminated. Moreover, unlike all other fiscal decision-making procedures that require unanimity, these treaties provisions only require QMV.[105]

However, Article 116 TFEU, has not been used before with regard to direct taxation. This seems to be because qualified majority does not seem to be possible to achieve. MS tend to protect each other with regard to possible attacks to their ability to design their own tax system, and by doing so, they protect themselves and their own interests, because Member States do not want to be the next possible target[106]. As a result, all Member States will most likely vote against any such proposal from the Commission, even if they support the subject matter, since fiscal sovereignty is a Member States priority.[107] However, when we have a national tax measure that is selective, the Commission can reject the action under state aid rules.

Nevertheless, when the action is not selective and is not discriminatory, but it can still create a distortion on the level playing field in the internal market, then either positive

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[104] In this regard, it is worth noting that in its conclusions on fair and effective taxation in times of recovery, on tax challenges linked to digitalisation and on tax good governance in the EU and beyond of November 27, 2020, the ECOFIN Council had welcomed discussions on the revision of the mandate of The Group and agreed that its scope should also cover features of tax systems that have general application and that may have harmful effects. In an initial draft of the Group's report to the ECOFIN Council dated November 26, 2021, the Group presented its revised Code proposal. However, Member States did not agree on the revised Code proposal prepared by the Group. The revised Code proposal provided for an expanded definition of harmful tax regimes to cover features of tax systems that have general application and that may have harmful effects, provided for additional options to rollback harmful tax regimes, and for stricter rules for the exchange of information on new potential harmful tax measures. See in this regard, for e.g., https://home.kpmg/xx/en/home/insights/2021/12/etf-461-eu-code-of-conduct-group-reports-to-ecofin.html

[105] MARTIJN NOUWEN, *The Market Distortion Provisions of Articles 116-117TFEU : An Alternative Route to Qualified Majority Voting in Tax Matters ?,p.14-18 available at : https://www.europarl.europa.eu/cmsdata/215812/Nouwen%20Article%20116%20EP.pdf*

[106] *See* WATTEL, P. *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016. pp. 59-71.

[107] *Ibid.*

integration (harmonization or approximation of tax laws) or negative integration, through hard law (Art. 116 and 117), or soft law (within the Code of Conduct) can be the answer for the elimination of such a disparity.[108]However, these articles have never been used by Commission to tackle harmful tax competition, because of political and practicability reasons, since these articles make the Commission dependent on the Member States political alliances, which may not be interested in binding measures at EU level that intrude upon their tax sovereignty.[109] The fact remains that when it comes to state aid, on the contrary to what occurs in the realm of articles 116 and 117 TFEU, the Commission has all the power, it has an exclusive competence of assessing whether there is illegal state aid, operating in a completely independent way from Member States.[110]

2.1.5 State aid & Free movement

Scholars, such as WATTEL and SZUDOCZKY, when approaching Article 107, share the opinion that the case law of the CJEU with regard to State aid is developing to be more in line with case law about the fundamental freedoms[111]. When looking towards the interpretation of free movement provisions (Articles 28, 29, and 45–66 TFEU), by the CJEU, we can conclude that there is a similarity with state aid.[112] Both concepts rely on a case analysis of a comparable situation or discrimination, and on a justification criterion. In circumstances of free movement, the comparison analysis focuses on cross-border disadvantages against domestic disadvantages.[113] The issue in both fields of EU law, lays in whether the discrimination is justified by the objective pursued. This means that the identification of state aid in fiscal cases shares similarities to the Rule of Reason test that is being applied to interpret the fundamental freedoms.[114]

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[108] *Ibid.*
[109] MARTIJN NOUWEN, *The Market Distortion Provisions of Articles 116-117TFEU : An Alternative Route to Qualified Majority Voting in Tax Matters ?, available at : https://www.europarl.europa.eu/cmsdata/215812/Nouwen%20Article%20116%20EP.pdf*
[110] *Ibid.*
[111] *See* WATTEL, P. *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016. pp. 59-71.
[112] MARC CUSTERS & BOYD WOLFFERS. *State Aid and the Free Movement Provisions – A Difficult Relationship*, European State Aid Law Quarterly, vol. 18, no. 4, Lexxion Verlagsgesellschaft mbH, 2019, pp. 561–66, https://www.jstor.org/stable/26893460
[113] *See* WATTEL, P. *Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities*, in State Aid Law and Business Taxation, edited by I. Richelle, W. Schön and E. Traversa, Springer, Berlin and Heidelberg, 2016. pp. 59-71.
[114] *Ibid.*

Chapter 3 – EU State Aid Policy Evolution

The Treaty of Maastricht introduced Art. 107 para. 2, but art. 107 TFEU has not really changed since the Treaties were initially signed. Furthermore, the Treaty of Rome was established based on the idea of creating an efficient internal market and a level playing field[115]. Above all, as we discussed in the previous chapter, the principle of a free market without competition distortions, relies on the idea of an effective allocation of the EU's resources. Following this notion, we have seen that State intervention should be limited to correct market failures or with the purpose of social justice.[116] Moreover, *"there are no procedural principles regarding state aid, therefore their interpretation was left to the Commission discretion and to the case law of the courts of the European Union"* [117]. Later on, the Commission began releasing communications, press releases, guidelines and decisions that came to shape state aid.[118] Further on, in March 2000, the Lisbon Strategy[119] was launched with an aim of growth and development within the EU. Moreover, in 2005, the "State Aid Action Plan" was released[120], a strategy document by the Commission, that proposed implementation of state aid reforms. The plan aimed at achieving better targeted state aid and develop a more effective and transparent procedures and economic approach[121], as well as to implement a shared responsibility between the Commission and the Member States.[122]

3.1 The European legal framework of State Aid

The Treaty Articles that refer to state aid are Article 107; Article 108 and Article 109 of the TFEU.[123] Article 107(1) TFEU sets out a general prohibition[124], stating that: *"Save as*

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[115] *See* FREE UNIVERSITY OF BERLIN, The introduction to Art. 107 TFEU (January 19, 2012), available at http: *https://wikis.fu berlin.de/display/oncomment/The+introduction+to+Art.+107+TFEu*

[116] *See* CLAIRE MICHEAU, State Aid, Subsidy and Tax Incentives under EU and WTO Law, Series on International Taxation Vol.45 (Wolters Kluwer 2014), p.37.

[117] *See* Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the TFEU; FREE UNIVERSITY OF BERLIN, The introduction to Art. 107 TFEU (January 19, 2012), available at http: *https://wikis.fu berlin.de/display/oncomment/The+introduction+to+Art.+107+TFEu*

[118] *Ibid.*

[119] PRESIDENCY CONCLUSIONS, Lisbon Strategy (March 2000) available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/00100-r1.en0.htm

[120] EUROPEAN COMMISSION, State aid action plan (June 7, 2005) available at:: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52005DC0107:EN:HTML;

[121] EUROPEAN COMMISSION, State Aid Reform, available at: https://ec.europa.eu/competition/state_aid/reform/archive.html;
EUROPEAN COMMISSION, Broadband State aid ,Shaping Europe's digital future, available at: https://digital-strategy.ec.europa.eu/en/policies/broadband-state-aid.

