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# A new approach to Article 107(1) TFEU?

## - An investigation Into Commission's "New" Approach in State Aid Cases Relating to Tax Rulings

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# SUMMARY

In recent years, there has been significant amount of attention towards harmful tax competition and tax avoidance. These issues are of particular importance to the EU and its Member States, because of the internal market. As the internal market guarantees free movement of goods, capital, services and labour it offers great opportunities for economic operators to pick and choose the best business environment and tax regime for their enterprise, while enjoying the fundamental freedoms throughout the Union. The scope and nature of the tax regime in a particular Member State is a matter for the State itself and the EU does not have competence over direct tax matters. However, the EU became concerned that some Member States were introducing tax measures which were distorting competition within the single market. These measures had a number of common features, including a lack of transparency, offering benefits on a selective basis, or offering effective tax rates significantly lower than the normal base. The Commission took action against such practices and after its investigations decided that the tax rulings given by Ireland, Netherlands and Luxembourg to Apple, Starbucks and Fiat constitute illegal State aid according to article 107 TFEU.

The Commission has lot of criticism for these decisions. The Commission has also been accused to depart from its previous practice in finding incompatible State aid. Major part of the criticism concerns the selectivity criteria and the new independent EU ALP. This thesis examines weather Commission has used "a new" approach in its State aid investigations relating to tax rulings and hence departed from its previous practice. The Apple case will be used as an anchor to test the practice of the Commission, but Starbucks and Fiat cases will be briefly discussed to illustrate my points even further. The thesis introduces each component of the EU State aid regime and tax rulings and analyses them separately. The final chapters

The conclusion of the thesis is that the Commission has not erred in its investigations nor departed from its previous practice. A careful reading of the ECJ case law and the Commission's practice shows that the Apple decision follows the already established principles by the ECJ. Selectivity criteria has been conflated into a single selective-advantage test previously as well by the ECJ, therefore the application of such test is based on the circumstances and facts of the case at hand. Hence, the Commission has

satisfied all conditions laid down in Article 107(1) TFEU to find incompatible State aid correctly. Furthermore, the effects-test used by the ECJ supports the finding of the incompatible State aid in the Apple case. Only viable argument against the Commission can be the use of a new independent EU ALP. Since the use of an independent EU ALP has not been tested in the ECJ before it is difficult to comment on it. We will have to wait for a clarification from the ECJ weather there can be an independent EU ALP.

# Sammanfattning

<Sammanfattningstext>

# PREFACE

My sincere thanks go to my dearest friends who have always supported me. I would also like to thank my Mom, Sister and Dad for always letting me be myself and for supporting me in anything I choose to do.

Lastly I would like to thank “European Business Law” and “European and International Tax Law” programmes and all the people that I have met there, they have made this journey very pleasant. Also special thanks to my supervisor Axel Hilling for guiding me when needed.

Khusndip Paran Kumar

Lund, May 24 2018

# ABBREVIATIONS

| | |
|---|---|
| Art. | Article |
| MS | Member State |
| ASI | Apple Sales International |
| AOE | Apple Operations Europe |
| APA | Advanced Pricing Agreement |
| ALP | Arm’s Length Principle |
| BEPS | Base Erosion and Profit Shifting |
| ECJ | European Court of Justice |
| EU | European Union |
| JTPF | Joint Transfer Pricing Forum |
| MNE | Multinational Enterprise |
| OECD | Organisation for Economic Cooperation and Development |
| TNMM | Transactional Net Margin Method |
| TP | Transfer Pricing |
| TFEU | Treaty on the Functioning of the European Union |
| IP | Intellectual Property |
| R&D | Research and Development |
| CA | Competentt Authorities |
| CSA | Cost Sharing Agreement |
| CUP | Comparable Uncontrolled Price |
| RPM | Resale Price Method |
| MAP | Mutual Agreement Procedure |

# 1 INTRODUCTION

The fight against aggressive tax planning by MNEs has never been more interesting than it is today. For this we can thank Margarethe Vestager, European Commissioner for Competition who has since assuming the post in 2014 changed the whole landscape of aggressive tax planning and harmful competition within the EU. Vestager has taken a strong stance against illegal State aid and she has with her policies and actions, changed the focus of blame solely from multinationals, but to the harmful conduct of Member States as well. What I mean by harmful conduct is the tendencies of various Member States and their tax authorities to engage with multinationals more close than they should, there should be at least an arm's length between them, so to say. The recent LuxLeaks and Panama Papers showed that despite the strong initiatives, such as the BEPS project we are still far from the goals set by the EU and the OECD to curb tax avoidance and the issues related to them. As long as Member States are willing to enter into sweetheart deals with the multinational these goals will remain unachieved.

To response to these concerns the Commission truly changed its approach to harmful tax competition and aggressive tax planning by using the State aid regime and the rules therein to its full extent, some would say beyond their extent. Fact remains that since 2014 Commission has opened number of investigations into tax rulings given by Member States to private companies. Some of these cases has caused a lot of criticism from stake-holders and experts alike. There is a concern, that the Commission is using the State aid to infringe the sovereignty of the Member States when it comes to direct taxation. Also there are questions regarding weather Commission really has taken an unprecedented approach in satisfying the art. 107(1) TFEU and the conditions therein.

The Commission has reached final conclusion in some of its investigations already and its arguments for finding incompatible State aid is essentially quite similar, therefore it might be that the Commission intends to take a whole new approach to State aid and taxation related cases. Whether this approach is correct is a matter that ultimately ECJ will have to clarify.

## 1.1 PURPOSE

The purpose of this thesis is manifold. I hope by the end of this thesis the reader will have a general idea what is the framework of EU State aid regime and how it operates in relation to taxation and the issues therein, especially the selectivity criterion.

The primary aim of this thesis is however to ascertain how the State aid regime applies to direct taxation, multinationals in particular. I have chosen to focus on the specific issue of State aid and tax rulings, more specifically the advance pricing agreements between national tax authorities and individual undertakings.

When the conditions laid down by the art. 107(1) TFEU are cumulatively satisfied, there is incompatible State aid. I will see what is the approach of Commission in satisfying those conditions and why has its practice garnered so much criticism, especially the Commission's own application of its own independent arm's length principle. I have chosen to focus on a well-known Apple decision of the Commission, where it found that Ireland has conferred illegal State aid to Apple through after conducting thorough investigation. I will use some pointers from other relevant investigations as well as I feel it is necessary in order to see the practice of Commission and whether it is consistant in applying such practice. I intend to find out whether the Commission has gone too far with its so called "novel" application of art. 107(1) TFEU.

In the end I will propose a possible solution as to how the European Courts might rule on the Appeal lodged by both Ireland and Apple. I will do this based on previous case law and analysis by the experts of the field.

I have chosen two main research questions that I will try to answer at the end of my thesis:

1. Has Commission erred in its application of art. 107(1) TFEU in finding illegal State aid in its Apple decision by using a single selective-advantage test?
2. What impact can taxpayers rights have on the new unannounced EU ALP? Does the use of a State aid ALP breach taxpayers rights?

## 1.2 METHODOLOGY AND MATERIALS

In order to answer my queries I have chosen to follow a legal dogmatic method. I will analyse the relevant caselaw by the ECJ to know how it has shaped the State aid regime of the European Union and how it has ruled on these issues before. I will also use Commission decisions to ascertain how its practice forms and what is the basis of its decisions. I will use academic literature such as articles, books and journals by authors and experts of the field. Furthermore, I will focus on relevant legislation, regulations, Commission notices and other policy documents to base my analysis on good foundations. Because this specific area and issue is new and there is a limited number of articles and other relevant material for my use, I have also been influenced by various lectures and debates by the policy makers that have been provided online.

## 1.3 DELIMITATIONS

This thesis specifically looks at the Commission's practice in satisfying the conditions of art. 107(1) TFEU and its application to State aid and taxation, more specifically to tax rulings and the related transfer pricing issues. All other associated topics are covered on the basis of bringing the reader's general knowledge to a level where he/she can understand how State aid and tax rulings operate. Any related problems to State aid and its history will be out of the scope of this thesis. For example, I will not assess other related issues of incompatible State aid, such as the recovery of aid.

## 1.4 OUTLINE

There are 7 Chapters in this thesis. I have tried to build the Chapters with a view that by Chapter 6 and Chapter 7 the reader is able to follow and understand the discussion therein, which is the most relevant part of this thesis. I have concluded under each Chapter the most relevant points.

You are reading Chapter 1 right now. This sets the limits and scope for my thesis and will help you understand what you will find in the subsequent Chapters.
Chapter 2 gives a general introduction to the State aid regime and the governing authorities. I shortly explain why State aid rules are necessary. Chapter 3 builds on the information on State aid and taxation. I will show how art. 107(1) TFEU and its conditions are satisfied by using precedents from the earlier ECJ caselaw. Chapter 4 introduces tax

rulings and transfer pricing. Chapter 5 builds on the practice of the Commission in satisfying the conditions laid down in art. 107(1) TFEU. I have used Apple as my anchor, but refer to Starbucks and Fiat decisions when relevant. Chapter 6 takes a close look at the Apple decision and assesses whether Commission has erred in its application of art. 107(1) TFEU by conflating advantage and selectivity into single selective advantage test. I will also propose what I think the European Courts might rule once the appeal reaches there. The last Chapter 7 is a concluding Chapter. Here I will answer seperately my research questions and share my thoughts.

# 2 STATE AID IN THE EU

## 2.1 INTRODUCTION

EU and its single market have been a constantly evolving project since its inception. This project has been built on core principles, humanitarian values and fundamental freedoms that ensure protection and progression of both social and economic development, such as free competition and trade between the member states (MS)[1]. One of the earliest obstacles to this project was to curb the desires of MS to favor their national economies by giving preferential treatment to the domestic industries and undertakings[2], thus giving them a competitive advantage, also known as State aid. Such protectionist behavior was recognized and addressed quickly by introducing a State aid legal framework in Treaty of Rome[3] to preserve competition and the development of the internal market. Although the Single Market project has reached great lengths compared to those early years, it is still as important as ever to ensure that individual national interest does not prevail over the Community objectives through the correct application of the State aid regime.

Currently, Articles 107 to 109 of the Treaty on the Functioning of the European Union[4] (TFEU) regulate the State aid prohibition within the EU. The current State aid regime aims to control aid granted by the MS to companies, but also to safeguard the proper functioning of the internal market and ensure that the competition is free from discrimination or protectionism[5]. Furthermore, it can be said that the State aid regime has expanded from its origins, which was to deter protectionism, but now it is also used as a combative tool against harmful tax competition[6].

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[1] E. Fort, "EU State Aid and Tax: Evolutionary Approach", European Taxation IBFD, 2017, p. 370
[2] In the case C-41/90 Höfner and Elser, EU:C:1991:161, para 21, undertaking was defined in the following "concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed"
[3] Treaty Establishing the European Community, 25 Mar. 1957, art. 87
[4] Treaty on the Functioning of the European Union (2012/C 326/01) (Further reference will made in text as TFEU)
[5] Supra note 1, E. Fort, p. 370
[6] R. Mason, "Tax Rulings as State Aid", Tax Notes, 23 Jan 2017, p. 452

## 2.2 GOVERNING AUTHORITIES

For the purpose of this thesis, I feel it is necessary to briefly present the authorities that govern the State aid regime within the EU. Importance will only be given to authorities that are deemed to be necessary for the understanding of the topic.

Art. 107(1) TFEU prohibits State aid. Exceptions to these prohibitions are laid down in art. 107(2) and (3) TFEU. The general rule that the art. 107(1) TFEU sets out is that any aid granted by an MS that favors certain undertakings or the production of certain goods is incompatible with the internal market. The specific language used is the following:
"Any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Member States, be incompatible with the internal market."[7]
Because the article does not lay down the exact conditions that need to be satisfied for there to be incompatible State aid, there is not a standard test which is used, but different authors use different tests[8] to ascertain whether the measure is incompatible with the internal market. I will later go through the criteria used by the Commission, but until that this thesis will refer to the following test[9]:

1. There must be an advantage granted to an undertaking
2. It has to be granted by a MS or through MS resources
3. It has to be selective, favoring certain undertakings or the production of certain goods
4. It has to distort or threaten to distort competition and it has to affect trade between MS

In order for there to be incompatible State aid, all four conditions or prongs have to be satisfied. I will assess the mentioned four cumulative conditions in accordance with the established case law of the European Court of Justice (ECJ) and previously approved Commission's practice to ascertain weather Commission has erred in its recent State aid investigations relating to tax rulings.

[7] Art. 107(1) TFEU
[8] Please note that the difference is insignificant. The ultimate way of testing the measure is essentially the same. Still, I find it important to point this out, because it matters when I lay out the tests to be satisfied.
[9] See supra note 1, E. Fort, p. 375, This approach is perhaps the most common one.

Rest of the authorities connected with this thesis are, art. 108 TFEU, which empowers the Commission and obliges the EU's executive body to monitor lawful aid and to take enforcement actions against MS that grant unlawful aid. Art. 108 TFEU empowering effect comes from the fact that it grants Commission with sole discretion to determine whether a MS has granted aid, subject to review by the EU courts. Art. 109 allows the EU Council to make new State aid regulations, but first Commission has to propose and the EU Parliament has to approve that regulation. The MS is obliged to cooperate with Commission's investigations in accordance with the duty of loyal cooperation laid down in the TFEU. Another important State aid legislation is Council Regulation 2015/1589, which governs the State aid procedures and binds the Commission and the MS to the State aid regime. The commission is also bound by the enforcement policies and guidelines that it has drawn up for itself[10].

There are other relevant authorities regarded as soft-law that will be used as reference point in the argumentation. The most important ones to be used in this thesis are Commission Notices[11][12] regarding State aid and taxation, and OECD guidelines and reports. Furthermore, a reference to other relevant authorities that are not specifically mentioned here will be made when deemed necessary.

## 2.3 TAX AVOIDANCE AND HARMFUL COMPETITION

### 2.3.1 AGGRESSIVE TAX PLANNING

There is an idea originated from a Darwinian evolutionary theory called "survival of the fittest". This idea essentially means that within a world of limited resources and deadly competition, the one who can best accommodate to the changing environment and adapt to the situation will survive. Now, as far-fetched as it might sound, I think this applies not only to the natural environment, but also to the corporate world – Only the strongest and most adaptive companies are able to compete on the market and survive. With this idea

[10] R. Mason, supra note 6, p. 451

[11] Commission notice on application of the State aid rules to measures concerning direct business taxation, 1998 O.J. (referred as 1998 Notice from herein). This Notice was replaced by the Notice on State aid 2016. The contents are however same, with some further clarifictions brought in the Notice on State aid 2016 version. I will use both depending on a situation.

[12] Commission notice on the notion of State aid as referred to in TFEU art. 107(1), O.J (referred as 2016 Notice from herein)

in mind, MNEs often take part in different tax planning activities[13] in order to maximize their profits. The most common way to do this is through aggressive tax planning, which is legal to a certain extent.

Aggressive tax planning by MNEs results in very low, sometimes even zero taxation on their profits, because their intragroup system allows them to abuse the tax regimes of different countries and their discrepancies. When a taxpayer achieves zero taxation, such income is called "stateless" income, because it is not taxed in any jurisdiction[14]. Ruth Mason in her article refers to EU Competition Commissioner Margreth Vestager's comments which indicate that the current State aid regime aims to force a single-tax principle[15], which means that the MNEs income must be taxed exactly once. This seriously limits the space that the aggressive tax planning within the MNEs can be successfully done. Furthermore, it also explains why Commission has focused on its recent State aid cases primarily on large MNEs. This is one of the cornerstones of this thesis, as most of the actions taken by Commission to suspect and assess incompatible State aid in recent years relate to aggressive tax planning by MNEs like Apple and Starbucks. Furthermore, aggressive tax planning has become a very politicized issue, because of the recent economic crisis. The tax revenue that the state receives is used for the benefit of the society in general and avoiding your fair share of taxes is seen as something immoral and harmful to the society. This has opened up doors for the Commission to take an unprecedented hard stance on aggressive tax planning by the MNEs.