[122] *See* free UNIVERSITY OF BERLIN, The introduction to Art. 107 TFEU (January 19, 2012), available at http: *https://wikis.fu berlin.de/display/oncomment/The+introduction+to+Art.+107+TFEu*

[123] EUROPEAN COMMISSION, Treaty Provisions on State Aid (December 1, 2009), available at: https://ec.europa.eu/competition/state_aid/legislation/compilation/a_01_03_11_en.pdf; *see* also EUROPEAN COMMISSION, State aid Overview, available at: https://ec.europa.eu/competition-policy/state-aid_en

[124] *Ibid.*

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." [125] Moreover, article 107 (2) TFEU lists the types of aid that are considered to be in line with the internal market,[126] and article 107(3) allows for some types of aid in certain situations, that might be considered compatible with the internal market or when the anticompetitive effects of the aid outweighed other benefits. In conclusion a "*measure to be qualified as state aid, need to be granted of state resources, confer a selective economic advantage to undertakings, and be capable of distorting competition and affecting trade between Member States".*[127] Therefore, if state aid is involved, the EC needs to make a compatibility assessment based on Art. 107 TFEU and other relevant EU Guidelines to see if the tax ruling in question is lawful.

3.2 Notions of the provision.

With the courts and its established case-law, the European Commission's decisions and general guidance on the definition of State aid, [128] we can conclude that in order to be in the presence of state aid there are four cumulative criteria that must be met: "*the support is granted by the State or through State resources; it favours one or more undertaking and there is a selective advantage; the support distorts or has the potential to distort competition; and it affects trade between EU Member States".*[129] Each of the characteristics of state aid will be explored next.

3.2.1 The "State resources" criterion

When interpreting the concept of State in article 107 (1) TFEU, this concept is to be interpreted widely. State's resources relates to whether the aid is of public origin.[130] As stated on the Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU: *"State resources include all resources of the public sector, including resources of other bodies within the State and, under certain circumstances, resources of private bodies*"[131].

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[125]TFEU.
[126] *Ibid.*
[127] EUROPEAN COMMISSION, Broadband State aid | Shaping Europe's digital future, available at: https://digital-strategy.ec.europa.eu/en/policies/broadband-state-aid
[128]Commission notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016).
[129] *Ibid.*
[130] MARIE SCISKALOVÁ & MICHAEL MÜNSTER, *Definition and Characteristics of State Aid*, Procedia - Social and Behavioural Sciences, Volume 110 (2014), p. 223-230, available at: https://www.sciencedirect.com/science/article/pii/S1877042813055055
[131] Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU (2016).

Therefore, it involves organizations that are directly or indirectly managed by public administration (local government, public institutions, universities, etc.), and it includes states resources, from public resources, state funds or public funds.[132]

According to case law,[133] state aid can be granted by any type of entities whether they be public, private or a state body.[134] The aid must be provided directly or indirectly through State resources. [135] Another important aspect is that the level of State influence in the organization that manages and supplies the aid is not relevant.[136] The mere existence of influence on the decision-making process, which may have the power to impact the terms under which the state aid would be granted, is sufficient.[137] Furthermore, the measure must have a direct or indirect influence on the budget of the state aid provider.[138] In this regard, a measure can only be deemed state aid if the State can affect and influence the cashflow[139] and, as a result of that, "*also a certain undertaking receiving the benefit*[140]".

3.2.2. The "distortion of competition" criterion

When it comes to this criterion, we must assess if a measure disrupts or distorts competition or at least threatens to disrupt or distort competition, and it must also affect trade between MS.[141] Under this criterion, it is not necessary to show that the aid has a real impact on trade between MS or that competition is actually distorted for a measure to be classified as state aid; rather, it is sufficient to determine whether the aid is likely to affect such trade and distort competition.[142] Therefore, a measure granted by the State, distorts or threatens to distort competition when it has the potential to strengthen the beneficiary's competitive position in

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[132] *See ibid;* MARIE SCISKALOVÁ & MICHAEL MÜNSTER, *Definition and Characteristics of State Aid*, Procedia - Social and Behavioural Sciences, Volume 110 (2014), p. 223-230, available at: https://www.sciencedirect.com/science/article/pii/S1877042813055055

[133] Case C - 78/76 Steinike und Weinlig vs. Germany.

[134] MARIE SCISKALOVÁ & MICHAEL MÜNSTER, Definition and Characteristics of State Aid, Procedia - Social and Behavioural Sciences, Volume 110 (2014), p. 223-230, available at: https://www.sciencedirect.com/science/article/pii/S1877042813055055

[135] Case T-358/94, Air France v Commission, para. 63.

[136] Cases C-67/85, C-68/85, C-70/85 Van der Kooy vs. Commission.

[137] MARIE SCISKALOVÁ & MICHAEL MÜNSTER, Definition and Characteristics of State Aid, Procedia - Social and Behavioural Sciences, Volume 110 (2014), p. 223-230, available at: https://www.sciencedirect.com/science/article/pii/S1877042813055055

[138] Case C - 379/98 Preussen Elektra AG vs. Schleswag AG; *see* MARIE SCISKALOVÁ, MICHAEL MÜNSTER, Definition and Characteristics of State Aid, Procedia - Social and Behavioral Sciences, Volume 110 (2014), p. 223-230, available at: https://www.sciencedirect.com/science/article/pii/S1877042813055055

[139] Case C-482/99 France vs. Commission.

[140] MARIE SCISKALOVÁ & MICHAEL MÜNSTER, Definition and Characteristics of State Aid, Procedia - Social and Behavioural Sciences, Volume 110 (2014), p. 225, available at: https://www.sciencedirect.com/science/article/pii/S1877042813055055

[141] *See* Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU , 185 - 198.

[142] C-518/13, Eventech Ltd v The Parking Adjudicator, EU:C:2015:9, para. 65.

comparison to other undertakings that are in the same competitive field with. In addition, when article 107(1) TFEU states *"trade between EU Member States",* this requirement demonstrates that there must be "*economic activity involving at least two EU Member States"*[143], because it is impossible to affect the market without trade between EU Member States.[144]

3.2.3 The "advantage" criterion

In state aid rules the advantage criterion is fulfilled "*whenever the financial situation of an undertaking is improved as a result of State intervention on terms differing from normal market conditions"*[145]. According to case law,[146] a competitive advantage exists when an advantage that would not be available under normal market conditions was granted.[147] As a result, a competitive advantage refers to "*any measure that is selectively granted to an undertaking without adequate consideration"*[148], or as a beneficiary, the recompense supplied by the undertaking is not proportional to the level of the benefit obtained.[149] Furthermore, it does not matter the type of the advantage that was granted. It includes advantages such as subsidies and grants, to measures, such as tax reliefs.