### 2.3.2 HARMFUL TAX COMPETITION

Countries are competing against one another in an increasingly global and mobile economy, this is called tax competition. By tax competition is meant practices by which countries implement their tax legislation, with the purpose of attracting multinational enterprises (MNEs) and economic activity in general to its territory. This, in turn, increases country's tax base and generates wealth within the state. The argument against

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[13] When MS use their tax planning activities to evade taxes instead of minimizing them, in compliance with the law, it is deemed illegal. This is called tax evasion. I will not further delve into MNEs tax planning methods and their differences, as this is not relevant for this thesis.

[14] P. Piantavigna, "Tax Abuse and Aggressive Tax Planning in the BEPS Era: How EU Law and the OECD are Establishing a Unifying Conceptual Framework in International Tax Law, Despite Linguistic Discrepancies", World Tax Journal vol 9:1, 2017, p. 47

[15] R. Mason, supra note 6, p. 452

this form of tax competition amongst governments is that it inevitably results in a so-called "race to the bottom".[16] Smaller countries are not able to attract economic activity from large MNEs except through offering them lower taxes. This forces bigger countries to lower their tax rates as well – resulting in lower tax revenues for the governments, which means that the welfare system and the ability to provide public goods and services is compromised[17]. This further emphasizes point mentioned above, that aggressive tax planning is not only an economic issue, but a political issue as well.

### 2.3.3 INTERPLAY BETWEEN THE TWO

Bogenschneider and Heilmeier indicate in their article[18] succinctly that the interests of taxpayer and State coincide; the taxpayer wants to avoid taxes and will use aggressive tax planning to do it, and a State wants to increase its tax base by poaching the tax base of other State's.

Professor Pistone highlighted at the 10th GREIT Annual Conference on EU BEPS[19], that the actions against harmful tax competition precede the BEPS project. It was already during the 1990s that the EU policymakers wanted to address the issue of Member States (MS) attracting investors and taxpayers by concluding questionable agreements with them. Nevertheless, the measures taken by the EU policymakers were not as successful as they might have hoped. Recently the infamous LuxLeaks provided evidence that despite tax compliance and prohibition of State aid, MS is actively concluding sweet-heart deals with MNEs to attract them under their jurisdiction. In this regard Pistone thinks that the two phenomena of harmful tax competition and State aid overlap significantly[20]. Indeed, the European Commission has taken a strong and controversial approach towards the fight against harmful tax competition and problems associated with it. The approach taken by Commission has garnered a lot of criticism, and in the following chapters the aim is to ascertain whether this criticism is well-founded and justified.

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[16] V. Sobotková, "Revisiting the debate on harmful tax competition in the European Union.", Acta univ. agric. et silvic. Mendel. Brun., Volume LX No. 4, 2012, p. 343-345

[17] When MS use their tax planning activities to evade taxes instead of minimizing them in compliance with the law, it is deemed illegal. This is called tax evasion. I will not delve into MNEs tax planning methods and their differences, as this is not relevant for this thesis.

[18] B.N. Bogenschneider and R. Heilmeier, "Google's 'Alphabet Soup' in Delaware", 16:1 Houston Business and Tax Law Journal 1-43, 2016

[19] L. Allevi & C. Celesti, "10th GREIT Annual Conference on EU BEPS; Fiscal Transparency, Protection of Taxpayer Rights and State Aid and 7th GREIT Summer Course on Tax Evasion, Tax Avoidance & Aggressive Tax Planning", Intertax, Volume 44, Issue 1, p. 88

[20] Ibid. p. 89

# 3 STATE AID AND TAXATION

## 3.1 INTRODUCTION

Having outlined the principles of State aid, I will now go on to look at how the State aid rules have been applied by the ECJ in the field of taxation. The area of direct taxes for both corporate entities and individuals is not one over which the EU has competence[21]. Member States are free to determine how their tax systems operate. They are free to determine a wide range of issues including the tax base and the tax rate to apply. Although the EU does not have competence over the tax systems implemented by the Member States, the tax system must operate in a way which is in line with EU law. This is generally taken to mean that the tax system must not impact on what is referred to as the Fundamental Freedoms[22] established in the Treaty on the Functioning of the European Union. If national legislation infringes any of the fundamental freedoms, it will be found to be discriminatory, and the MS will be required to amend its legislation to remove the discrimination. An example of such a challenge which is relevant in the present context is the Lankhorst-Hohorst[23] case. The ECJ found that German thin capitalization rules[24] were discriminatory because they applied only to cross-border loans. Loans between two German companies would not be subject to any restriction, and so the law treated overseas companies less favorably. As a result of this case, a number of countries, including the UK in 2004[25], amended their TP legislation so that it also applied to transactions between two companies resident in the same state.

Other actions which the EU has taken to defend the principle of free trade within the single market specifically in relation to taxation concern the issue I briefly presented in the previous Chapter concerning prevention of harmful tax competition. In 1997, the

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[21] V.Englmair, "The Relevance of the Fundamental Freedoms for Direct Taxation" in Lang, Pascale Pistone, Schuch and Staringer (eds), "Introduction to European Tax Law on Direct Taxation", 4th edition, 2016, p. 55

[22] Ibid. p. 55

[23] Case C-324/00 Lankhorst-Hohorst GmbH v Finanzamt Steinfurt [2002] ECR I-11779

[24] Thin capitalisation refers to the practice of funding companies with high levels of debt rather than equity to take advantage of the different tax treatments applied to debt and equity. Interest payments are usually allowed as deductions in calculating profits, but dividends are not.

[25] C. Clavey & N. Abhat, "An Introduction to Transfer Pricing", Taxation, 2 December 2004 <https://www.taxation.co.uk/Articles/2014/03/13/230161/transfer-pricing accessed 26 April 2018

Council of Economic and Finance Ministers agreed to adopt the Code of Conduct[26] on taxation policy which highlighted many practices as being harmful tax competition, including: *Advantages offered only to non-residents of where transaction is with non-residents*, *advantages offered where there is no economic activity or substance in the territory* and finally *tax measures which are not fully transparent.* The Code of Conduct does not have the same status as EU laws or Directives, and it is often referred to as a soft law[27], which largely explains its failure to have any substantive effect.

The approach of using State aid rules to tax measures perceived to be harmful to the functioning of the single market began to take shape in the late 1990's and early 2000's[28]. Individual tax measures were challenged as contravening art. 107(1) TFEU, and so amounted to unlawful[29] State aid. Countries could not ignore ECJ judgments in the way they had ignored the soft law of the Code of Conduct. A measure will constitute State aid in the event that the following tests, or prongs, of art. 107(1) TFEU are all satisfied[30]: 1. *There must be an advantage granted to an undertaking.* 2. *It has to be granted by MS or through MS resources.* 3. *It has to be selective, favoring certain undertakings or production of certain goods. 4. It has to distort or threaten to distort competition and it has to affect trade between MS*

I will now go on to look at how each of these tests has been applied to tax measures in the ECJ cases. I will specifically comment on the more recent Commission State aid Decisions in later sections. This section will consider the way in which the ECJ has established the principles of determining whether a tax measure constitutes State aid and later sections will examine how recent Commission decisions apply these principles.

[26] Conclusions of the Council of Economics and Finance Ministers of 1 December 1997 Concerning Taxation Policy (98/c 2/01)
[27] H. Gribnau, "Soft Law and Taxation: EU and International Aspects", Legisprudence Vol II No 2, 2008, p. 67 https://ssrn.com/abstract=2445018 accessed 5 May 2018
[28] In 2001, the EU launched a State Aid investigation into preferential tax arrangements offered by 12 Member States, European Commission "Commission Launches Large Scale State Aid Investigations into Business Taxation Schemes" [2001] IP/01/982
[29] Terms unlawful, illegal and incompatible will be used to describe State aid which does not confrom with art. 107(1) TFEU
[30] The exact order of these tests laid down might change when deemed necessary by the author

## 3.2 ESTABLISHING STATE AID IN ACCORDANCE WITH ARTICLE 107

### 3.2.1 INTERVENTION OF THE STATE OR USE OF STATE RESOURCES

The first of the four tests requires that there has been either an intervention of the State or a use of State resources. In most State aid cases, the discussion concerns whether or not some type of subsidy amounts to aid, but in the area of taxation, the question is whether or not a reduction in taxes, or some other form of preferential tax treatment, may constitute State aid. In considering this question, the main point at issue is to determine whether the intervention of the State has provided the undertaking with an advantage. This provides a particular difficulty for tax cases, because the standard test for identifying whether or not the measure confers an advantage is the Market Economy Operator Test (MEO). The Commission published a document[31] which defines the purpose of the MOE test in State aid cases as being "to assess whether the State has granted an advantage to an undertaking by not acting like a market economy operator with regard to a certain transaction". Clearly, this cannot apply in the context of a State determining how a transaction should be taxed as there is no market economy operating in the area of taxation. The courts have therefore had to adopt a different approach in defining an advantage in the cases involving taxation.

Most writers agree that the first State aid case involving taxation heard by the ECJ was the Steenkolenmijnen [32] case, which found that a tax break given to miners to encourage them to remain in the industry amounted to State aid. The more recent Paint Graphos[33] case provided a clear definition of what constitutes an intervention by the state. The ECJ ruled that advantageous tax treatment constituted State aid because there is a "mitigation of charges which are normally included in the budget of an undertaking" This is the same definition used by the Steenkolenmijnen Case. The courts have since found that a range of tax practices amount to a use of State resources[34], including reductions in the tax base,

[31] Supra note 12, Commission 2016 Notice, para. 76
[32] Case 30/59 De Gezamenlijke Steenkolenmijnen Limburg v. High Authority [1961] ECR , para. 19
[33] Joined Cases C 78/08 to C 80/08 – Ministero dell'Economia e delle Finanze, Agenzia delle Entrate v Paint Graphos Soc. coop. arl & Others [2011] ECL I-7611, para. 45
[34] V.H. Guerrero, "Defining the Balance between Free Competition and Tax Sovereignty in EC and WTO Law: The "due respect" to the General Tax System" German Tax Law Vol 05, No 1, 2004 p. 87

allowing tax-free reserves to cover future risks, special depreciation allowances, derogations from general limits and full or partial exemption from paying taxes.

### 3.2.2 AFFECTING TRADE BETWEEN MS AND DISTORTION OF COMPETITION

The tests on the impact on trade and distortion of competition are usually considered together. The Philip Morris[35] case is the leading judgment in this area. It was not a tax case, but the case is usually cited when considering the distortion of competition, even in the tax cases[36]. In the Philip Morris case, the ECJ found that a distortion of competition would arise where the aid strengthened the undertaking's position in the market compared to other undertakings which it competed with. The barrier for demonstrating a distortion of competition is low. It is not necessary to prove a distortion has occurred, or to quantify its nature. It is sufficient that the measure has the capacity to distort trade[37].

Regarding the question of the impact in intra-community Plender[38] makes an important point by saying that the Court does not spend too much time assessing the effect of trade between the MS and the resulting distortion, because the two usually go together[39]; If an undertaking gets favourable treatment from the authorities, it clearly results in distortion of competition and hence affects the trade between the MS.

It should be noted that the Notice specifies these two as distinct and necessary elements of State aid and they both must be satisfied[40], albeit in practice the assessment is done jointly and swiftly.

A paper by the German Federal Finance Ministry[41] includes a useful example to illustrate that the important point regarding the "trade between MS" part, that any impact must be on cross-border trade. In the case of residential property construction, any aid would not contravene art. 107 TFEU if it was available to both domestic and foreign construction

[35] Case C-730/79 Philip Morris Holland v Commission [1980] ECR I-2671, para. 11
[36] Supra note 11, Commission 1998 Notice
[37] Supra note 35, para. 12
[38] R. Plender, "Definition of Aid' in Andrea Biondi", in P. Eeckhout & J. Flynn (eds) "The Law of State Aid in the European Union", Oxford University Press, 2004, p. 33-34
[39] Supra note 12, Commission 2016 Notice, para. 186
[40] Ibid. para. 198
[41] The Advisory Board to the German Federal Ministry of Finance, "Tax benefits and EU state aid control: The problem of and approaches to resolving the conflict of jurisdiction with fiscal autonomy", 2017, p. 22

undertakings. This is because it is a place-bound activity and so would not have a cross-border effect on trade.

### 3.2.3 ECONOMIC ADVANTAGE

Art. 107 TFEU does not use the word advantage, so it is useful to consider where the concept of advantage arises. Schön [42] states that the concept of advantage is the starting point in any consideration of illegal State aid and that "the concept of state aid is about *favors*." So the advantage is the aid itself, and the four tests or prongs of art. 107 TFEU are then used to determine if that aid or advantage is illegal State aid.

The Commission's Notice clearly dictates that advantage is conferred upon the undertaking if it gets "Any economic benefit which an undertaking could not have obtained under normal market conditions, that is to say in the absence of State intervention[43]". The existence of this advantage is established by evaluating the situation of an undertaking before and after State intervention. If State intervention has improved the financial situation of an undertaking and altered the normal market conditions, it indicates that advantage is present. Furthermore, if a measure taken by the State relieves an undertaking of charges that are normally attributable to it, the advantage has been conferred[44]. Therefore in relation to tax rulings, a ruling confers advantage if the ruling allows the undertaking to pay fewer taxes than it would pay in absence of such ruling.

### 3.2.4 THE MEASURE FAVORS CERTAIN UNDERTAKINGS OR THE PRODUCTION OF CERTAIN GOODS

#### 3.2.4.1 GENERAL

The test covering measures favoring certain undertakings, or the production of certain goods, has been the main focus of the deliberations of the ECJ when State aid rules applying to taxation measures have been examined by the court. It has become known as the selectivity test, although art. 107 TFEU itself does not use the word selectivity. The selectivity criterion comes from the use of the word certain – if a measure is only available to "certain" undertakings, then it is by definition a selective measure.

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[42] W. Schön, "Tax Legislation and the Notion of Fiscal Aid —A Review of Five Years of European Jurisprudence" Max Planck Institute for Tax Law and Public Finance, Working Paper, 2015, p. 4
[43] Supra note 12, Commission 2016 Notice, para. 66
[44] Ibid. paras. 67-70

The consideration of whether a measure is selective generally involves three separate steps[45]: *1. Determining the reference system against which the measure must be considered. 2. Is the measure selective when compared to the reference system, in other words does it derogate from it? 3. Is there a justification for the measure if it does derogate from the reference system?* I will go each of these tests separately through established case law in the following sections.

### 3.2.4.2 DETERMINING THE REFERENCE SYSTEM

The starting point in identifying the reference system is to assess what the nature of the advantage is in the general taxation system of the MS. The reference system will be used as a benchmark when assessing the selectivity of the measure. The Commission Notice states that "The reference system is composed of a consistent set of rules that generally apply –on the basis of objective criteria – to all undertakings falling within its scope as defined by its objective".[46]

The Adria-Wien[47] case set out a useful definition of the reference system to apply. The case concerned a rebate offered by the Austrian state to certain manufacturers to encourage efficient use of energy. The benchmark against which the measure had to be judged as "other undertakings, which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question." The ECJ found that because the rebate was only available to manufacturers, and not service providers, then it was selective in its nature. Other points to note about the judgment are that the number of taxpayers who are able to take advantage of the measure is not relevant, and the motive cannot be taken into account. The measure had been introduced to encourage efficient use of energy, and not to offer a specific tax benefit to manufacturers.

### 3.2.4.3 DEROGATION FROM THE REFERENCE SYSTEM

The selectivity test builds on this established benchmark by examining the impact of the measure on different undertakings. If the measure applies to them in different ways, or in other words, derogates from that normal reference system, then it is said to be selective and thus derogation from the benchmark. This was recognized in the Paint Graphos

[45] Supra note 12, Commission Notice 2016, paras. 128
[46] Ibid. paras. 132-133
[47] C-143/99, Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke [2001] ECR I-08365, paras. 48-53

case[48]. The Paint Graphos case concerned the tax treatment of certain co-operative societies, which were acknowledged by the ECJ to be different entities from a typical corporation. They were established for the mutual benefit of their members, and not with a view to generating a profit. The ECJ[49] made clear that having established the benchmark as the normal rules of Italian corporate taxation, the tax exemption offered to co-operatives could not be regarded as being selective to the extent that it applied to transactions between the members of the co-operative but not to profits from other sources. Wattel[50] summarises the judgment by stating that no State aid was due because the Societies were sufficiently uncomparable from normal companies.