3.2.4 The "selectivity" criterion:

In regard to this criterion, if the authorities implementing the measure have some discretionary power or if the scheme only applies to certain undertakings, it is considered to be selective.[150] Selectivity is what makes state aid different from the other general measures explored in chapter 2. Therefore, when talking of selectivity, this criterion is present "*if the state aid is granted only to certain undertakings"*[151] and "*if the state aid is granted only when certain conditions are met by the beneficiaries."*[152]

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[143] MARIE SCISKALOVÁ & MICHAEL MÜNSTER, Definition and Characteristics of State Aid, Procedia - Social and Behavioral Sciences, Volume 110 (2014), p. 226, available at: https://www.sciencedirect.com/science/article/pii/S1877042813055055
[144] *See* Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU, 187 – 198.
[145] *Ibid* para 67.
[146] Case C - 39/94 SFEI; MARIE SCISKALOVÁ & MICHAEL MÜNSTER, Definition and Characteristics of State Aid, Procedia - Social and Behavioral Sciences, Volume 110 (2014), p. 223-230, available at: https://www.sciencedirect.com/science/article/pii/S1877042813055055
[147] MARIE SCISKALOVÁ & MICHAEL MÜNSTER, Definition and Characteristics of State Aid, Procedia - Social and Behavioral Sciences, Volume 110 (2014), p. 223-230, available at: https://www.sciencedirect.com/science/article/pii/S1877042813055055
[148] *Ibid* p. 225.
[149] *Ibid.*
[150] *Ibid.*
[151] *Ibid.* p.225.
[152] *Ibid.* p.225.

3.2.4.1. Selectivity's three - step analysis

According to the CJEU case law[153], the decision-making practice of the European Commission and the 2016 Commission Notice on Article 107(1), the selective nature of tax measures is to be assessed based on a three-step test. The three-step approach is a route established to verify if an advantage is selective[154]. It consists of establishing the framework of reference, verify if there is a derogation from that framework, and finally, to assess if such a derogation exists, if it can be justified. First, when establishing the framework of reference, this first step brings concerns to the issue of the broad or narrow approach, since it can suggest the idea of two equally valid approaches to selectivity in cases, that the choice for the reference framework is entirely free.[155] However, the three-step analysis must be based on a precise legal analysis. State aid focuses on the impact of the individual measures, the assessment of state aid is implemented according to its effects and not to its specific legal form.[156] Furthermore, concerning the second step of the test, the assessment of whether a derogation exists, this is the essential element of the test, and allows to make a conclusion as to whether the measure is *prima facie* selective. For a measure to be selective, it must constitute a derogation from the reference system, if it does not, then it is not selective.[157] Consequently, for a derogation to be present, then, situations that are comparable considering the objective of the measure, are being treated differently.[158] Consequently, if the measure constitutes a derogation from the reference system, then we arrive at the third and final step of the selectivity test, which is the justification of the derogation. What can constitute a ground for justification is not always obvious, although it relates to the nature and general scheme of the tax system, based on the characteristics of the system of reference[159]. In addition, a *prima facie* selective measure cannot be justified by

[153] Case C-78/08 Paint Graphos and Others.
[154] *See* also Commissions notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, at 125-130.
[155] ARTIKEL104, Material selectivity and tax measures: How do you catch a cloud and pin down? (March 6, 2017), available at: https://artikel104.nl/cloud/
[156] *Ibid.*
[157] LONDON SCHOOL OF ECONOMICS AND COLLEGE OF EUROPE, State Aid workshop, *Selectivity and advantage: charting the territory* (June 14, 2019), available at https://antitrustlair.files.wordpress.com/2019/06/ibanez-colomo-selectivity-and-advantage.pdf.
[158] ARTIKEL104, Material selectivity and tax measures: How do you catch a cloud and pin down? (March 6, 2017), available at: https://artikel104.nl/cloud/
[159] HOUTHOFF, State aid and taxation- The European Commission's decisions on tax rulings in the broader State aid perspective (May 2019), available at: https://www.houthoff.com/-/media/Houthoff/Docs/Brochure-State-Aid.pdf

arguing that the measure was aimed as *prima facie* selective.[160] Moreover, a policy reason is not a possible justification for a *prima facie* selective measure.[161]

3.2.4.2. The Gibraltar case

This case concerns the Government of Gibraltar,[162] which had proposed to introduce a tax reform, that was notified to the Commission in 2002. Under the proposed reform, in what is relevant to the case, all Gibraltar companies would have to pay a payroll tax on their employees in Gibraltar, and a tax on property in Gibraltar. Under these two taxes, a company with no profits would not pay taxes and the other companies would pay 15% of their profits. The Commission adopted a decision holding that this was material selective, since it gave an advantage to companies with no profits, and, also, that it was regionally selective because the tax rate under these measures would be lower than the tax rate in the UK. In this case, the CJEU stated that selectivity was present. To this extent we can question whether Gibraltar case brought a new perspective to selectivity[163]. The Gibraltar case is seen as a landmark case because, as observed by TURMO, "*the Court seems to accept the Commission's proposal insofar as it held that the general features of a tax system, which favours certain types of companies without creating a derogatory regime, can nevertheless lead to selective effects that may constitute a State aid scheme".*[164]

In this regard we can discuss if the decision by the CJEU was an exception or a new route on how state aid should be applied, since in this case, according to the traditionally followed three-step selectivity tests, the existence of a derogation from the normal rules should be established, otherwise the measure itself would not be considered selective. The problem in the Gibraltar case is that the general rules applied to all companies in Gibraltar, including the offshore companies. In principle, a measure needs to be selective for state aid to be illegal, therefore if it is a general tax measure applying to the whole economy it would not be

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[160] ARTIKEL104, Material selectivity and tax measures: How do you catch a cloud and pin down? (March 6, 2017), available at: https://artikel104.nl/cloud/

[161] Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU para. 1-50.

[162] *See* joined Cases C-106/09 P and C-107/09, Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland, EU: C:2011:732

[163] JOHN TEMPLE LANG, "The Gibraltar State Aid and Taxation Judgment – A 'Methodological Revolution'?" *European State Aid Law Quarterly*, vol. 11, no. 4, Lexxion Verlagsgesellschaft mbH, 2012, pp. 805–12, https://www.jstor.org/stable/26686782; LONDON SCHOOL OF ECONOMICS AND COLLEGE OF EUROPE, State Aid workshop, *Selectivity and advantage: charting the territory* (June 14, 2019), available at https://antitrustlair.files.wordpress.com/2019/06/ibanez-colomo-selectivity-and-advantage.pdf.

[164] *See* TURMO ARACELI, *"Tax exemption for offshore companies in Gibraltar constitutes a State aid scheme incompatible with the internal market",* (November 18, 2011) available at: www.ceje.ch; joined Cases C-106/09 and C-107/09, Gibraltar Case.

selective.[165] What Gibraltar comes to establish is that, even without a full three-step test, a measure could still be seen as selective, where, due to the combination of different tax rules, an advantage was still considered to be granted.[166] Hence, the judgment of the CJEU in the case of Gibraltar may have introduced an important new approach to selectivity.

3.3 The Importance of the Reference System

When applying the three-step approach, the reference framework tends to be problematic. There is an uncertainty about the reference framework. This is a question that needs a legal analysis. The Commission has established a broad definition of the reference system, specifically the general corporate income tax system, applying to all kinds of enterprises (including standalone companies).[167] The goal of corporate tax is to tax all firms' profits in a non-discriminatory manner.[168] As a result of the Commission's broad definition of the reference system, in the second step of the selectivity test, regarding "*transfer pricing rulings endorsing a method that results in a different outcome for a corporate group than a stand-alone company, these measures are viewed as a discriminatory derogation from the reference system.*"[169]

However, if we were to define the reference system in a narrower way, for instance including the OECD Transfer Pricing Guideline, it becomes more difficult to assess the second step of the selectivity test and prove deviations from the reference system[170]. This difficulty comes from the fact that "*all corporate groups would be taxed on the same basis*"[171], which would then make it more difficult to categorize certain schemes as state aid.[172] Relevant corporate groups and MS have supported a narrower reference system. The Commission's approach has yet to change, and the broad definition of the reference is still used by the Commission in matters involving tax rulings.[173] What we can conclude is that the broader we define the reference system, the more it opens up the number of situations and schemes that can

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[165] JOHN TEMPLE LANG, "The Gibraltar State Aid and Taxation Judgment – A 'Methodological Revolution'?" *European State Aid Law Quarterly*, vol. 11, no. 4, Lexxion Verlagsgesellschaft mbH, 2012, pp. 805–12, https://www.jstor.org/stable/26686782.
[166] *Ibid.*
[167] HOUTHOFF, State aid and taxation- The European Commission's decisions on tax rulings in the broader State aid perspective (May 2019), available at: https://www.houthoff.com/-/media/Houthoff/Docs/Brochure-State-Aid.pdf
[168] *Ibid.*
[169] *Ibid* p.5.
[170] *Ibid.*
[171] *Ibid* p.5.
[172] *Ibid.*
[173] *Ibid.*

constitute state aid and, by doing so, this approach allows the Commission to have a bigger impact and involvement in direct tax.

3.4 The advantage vs. the selectivity criterion

When it comes to the ideas of advantage and selectivity, these should be viewed as two separate criteria, when interpreting article 107(1) TFEU. However, they are, nevertheless, connected,[174] since the existence of an economic advantage can only be assessed by comparing it to the tax system generally applicable to all undertakings, and the selectivity of a measure should be assessed by detecting a derogation from the reference system that leads to unfair discriminatory treatments.[175] As a result, both factors need that the normal taxation system be defined, and that there is a deviation from it.[176] However, as we will discuss further in the following chapters, there seems to be a trend in the decisions of the Commission and recent case law of the CJEU, where the assessment of an economic advantage and the selectivity criterion have overlapped into one single test of a selective advantage test. Consequently, the lack of boundaries between the concepts of advantage and selectivity, as well as the merging of the selective-advantage test, has the possibility to reinforce and empower the Commission's position in state aid.

Chapter 4 – The European Commission's recent decisions

Since 2014, the European Commission has opened multiple State aid investigations into advance tax agreements between significant US and European multinational enterprises (MNEs) and the tax authorities of Belgium, Ireland, Luxembourg, and the Netherlands. The European Commission looked into whether the decisions taken by tax authorities in Ireland, the Netherlands and Luxembourg with regard to the corporate income tax to be paid by Apple, Starbucks, Amazon, and Fiat Finance & Trade complied with the European Union rules on state aid. The European Union decided that Fiat Finance and Trade (FFT) and Starbucks had been granted selective tax advantages through tax rulings by Luxembourg and the Netherlands and that Apple was granted undue tax benefits by Ireland. Furthermore, in Engie, the Commission considered in its decision that the tax rulings granted by the Luxembourg tax authorities to the French group Engie to be incompatible aid. Currently the Fiat judgment of the

[174] *See* WOLFGANG SCHÖN, T*ax legislation and the notion of fiscal aid: a review of 5 years of European jurisprudence*, as in Richelle, I., Schön, W. & Traversa, E. (red.), State Aid Law and Business Taxation, Springer Berlin Heidelberg, 2016, p.8.
[175] OYABRADOH ENODEH, *The notion of (fiscal) State aid: decisions of the EU Commission and case law of the EU Courts*, Tilburg University (2018), p. 6.
[176] Ibid. p. 7.

General Court is under appeal to the CJEU (Ireland v. Commission, C-898/19 P), in order to set aside the judgment of the General Court.

It's the Commission general belief that *"tax rulings as such are perfectly legal."*[177] However, there has definitely been an aggressive approach to investigate tax rulings from Commissioner Vestager. The Commission decisions we will focus on further, concern tax rulings that were provided to MNEs by Member States, in which Fiat[178], Starbucks[179] and Amazon[180] address transfer pricing methodology techniques. We will also discuss the decisions regarding Engie[181] and Apple.[182] When we analyse the EC's decisions we can conclude that the reference system used to demonstrate a selective advantage and the arm's length principle legal basis are two of the main issues to discuss.

4.1 The reference system

As we have analysed above in the assessment of a tax ruling, in order to check if a measure is selective, the Commission 's traditional approach is to define a benchmark system and to establish a deviation from that system. In this regard, when the Commission analyses the reference system in its decisions, the general tax regime is not always considered as the reference framework. For example, both in *Autogrill* and *Banco Santander,* the Commission considered the rules on the tax treatment of financial goodwill in the Spanish tax system the appropriate reference system, and not the general Spanish corporate tax system.[183]

However, in cases like Apple[184], Starbucks[185], and Amazon[186], the European Commission "*considers the reference system to be the general corporate income tax system, which has as its objective the taxation of profits of all companies subject to tax in the Member States concerned, irrespective of whether they are nonintegrated companies or integrated companies*",[187] focusing on the issue of transfer pricing in the field of selectivity. To the Commission this difference does not influence the objective of a corporate income tax system

[177] EU COMMISSION, press release nº. IP/16/2923 (30.08.2016).
[178] Commission Decision SA.38375 (Fiat Decision), para 52.
[179] Commission Decision SA.38374 (Starbucks Decision), para. 46.
[180] Commission Decision SA.38944 (Amazon Decision), para. 129.
[181] Commission Decision SA.44888 (Engie Decision) para. 93.
[182] Commission Decision SA.38373 (Apple Decision), para. 148-150.
[183] Autogrill Case p. 50; Case T-399/11 Banco Santander SA and other v Commission para. 54.
[184] Commission Decision SA.38373 (Apple Decision), para. 227 *et seq.*
[185] Commission Decision SA.38374 (Starbucks Decision), para. 232 *et seq.*
[186] Commission Decision SA.38944 (Amazon Decision), para. 587 *et seq.*
[187] PETER WATTEL, HEIN VERMEULEN, OTTO MARRES, European Tax Law 7th ed Volume I: General Topics and Direct Taxation (Abridged Student Edition) $22..2.7.