The Gibraltar case[51] further developed the way in which the ECJ applies the selectivity test. Gibraltar had previously operated a "normal" corporation tax regime, under which companies were taxed on profits. This was replaced by a number of different expenditure taxes, the two most important being a payroll tax based on the number of employees on the payroll, and the second based on the value of the business property occupied in Gibraltar. The tax on these two measures was capped at 15% of profits. The new tax system resulted in overseas companies receiving significant reductions in the amount of taxes they paid as they employed relatively few employees in Gibraltar and occupied the smaller property. The 15% cap on the tax meant that local companies would find themselves no better or worse off. The ECJ found it difficult to apply the benchmark test in the Gibraltar case. The normal tax system applied the different expenditure taxes to all companies in the same way, and the 15% cap applied to all taxpayers. However, the ruling stated that the tax system "discriminates between companies which are in a comparable situation.[52]" In reaching this conclusion, the court took what it described as a "form over substance", or the effects test, approach and concluded that the new tax system applied was a disguised income tax which offered significant benefits to non-residents.

Schön[53] notes that the discriminatory test developed in the Gibraltar case does amount to a significant change in the way in which the ECJ considers the point of selectivity.

[48] P. Wattel, "Forum: Interaction of State Aid, Free Movement, Policy Competition and Abuse Control in Direct Tax Matters", World Tax Journal, 2013, p. 133
[49] Supra note 33, Joined Cases C 78/08 to C 80/08, paras. 64 to 76
[50] Supra note 48, p.132-133
[51] Joined Cases C-106/09 P and C-107/09 P Commission v Governments of Gibraltar and UK [2011] ECR I-11113, para. 21
[52] ibid. para. 101
[53] Supra note 42, p. 6-7

However, his interpretation is that it does not amount to a complete change in direction or a move away from considering whether there has been a derogation from the reference system. The facts of the case were unusual, and future cases will still consider whether an appropriate benchmark can be found.

#### 3.2.4.4 IS THERE A JUSTIFICATION FOR DEROGATION FROM THE REFERENCE SYSTEM

The final consideration in applying the selectivity test involves assessing whether the measure is part of the general tax system of the State and thus could be justifiable based on that. A measure cannot be a specific one if it is a general measure which is a component part of the applicable national tax system. The Commission Notice[54] issued to clarify the developing approach to State aid in 1998 states that a "general tax measure, effectively open to all firms on an equal access basis" will not constitute State aid. A number of examples were given to illustrate general tax measure which would not be regarded as State aid, including setting tax rates, depreciation rules, loss relief rules, and tax avoidance measures. The General rule argument was also put forward by Gibraltar in supporting the various expenditure taxes introduced in the Gibraltar case discussed above. It was argued that as the taxes were applied to all taxpayers in the same way, and that the 15% cap was also applied to all taxpayers, that these measures amounted to an integral part of Gibraltar's general tax system. These arguments were not accepted by the ECJ[55]. Another important point about this test is that in recent cases, the Commission holds the MS accountable for proving that the measure is justified.

#### 3.2.4.5 SOME FURTHER REMARKS

The final point to make on the issue of selectivity concerns the frequent approach of conflating the advantage and selectivity tests to produce a single selective advantage test. Many writers note that there is a tendency to apply a single "selective advantage" test in State aid cases[56]. However, the two issues must be considered separately in order to apply art. 107(1) TFEU correctly. The tendency in many cases which apply a single "selective advantage" test is to focus on the advantage test and assume that it is necessarily selective. Schön [57] stresses that in cases where this approach is taken, there is a risk that the general measures of justification is not properly applied. He illustrates this with the approach taken by many countries to encouraging R&D activity by offering tax incentives such as

[54] Supra note 11, Commission notice 1998
[55] Supra note 42, p. 7
[56] Supra note 42, p. 5
[57] Supra note 42, p. 11-15

enhanced deductions for expenditure on R&D expenses, or lower tax rates on income derived from IP which this research has developed. When compared to the general tax measures in the country, these measures offer significant advantages to companies which carry out R&D when compared to the normal rules for giving deductions for business expenses or taxing income. However, if the measures are available to all economic operators, then they will not be selective, and will not therefore constitute State aid.

In understanding how the selectivity criteria have been applied in different situations, the German Federal Finance Report[58] contains a useful table which shows the different areas of selectivity which the ECJ has identified:

1. Selectivity based on the residence of the undertaking – the Gibraltar case mentioned above is used as an example of selectivity based on residence
2. Selectivity based on the nature of economic activity undertaken – the example used here is the Adria-Wien case, which provided rebates on energy used only to manufacturing undertakings
3. Selectivity based on location in a particular region – a tax measure to encourage investment in eastern Germany was found to be selective because it offered an advantage only to taxpayers in particular regions[59]
4. Selectivity based on country of residence of investment – a case involving an amortization allowance of 5% was found to be selective because it was only available on investments in shares in foreign subsidiaries. This was the case even though it was open to any undertaking to purchase shares in an overseas company and claim the relief[60]
5. Selectivity based on the type of employees of the undertaking – a reduced social security contribution rate was offered to companies employing a certain number of women was selective on the grounds it discriminated against undertakings which traditionally employed a majority of men.

The Commission Notice on State aid also contains some specific comment on the particular issues which taxation measures can raise. It identifies a number of specific

[58] Report of the Advisory Board to the Federal Ministry of Finance, “Tax benefits and EU State aid control: The problem of and approaches to resolving the conflict of jurisdiction with fiscal autonomy”, 2017, p. 15
[59] Case C-156/98, Federal Republic of Germany v Commission [2000] ECR I-6882
[60] Joint Cases C-20/15 P and C-21/15 P, Commission v World Duty Free Group [2016] ECR I-981

situations and offers guidance on when they may be considered to be State aid, and when they may be general measures. Examples include:

1. Tax amnesties[61] – in order to be general tax measures, they must be open to all taxpayers, available for a limited duration, and to apply to tax liabilities arising before a particular date and which are still outstanding at the time of the amnesty
2. Tax rulings[62] – it is a feature of the Apple (and other) decisions that the taxpayers had all entered into a tax ruling. A tax ruling which allows a treatment which is not in accordance with the normal tax rules of the country is likely to be a selective advantage
3. Tax settlements[63] – where the conclusion of a tax dispute results in the reduction of the amount of tax sought from a taxpayer this may indicate that State aid has been granted

#### 3.2.4.6 CONCLUSION

In conclusion, the EU has increasingly tried to tackle the problem of unfair tax competition by using the State aid rules set out in art. 107(1) TFEU. Of the four tests which this legislation contains, 3 are not usually difficult to prove in the case of a tax measure. A reduction in the amount of tax payable will constitute a use of State resources because it will reduce the charge which a business will normally expect to incur. The two other tests of distorting inter-community trade are also usually covered. The ECJ will usually take the view that State aid will distort trade unless there are special circumstances which suggest otherwise. The decisive test for whether unlawful State aid has been granted will therefore be the selectivity test. An advantage is selective if only certain undertakings benefit from it. The essence of the selectivity test is to identify whether other undertakings in a comparable legal and factual position can also obtain it. If they cannot, then the advantage is likely to be a selective one. If the measure is part of the general tax code of the State, then it will not be a selective advantage, and will not constitute State aid. Selectivity can arise in many different ways. A measure will be selective if it applies to certain types of business, certain sectors, or even certain regions. It will be an issue if domestic and overseas companies are treated differently.

[61] Supra note 12, section 5.4.3
[62] Ibid. section 5.4.4.1
[63] Ibid. section 5.4.4.2

In this section, I have set out the approach taken by the ECJ in developing the selectivity test. There have been several high-profile State aid decisions by the Commission in the last two years in the area of TP. In the rest of this work, I will go on to outline some important TP concepts, because the cases all involve TP issues. I will outline the key points of the decisions in three of the cases, and in the final section, I will look at how the Commission has applied the selectivity test developed by the ECJ.

# 4 TAX RULINGS AND TRANSFER PRICING

## 4.1 INTRODUCTION

There are two common factors in all of the EU State aid cases – firstly, that in all cases the tax authority in the Member State had granted a tax ruling to the taxpayer stating xxx, and secondly that the tax issues at stake involved TP. I will outline in this Chapter what a tax ruling is, and then go on to discuss how TP operates within multinational enterprises.

## 4.2 TAX RULINGS

Waerzeggers[64] states that a tax ruling is a method by which both taxpayers and tax authorities can promote clarity and consistency in the application of the tax law. He distinguishes between public tax rulings and private rulings. Generally, public rulings are used by tax authorities to give clarification to all taxpayers on how local tax laws will be applied in particular situations. Private rulings are rulings given to individual taxpayers to confirm how the tax authority will apply the law to the facts and circumstances which apply to that taxpayer. The rulings are usually binding. They are also usually confidential to prevent the disclosure of commercially sensitive information about the taxpayer's business. It is the confidential nature of these private rulings which gives rise to some of the issues which are relevant to the State aid cases. The Commission Notice recognizes that tax rulings per say do not constitute State aid, but they must respect and be in accordance with the State aid rules[65].

In the context of TP and this thesis, we will refer to tax rulings in the form of Advance Pricing Agreements (APAs). The OECD Guidelines[66] defines an APA as "an arrangement that determines, in advance of the controlled transactions, an appropriate set of criteria for the determination of the TP for those transactions, over a fixed period of time". It is

[64] C. Waerzeggers and C. Hillier, "Introducing an advance tax ruling (ATR) regime—Design considerations for achieving certainty and transparency", Tax Law IMF Technical Note Volume 1, IMF Legal Department 2016
[65] Supra note 12, section 5.4.4.1
[66] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, (2017 edition, OECD Publishing, 2017), p. 214

therefore a type of tax ruling which will allow a taxpayer to agree with the tax authority how the TP provisions will apply to the transactions which it includes in the request for the APA. I will consider in detail later in this section how the TP rules set out in the OECD Guidelines operate

A research document produced by DLA Piper[67] states that in 2017, 39 different countries operated an APA programme.

There are three different types of APA available[68], which are as follows:

- Unilateral – an APA between the taxpayer and the tax authority in the jurisdiction where it is resident
- Bilateral – a single agreement between the competent authorities of two tax administrations
- Multilateral – a series of bilateral agreements between the taxpayer and more than one tax authority

A bilateral or multilateral APA will involve a negotiation between the two tax authorities and takes place within the scope of the Mutual Agreement Procedure (MAP) of art. 25 of the OECD Model Tax Convention on Income and On Capital[69]. This provides a mechanism for tax authorities to resolve instances of double taxation. The discussions and correspondences take place between authorized government representatives known as Competent Authorities (CA). Art. 26 of the Model Treaty[70] which authorizes the exchange of information is also relevant in this context. Although double taxation has not yet occurred, the APA is intended to prevent it arising in the event of a TP dispute, and so is treated as a part of the MAP programme. A bilateral APA can therefore only be agreed by two countries which have entered into a valid tax treaty which contains a MAP clause.

[67] DLAPiper, APA and MAP Country Guide 2017, Managing Uncertainty in the New Tax Environment https://www.dlapiper.com/en/uk/insights/publications/2017/05/apa-map-country-guide-2017/ accessed 21 April 2018

[68] M.T. Leão, "Advance Pricing Agreements and the Principles of Legality and Equality: The Problems Surrounding Contracts in Tax Law", International Transfer Pricing Journal, 2014 (Volume 21), No. 4, IBFD database

[69] OECD, Model Tax Convention on Income and on Capital: Condensed Version 2017 (2017 edition, OECD Publishing, 2017)

[70] Ibid. Article 26

The opportunity to enter into the APA programme offers both advantages and disadvantages to taxpayers and tax authorities. The most obvious advantage is the removal of uncertainty in predicting future tax liabilities[71]. From a tax policy point of view, governments will wish to offer this level of certainty to taxpayers to encourage a positive investment environment[72]. Another advantage for both parties is that an APA allows complex TP issues to be explored in a collaborative environment rather than a confrontational tax audit situation. Both parties are approaching the APA open to the idea of a settlement. Although the process will be resource intensive on both sides, the APA process allows it to be managed in a predictable manner[73], furthermore since discussions are taking place in advance of the transactions, they will not be clouded by the issue of hindsight. The final advantage applies only in the case of bilateral APAs. As both authorities party to the transaction have signed up to the APA, then it will remove the risk of double taxation[74].

The APA process is not, though, without some disadvantages. Taxpayers have to be prepared to provide a lot of information about their operations, tax affairs and TP policy, and not all companies will be comfortable to do this. It is also the case that the APA process is costly and time-consuming, and not all taxpayers will be willing to commit this level of resource[75]. Smaller tax authorities may not have sufficient staff with the level of TP experience to be able to work the number of APA applications they have[76].

Having set out the background to the APA process, I will now look at a number of specific issues which are relevant to the State aid cases. A study produced for the EU ECOM Policy Department in 2015[77] (ECON 2015) places the APAs within a three-tier system of law and policy: At the top level is international policy and law (1), which includes the

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[71] S. Wrappe, "Are You Considering an APA, Tax Executive, 2016 http://taxexecutive.org/are-you-considering-an-advance-pricing-agreement accessed 4 May 2018

[72] J. Becker, R.B. Davies and G. Jakobs, "The Economics of Advance Pricing Agreements", Oxford University Centre for Business Taxation Working Paper 14/26, 2014 https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Working_Papers/series-14/WP1426.pdf accessed 4 May 2018

[73] W. Abdallah, "Critical Concerns in Transfer Pricing Principles and Practice", Greenwood Publishing Group, 2004, p. 200

[74] Supra note 71

[75] Robert Feinschreiber, "Advance Pricing Agreements: Advantageous or Not?", The CPA Journal Online http://archives.cpajournal.com/old/12650269.htm accessed 4 May 2018

[76] United Nations, "Practical Manual on Transfer Pricing for Developing Countries" (United Nations 2017), C.4.2.1

[77] European Parliament (2015) Tax Rulings in the EU Member States, EU Directorate General for Internal Policies, Policy Dept A

OECD Guidelines and Model Convention which I have already mentioned. It is clear that if two tax authorities are discussing the TP policy of a multinational, it is expected that they would both refer to the OECD Guidelines. The next level is EU law and policy (2). There are obvious TP related policy documents such as those produced by the EU Joint Transfer Pricing Forum (JTPF) but any APA must be compliant with all aspects of EU law. This is where the concept of Fiscal State aid enters the broader discussion on whether the APA is compliant with EU law. The third and final level is national law and policy (3). All taxpayers have an expectation that any tax ruling should be compliant with national tax laws.

The overall conclusion is drawn, that any APA must be in accordance with all applicable law and policy at these three different levels is also highlighted by the OECD Report[78] into Harmful Tax Competition. This specifically states that tax authorities should not offer to enter into agreements with taxpayers which either negate or nullify local laws, or which do not apply the relevant law correctly. The Harmful Tax Competition Report also introduces another area of concern related to tax rulings – namely the lack of transparency which is required to allow arrangements to be made which involve an approach which is not in line with international or local law. In the context of an APA programme, a bilateral APA would expose any proposed solution which deviated from local or international legal practice to scrutiny by the other tax authority. Any such agreement would not be accepted by the other party. This makes unilateral APAs the preferred options for taxpayers and tax authorities seeking to enter into an agreement which would offer a potentially unfair tax treatment to certain taxpayers or groups of taxpayers.

Willems[79] states that Belgium has a long history of setting up “safe harbor” tax regimes to attract international business to establish there. These offer specific tax benefits to the companies who are targeted. A unilateral APA programme operated in order to give comfort to companies that they would be able to qualify for the safe harbor regime, and to determine the level of taxes payable. Regarding “safe harbor” tax regimes, the JTPF produces statistics[80] on the number of APAs granted by the EU member states. I have

[78] OECD, Harmful Tax Competition. An emerging global issue (OECD Publishing 1998) 82
79 R. Willems, “Guide to Tax Rulings in Belgium”, IBFD, 2012, p. 63
[80] European Commission (2018) EU Joint Transfer Pricing Forum: Statistics on APAs in the EU at the end of 2016, Document JTPF/015/2016

presented some selected statistics here to show the number of APAs in force at the end of 2016:

| Country | Total APAs in Force | No Unilateral APAs in Force | % Unilateral APAs |
|---|---|---|---|
| Belgium | 1095 | 1071 | 98% |
| Luxembourg | 539 | 539 | 100% |
| Rep of Ireland | 5 | 0 | 0% |
| France | 51 | 15 | 29% |
| Germany | 45 | 0 | 0% |

It is striking to note both the high numbers of APAs in force in Belgium and Luxembourg, and the high proportion of the APAs which are unilateral. This contrasts with countries such as France and Germany. Germany will offer unilateral APAs only in exceptional circumstances, such as where Germany does not have a tax treaty with the other country[81]. Ireland did not introduce a formal APA programme until 1 July 2016. Before this date, the tax authority was willing to issue tax rulings to individual taxpayers such as Apple. These were not classed as unilateral APAs, and so are not included in the JTPF statistics.

Whilst the JTPF recognizes that there is a place for unilateral APAs, they advise that "Care must be taken that unilateral APAs are consistent with the arm's length principle in the same way as bilateral or multilateral APAs". This serves both as a useful concluding remark on the subject of tax rulings, and also on a useful link into the subject of TP and the ALP.

## 4.3 TRANSFER PRICING

Rene Willems succinctly states that "related undertakings fundamentally have to stick to the ALP for intra-group dealings"[82], in other words, deal as unrelated undertakings would on the market. TP assumes significance within the field of international taxation because

[81] E. Sporken & M. Stuyt, "Do Advance Pricing Agreements Still Provide Certainty in the Netherlands", BNA Bloomberg Transfer Pricing Report, 2017, https://www.bna.com/advance-pricing-agreements-n73014451303/ accessed 21 April 2018

[82] Supra note 79, p. 64

the prices which international businesses set will determine the level of profit which each part of the business generates, and hence the amount of tax which each company within the MNE will pay. TP is used by some, but not all, MNEs as a way of manipulating the level of profit which is allocated to individual companies in order to gain a tax advantage. In an effort to protect the tax base against attempts by MNEs to divert profits into low tax jurisdictions, most countries have introduced TP legislation which requires the entities trading within their jurisdiction to support the reasonableness of the TP policy employed. Ernst & Young[83] have counted that there are 118 countries or territories which now have TP legislation.

There will be a clear potential for double taxation to arise if different tax authorities operate different TP standards, and so the OCED began an international discussion process on TP in 1979, with the publication of a report *Transfer Pricing and Multinational Enterprises*. Subsequently, the first version of the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Authorities* was published in 1995. The Guidelines have been updated and expanded, with the 2017 version updated to include the changes recommended in the 2015 BEPS Final Reports. During this period, the OECD Guidelines have become established as the international TP standard[84]. I will now go on to look at some of the key concepts which the OECD Guidelines include.

The OECD Guidelines[85] state that the ALP is the international transfer pricing standard which MNEs and tax authorities have agreed to use for tax purposes. The ALP itself is derived from art. 9 of the OECD Model Treaty (the Associated Enterprises Article). Although art. 9 does not use the term ALP, it means the same thing what I interpreted from Willems quotation above; It sets out that transactions between associated parties must be treated for tax purposes as if they had been undertaken between independent parties, entering into the transaction on the same terms. The OECD Guidelines effectively set out to assist MNEs to understand how to apply the ALP to a given transaction.

[83] Ernst & Young, 2016-17 Transfer Pricing Reference Guide http://www.ey.com/gl/en/services/tax/international-tax/transfer-pricing-and-tax-effective-supply-chain-management/worldwide-transfer-pricing-reference-guide---country-list accessed 3/5/18
[84] R. Feinschreiber and M. Kent, Transfer Pricing Handbook Guidance for the OECD Regulations, Wiley, 2012, Chapter 1 Summary
[85] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, p. 26

If the ALP is founded on the basis that transactions between associated parties must take place on the same terms as those between independent parties, then it follows that there must be a form of comparability analysis which identifies the terms of the transaction under review (the tested transaction) and compares this with the way in which unrelated parties would be expected to behave. This is referred to as the Comparability Analysis in the OECD Guidelines. The UN TP Manual[86] summarises the main stages of the Comparability Analysis as follows:

- Determine the economically significant characteristics of the tested transaction
- Identify the roles of the parties to the tested transaction
- Compare the conditions applied to the tested transaction with comparable transactions between independent parties

A detailed comparability analysis produced to support an APA application will be a substantial document, running to several hundred pages[87]. Another important part of the comparability analysis is the functional analysis which determines the functions undertaken, assets employed by, and risks assumed by the tested parties[88]. This functional analysis is generally the most important section of a comparability analysis because it identifies which areas of the business contribute to the value it generates, and sets out the roles of the tested parties in contributing to them. The general principle is that parties taking on more significant business risks, developing valuable assets, and performing more important functions should receive higher levels of reward than relatively routine operations.

Once the comparability analysis has been completed, the TP process can move onto selecting an appropriate TP methodology which can be used to test whether the price for the tested transaction is at arm's length. The OECD Guidelines set out information about five different methodologies, and I will consider each of these briefly as follows:

- Comparable Uncontrolled Price Method (CUP) This method compares the price at which goods or services are transferred between connected parties with the price applied by unconnected parties transacting incomparable goods or services.

[86] United Nations, Practical Manual on Transfer Pricing for Developing Countries (United Nations 2013), section 5.1.1
[87] Tax Justice Network, 'Transfer Pricing for Developing Countries, section 7.2.2 https://www.taxjustice.net/wp-content/uploads/2013/04/TP_in_developing_countries.pdf accessed 4 May 2018
[88]R. Robillard, "The functionality analysis in transfer pricing", RBRT Tax, 2014, http://rbrt.ca/en/the-functional-analysis-in-transfer-pricing/ accessed 4 May 2018

The OECD Guidelines[89] state that this method is most reliable where an independent enterprise sells the same goods or services as are transferred between connected parties. It also recognizes, however, that there are difficulties in obtaining reliable data on transactions between independent parties.

- Resale Price Method (RPM) – RPM starts with the price at which a product purchased from a connected party is sold to a third party. The reseller retains an amount of gross margin to allow it to cover its selling costs and to earn an arm's length return. The difference between the resale price to the third party and the gross margin retained by the reseller is the arm's length price paid for the goods. The OECD Guidelines[90] state that RPM is particularly appropriate where goods are resold by a reseller who does not add significant value to the goods. The disadvantages of RPM again relate to the difficulty of obtaining reliable data. In practice, comparable resellers are identified from databases, and their gross margins established from published financial data. Differences in the way in which companies prepare their accounts can cause variations in the gross margin.
- Cost Plus Method – This method sets an arm's length price by taking the costs of producing goods or services and adding to that cost a profit margin which allows the entity to earn an appropriate margin in light of the functions it performs and the risks it assumes. The OECD Guidelines[91] indicate that Cost Plus is most useful in transactions involving the supply of services, or for contract manufacturers.
- Transactional Net Margin Method (TNMM) – TNMM compares the net margin earned by the tested party with the net margin earned by independent parties in comparable transactions. It is often impractical to look at the margin on individual products, and the exercise usually looks at the entire profits of a particular entity. Hughes and Nicholls[92] state that TNMM has become the "default" TP method because it is usually possible to find data on the profit margins earned by third parties from databases. They caution that there are limitations on the amount of information available on the comparable companies identified by the database. As we cannot undertake a functional analysis for each of these potential comparables, we will not be able to conclude that they are reliably comparable.

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[89] Supra note 86, OECD, p. 101-104
[90] Ibid. p. 105-110
[91] Ibid. p. 111-116
[92] E. Hughes & W. Nicholls, "The Different Methods of TP:Pros and Cons", Tax Journal, 28 September 2010, https://www.taxjournal.com/articles/different-methods-tp-pros-and-cons accessed 21 April 2018

- Profit Split Method (PSM) – The final method takes the profit generated in a particular transaction, and looks to allocate it between the connected parties again based on the functions they undertake, the assets they own, and the risks they assume. The OECD Guidelines[93] suggest that this approach is most useful where more than one of the parties owns valuable intangibles or assumes significant risks.

The final step in the process compares the price or level of profit for the tested transaction with the price or level of profit generated by unconnected parties. If the prices are the same, then the taxpayer can justifiably claim that it transfers prices conform to the ALP. If they are different, then adjustments will need to be made. In the present State aid investigations relating to TP, the level of profit determined by the MNEs was artificially lowered by wrong use of the TP methods. I will present this in the next Chapter.

The expanded 2017 version of the OECD Guidelines runs to over 600 pages of guidance on how taxpayers and tax authorities can apply the ALP. Although the theory of establishing how independent parties would behave and applying these terms to transactions between connected parties is a simple one, the realities of determining how third parties would behave, and identifying comparable data can be very difficult. Applying the ALP to a given transaction can raise significant practical difficulties, and it must be recognised that the practice of testing whether a transaction conforms with the ALP can be a complex one. I will now go on to look at how these complex TP issues contributed to the tax advantages raised in the State aid cases.

[93] Supra note 86, OECD, p. 133-135

# 5 SOME COMMON POINTS RAISED FROM THE RECENT STATE AID CASES

## 5.1 INTRODUCTION

In the previous section, I set out how tax rulings operate, and the OECD approach to TP with the application of the ALP. These two issues were significant in a number of State aid cases, initiated by the European Commission, therefore I will build on the theory of the previous section regarding tax rulings and TP by looking at the areas which the Commission decisions focus. I will also try to see how the State aid regime and the rules therein has been applied by the Commission in a more general way.

The DG Competition Working Paper[94] provides some useful background information into how the various State aid cases came to be taken up. The current cases have arisen from an inquiry initiated in 2014 by the Directorate General, Competition. Prompted by concerns raised by a number of countries, all EU Member States were asked to provide details of all tax rulings they had granted during the years 2010 to 2013. It focussed particularly on tax rulings which related to TP arrangements. The focus of the inquiries was specifically stated to be:

1. That some Member States were entering into very large numbers of tax rulings[95]. The data I have included in the previous section illustrates how Belgium and Luxemburg issue 10 times as more APAs than other, larger countries such as France and Germany.
2. That a significant number of agreements relating to TP arrangements appear to be concluded on a nonarm's length basis[96].

[94] European Commission (2016), DG Competition Internal Working Paper On State Aid and Tax Rulings of 3 June 2016, http://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf accessed 21 April 2018
[95] Ibid. para. 11
[96] Ibid. para. 14

In June 2014, the Commission opened formal State aid inquiries into tax rulings entered into by Ireland[97] (Apple), Luxemburg[98] (Fiat) and the Netherlands[99] (Starbucks). Further investigations were opened into rulings granted by Luxemburg[100] and Belgium[101] in 2015 and from there the amount of investigations has continued to rise. It is important to understand that the hearings which have taken place are investigations by the DG Competition to determine whether State aid has been granted to the company which has received the tax ruling. They are not court cases where the ECJ determines whether or not a particular issue is in accordance with EU Law. The outcomes of the investigations have been released in a series of decisions released after the conclusion of the investigation.

The format of these decisions includes an analysis of the nature of the business operations within the country, the nature of the tax ruling, and detail about the TP arrangements implemented. Both the taxpayer, the country, and third parties may make representation to the investigation, and the final section sets out the Commission's decision – that State aid had been provided in all cases.

In the rest of this section, I will use Apple case as my anchor when considering the main arguments of the Commission, but I will also bring out examples from the Fiat and Starbucks cases. The focus will be on the implications of the tax ruling system operated by the Member State, and of the TP arrangements which it covered. The detail discussion regarding Commission's novel approach in satisfying conditions laid in art. 107(1) TFEU will be covered in the next Chapter.

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[97] EU, Letter to the Member State (Decision to instigate the formal investigation procedure) 2014 JOCE C/369/2014

[98] Ibid, the Apple and Fiat cases were covered in the same letter, which was addresses to Ireland and Luxembourg

[99] EU, Letter to the Member State (Decision to instigate the formal investigation procedure) 2014 JOCE C/460/2014

[100] EU, Letter to the Member State (Decision to instigate the formal investigation procedure) 2015 JOCE C/44/2015, covering Aid to Amazon

[101] EU, Letter to the Member State (Decision to instigate the formal investigation procedure) 2015 JOCE C/188/2015, covering the Belgian Excess Profits cases

## 5.2 FACTS OF THE APPLE CASE

I find it necessary to outline the basic facts of the Apple case[102]. This will help the reader understand the very complex situation and the issues that arise from such complexity.

Apple Inc[103] is a US-headquartered multinational, and the case concerned two Irish group members. Both companies were incorporated in Ireland, but not tax resident. They each had an Irish Branch.

The first company, Apple Sales International (ASI) was responsible for purchasing a finished product from internal manufacturers. It then sold these products on to customers not just in Ireland, but across many non-US countries. ASI first obtained a tax ruling in Ireland in 1991, and this was replaced by a second ruling in 2007. The ruling covered the allocation of profits between the "head office" activities of ASI, and its Irish Branch. In 2011, ASI generated profits on its sales of €16 billion, but only €50 million of this was attributed to the Irish Branches, with the rest going to the head office functions.

The 1991 ruling set the Irish Branch profits at 12.5% of all of the operating costs allocated to the Branch. This did not include the cost of materials. The 2007 ruling took a similar approach, setting the profit margin at between 10% to 15% of the operating costs, not including payments made to other Apple companies, or costs of materials.

The second Apple company operating in Ireland was Apple Operations Europe (AOE). AOE's main activity was the manufacture of a range of Apple's computing products. These were sold onto other Apple companies (including ASI) for sale to third-party customers. AOE was also party to the two tax rulings. The 1991 agreement determined its taxable income as a percentage of operating costs. The 2007 agreement added a return on the intangible property which AOE had developed as part of its manufacturing processes.

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[102] Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple (notified under document C(2017) 5605), Hereinafter referred to as Apple case or Apple decision
[103] Ibid. The summary of the main facts relevant to the Apple case is taken from Section 2 (Factual and Legal Background) of the Commission Decision

ASI and AOE entered into a Cost Sharing Agreement (CSA) with Apple Inc. AOE received the rights to Apple's name and trademarks for use in Europe and other territories, Going forward, the three companies also agreed to pool their R&D efforts. 45% of the costs of the R&D activity were allocated to Apple Inc, with the remaining 55% allocated to ASI and AOE.

It is a differentiating feature of the Apple case that in addition to considering TP issues, there was also a question of how to attribute profit between the Head Office and Branches of the two companies. Ireland will be entitled to tax the profits earned by the two Irish Branches, but the amount of profit earned by the Branch will first have to be determined. The starting point is art. 7 of the OECD Model Treaty which states that the profits should be calculated as if it was a "distinct and separate enterprise". In practice, TP principles are used to determine the profits attributed to it.

## 5.3 POINTS RAISED FROM THE COMMISSION'S INVESTIGATIONS IN THE CASES

As stated above, I think that it is useful to consider the final decisions of the 3 separate EU Commission investigations/decisions together in order to focus on the similarities and differences between them. I have chosen to use Apple, Starbucks[104] and Fiat[105] cases. In each case, the focus of the investigation was on the four separate tests (or prongs) of art. 107(1) TFEU. A measure will constitute State aid if all four of the conditions are met[106]:

1. There is an intervention of the State or a use of State resources
2. The intervention affects trade between the Member States
3. It confers a selective advantage
4. It distorts competition

Where the measure concerns special taxation treatment, it is not difficult to establish that the first, second and fourth tests are satisfied. The following excerpts from the Starbucks decision illustrate the position:

[104] COMMISSION DECISION of 21.10.2015 ON STATE AID SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks, hereinafter referred to as Starbucks decision or Starbucks case

[105] COMMISSION DECISION of 21.10.2015 ON STATE AID SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat, hereinafter referred to as Fiat decision or Fiat case

[106] Supra note 105, Starbucks decision, para. 224

Test 1[107] – Where a measure is the grant of a tax exemption by the public authorities of a MS, this constitutes a financial advantage coming out of state resources.
Tests 2 and 4[108] were then considered together. Where a global company receives a benefit from one MS, this will impact other MS negatively. A taxpayer offered favorable tax treatment will be at a competitive advantage, and so there will also be a distortion of competition.