"*which aims to tax profits of all companies subject to tax in the Member State*."[188] Whether non-integrated or integrated, both types of companies should be considered in a similar factual and legal situation reflecting the essential objective of that system.[189]

On these grounds, according to the Commission "*it is the general corporate income tax system that constitutes a reference system against which it should be examined whether a correct transfer pricing between group companies has taken place"*.[190] It is not new to use the general tax regime as the reference system[191], however what comes as the new approach is the legal basis for the arm's length principle, which accordingly forms parts of the EC`s assessment under 107 (1) TFEU *"independently of whether a Member State has incorporated this principle into its national legal system"*.[192] The interpretation made by the Commission in regard to the fact that the Commission ALP is an inherent part of Article 107, has allowed the Commission to create a reference framework in which the Commission's ALP become an integral part of the direct taxation provisions.[193]

4.2 Economic advantage and selectivity

The Commission is of the opinion that *"a derogation from the reference system will generally coincide with the identification of the advantage granted to the beneficiary under that measure"*.[194] Hence, it can be argued that from the perspective of the EC there is a presumption that selectivity relies on finding an economic advantage, appearing to establish an economic advantage by finding a derogation from the reference framework.[195] Thus, a tendency to overlap the analysis of the selectivity with the analysis of the criterion of advantage and to carry out a single analysis of a selective advantage is common in the decisions.[196]

In Fiat, the EC found that the method employed by Luxembourg to determine taxable profits departed from the ALP. Thus, it stated that this resulted in the tax ruling conferring a

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[188] PETER WATTEL, HEIN VERMEULEN, OTTO MARRES, European Tax Law 7th ed Volume I: General Topics and Direct Taxation (Abridged Student Edition) $22..2.7.
[189] *Ibid.*
[190] *Ibid.*
[191] *See* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings, (Cheltenham : Edward Elgar, 2019) p .55 *et seq.*
[192] Commission Decision SA.38375 (Fiat Decision) para. 228 & Commission Decision SA.38374 (Starbucks Decision) para. 264.
[193] *See* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings, (Cheltenham : Edward Elgar, 2019) p .43 *et seq.*
[194] Commission Decision SA.38374 (Starbucks Decision) para. 253.
[195] *See* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings, (Cheltenham : Edward Elgar, 2019) p.51 *et seq.*
[196] *Ibid.*

selective advantage.[197] Similarly, in Starbucks, using the three-step analysis, the EC considered the general Dutch corporate tax system as the relevant reference system [198], and "*that the difference in determining taxable profits for non-integrated companies and integrated companies*[199]*"* was not important to the objective of the Dutch corporate income tax system[200]. Also, the EC stated that there was a derogation from this reference system which led to unequal treatment between companies in a factual and legal similar situation[201]. Again, it stated that "*whether a tax measure constitutes a derogation from the reference system will generally coincide with the identification of the advantage".*[202] In the Apple decision, the EC found that an advantage presumes the selective nature of the individual aid measure in question, and, thus, it is unnecessary to undertake an analysis of the selectivity of a measure[203]. However, with the Amazon decision there seems to have been a change, since in this decision, the Commission separated its analysis of the requirements of advantage and selectivity.[204] However, the EC still maintained its position that if an economic advantage is present, it is not necessary to analyze the selectivity criteria.[205]

4.2.1 The Courts

It may be observed that the CJEU, has held that an economic advantage and its selective character are two separate criteria, mainly with the *Autogrill* and *Banco Santander* cases, where the judges held that only after the measure is found to be selective, then it should be considered if the measure at issue, provides that a tax advantage is to be granted on the basis of the conditions laid down by the measure itself. Furthermore, the *MOL*[206] case is another established case law that shows the court views, where the court clearly states that it falls on the Commission to verify both criteria.

[197] Commission Decision SA.38375 (Fiat Decision) para. 217; LIZA LOVDAHL-GORMSEN, European state aid and tax rulings, (Cheltenham: Edward Elgar, 2019) p.20 *et seq.*
[198] Commission Decision SA.38374 (Starbucks Decision) para. 251.
[199] *Ibid*, para. 236 & 251; LIZA LOVDAHL-GORMSEN, European state aid and tax rulings, (Cheltenham: Edward Elgar, 2019) p.23 *et seq.*
[200] *Ibid.*
[201] *Ibid*. para 252.
[202] Ibid, para. 253.
[203] Commission Decision SA.38373 (Apple Decision), para. 224.
[204] Commission Decision SA.38944 (Amazon Decision) para. 399; LIZA LOVDAHL-GORMSEN, European state aid and tax rulings, (Cheltenham: Edward Elgar, 2019) p.40 *et seq.*
[205] Commission Decision SA.38944 (Amazon Decision) para. 398; ; LIZA LOVDAHL-GORMSEN, European state aid and tax rulings, (Cheltenham: Edward Elgar, 2019) p.31 *et seq.*
[206] Case C-15/14 European Commission v MOL Magyar Olaj- és Gázipari Nyrt. 2015, para 59.

4.3 The arm's length principle

As observed by WATTEL :" *The ALP is used to establish whether the taxable profits of a group company for corporate income tax purposes have been determined on the basis of a methodology that approximates market conditions, so that that company is not treated favourably under the general corporate income tax system as compared to non-integrated companies whose taxable profit is determined by the market*."[207]

The international agreed definition of the ALP can be found in art. 9 of the OECD Model tax Convention[208]. In contrast, Art. 107 TFEU does not mention the ALP. However, when assessing state aid, the Commission uses an ALP derived not from Article 9 of the OECD Model Tax Convention, which is a non-binding instrument, but from a general principle of equal treatment in taxation that falls under the application of Article 107(1) of the TFEU, which binds Member States and does not exclude national tax rulings (independently of whether a Member State has incorporated this principle into its national legal system)[209]. The Commissions argues, as observed by LOVDAHL-GORMSEN, that its ALP is a condition that is part of Art. 107 TFEU, with the decisions about Fiat[210] and Starbucks[211]. We see this view also displayed in the EC's following decision[212], and later in the Commission's 2016 Notice on the notion of state aid, where we see this claim of the ALP supported by the Commission as the result of the principle of equality, which *"prohibits unequal treatment in taxation of undertakings in similar factual and legal situations"*.[213] However, as observed by LOVDAHL-GORMSEN, the Commission's 1998 Notice on business taxation or the Commission's draft notice on the notion of state aid of 2014 does not mention the ALP supported by the Commission.[214] Furthermore, in the Commission's notions of state aid in 2016, the document refers to the OECD transfer pricing guidelines to emphasize that a tax ruling on transfer pricing is unlikely to give rise to state aid within the meaning of article 107 when it complies with the OECD transfer pricing

[207] *See* PETER WATTEL, HEIN VERMEULEN, OTTO MARRES, *European Tax Law 7th ed Volume I: General Topics and Direct Taxation (Abridged Student Edition,)* Kluwer Law International (2018), $22..2.7.
[208] OECD (2017), Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing Paris.
[209] Commission Decision SA.38375 (Fiat Decision), para. 228; *see* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings (Cheltenham : Edward Elgar, 2019) p. 45 *et seq*.
[210] *Ibid*, para. 228.
[211] Commission Decision SA.38374 (Starbucks Decision), p 264.
[212] Commission Decision of 11 January 2016 on the Excess Profit Exemption State aid scheme SA.37667 (Belgium Excess Profit Decision), para. 150.
[213] Commission notice on the notion of State aid as referred to in Article 107(1) of the TFEU (2016) para. 172 ; *see* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings (Cheltenham : Edward Elgar, 2019) p. 45 *et seq*
[214] *Ibid.*

guidelines[215], stating: *"Consequently, if a transfer pricing arrangement complies with the guidance provided by the OECD Transfer Pricing Guidelines, including the guidance on the choice of the most appropriate method and leading to a reliable approximation of a market based outcome, a tax ruling endorsing that arrangement is unlikely to give rise to State aid."*[216]