The rest of the decision then focusses on whether the terms of the tax rulings entered into by the three different tax authorities in Ireland, Luxembourg and the Netherlands constituted a selective advantage to the taxpayers. I will cover in detail in the next Chapter how the Commission approached the question of a selective advantage. This section will therefore build on the theory in the previous section on tax rulings and TP by looking at the areas which the Commission decisions focus on.

The approach taken by the Commission in considering the selective advantage question as a single issue has met with significant criticism. The viewpoint which has received the greatest level of publicity in this area was expressed in a US Treasury Dept White Paper[109], which was issued in response to the State aid decisions. It is notable that the majority of the taxpayers involved are part of multinational groups with headquarters in the USA. Bobby[110] points out that "advantage" and "selectivity" are separate concepts in EU law, and states that the Commission has "hopelessly conflated them." This article focuses only on the Apple decision, and he describes the Commission's approach as being focussed on the advantage test and assuming that a prima facie case for selectivity existed once the advantage had been established. He suggests that this is because the cases involve taxpayers who had been given a tax ruling, and that this in itself is taken to demonstrate selectivity by the Commission. I will consider in the next Chapter how the concepts of advantage and selectivity have developed in the courts, and how the Commission applied the selective advantage test in its State aid investigations relating to APAs, including the cases discussed in this Chapter.

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[107] Ibid. para. 226
[108] Ibid. para. 227
[109] U.S. Department of the Treasury, "The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings", White Paper, 2016
[110] C. Bobby "A Method Inside the Madness: Understanding the EU State Aid and Taxation Rulings" Chicago Journal of International Law Vol 18 No 1, 2017, p. 185

In outline, when applying the selective advantage test, the Commission first looked at a number of aspects of the tax ruling systems in each of the three Member States. A significant difference between the Apple decisions on the one hand, and the Fiat[111] and Starbucks[112] decisions on the other, is that the Apple tax ruling was not based on discussions around a TP report, even though it focussed on the allocation of profits to different legal entities within the same multinational group. The Commission is critical to Ireland's approach to agreeing on the ruling, stating[113] that it "appeared to be negotiated rather than substantiated" and that "Irish Revenue did not seem to have had the intention of establishing a profit allocation based on TP." In contrast, both Fiat and Starbucks had prepared TP reports to support their APA negotiations with the relevant tax authority. As referenced above, Ireland did not have an APA programme until 2016, so the tax rulings granted to Apple were not APAs per say.

In the Fiat case, the Commission criticised Luxembourg's entire tax ruling practice as being inconsistent[114]. The State aid investigation had examined a number of APAs involving other finance companies, and noted a number of concerns. There was no consistency of treatment between finance companies applying for an APA. Some were not required to submit TP reports although that was a stated requirement of the APA process. In other cases, different TP approaches were applied to broadly similar transactions, with different results.

Having commented on the tax ruling systems, the Commission then goes on to establish an appropriate tax reference system, and to determine whether or not the ruling allowed the taxpayer an advantage due to a derogation from that reference system. This was determined to be the "ordinary rules of corporate taxation" in Ireland[115], Luxembourg and the Netherlands.

A feature which was present in the Apple decision, but not in the others arose from the nature of the Irish Corporate tax system. Ireland did not implement TP legislation until

[111] See supra note 106, Fiat decision, section 2.2.2
[112] See supra note 105, Starbucks decision, section 2.2.2
[113] Supra note 103, Apple decision, para. 147
[114] Supra note 106, Fiat decision paras. 326-336
[115] Supra note 103, Apple decision, para. 242

2010[116], and earlier versions of the law made no reference to the arm's length standard. Ireland therefore argued[117] that there was no requirement for profits of an Irish resident taxpayer to be computed with reference to the OECD TP Guidelines. Ireland also argued that the OECD rules on attributing profits to a branch (which were relevant to both ASI and AOE) were not formulated until 2010, which was after the rulings were made.

The Apple decision[118], also finds that an advantage would occur to a taxpayer if it was allowed to reduce its profits when compared with "independent undertakings whose taxable profits reflect prices determined on the market negotiated at arm's length." This comment makes clear that a consideration of whether or not State aid has been granted to a taxpayer will require an assessment of whether the profits allocated to that taxpayer are at arm's length. It is important to note, however, that the decision[119] goes on to restate the Commission's position that the OECD Guidelines are non-binding. Whilst they are a useful aid in determining whether or not the ALP has been applied, the test for whether there has been an advantage under art. 107(1) TFEU is a different one. This raises the question of whether or not the approach adopted by the Commission in testing the arm's length nature of connected party transactions in State aid cases is different to the ALP contained in the OECD Guidelines. I will consider this in detail in the next section.

The bulk of the evidence presented and discussed in each of the three State aid cases relates to the question of whether or not the TP policies operated by each of the three taxpayers could be considered to be at arm's length. In the DG Competition Working Paper, concern is raised about cases where a ruling agrees to arrangements which "manifestly deviates from a reliable approximation of a market-based outcome."[120]The decisions show that in each case, the Commission is effectively trying to demonstrate that the TP approach taken does deviate from the ALP to such an extent that it amounts to State aid. The Taxpayers and Member States are united in pointing out that "TP is not an exact science, and there is therefore a range of figures within which the TP can lie"[121] and

[116] PWC, "International Guide to Transfer Pricing", Chapter 40 Ireland https://www.pwc.com/gx/en/international-transfer-pricing/assets/ireland.pdf accessed 5 May 2018
[117] Supra note 103, Apple decision, para. 242
[118] Ibid. para. 249
[119] Ibid. para. 255
[120] Supra note 95. DG Competition, para.14
[121] Supra note 105, Starbucks decision, para. 162

"in TP the exact arm's length price cannot or does not need to be determined under OECD rules"[122]

## 5.4 CONCLUSION

I have drawn a number of key themes from the way in which the taxpayers presented their TP reports, and the way in which the Commission challenged these positions. I have briefly summarised these main themes in this section, and will then go on to analyze their significance in the next Chapter. All of these themes are familiar issues within TP.

The first key issue is that any allocation of profit within a MNE (whether between companies or a branch and its head office) must involve allocating assets, functions and risks between the various parts of that MNE. This was the key issue in determining what the Irish Branch profits should be in Apple, and it was also important in both of the Starbucks and Fiat cases. There was no controversy about whether a functional analysis is necessary. The point under discussion comes from the comment in the TP section above that the level of functions undertaken, assets contributed and risks assumed will determine the profit level. The Commission made challenges particularly in the Apple and Starbucks cases to the way in which the functional analysis had allocated functions, assets and risks to the parties.

The second TP issue which is relevant is the selection of the TP methodology to be applied. For example, in the Fiat decision , the Commission states that the CUP method is usually a more direct method of setting prices. It notes that other group companies were funded not by loans from FFT, but by capital market funding, and that some of these transactions appeared to be comparable with loans which FFT made.[123]

The third key issue concerns the application of the TNMM, which featured in all three of the cases. Common themes include:

1. The tested party should be the one with the less complex parties. Depending on the outcome of the functional analysis, it is essential to ensure that it is always the least complex party which is tested. This point is made by Hughes and Nicholls[124].

[122] Supra note 106, Fiat decision, para. 128
[123] Supra note 106, Fiat decision para. 132
[124] See supra note 93 and the link therein.

2. Where the method applies a mark up to costs, what should the cost base be? Both Apple and Starbucks excluded significant costs from the profit calculation.
3. The application of the TNMM compares the net profit of the tested party with the net profit earned by comparable companies. The net profit measure can be calculated in a number of different ways, and in the context of applying TNMM, they are known as Profit Level Indicators (PLI). Two of the most commonly applied are Operating Margin[125] and Return on Total Costs[126]. King[127] notes that "Different PLIs … can produce markedly different allocations of income across countries." It is therefore essential to be able to justify the selection of the PLI.
4. In the Fiat case, The Commission[128] also queried whether many of the companies selected were really comparable with FTT's activity as they contained companies which did not undertake the comparable activity. They highlight that the data set contained two central banks, stock exchanges, and companies involved in leasing. This highlights a key difficulty in applying the TNMM – that there can often be difficulties in determining exactly what functions comparable companies undertake, and in identifying a sufficient number of companies which are sufficiently comparable to the tested party.
5. The final point to consider is how to approach data which produces a range of possible values, and how to set an appropriate TP where data suggests that there is a wide range of possible prices. An example of this is covered in the Fiat[129] decision.

I have given a general approach and arguments from Commission and the interested parties alike in these recent State aid investigations relating to tax rulings and TP. In the last Chapter of my thesis, I will now assess the Apple decision in a more thorough manner and see whether Commission has actually erred in finding illegal State aid, the issues connected to that finding.

[125] Operating profit divided by sales
[126] Operating profit divided by total costs
[127] E. King, "Transfer Pricing and Corporate Taxation: Problems, Practical Implications and Proposed Solutions", Springer, 2009, section 3.1.5, p. 17
[128] Supra note 106, Fiat decision, para. 293 [293]
[129] Ibid. section 7.2.2.9

# 6 ASSESSING COMMISSION'S NOVEL APPROACH AND THE ASSOCIATED ISSUES

## 6.1 INTRODUCTION

In previous sections of this thesis, I have set out to define what illegal State aid is, how the ECJ has established which tax measures constitute illegal State aid, and covered the basic principles of TP and APAs. I have also looked at the Commission Decisions in three cases where TP agreements reached by three different MS with multinational taxpayers have been determined to be illegal State aid. In this final Chapter, I will draw all of these points together to focus on two main aspects of the Commission's final decision on Apple:

1. How does the Commission's decision accord with the legal principles established by the ECJ case law in previous cases, in other words, are Commission's findings wrong? Other dimensions will be to see what approach is the Court likely to take when the appeal[130][131] against the Commission's decision in Apple is heard?
2. How does the Commission's approach to applying its own arm's length test in the State aid cases impact taxpayers' rights within?

I will divide this Chapter into three separate discussions; First I will assess the Commission's critiqued approach in satisfying the conditions laid down in art. 107(1) TFEU by using the Apple case as an example. I will then present a possible scenario how the EU Courts might view the case. Last part will focus on the ALP from the point of view of taxpayers' rights, focusing on the legal certainty and legitimate expectations.

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[130] Action brought on 9 November 2016 – Ireland v Commission (Case T-778/16), Apple case
[131] Communication from the Commission -  Action brought on 19 December 2016 — Apple Sales International and Apple Operations Europe v Commission (Case T-892/16) (OJ C 53/37, 20.02,2017)

## 6.2 SATISFYING THE CONDITIONS OF ARTICLE 107(1)

As I set out in Chapter 2, there are four separate tests or prongs to art. 107(1) TFEU which must all be satisfied in order for State aid to be ruled incompatible or illegal. The four tests themselves seem to be clearly laid out, but it is notable that both the Commission, and many authors refer to the tests in different ways, and it is useful to look at how the Commission approaches the different tests. In the Apple decision[132], the Commission lists the four conditions to be assessed as follows:

1. An intervention by the State or by State resources
2. Liable to affect trade between the Member States
3. Confers a selective advantage on an undertaking
4. Distorts or threatens to distort competition

As I have stated earlier, in practice tests 2 and 4 are considered together by the Commission, so there are only three separate tests applied in the Apple Decision. This approach comes from the Commission Notice on State aid, which has chapters titled "State Origins[133]", "Advantage[134]", "Selectivity[135]" and "Effect on Trade and Competition[136]". Other writers take a different approach again. Mason[137] identifies five elements to an illegal state aid. There must be:

1. an advantage
2. granted by a member state
3. to an undertaking. The advantage must be granted
4. selectively, and it must
5. distort trade or competition in the internal market

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[132] Supra note, Apple decision, para. 220
[133] Supra note, 2016 Notice, p. 9
[134] Ibid. p. 15
[135] Ibid. p. 27
[136] Ibid. p. 40
[137] R. Mason, "Tax Rulings as State Aid FAQ", University of Virginia School of Law, Law and Economics Research Paper Series, 2017, p. 452 available at https://ssrn.com/abstract=2922069

Of these four or five separate tests, it is usually the case that only the questions of advantage and selectivity require detailed discussion by the ECJ. Gormsen[138] goes further, and states that selectivity is the key test – "In matters of tax law in particular, the decisive criterion is whether a provision is selective because the other conditions laid down in art. 107(1) TFEU are almost always satisfied."

# 6.3 CLOSER LOOK AND ASSESSMENT OF COMMISSION'S APPLE DECISION

I will now look at the Commission's approach to applying these four tests in the Apple Decision. As I have previously noted throughout this thesis, the Commission applied a single "selective advantage" test, and I will look separately at whether this is appropriate, or whether these two tests should be applied separately. The selectivity test is the most significant of the four tests, but I will also look briefly at the other aspects of State aid.

## 6.3.1 INTERVENTION OF THE STATE OR USE OF STATE RESOURCES

The first prong of art. 107 TFEU requires that there has been State intervention. The Commission sets out[139] that the measures under review were agreed by Irish Revenue, which is the tax administration of the Irish State. It also references the agreed principles that I covered in Chapter 2 – that there does not need to be a positive transfer of resources to Apple for the State intervention test to be met. If Apple is better off as a result of the tax agreement than it would have been without it, then it is in a favorable position, and will have received State aid. The conclusion is that if Irish Revenue has collected less tax from Apple that should properly have been paid, then this will amount to a use of State resources. This conclusion is in line with previously decided ECJ case law (such as Adria-Wien[140]) and so I do not consider that it could be challenged on appeal.

[138] L. L. Gormsen, "Has the Commission Taken Too Big a Bite of the Apple?" European Papers Vol I No 3, 2016, p. 1139
[139] Supra note, 103, Apple decision, para. 221
[140] C-143/99, Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke [2001] ECR I-08365

### 6.3.2 AFFECTING TRADE BETWEEN MS AND DISTORTION OF COMPETITION

The consideration as to the effect of the tax measures on Apple's trading position and the impact on competition within the market are considered together in a single paragraph, which is relatively brief, but sufficient.[141]. The Commission determines that if Apple has been able to benefit from a reduction in its tax liability, then this will put it in a stronger position than it would have been in if it had paid tax at the full rate. There is therefore an effect on trade. As I set out in Chapter 2, it is not necessary for the Commission to demonstrate or quantify the impact on the trade in electronic equipment which Apple manufactures and sells. This conclusion is in line with the Philip Morris case cited in Chapter 2[142] and there does not seem to be any scope for the challenge to the Commission's finding in this area.

### 6.3.3 THE MEASURE FAVORS CERTAIN UNDERTAKINGS OR THE PRODUCTION OF CERTAIN GOODS – SELECTIVITY

#### 6.3.3.1 INTRODUCTION

I have already covered in section 2 the definition of selectivity to show how the ECJ has determined whether an advantage obtained by a particular undertaking is a selective one. Art. 107 TFEU does not refer specifically to selectivity. Cleary Gottlieb[143] defines selectivity as a measure which "differentiates between economic operators who, in light of the objective assigned to the tax system of the Member State concerned, are in a comparable factual and legal situation".

As previously noted, the Commission combined advantage and selectivity into a single selective advantage test. I will still cover this as a traditional selectivity test, so the reader of this thesis finds it easier to follow the test in accordance with the previously established principles. At the end of this section, I will consider the selective-advantage test separately, which in my opinion will make the matter easier to understand and also to form an objective opinion regarding the single selective advantage test.

[141] Supra note, 103, Apple decision, para. 222
[142] Case C-730/79 Phillip Morris Holland v Commission [1980] ECR I-2671
[143] C. Gottlieb, "Three Years of EU State Aid Review of Tax Rulings: Taking Stock", Alert Memorandum, 2016, p. 5, available at https://www.clearygottlieb.com/~/media/organize-archive/cgsh/files/publication-pdfs/alert-memos/three-years-of-eu-state-aid-review-of-tax-rulings-taking-stock.pdf

As I have previously established the approach adopted by the ECJ in establishing selectivity involves three separate steps. The first step is the identification of the reference system; the second step is the identification of operators in a comparable legal and factual situation and whether a measure differentiates between them; the third step considers whether the measure can be justified by the nature of the general scheme of the system itself.

#### 6.3.3.2 DETERMINING THE REFERENCE SYSTEM

The starting point in applying the advantage test is to establish the appropriate benchmark against which to compare Apple's tax position in Ireland. The Commission sets out[144] that "a reference system is composed of a consistent set of rules that apply on the basis of objective criteria to all undertakings falling within its scope as defined by its objective."

In Chapter 3 I set out that the usual approach in identifying the appropriate reference system is to start with the ordinary rules of taxation in the country. This is the approach taken by the Commission in Apple. Determining what these tax rules were in the Apple case poses a number of difficulties as the two Apple entities which had entered into the Irish tax rulings were Branches rather than companies. This means that the computation of the profits of the Irish Branches would follow a two-step process[145]:

1. Irish resident branches of overseas companies are subject to tax only on the profits of the Irish Branch. An exercise will therefore be needed to determine the profits of the Branch, and to exclude from taxation in Ireland the profits on the non-Irish source income
2. The corporate accounting profits of the Branch are then subject to tax at the prevailing corporate tax rate of 12.5%, which is charged to all companies.

The Commission Decision examines a number of separate points in establishing the ordinary rules of taxation which should apply to the Apple Irish Branches. Overall, however, it maintains the approach of identifying entities in a comparable factual and legal position[146]. It concludes that all companies and Branches which are subject to Irish

[144] Supra note, Apple decision, para. 227
[145] Ibid. para. 222
[146] Ibid. para. 241

Corporation tax are in a comparable position, regardless as to whether or not they are resident in Ireland.

#### 6.3.3.2.1 GENERAL TAXATION SYSTEM

I set out in Chapter 3 that the approach taken by the ECJ in previous tax cases is to use the normal rules of taxation applying in the Member State. The Adria-Wien[147] case defined the relevant benchmark as being "other undertakings, which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question."

In identifying the benchmark to apply, the Commission starts by setting out that the normal rules of taxation require consideration of factors such as who is taxable, the extent of the taxable base, taxable events, and the rate applied.[148] The conclusion is reached that the reference system should be the ordinary rules of corporate taxation in Ireland[149].

It is recognized that the income of companies may arise from different sources, which will be taxed in a different way:

1. Irish resident companies are taxed on their worldwide income and gains
2. Non-resident companies with a Branch in Ireland are taxed on the profits or gains of the Irish Branch
3. Non-resident companies without a Branch are taxed only on any Irish-source income, and gains on the disposal of certain Irish assets

Regardless of the residence of the company, the Irish corporate tax system has as its objective the purpose of taxing all income and gains within the scope of the Irish corporate tax system, and so the tax reference system to take as the benchmark is the normal rules of taxation which apply to a company having an income in Ireland. The decision specifically states that "all companies subject to tax in Ireland, whether resident or non-resident, are in a comparable factual and legal situation[150]"

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[147] C-143/99, Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke [2001] ECR I-08365, paras. 48-53
[148] Supra note 103, Apple decision, para. 227
[149] Ibid. para. 228
[150] Ibid.

This conclusion is in line with previously decided cases such as Adria-Wien and Paint Graphos which I covered in Section 2. The Commission references that it has adopted the Paint Graphos approach in identifying the reference system. In supporting the conclusion that all companies subject to Irish taxation form the reference system, the Commission examines a number of particular points, which I will now review.

#### 6.3.3.2.2 EQUAL TREATMENT OF INTEGRATED AND NON-INTEGRATED ENTREPRISES

The Commission determined that in applying the advantage test, the reference point to use in assessing the position of the Apple Irish Branches was the tax law which applies to stand alone companies.[151] Stand-alone companies are defined as companies deriving profits from the market, which are at arm's length, because they are independent. Integrated companies may earn profits from transactions either with other members of the same MNE, or there may be transactions within the same company, such as those between a Branch and its Head Office. The Commission states that the Irish tax applies to both types of company, regardless of how the profits arise. Integrated and stand-alone companies should therefore be regarded as being comparable in determining the tax reference base in conducting the selectivity test.

The Decision does recognize that there are differences in how the taxable bases of integrated and non-integrated businesses are determined. Non-integrated businesses trade on market influenced terms, and so their accounting profits can be taken to be the starting point in determining the taxable base. Integrated entities may enter into transactions with other group companies, and so determining the accounting profit "requires the use of estimates[152]". The estimates referred to here are TP adjustments, and I will cover the Commission's comments on these later. Despite the fact that these estimates or adjustments are required to arrive at the taxable base of an integrated company, the Commission is clear that the principle remains that the reference system should be taken to be the taxable profit of the company according to the normal rules of taxation. The fact that integrated companies have to adjust their profits to recognize that they do not trade with connected parties on market conditions does not mean that they are not comparable with non-integrated companies.

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[151] Ibid. paras 229 and 230
[152] Ibid. para 230

The US Treasury White Paper[153] queries whether it really is appropriate to compare integrated and stand-alone companies. It refers to a number of ECJ cases which found that an advantage would not necessarily be selective if it was available to other multinational companies. Stand-alone companies in such circumstances are not factually and legally comparable. One of these cases was put forward by Apple to challenge the Commission's approach. In the Groepsrentebox[154] case, the Netherlands was proposing a reduced tax rate to be applied to interest received from connected parties. After a State aid investigation, the commission found that integrated and non-integrated companies could not be held to be comparable. The case concerned loans between connected parties, and the decision found that there were differences between a stand-alone company determining the optimal capital structure, and a parent company lending to its subsidiaries, so the two types of entities were not factually and legally comparable[155]. The reasoning behind this decision is that independent parties are both seeking to maximize their profit earning potential, whereas an integrated entity will consider the joint interests of both of the parties, and may enter into non-commercial transactions[156].

In assessing the significance of this argument, I think that it is relevant that the decision has not been considered by the Courts, as the Commission found that there was no State aid, and there was no subsequent appeal. I also think that the facts of the case are very specific – the case was looking at the taxation inter-company loans, which are often not comparable with loans taken by stand-alone companies. It is also the case that the Commission's decision is regarded as being a controversial one, and Szudoczky [157] considers that it is incorrect in many areas, including the fact that the measure was selective because it was clearly only available to groups of companies.

#### 6.3.3.2.3 RESIDENCE STATUS OF BRANCH NOT RELEVANT

The next point which the Commission examines in establishing the reference base is also related to determining what the taxable base should be. In the section above, I set out that Irish tax base for a resident company will be different to that of a non-resident company.

[153] Supra note 110, U.S. Treasury, p. 9 to 14

[154] Commission Decision 8 July 2009 on the Groepsrentebox scheme which the Netherlands is planning to implement, State aid decision C4/2007 (ex N 465/2006) OJ L 288

[155] Ibid. para. 103

[156] Ibid. para. 110

[157] R. Szudoczky, J.L. van de Streek, "Revisiting the Dutch Interest Box under the EU State Aid Rules and the Code of Conduct: When a 'Disparity' Is Selective and Harmful", 38 Intertax, Issue 5, 2010, p. 260

The Commission considered whether these differences in approach would mean that only companies with the same residence status would be considered factually and legally comparable. The conclusion was that all companies should be treated as being comparable, regardless of whether they are resident in a State, or operating there through a Branch[158]. The principle of territoriality applies. This is the principle that States will only tax income which arises within their jurisdiction.

Ireland had argued that the fact that the Apple entities in Ireland were Branches meant that the comparable entities for the selectivity test should be other Irish Branches of foreign companies, and should not include Irish resident companies as well. This argument was not accepted by the Commission, which relied on previous judgments to support its position[159]. One of the cases cited is the Royal Bank of Scotland case[160]. In this case, Greece proposed that different tax rates should apply to banks which were resident in Greece (35%) and Greek Branches of foreign resident banks (40%). In considering the question of selectivity in the Royal Bank of Scotland case, the court found that there was no justification for making a distinction between an overseas company which establishes a subsidiary in another territory, or one which establishes a Branch.

#### 6.3.3.2.4 IMPACT OF ALP ON REFERENCE STANDARD

The Commission has by now set out that it considers that the Apple Irish Branches should be considered to be in a comparable tax position to all other companies subject to taxation, but this throws up a further issue which must be resolved in order to determine the tax reference base. The discussion on non-integrated businesses has identified that MNE's can set prices or enter into transactions on terms which are not set by the market, and the question of branch taxation has recognized in general terms that the profit of the Branch must be separated from the profit generated by its activities outside Ireland. In tackling both of these issues, the Commission raises the issue of TP, and the role which it plays in determining the tax reference base. It does this by introducing what Mason has termed a "sui generis arm's length principle.[161]" There are three separate lines of reasoning contained in the Commission's argument that this arm's length standard should form a part of the tax reference system in State aid cases.

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[158] Supra note 103, Apple decision, para. 238
[159] Ibid. para. 239
[160] Judgment of 29 April 2009, Royal Bank of Scotland, Case C-311/97, EU:C:1999:2664.
[161] Ruth Mason, "Special Report on State Aid - Part 6: Arm's Length on Appeal", Tax Notes 158, 2018, p. 783

The first of these relates to the question of allocating profits to the two Apple Branches in Ireland. Ireland argued that as its national tax code did not include TP rules at the time, and because there was no prescriptive rule for determining branch profits, then the Commission could not require that it applied a particular approach, and that the same set of general tax rules applied to all companies. The Commission is clear that in determining Branch profits, the ALP must apply – "it is necessary to apply the principle that transactions within an integrated company should be conducted as if they were carried out between non-integrated companies on the market.[162]" It goes on to state that although the OECD Guidelines are not binding, they offer useful guidance to tax authorities on how to approach the problem, and any ruling which is not in accordance with OECD principles is likely to be queried[163]. This is probably the least controversial of the three arguments put forward on the ALP.

The second concerns the statement that the correct application of art. 107(1) TFEU requires that transactions within an integrated enterprise should be conducted on an arm's length basis. The decision states that an integrated business will receive a selective advantage compared to a stand-alone company if its profit "is reduced as compared to independent undertakings whose taxable profit reflects prices determined on the market negotiated at arm's length[164]". Mason[165] argues that in reaching this conclusion, the Commission has confused two different arm's length tests. The State aid rules have always required the state to act at arm's length from undertakings it is dealing with. Chapter 3 refers to the market economy operator test, which is used to determine whether there has been State intervention. This is an arm's length test which requires that the state should act as an independent party in matters of State aid. Mason is clear that "no clear precedent supports the notion that independently of member state domestic law, the state aid rules require parts of an enterprise to hold each other at arm's length[166]."

Although there is clearly an ALP defined by the OECD Guidelines, it does not necessarily follow that there is a separate ALP imposed by art. 107 TFEU which is applied when determining whether or not State aid has been granted. The Commission is likely to have

[162] Supra note 103, Apple decision, para. 250
[163] Ibid. para. 255
[164] Ibid. para. 249
[165] Supra note 162, R. Mason, p. 786
[166] Ibid. p. 786

taken this approach to recognize the difficulty which can arise in TP cases. Each country has different TP legislation, and these refer to the OECD Guidelines to a different extent. Even where there is TP legislation in place, each country may interpret the OECD Guidelines in a different way. Introducing a separate State aid ALP allows the Commission to avoid these issues. However, this approach is a controversial one, and many authors disagree with at least some aspects of the Commission's reasoning here[167].

The final line of argument put forward by the Commission relies on the concept of "Free Competition" which was established in the Forum 187[168] case. This case concerned a Belgian tax measure which was aimed at encouraging MNEs to establish headquarters in Belgium, known as coordination centers. The tax measure extended to such companies allowed them to calculate profits by applying a fixed mark-up to only certain parts of their costs in Belgium, and did not look at either the income or profits earned by the Belgian companies. The ECJ decision determined that the measure did confer illegal State aid because the approach was not in line with OECD principles[169]. The Apple decision quotes a part of the judgement from the Forum 187 case which said that in order to determine whether or not the coordination centre measure was selective, it was necessary "to compare that regime with the ordinary tax system, based on the difference between profits and outgoings of an undertaking carrying on its activities in conditions of free competition[170]".

The Commission has interpreted this as meaning that the ECJ "endorsed the arm's length principle as the benchmark for establishing whether an integrated group company receives a selective advantage for the purposes of art. 107(1) TFEU[171]." If the ALP is not applied to integrated companies, then they will be able to "benefit from a favorable treatment under the ordinary rules of taxation of corporate profit when it comes to the determination of their taxable base which is not available to non-integrated standalone companies[172]". The Commission's argument that the ALP should be applied to integrated businesses is a reasonable one, as there would be a selective advantage if they were able to use transactions with other parts of the MNE to influence the tax base in a particular

[167] Ibid. p. 786
[168] Joined Cases C-182/03 and C-217/03, Belgium and Forum 187 ASBL v. Commission, EU:C:2006:416
[169] Ibid. para. 6
[170] Ibid. para. 254
[171] Supra note 103, Apple decision, para. 251
[172] Ibid. para. 252

territory. However, the conclusion that the use of the term "free competition" creates a separate ALP for the purposes of art. 107(1) TFEU is not as clear. Mason[173] is of the view that at best, the Forum 187 case at best provides "modest support" for the Commission's view. This will be an area which the ECJ will ultimately be required to clarify and until it does so, we can only speculate.

#### 6.3.3.3 DEROGATION FROM THE REFERENCE SYSTEM

Having established the tax reference system, the second leg of the selectivity test is to consider whether the measure allows the undertaking a derogation from that reference system. The reasons why the Commission concluded that there had been a derogation from the normal rules of Irish taxation have attracted a substantial amount of comment. Mason[174] summarises the key issues contributing to the controversy in this area as "the Commission concluded that State aid law requires profits to be allocated according to an independent, state-aid-specific arms-length standard."

The purpose of this section is to consider how the Commission's decision in Apple accords with previous ECJ judgments in the area of State aid. Although the Commission's decision on the application of the ALP is not the main focus of this work, it is nevertheless useful to set out some of the main reasons why the Commission found that the tax treatment received by Apple did deviate from the normal Irish rules.

The first points considered involve the determination of the levels of profits allocated or attributed to the two Irish Branches. The Commission identifies several areas of concern, including:

1. Irish Revenue accepted that certain intangible assets licensed by the two Apple companies (ASI and ASO) should not be allocated to the Branches without substantiated evidence that this was appropriate[175].
2. The determination of profits to the Irish Branches requires an allocation of assets, functions and risks between the various parts of the company. The Commission did not accept that such an exercise had been undertaken, or that the level of profits

[173] Supra note 162, R. Mason, p. 787
[174] R. Mason, "Special Report on State Aid - Part 3: Apple" (2017) University of Virginia School of Law, Law and Economics Research Paper Series, 2017, p. 740, available at https://ssrn.com/abstract=2927843
[175] Supra note 103, Apple decision, para. 260

allocated to the Irish Branches properly reflected their contribution to business profits[176].

3. There was no substance to the Head Offices of either Irish Branch. The Head Offices did not perform "active and critical functions" required to manage the IP attributed to them, and so Apple could not justify the attribution of the majority of the profits to the Head Offices.[177]

The Decision concludes[178] that in allowing Apple's two Irish Branches to use a method of determining their profits which was not correct, Irish Revenue extended a tax advantage. Apple's appeal[179] contests these conclusions in several areas. The third and fourth Pleas[180] argue that the Commission has erred in fact in deciding that the Head Office did not have sufficient substance, and of the nature of the activity taking place in Ireland, which is said to be routine in nature. The second and fifth Pleas[181] also argue that the ALP test applied is incorrect, and that the Commission has not applied the OECD Guidelines correctly, or taken note of expert evidence presented.

There are other arguments presented by the Commission concerning an advantage arising from an incorrect application of the TNMM method and the comparability and functional test[182].

#### 6.3.3.4 IS THE MEASURE JUSTIFIABLE?

The third step in the selectivity analysis concerns justification and therefore requires an evaluation of whether or not a measure is a general measure - ie it is available to all undertakings. Where an advantage arises from a measure which is a part of the general tax system of the MS and is open to all, then it cannot be a selective one.

The Commission considers this leg of the selectivity test by looking at whether the advantage is an individual one (ie available only to a single enterprise) or a general one (ie available to a number of enterprises, whether or not they actually benefit from it). An

[176] Ibid. paras. 265 to 275
[177] Ibid. paras. 276 to 306
[178] Ibid. para. 320
[179] Action brought on 19 December 2016 — Apple Sales International and Apple Operations Europe v Commission, (Case T-892/16)
[180] Ibid. paras. 3 to 4
[181] Ibid. 2 and 5
[182] These were briefly covered in Chapter 4 and 5

individual measure is by definition selective because it is offered only to a single taxpayer, but an additional selectivity test must be performed where the measure is a general one.