4.3.1 The Forum 187 case

The Commission found support by the CJEU case law on its view regarding the arm's length principle in *Belgium and Forum 187 ASBL v Commission*. The *Forum 187* case concerns transfer pricing methodology.[217] In addition, as shown in the case, "*a reduction in the taxable base that results from a tax measure that enables a taxpayer to employ transfer prices in intra-group transactions that do not resemble prices which would be charged in conditions of free competition between independent undertakings negotiating under comparable circumstances at arm's length confers a selective advantage on that taxpayer for the purposes of Article 107(1) of the Treaty"*.[218] The EC uses this case as a way of showing that any tax measures can be, under the state aid rules in article 107(1) TFEU, assessed as to whether they are lawful aid.[219]

Even in cases where the Court rules in favour of the taxpayer, the court in its judgments acknowledges that the Commission must "*be allowed to apply the arm's-length standard to determine if the profit allocation to local affiliates fairly corresponds to what would have occurred between unrelated parties under market conditions"*.[220] According to the Fiat decision[221] the Commission's authority for the principle of equal treatment is *forum 187* para. 81, a reminder that national tax rules are not excluded from the scope of Art. 107. In Apple[222], the General Court ruled that it was required that the Commission applies the arm's length standard in a consistent manner, independently of the domestic laws of the MS. Moreover, in the Amazon judgment[223], the court stated that MS had a margin of appreciation in the approval of transfer pricing, but this could not prevent the Commission from checking that the transfer

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[215] *Ibid*.
[216] Commission Notice on the notion of State aid as referred to in Article 107(1) of TFEU (2016) para 173.
[217] C-182/03 and C-217/03, Belgium and Forum 187 ASBL v Commission, EU:C:2006:416, para. 81.
[218] T-778/16 and T-892/16, Ireland v Commission, EU:T:2020:338, para. 193.
[219] Commission Decision SA.38375 (Fiat decision), para. 228, Commission Decision SA.38374 (Starbucks decision), para. 264, Commission Decision SA.38373 (Apple decision), para. 249. Commission Decision SA.38944 (Amazon decision), para. 405, Commission decision SA.37667 (Belgian Excess Profit Exemption Scheme decision), para. 150 and Commission Decision SA.44888 (Engie decision), para. 347.
[220] ROBERT GOULDER, The Good News for Fiat Is Better News for Apple, Tax Notes International, Volume 105, (January 17, 2022), p. 388.
[221] Commission Decision SA.38375 (Fiat decision), para. 228.
[222] *See* Joined cases T-778/16 and T-892/16, Apple Sales International and Apple Operations Europe v. Commission
[223] Cases T-816/17 and T-318/18, Grand Duchy of Luxembourg , Amazon EU Sàrl and Amazon.com, Inc. v European Commission, para. 126.

pricing in question did not lead to granting a selective advantage.[224] We should also mention the AG opinion on Case C-898/19 P, *Ireland v European Commission*, (The Fiat appeal)[225], where AG Pikamäe shares an opinion that goes against the General Court's judgment, arguing in line with the appellants, that the Commission goes beyond its jurisdiction by saying how transfer pricing methodology should be applied by MS. The AG Pikamäe's breakdown is that the Commission oversteps on Member State sovereignty when it pushes its own interpretation of the arm's-length standard into their legal systems, a view that has been shared by many commentators.[226] However, the CJEU judgment has not been released yet.

Chapter 5 - A Critical analysis of State aid and Tax

To wrap up our look at the Commission's tax rulings practice, we should analyse what has been the overall understanding of academics and tax experts about the application of the Commission's approach. There has been a lot of commentators that criticised the Commission's approach.[227] For example, the US Department of Treasury published a white paper condemning the European Union's decisions and methods in response to the Apple decision and other cases such as Fiat, Starbucks, and Amazon.[228] Consequently, this White Paper[229] is a good instrument to display the main criticisms from American Commentators[230]. As observed by BOBBY and HRUSHKO the paper claims that the "*Commission's approach is new and departs from prior EU case law and Commission decisions*"[231]; with the Commission overlapping the notions of selectivity and advantage and that the Commission by making its own interpretation of the arm's length principle can create issues in law[232], obstructing international efforts to combat

[224] ROBERT GOULDER, The Good News for Fiat Is Better News for Apple, Tax Notes International, Volume 105, (January 17, 2022).
[225] Opinion of Advocate General Pikamäe on Case C-898/19 P, Ireland v European Commission,16.12.2021.
[226] ROBERT GOULDER, *The Good News for Fiat Is Better News for Apple*, Tax Notes International, Volume 105, (January 17, 2022).
[227] NINA HRUSHKO, *Tax in the World of Antitrust Enforcement: European Commission's State Aid Investigations into EU Member States' Tax Rulings*, 43 Brook. J. Int'l L. 327 (2017). Available at : https://brooklynworks.brooklaw.edu/bjil/vol43/iss1/32 p. 330 *et seq.*
[228] CHRISTOPHER BOBBY *A Method inside the Madness: Understanding the European Union State Aid and Taxation Rulings*," Chicago Journal of International Law: Vol. 18: No. 1, Article 5. (2017) Available at: https://chicagounbound.uchicago.edu/cjil/vol18/iss1/5 p. 197 *et seq.*
[229] U.S. Department of the Treasury, The European Commission's Recent State Aid Investigation of Transfer Pricing Rulings (24th August 2016).
[230] LILIAN V. FAULHABER, *Beyond Apple: State Aid as a Model of a Robust Anti-Subsidy Rule*, Georgetown Journal of International Law No. 48 (2017). at p. 392.
[231] U.S. Department of the Treasury, The European Commission's Recent State Aid Investigation of Transfer Pricing Rulings (24th August 2016), p.1.
[232] NINA HRUSHKO, *Tax in the World of Antitrust Enforcement: European Commission's State Aid Investigations into EU Member States' Tax Rulings*, 43 Brook. J. Int'l L. 327 (2017) . Available at: https://brooklynworks.brooklaw.edu/bjil/vol43/iss1/32 p. 343 *et seq.*

harmful tax competition.[233] Furthermore, besides this criticism, Member States and European tax experts have made the claim that the Commission is overstepping its jurisdiction by using Article 107(1) TFEU as a corporate tax harmonization tool that cannot be achieved through more direct means. All in all, it seems clear that, despite controversial, Art. 107 TFEU remains the most important Treaty provision when it comes to tax rulings.