The Decision[183] first considers that as the advantage arises from an individual tax ruling, then by its nature, any advantage arises from an individual tax measure, which will be selective. As an alternative, it then goes on to look at whether the measure is a general one. The Commission[184] concluded that it was not, because the advantage was only available to branches, and arose because Irish Revenue allowed branches to determine their taxable profit in an ad hoc manner.

The Commission state in its decision that the burden of proof regarding justification lies with the MS[185]. It is very striking to note, that Ireland did not put forward any justification when it had the chance to do so and the justification put forward by Apple were duly refuted by the Commission.[186]

#### 6.3.3.5 CONCERNS REGARDING COMMISSION'S SINGLE SELECTIVE ADVANTAGE TEST

The bulk of the Commission's analysis on the application of art. 107 TFEU covers whether there has been a "selective advantage". There has been much comment that the Commission has considered these two tests together, rather than individually – for example the US Treasury[187] stated that a "foundational principle of E.U. State aid law is that advantage and selectivity are distinct elements". This is however not as clear and "black and white" as the US Treasury claim, because case law has conflated advantage and selectivity before as well[188], what matters is the individual situation and the facts of the case at hand. Bobby[189] sets out a useful analysis of ECJ case law on the question of separating the two tests, and identifies three separate approaches which have been adopted:

1. There are cases where the two tests are applied separately
2. There are cases where the two tests are applied together where the alleged State aid is an individual measure

[183] Supra note 103, Apple decision, para. 224
[184] Ibid. paras. 230 and 253
[185] Ibid. para. 226
[186] Ibid. paras.. 405-407
[187] Supra note 110, U.S. Treasury, p. 6
[188] Case C-169/08, Presidente del Consiglio dei Ministri V Regione Sardegna, paras. 59-61 and the footnotes therein
[189] Supra note 111, C. Bobby, p. 207-209

3. There are cases where the two tests are applied together regardless of the nature of the measure – these are mostly the recent Commission decisions referred to in Chapter 4.

In determining whether it is a reasonable approach for the Commission to collapse the Advantage and Selective criteria into a single test, I have considered a number of additional cases. In the Orange[190] Case the ECJ considered an arrangement reached between the French government and the telecom company concerning the funding of pension arrangements from the period when the company was a nationalized business. AG Wahl states that "the issue of identifying an economic advantage … is intimately linked to the question of whether the contested measure is selective. " He then goes on to state "In the assessment of an individual measure, the identification of the economic advantage is, in principle, sufficient to support the presumption that it is 'specific' and, therefore, the conclusion that it is also selective[191]".

In contrast, the Magyar case[192] concerned increases to hydrocarbon extraction fees in Hungary imposed by the government. However, the increases were not passed on to all companies operating in the market. In this case, AG Wahl states that "the requirement as to selectivity under art. 107(1) TFEU must be clearly distinguished from the concomitant detection of an economic advantage[193]".

The key to understanding these two apparently contradictory approaches is the nature of the advantage afforded to the enterprises. In Orange, the advantage was an individual advantage, only made available to Orange. In Magyar, the advantage was potentially available to other companies – ie it was a general advantage. ECJ case law is therefore clear that where there is a general advantage, the two tests must be considered separately, but where there is an individual advantage, a single selective advantage test may be applied. Although he references different cases, Bobby[194] endorses this conclusion, stating that "it is not logical to analyze whether selectivity is present in an advantage aimed at only a single taxpayer.", such as APA granted through negotiations.

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[190] Case C-211/15-P, Orange v Commission
[191] OPINION OF ADVOCATE GENERAL WAHL delivered on 4 February 2016, Case C-211/15 P (see footnote above), para. 67
[192] Case C-15/14-P, European Commission v. MOL Magyar Olaj- és Gázipari Nyr [2015] ECR I-471
[193] Ibid. para. 59
[194] Supra note 111, C. Bobby, p. 210

I do not consider that this approach contradicts previous ECJ precedents because the overlap between the advantage tests and the selective tests is clear. Where the selectivity test is applied individually, the court looks to identify a reference system, and to consider whether there is a deviation from it. There is then a final consideration of whether any advantage is part of the general tax system. If there is, then there is an advantage. The two-step test for an advantage is very similar to the first two legs of the selectivity test, and in practical terms, it makes sense to consider these aspects together. Furthermore, the case law clearly shows that the selectivity requirement differs and the need for in-depth assessment is not needed when there is individual aid case at hand[195], which is the situation with the APAs. In addition to that, there are other cases where advantage and selectivity are not clearly differentiated by the Court, therefore this is not a completely novel approach from the Commission as many have contended.[196]

### 6.3.3.6 SELECTIVE-ADVANTAGE – CONCLUSIONS

The Commission devotes the majority of its final decision to consider whether the measures granted to Apple confer a selective advantage on the Irish Branches. There are many aspects of the Decision which follow the previous approach established by the ECJ. Applying the three-step selectivity test does indicate that the measure is selective. The ECJ has traditionally viewed the general tax system as being the reference system against which the measure must be compared. The Apple Decision adopts this approach, specifically stating that all companies subject to Irish taxation should form the reference system. It is not relevant whether they are integrated or independent undertakings, and nor is it significant that the Apple entities are Branches of non-resident companies.

There is a derogation from the reference system because the Apple Branches have been allowed to determine their profits using a method which is not in line with OECD TP Guidance. The Commission also looks at whether the measure is a general one, and finds that as it is only available to integrated entities, then it cannot be general. There is therefore selectivity.

There are a number of controversial aspects of the decision as well. The adoption of a single selective advantage test may be novel to some extent, but the way in which the

[195] Supra note 193, C-15/14 P, MOL, para 60
[196] Supra note 189, Case C-169/08, Sardegna

Commission applies it is in line with the ECJ approach because of the similarities between the approach to determining selective advantage and selectivity.

The issue which is likely to require consideration by the Courts on appeal is the approach to applying the ALP to State aid cases. Whilst it appears reasonable to contend that the OECD principles should be used to attribute profits to the Irish Branches, it is a not matter for the Commission to try to establish a separate ALP for use in determining whether State aid has been provided under art. 107(1) TFEU. Caytas[197] points out the difficulty in reconciling that MS would be restricted to determine their own tax codes with the establishment of a separate ALP to be applied in State aid cases.

## 6.4 SPECULATING THE VIEW OF THE EU COURTS – THE APPLE CASE

### 6.4.1 INTRODUCTION

Both Apple and Ireland has appealed against the Commission decision as previously stated, and so the question of whether illegal State aid has been provided will ultimately be referred to the General Court, and a subsequent appeal is likely to be determined by the ECJ. In this section, I will look in more detail at two possible areas of controversy in the area of selectivity which these hearings will need to examine in deciding whether the Commission's decision is in line with previous State aid case law.

### 6.4.2 EFFECTS TEST

The Commission Notice on State aid introduces a distinction between two types[198] of selectivity, namely de jure and de facto selectivity. De jure selectivity can be described as a measure which is mandated by law, and which will apply to a certain group of undertakings. The Adria-Wien case illustrates an example of de jure selectivity because the tax measure implemented was available only to manufacturing undertakings. A de facto measure "encompasses measures which apply in principle to any undertaking, but

[197] J.D. Caytas, "Tempted by an Apple: Europe's Fall from Grace on Retroactive Taxation", Columbia Journal of European Law, 2016, available at: https://ssrn.com/abstract=2872920
[198] Supra note 12, 2016 Notice, paras. 121-122

are in practice only available to a restricted number of undertakings."[199] In determining whether an advantage is a de facto selective one, Schön[200] introduces the concept of disguised selectivity. He refers to tax measures disguised as general measures which actually allow an advantage to an individual taxpayer. He states that it is necessary to look not at the "aims and causes but strictly at the effects of a tax provision". Mason[201] puts forward her own similar definition of an effects test as "A situation that could be discerned by looking at the anticipated effects of the regime, not just the language of the statute". It is interesting that Schön's article was written in 1999, which is many years before the Gibraltar[202], a case I referred to in Chapter 3. His comments[203] that the effect of the measure should be the guiding principle rather than the content of the legislation are the key to understanding the Gibraltar reasoning. The ECJ found that Gibraltar's entire tax system could still be held to confer a selective advantage because it was designed to ensure that foreign resident companies paid less tax than domestic companies.

In the Apple case, Ireland argued that its general taxation system applying to Branches was consistent, and applied to Apple in the same way that it applied to other companies with Irish Branches[204]. Branches were only taxed on the profits which could be attributed to assets, risks or functions attributed to Ireland. It did not accept that the Apple Branches in Ireland received an advantage, but contended that if they did, this was part of a general tax measure, and so would not constitute illegal State aid. The Commission Decision does not specifically cover an effects test in the selectivity criterion, but there is a useful comment by Mason which allows me to consider how the ECJ may apply it.

In assessing Ireland's approach to determining the profits of a branch, Mason comments that "Although Ireland insisted that it had not adopted the OECD ALP, it never clearly articulated what its branch profits attribution rule actually was"[205] and Donohue, in

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[199] C. Micheau, "Tax selectivity in European law of State aid - Legal assessment and alternative approaches", University of Luxembourg, Law Working Paper No. 2014-06, p. 4, available at: https://ssrn.com/abstract=2499514

[200] W. Schön, "Taxation and State Aid Law in the European Union", Kluwer, Common Market Law Review 36, 1999, p. 933

[201] Supra note 162, R. Mason, p. 790

[202] Joined Cases C-106/09 P and C-107/09 P Commission v Governments of Gibraltar and UK [2011] ECR I-11113

[203] Supra note 201

[204] State aid implemented by Ireland to Apple (Case 2014/C ex 2014/NN) Commission Decision 1283/2017/EU [2016] OJ L/187/2017, para. 178

[205] Supra note 175, R. Mason, p. 741

referring to the various parts of the Irish tax legislation covering Branch taxation says "Their interaction is entirely unclear, is based on ambiguous legislation, and has never been tested in the Irish courts."[206]

Taking these two statements together, the effects test for selectivity would run such that the Irish tax law as it applies to Branches would be a general tax measure, because it applies to all overseas resident companies with an Irish Branch. However, the ECJ would have to consider the effect of the law as well as its content. If the impact of the legislation is such that its interpretation leads to confusion about how it should operate, and its application gives rise to opportunities for Branches to use a method of attributing profits which is not at arm's length, then using the substance over form approach advocated in the Gibraltar case will allow the Court to consider the effect of the branch taxation rules, which is to allow Branches to reduce their taxable base when compared with other Irish entities. This will therefore constitute a selective advantage, and as the other conditions of art. 107 TFEU are likely to be satisfied, there will be an illegal State aid.

### 6.4.3 SELECTIVITY OF THE MEASURE – INDIVIDUAL TAX TREATMENT

The final point which I think is relevant in assessing the approach which the ECJ will take on selectivity is connected with the type of agreement which Apple made with Irish Revenue. I have previously set out that Ireland did not have a formal APA programme at the time it entered into the agreements with Apple, however, it was the practice in Ireland that the tax authority would enter into negotiations with large MNEs in order to reach agreements which would give both parties certainty about the tax treatment. The agreement only covered the tax position in Ireland, therefore it was a unilateral one.

The previous Chapter 4 which covered APAs makes clear that there are many advantages to both parties in entering into APAs when it comes to complex transactions. However, care must be taken about the way in which the arrangement is agreed, and there are circumstances in which such agreements can give rise to State aid. The general principle[207] to bear in mind is that agreements which clarify the application of the law to

[206] A. Donohue, "The EC's State Aid Ruling on Apple", Tax Journal, 2017, accessed at https://www.taxjournal.com/articles/ec-s-state-aid-ruling-apple-02022017

[207] A. Gunn & J. Luts, "Tax Rulings, APAs and State Aid: Legal Issues", 24 EC Tax Review 2, 2015, p. 121

a particular set of circumstancesis likely to be acceptable, but where the agreement allows a taxpayer to obtain treatment which deviates from the normal rules which would be expected to apply, then this may give rise to State aid. I will look at a number of aspects of the Apple decision to consider whether this is the case.

The first of these relevant issues is the way in which the agreement was actually made. The Commission sets out that the original 1991 agreement was "negotiated rather than substantiated by comparable transactions.[208]" This is significant because the transactions under review are complex and clearly involve TP principles. I set out in the TP section that the APA process requires the applicant to provide a substantial amount of information about its business operations and its proposed TP methodology. There would be support, including identification of comparable transactions, for the prices proposed. The decision is clear that Apple did not provide either "a contemporaneous profit allocation study or a TP report[209]". Any discussions or negotiations which took place between Apple and Irish Revenue without being informed by a TP report could not be described as a determination of how the Irish law in force at the time could apply to the specific facts of the case.

The second area of concern involves the application of the TP methodology – in this case TNMM. I have previously highlighted some concerns which the Commission raised about the way in which the methodology was applied. If the agreement allows Apple to use a methodology in such a way that it does not accord with an approach that the OECD has promulgated, then this too most likely would amount to selectivity.

The final area of concern with the agreement concerns its length. Apple negotiated its first agreement in 1991, which ran for over 15 years before it was replaced by a second agreement in 2007. This is a very long period for an agreement to run, and the Commission in its decision notes that thoroughly[210]. that it OECD Guidelines[211] suggest that a typical APA would cover a period of 3 to 5 years. The Guidelines state that too long an APA period will make future predictions unreliable. This will especially impact a fast-changing technology company such as Apple.

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[208] Supra note 103, Apple decision, para. 147
[209] Ibid. para. 68
[210] Ibid. paras. 364 and 368.
[211] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, (OECD Publishing, 2017)

These features all point towards a conclusion that Irish Revenue entered into an agreement with Apple which allowed it to obtain a selective advantage. Avi-Yonah[212] summarises the position by stating that "tax authorities should objectively and reasonably interpret the provision in light of the relevant case law and regulations." He goes on to say that "this margin might have discretionarily been exercised by the Irish tax authorities in the Apple case[213]"

### 6.4.4 CONCLUSION

In the final analysis of the Apple Decision, I have concluded that there few real opportunities for the ECJ to disagree with the Commission's decision as it is based on ECJ case precedents and sound analysis of the situation at hand.

I have set out that the advantage and selectivity criteria have been correctly applied, even if the two tests are conflated, which has been done in previous tax cases well. There is a high degree of similarity between the two tests. The decision recognizes that the final "general measures" leg of the selectivity test is necessary if the measure is not an individual one, and does apply this test. The Irish tax legislation in this area is not clear, but its effect is undoubtedly to allow Irish Branches of non-resident companies to gain a significant advantage when compared to non-integrated companies. This is likely to constitute selectivity using the effects test, a principle endorsed in the Gibraltar case. The agreement itself also has a number of highly selective features as having been demonstrated.

Finally, it is clear that case law in the area of State aid and taxes is constantly developing, and that the Court has shown it is willing to respond to illegal State aid by developing new approaches. I would conclude by referring to Mason's [214] remarks that "a lesson from Gibraltar is that the commission and the CJEU know State aid when they see it, and they are prepared to prohibit it under novel theories if precedents and published guidance are unable to supply established methods."

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[212] R. Avi-Yonah and G. Mazzon, "Apple State Aid Ruling: A Wrong Way to Enforce the Benefits Principle?", University of Michigan School of Law, Law and Economics Research Paper Series 16-24, p. 9, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2859996

[213] The reference to margin is the Margin of Appreciation, which is a separate concept in EU law which allows Member States some discretion in how certain laws are applied.

[214] Supra note 162, R. Mason, p 791

# 6.5 COMMISSION'S SUI GENERIS EU-ALP ON APPEAL[215]

## 6.5.1 INTRODUCTION

In the previous Chapter, I have examined whether the Commission's decision in the Apple case is likely to be upheld when the appeal is heard in the General Court and perhaps in the European Court of Justice. Although I concluded that the Commission's decisions on the main questions of determining single selective advantage are broadly correct, there are a number of other possible challenges which commentators of the State aid cases have discussed. These arguments originated in the US Treasury Note[216] previously cited, and also in the appeals against the Commission decision made by both Ireland[217] and Apple[218].