5.1 A presumption of selectivity?

One of the most popular claims made by commentators "*is that the Commission has collapsed the concepts of advantage and selectivity, which are distinct requirements under state aid law*."[234] As we have explored in the chapter above, it is true that in certain cases the Commission seems indeed to collapse the two notions concerned. Therefore, a tax ruling that meets the advantage criterion, according to the EC, does not need to be assessed under the selectivity test. As we have seen in the chapter above, the CJEU does draw a distinction between the two criteria. However, it must be stated that art. 107(1) TFEU, does indeed not explicitly make a distinction between both criteria.[235] Therefore, sharing the argument of LOVDAHL-GORMSEN, it can be argued that the approach adopted by the Commission, the EC's methodology does not appear to be in clear infringement of the article,[236] given that Art. 108 TFEU, gives the Commission margin of discretion in presenting its decisions.[237]

5.2 The issue of International Principles

Despite the fact that the OECD transfer pricing recommendations are soft law tools and do not give precedence to any of methodology of transfer pricing, the Commission compels the MS to give priority to one. If we look at the criticism in the White Paper from the US Department of State, it claims that "*the Commission's new approach is inconsistent with international norms and undermines the international tax system*."[238] It argues that the Commission's approach can jeopardize what has already been a long path and struggle at the

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[233] CHRISTOPHER BOBBY *A Method inside the Madness: Understanding the European Union State Aid and Taxation Rulings*," Chicago Journal of International Law: Vol. 18: No. 1, Article 5. (2017) Available at: https://chicagounbound.uchicago.edu/cjil/vol18/iss1/5 p. 188 *et seq.*

[234] U.S. Department of the Treasury, The European Commission's Recent State Aid Investigation of Transfer Pricing Rulings (24th August 2016). p.5 *et seq.*

[235] *see* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings (Cheltenham : Edward Elgar, 2019), 51 *et seq.*

[236] *Ibid*.

[237] *see* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings (Cheltenham : Edward Elgar, 2019), 51 *et seq.*

[238] U.S. Department of the Treasury, The European Commission's Recent State Aid Investigation of Transfer Pricing Rulings (24th August 2016), p.17 *et seq.*

international level towards legal certainty in tax matters[239]. However, we must have in mind that the legal basis for applying the OECD Guidelines has yet to be established, and neither is the notion that the OECD Guidelines represent international standards, since we are in fact dealing with a non-binding instrument when it comes to the OECD guidelines.[240] Indeed, the OECD constitutes a very important setting for international standards on transfer pricing, but it issues mostly non-binding recommendations.[241] Whereas the Treaties of the EU are legally binding towards the MS. Clearly, while the EU's Member States have tried to find ways at international level to prevent and combat harmful tax competition, this effort does not imply a waiver of the prohibition set forth by article 107(1) TFEU, which, in the end, is up to the European Commission to apply in the Union's framework.[242]

5.3 The issue behind the ALP

Finally, it is also argued that this approach taken by the Commission is an overstep of the EC`s jurisdiction, intruding on a Member State's exclusive competence and allowing the Commission to disregard national law when determining whether a transfer pricing tax ruling has violated the arm's length principle.[243] The main argument made by MS is that in binding EU law there is no reference to an EU arm's length principle. At some point, in all the proceedings, we have seen the MS party stating that the Commission's decision has exceeded its legal authority by imposing its preferred version of what the arm's length standard is supposed to mean, irrespective of the Member State's domestic law. For example, companies like Apple have accused the EC of causing *"a devastating blow to the sovereignty of EU member states over their own tax matters, and to the principle of certainty of law in Europe."*[244]

Transfer pricing is not an "exact science" with a single correct answer; the process of determining the suitable arm's length price using the OECD Guidelines methodology is not

[239] NINA HRUSHKO, *Tax in the World of Antitrust Enforcement: European Commission's State Aid Investigations into EU Member States' Tax Rulings*, 43 Brook. J. Int'l L. 327 (2017) . Available at: https://brooklynworks.brooklaw.edu/bjil/vol43/iss1/32 p. 347 *et seq.*
[240] *see* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings (Cheltenham : Edward Elgar, 2019) p. 42 *et seq.*
[241] NINA HRUSHKO, *Tax in the World of Antitrust Enforcement: European Commission's State Aid Investigations into EU Member States' Tax Rulings*, 43 Brook. J. Int'l L. 327 (2017) . Available at: https://brooklynworks.brooklaw.edu/bjil/vol43/iss1/32 p. 348 *et seq.*
[242] *see* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings (Cheltenham : Edward Elgar, 2019) p. 43 *et seq;* LUDOVICO LENNERS, *State Aid and Tax Rulings: The Problem of Harmful Tax Competition*, LUISS Guido Carli (2018) p. 126.
[243] NINA HRUSHKO, *Tax in the World of Antitrust Enforcement: European Commission's State Aid Investigations into EU Member States' Tax Rulings*, 43 Brook. J. Int'l L. 327 (2017) . Available at: https://brooklynworks.brooklaw.edu/bjil/vol43/iss1/32 p. 349 *et seq.*
[244] Ibid p. 329.

always well defined.[245] The problem stands that MS have an exclusive competence (transfer pricing methodology), however, with the EC`s approach, it can be argued that there is an attempt to harmonize a principle that has not been harmonized at the EU level.[246] The Commission, by stating that the ALP is a general principle of equal treatment inherited in article 107 TFEU, manages to apply its approach independently of whether a MS has incorporated the ALP in its national legal system.[247] Moreover, making this view of the ALP prevail over what MS had decided due to the principle of supremacy of EU law, even if they already incorporated the OECD ALP.[248] The Commission does seem to want the ALP to be an inherent part of Article 107, so that it binds all MS. In this way, the Commission is able to claim an important role in the definition of the direct taxation framework in the EU.[249] This approach, as argued by LOVDAHL-GORMSEN,[250] has the ability to allow the Commission to have an influence on matters that are, under the Treaties, of exclusive competence of MS under article 115 TFEU, thereby reducing the control of MS over their fiscal sovereignty.[251]

5.4 The role of the CJEU in state aid

As we have examined, to grasp the Commission's fundamental legal arguments in its state aid assessments, it is important to understand the role of the Court in the matter. The Court's judgments have highlighted the scope of state aid provisions in tax policy,[252] despite what has been argued by the EC when using state aid to target tax practices.

According to settled case-law, the Court defines the scope of state aid stating that, "*while direct taxation, as EU law currently stands, falls within the competence of the Member States, they must nonetheless exercise that competence consistently with EU law"*.[253] Moreover, with the Starbuck's judgment, the Court further defines the scope of state aid, stating that intervention by MS "*in matters of direct taxation, even if it relates to issues that have not been harmonised in the European Union, is not excluded from the scope of the rules on the*

[245] Convention on the Organization for Economic Cooperation and Development , Paris, (14th December 1960).
[246] *See* ROBERT GOULDER, *The Good News for Fiat Is Better News for Apple,* Tax Notes International, Volume 105, (January 17, 2022).
[247] *see* LIZA LOVDAHL-GORMSEN, European state aid and tax rulings (Cheltenham : Edward Elgar, 2019) p.42 *et seq.*
[248] *Ibid* p. 43.
[249] *Ibid.*
[250] *Ibid.*
[251] ROBERT GOULDER, *The Good News for Fiat Is Better News for Apple,* Tax Notes International, Volume 105, (January 17, 2022).
[252] Arthur Cox LLP, The end of the road for State aid claims to target tax policy?, (July 2020), available at: https://www.arthurcox.com/knowledge/the-end-of-the-road-for-state-aid-claims-to-target-tax-policy/
[253] *See Commission v Spain*, C-269/09, EU:C:2012:439, para. 47

monitoring of state aid."[254] Furthermore, according to this judgment, the Court comes to state that Member States "*must refrain from adopting any measure, in that context, liable to constitute state aid incompatible with the internal market"*.[255] As we have seen in chapter 4, according to *Belgium and Forum 187* v *Commission* in paragraph 81, the Court established that the Commission has competences to classify any tax measure as state aid so long as the conditions for such a classification are met and that MS must exercise their competence in respect of taxation in accordance with EU law.[256] The Court continues to define the scope of the role of state aid in the Apple judgment, in which the General Court's annulled the Commission's decision of August 2016 finding that Ireland had granted illegal state aid to Apple through selective tax breaks.[257] In this case the Court states how crucial it is for the Commission to meet the factual requirements of a state aid claim[258]. The Court in this case established a limit: any action by the Commission to avert competition distortion must be within the scope of the powers allocated for that purpose and must be supported by clear facts.[259]

In addition, the GC in the Amazon case plays a key role in defining the scope of State aid. The General Court of the European Union supported Amazon's appeal against the Commission's decision, that Luxembourg had provided unlawful State aid to Amazon.[260] When looking at the Amazon judgment, the Court again defines the scope of state aid by stating that the Commission must prove the legal requirements of state aid and make the full assessment, and that a mere error made by a tax authority in the process of giving a tax ruling is not state aid, unless the Commission can show that the error resulted in a selective advantage.[261] Finally, regarding the recent opinion of the AG about the Fiat Finance and Trade State aid case, we see from the AG a clear objective of not allowing the Commission to overstep into not harmonized matters,[262] claiming that if MS' tax systems work within the anti-discrimination provisions of the Treaties, they should be allowed to use and develop whichever taxation approach they chose.[263] In this history of jurisprudence, what we can conclude is that the Court holds that tax

[254] *See Netherlands and Others* v *Commission*, T-760/15 and T-636/16, EU:T:2019:669, para. 142.
[255] *Ibid*, para. 143.
[256] *See Commission* v *Spain*, C-487/08, EU:C:2010:310, para 37.
[257] *See* T-778/16, *Ireland v. Commission*.
[258] Arthur Cox LLP, The end of the road for State aid claims to target tax policy?, (July 2020), available at: https://www.arthurcox.com/knowledge/the-end-of-the-road-for-state-aid-claims-to-target-tax-policy/
[259] *Ibid*..
[260] *See* T-816/17 - Luxembourg v Commission.
[261] Ibid para 125 &126.
[262] Opinion of Advocate General Pikamäe on Case C-898/19 P, Ireland v European Commission.
[263] *Ibid*.

matters are not a standardized subject,[264] and that fiscal sovereignty is a right that Member States relish, but that such a right must comply with the EU rules.[265]

5.5 State aid & tax policy

As we have seen in the previous chapters, tax competition is not distortive in and of itself. The fact is that effective "*tax policy and the correct application of competition policy have similar aims"*[266], which leads to innovation and effective taxation policy.[267] Therefore, "*making the competition fair should not mean ending the competition"*.[268] The implementation of different tax policies among Member States might help answer important policy questions issues and should be supported inside the EU institutions.[269] Since there is no harmonization when it comes to direct tax matters, the Commission should recognize and apply the principle of subsidiarity, and state aid should be used within its scope of application. The fact is that unless there is a political agreement to begin harmonizing direct taxes, tax competition between Member States will inevitably persist.[270]

Conclusion

In this thesis, we attempted to answer the question of whether *"the Commission is heading in the right direction in its recent state aid tax rulings*" by reviewing the Commission's decisions on state aid. We've concentrated on two important points. First, whether this approach goes beyond the EC's competences and oversteps MS Fiscal Sovereignty, that have exclusive competence over direct taxes. Second, if state aid provisions are the most effective way for changing tax policies and addressing tax competition among MS. To answer this question, we looked at the institutional tensions between the MS and the EU, as well as to the balance between sovereignty and the EU's goals. We discussed article 107(1) of the TFEU and how the Commission has interpreted it.

We concluded that the EU competences and its Member States' sovereignty is confined to the goals of their respective policy sectors. As a result, the fiscal sovereign rights of Member States can only be applied in accordance with EU legislation. In addition, we investigated the

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[264] Arthur Cox LLP, *Update on State aid claims and tax policy* (June 2021) , available at: https://www.arthurcox.com/knowledge/update-on-state-aid-claims-and-tax-policy/ n 16 December 2021.
[265] *Ibid*.
[266] Arthur Cox LLP, *The end of the road for State aid claims to target tax policy?*, (July 2020), available at: https://www.arthurcox.com/knowledge/the-end-of-the-road-for-state-aid-claims-to-target-tax-policy/.
[267] *Ibid.*
[268] *Ibid.*
[269] *Ibid.*
[270] *Ibid.*

Commission's decisions and the significant legal issues it raises concerning state aid in direct tax law. Finally, we recognized that MS Fiscal Sovereignty has the limitation of having to comply with EU law. In the context of the European Union, achieving a free market with a level playing field should take precedence over fiscal sovereignty. Furthermore, we concluded that the Commission's action is going in the right way as long as it is taken to prevent market competition distortion and the requirements set out in Article 107(1) TFEU are met. And if the Commission's measures result in indirect harmonization, it is within the Court's jurisdiction to assess whether the Commission's choices are proportionate to the EU's direct tax law system. All in all, our research leads us to conclude that the core goal of the EU's State Aid law should not be to directly target tax policy, and that there needs to be better coordination between national and EU systems in this regard. Using the state aid rules to change or to further harmonize tax systems results in a direct conflict with the MS's fiscal sovereignty, breeding uncertainty and controversy. Further, the assessment of article 107(1) TFEU should have in its goals safeguarding of the EU market and fair competition. Therefore, the correct application of Art. 107 TFEU should not be based on what might benefit certain companies but on what might constitute an impairment to fair competition and a free EU's internal market.

Thus, "*is the Commission heading in the right direction*?". In our view, it all depends on whether in the future it will focus more on preventing market competition distortions and ensuring that the requirements set out in Article 107 TFEU are met, and less in intruding in pure tax policy issues, which are still the realm of sovereignty of MS. For this to change, according to the fundamental principles on which the Union has been erected, the MS must purposely decide in that direction, introducing the required alterations to the Treaties to transfer more of their sovereignty to the Union. The secret of the construction of the EU has always been to respect the graduality involved in the European integration process. The Commission needs to follow the lessons of time to keep heading in the "right" direction, a direction that ensures economic welfare and fair competition, while also respecting the pace of integration that MS are ready to follow.

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