These are:

1. That the decisions contravene the principle of legal certainty
2. That the decisions contravene the principle of legitimate expectations

A challenge using these arguments would need to establish that the approach adopted by the Commission is a novel one, so any recovery represents a retrospective measure.

These arguments allow for the possibility that the Courts may uphold the decision that the TP measures constitute State aid, but that recovery of the aid would not be enforced. These ideas have their origins in a Commission Notice issued in 2007 on the policy for recovering illegal State aid[219]. The policy is clear that "where negative decisions are taken in cases of unlawful aid, the Commission shall decide that the Member State concerned shall take all necessary measures to recover the aid from the beneficiary[220]". The

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[215] As previously stated in the first Chapter, this thesis does not address the issues of and relating to recovery of aid and the procedures therein. The perspective discussed here relates to the point of view of taxpayers' rights and weather the principles dscussed here can be used in their situation.

[216] Supra note 110

[217] Communication from the Commission - Action brought on 9 November 2016 - Ireland v Commission (Case T-778/16) (2017/C 038/48)

[218] Communication from the Commission - Action brought on 19 December 2016 — Apple Sales International and Apple Operations Europe v Commission (Case T-892/16) (OJ C 53/37)

[219] Notice from the Commission — Towards an effective implementation of Commission decisions ordering Member States to recover unlawful and incompatible State aid (2007/C 272/05)

[220] Ibid. para. 16

Commission has applied this approach in the Apple case, by taking Ireland to the ECJ[221] to enforce recovery of the State aid granted to Apple.

In determining the approach taken to recovering State aid, the 2007 Commission Notice[222] sets out that where there has been no notification of the aid to the Commission, then the advantage received as a result of illegal aid must be recovered back to the time when the aid was first granted. No notification was made to the Commission in Apple, or in other cases discussed in Chapter 5. This is significant because the notification gives the Commission a chance to review the proposed measure and reach an early decision on the measures. The advantage of notification is that recovery will be limited to the date when the Commission rules that the aid is illegal. The Apple case involved tax rulings which started in 1991, and so the amount requested by the Commission to recover the advantage dates back to then.

Although the Commission states that it expects the Member States to enforce recovery in State aid cases, there is an apparent get out. aid will not be recovered if it would be "contrary to a general principle of law.[223]" The two protections of legitimate expectation and legal certainty are given as examples which would contravene the general principles of law. I will look at these two issues to consider how they may be applied to the State aid cases.

### 6.5.2 TAXPAYERS' RIGHTS

#### 6.5.2.1 LEGAL CERTAINTY

The principle of legal certainty is defined by Gormsen[224] as one which "essentially seeks to ensure that laws are foreseeable, clear, precise and predictable as regards their effects." There are overlaps between the principles of legal certainty and legitimate expectations. She also identifies that legal certainty becomes more important where sanctions are applied in cases of breaches of the law, and where multiple and complex laws interact.

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[221] European Commission - Press release - State aid: Commission refers Ireland to Court for failure to recover illegal tax benefits from Apple worth up to €13 billion, 4 October 2017, available online at http://europa.eu/rapid/press-release_IP-17-3702_en.htm http://europa.eu/rapid/press-release_IP-17-3702_en.htm

[222] Supra note 220. para. 8

[223] Supra note 220. para. 17

[224] L.L. Gormsen and C. Mifsud-Bonnici, "Legitimate Expectation of Consistent Interpretation of EU State Aid Law: Recovery in State Aid Cases Involving Advanced Pricing Agreements on Tax", Journal of European Competition Law & Practice (2017) Vol. 8 No. 7, p. 425

These are both situations which are applicable in the State aid cases. The question of retrospective application is particularly relevant in evaluating legal certainty. All parties must accept that the way in which the Commission, MS and Courts will interpret legislation is subject to change, and that new precedent can be created which changes the previous view. Gormsen[225] considers that the ECJ is likely to adopt a position which would allow the Commission to adopt a State aid ALP, but that any application of a new position could not be applied retrospectively. This is in line with previous ECJ case law[226].

Gormsen cites the Racke case to illustrate the issues which the Courts are likely to consider. The case confirms that a measure cannot be applied retrospectively, unless there are exceptional circumstances. "Although in general the principle of legal certainty precludes a Community measure from taking effect from a point in time before its publication, it may exceptionally be otherwise where the purpose to be achieved so demands and where the legitimate expectations of those concerned are duly respected[227]."

She points out that the Commission had not considered the "exceptional circumstances" test in any of the State aid TP cases, and that there is therefore a need for the Appeals to consider whether the Commission's approach can be applied retrospectively. The view expressed is clear - that "the application of a novel interpretation and application of State aid, as any other aspect of EU law  should always be forward-looking[228]."

This view is based on a conclusion that the Commission's approach is novel. In the Fiat decision, the Commission clearly states that it does not consider its approach to be a novel one[229]. Gormsen does not agree with this statement, and points out that "There is no EU statute that makes the arm's length principle an EU-wide rule nor any case law, which confirms that the principle must be applied in all 28 Member States[230]." The establishment of a separate ALP to be applied to State aid cases which overrides the domestic TP legislation is a novel approach, and Gormsen[231] goes on to briefly summarise the

[225] Ibid., p.432
[226] Case C-288/11 P Mitteldeutsche Flughafen AG and others v Commission ECLI:EU:C:2012:821. and Case T-128/98 Aeroports de Paris v Commission ECLI:EU:T:2000:290.
[227] Case C-98/78 A Racke GmbH & Co v  Hauptzollamt Mainz (1979) ECLI:EU:C::14, para 20.
[228] Ibid., para. 433
[229] Supra note 106, para. 362
[230] Supra note 225, p.430
[231] Ibid. p.433

approach to TP in previous ECJ cases and Commission communications. She identifies that early cases, from 2001, made reference to the OECD Guidelines and the ALP, but not to an overarching State aid ALP.

The Forum 187 case[232] which has already been considered in relation to the selectivity test is also relevant when examining the principle of legal certainty. The Commission first considered the Belgian co-ordination center measures in 1984 and reviewed them again in 1987, and concluded on both occasions that the measures did not constitute illegal State aid. The cases were reopened, and appeals were eventually referred to the ECJ, which issued its final decision in 2006. This decision set out that the ALP should have been applied in determining the profits of companies which had qualified for the coordination center regime. As the ALP had not been applied, then the measures amounted to illegal State aid. Gormsen[233] argues that the first occasion on which the EU has set out a definitive position on the application of the ALP in State aid cases is the Forum 187 decision in 2006, and so recovery should not apply before this date if any of the State aid TP cases are found to involve the grant of illegal State aid. She goes on to make what I consider to be a telling statement in the evaluation of the three cases – "Forum 187 was a particularly extreme case, in which companies were essentially taxed on a completely notional basis. This is rather different from a case in which a tax authority genuinely tries to apply an arm's length standard[234]."

It is likely to be more difficult for Ireland and Apple to argue that a genuine attempt had been made to apply the ALP in its tax rulings. For Fiat and Starbucks, this argument could be run, that although the Commission and Courts may take issue with the conclusions of the TP reports, a genuine attempt had been made by both taxpayer and the tax authority to apply the OECD ALP. I find it necessary to note from the Commission's decision in Apple case, that in order for legal certainty to apply "There has to have been a prolonged lack of action on the part of the Commission from the moment that it became aware of the aid and a situation of uncertainty. A long lapse of time as such is insufficient to claim legal certainty and a delay can be imputed to the Commission only from the time when it learned of the existence of the aid"[235]. Since the contested tax rulings were never notified

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[232] Joined Cases C-182/03 and C-217/03, Belgium and Forum 187 ASBL v. Commission, EU:C:2006:416
[233] Supra note 225, p 425
[234] Ibid. p.425
[235] Supra note 103, Apple decision, para. 440

or made public by the tax authorities there was no way for Commission to be aware of such rulings. The Commission first learned about the rulings in 2013 and took action within a month[236].

#### 6.5.2.2 LEGITIMATE EXPECTATIONS

Mason[237] says that a "legitimate expectation has to be created through precise assurances by a community authority." Gormsen identifies that there are three separate principles to consider when trying to establish a Legitimate Expectations argument. The first is that the law or ruling under review gave rise to expectations on which the affected person relied. An example of this would be where assurances had been given by an EU institution[238]. The second is that this reliance is reasonable. Where reliance is placed on a position set out by the Commission, a person or undertaking relying on it must do so in good faith. A well informed and prudent person should be able to foresee whether any change in the position is likely, and cannot rely on the position if this is the case[239]. The final point relates to proportionality – any recovery must be limited to restoring the status quo, and must not be punitive[240]. This reflects the retrospective issue highlighted in the discussion above on Legal Certainty.

Gormsen acknowledges that the Legitimate Expectations argument is a "difficult defense to run[241]." She then sets out how it could be used in the recent State Aid cases. The key issue is "whether the Commission's recent approach is novel.[242]" The Legal Certainty section above sets out the arguments presented to support the position that the approach taken by the Commission is a novel one.

Mason reaches a different conclusion on the legitimate expectations question[243]. She states that the Commission's 1998 Notice[244] set out that tax rulings, including TP rulings, could constitute State aid. This article cites a comment by Lyall[245] that "if there was ever a new departure, it took place in the late 1990s, when the Member States . agreed to the

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[236] Ibid.
[237] Ruth Mason, "Special Report on State Aid - Part 2: Legitimate Expectations", Tax Notes, 2016, p. 621 available online at https://ssrn.com/abstract2925353, p. 621
[238] Supra note 225, p.426
[239] Ibid. p.427
[240] Ibid. p.427
[241] Ibid. p.427
[242] Ibid. p.430
[243] Supra note 238, p. 620
[244] Supra note 11, 1998 Notice
[245] Richard Lyal, 'Transfer Pricing Rules and State Aid' (2015) 38 Ford. Int'l L. J. 1017, 1018-1019

Code of Conduct''. Furthermore, Lyal[246] notes that there is hardly any novelty within the Commission's decisions.

There is certainly scope for discussion about whether the Commission is right in trying to impose an EU wide ALP to be applied in State aid cases. There can be no doubt, however, that MS are aware that the Commission will regard tax rulings which give a favorable treatment and allow individual companies to operate a non-arm's length TP policy to constitute illegal State aid.

### 6.5.3 CONCLUSION

The previous section considered whether the Commission's decisions in the area of State aid law were correct in their interpretation and application of art. 107(1) TFEU. In this Chapter, I have examined a number of alternative options which could be considered by the Courts when the hearings against the State aid TP cases are heard.

If the Courts accept that the Commission's approach to State aid is correct, it is open to them to confirm that illegal State aid has been granted, but to find that recovery should not proceed. I will summarise Gormsen's position to illustrate how this argument would run. It is open to the Commission to restate its position on State aid, but any change in position would only apply going forward, and cannot be applied retrospectively. The taxpayers have a right to expect that any agreement struck with the tax authorities would entitle them to rely on the principles of legal certainty and legitimate expectation because the Commission's "novel interpretation of selectivity was not foreseeable[247]". This statement raises an important question which will be vital in determining the outcome of the State aid TP cases as the appeals progress through the Courts. Both the General Court and the ECJ will need to establish whether the selectivity test applied by the Commission is novel, and therefore could not be foreseen by taxpayers.

The features of the selectivity test which have been described as novel are the combination of the selectivity and advantage tests into a single selective advantage test. I have previously set out that the way in which the Commission has applied this single test combines elements of both the individual selectivity and advantage tests, and that there

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[246] Ibid.
[247] Supra note 225, p. 424

are similarities between the two tests. This then leaves the question of the application of a new ALP which is applied to State aid cases. This is in itself a novel concept – the ALP is a familiar concept laid down in the OECD Guidelines, but the idea that there should be a different test applied in State aid cases has proved controversial.

If the Courts find that the application of a State aid ALP is a novel approach, then there are a number of options open to them. It is possible that they could take the view that the approach is so novel that it is incorrect in law, and that a separate ALP cannot be applied in State aid cases. This would not mean, however, that the ALP would not apply at all. I think that it is still possible that the Courts could find that although an overarching ALP could not be used in looking at art. 107(1) TFEU, the tax rulings concerned all involve TP issues, and the Court would still have to consider whether the tax rulings comply with the TP legislation in the MS. There is much detail in all three of the final decisions to show that the TP arrangements implemented and endorsed by the tax rulings did not comply with the OECD Guidelines.

Depending on the way in which the court approaches the "novel" question, there are therefore a number of decisions which could be reached. All are concerned with the selectivity test applied by the Commission, and in particular the conclusion that the determination of the tax base requires the application of a State aid specific ALP.

1. The approach adopted is not novel, because the Commission had given many indications that TP was an important component in determining whether or not State aid had been granted. The Legitimate Expectation/Legal Certainty defense could not be put forward in this case
2. The application of a separate ALP applied in State aid cases is incorrect and so the Commission has reached an incorrect conclusion in determining illegal State aid has been granted. In this case it may still be open to the Courts to apply the ALP of the national legislation.
3. The measure is novel, but it can be applied retrospectively, because the exceptional circumstances threshold test has been met

There is no doubt that the proposal of a State aid specific ALP will prove to be the key issue for the Courts to decide in resolving the appeals. My own view is that if the Courts do not accept that it is correct, there would still be scope to fall back on the national TP

legislation. There are enough holes in the methodologies applied by the tax authorities in all three of the cases to allow a reasonable challenge to be sustained.

If the Courts are seeking a middle ground, then a possible compromise would be that suggested by Gormsen – this would limit any recovery to the Forum 187 decision in 2006. The three Member States would recover aid going back to 2006. As the position on the ALP in State aid cases was that the Commission had accepted the Forum approach and there was no requirement to apply the ALP, then the principle of legal certainty would prevent recovery before this date.

# 7 FINAL CONCLUSION

The Commission decisions in the recent State aid cases can be regarded as the culmination of an attempt by the Commission to counter harmful tax measures which has lasted almost 20 years. The initiative can be traced back to 1997 and a meeting of the Council of Economics and Finance Ministers which identified the characteristics of harmful tax measures and agreed a course of action to remove them within the EU. The agreed actions had no legal force, and were referred to as soft law. Not all Member States took strong action to counter these measures, and in 2001, the Commission took action to try to force Member States to outlaw a number of specific measures. In recent times again, Commission has found new reasons to curb the national interests of MS and ensure that the Community principles prevail.

It is clear that the tax measure in the Apple case satisfy the first definition of harmful tax measures – it results in an effective level of taxation which is significantly lower than the general level of taxation in the country concerned, which has a significant impact on the location of a business within the EU. I feel I have concluded quite efficiently in my previous conclusions regarding the questions I set to clarify in my introduction Chapter, but for the sake of clarity I will answer my research questions in a more direct way down below:

1. Has the Commission erred in its state aid investigations when applying the conditions of art. 107(1) TFEU?

The starting point in answering this question was to look at the application of art. 107(1) TFEU by the Commission. In the area of taxation, the key issue is whether the measure is a selective one. The other three tests of art. 107(1) TFEU are usually satisfied, and are not considered in detail. I have concluded that the use of selective advantage test is not as novel as first thought, even by the author. The use of that test depends on the situation, and for example in situation of Apple, it was a correctly applied based on the previous ECJ case law and the facts at hand.

The Commission has put forward what has been described as a State aid ALP, which is not the same as the OECD standard. This is regarded as a controversial approach by many authors, not least because it can be seen to encroach on the principle that MS have

competence in the area of corporate taxation. The State aid ALP would apply to MS even where their own national legislation does not contain TP provisions as was the case in Ireland when the tax rulings were agreed. This use of a State aid specific ALP indicates that the Commission is willing to look at novel approaches to tackling what it perceives to be unfair tax advantages offered by certain MS. By establishing a separate EU wide State aid test, it is able to avoid arguments about whether a measure conforms with the ALP applied by a particular Member State.

It remains to be seen whether the Courts will uphold this approach. My own view is that it may not be needed in the cases I have considered. In Apple, the Commission has already stated that there was no real basis for the apportionment of profits to the Branches, so it should prove difficult for Ireland to challenge that it adopted a reasonable approach in entering into the agreement with Apple even though its legislation did not contain specific ALP rules at the time. In both Fiat and Starbucks, there are also many points around the application of the TP methodology which have been challenged by the Commission. A traditional argument around the correct application of the OECD methodology would allow the Commission to argue that profits were artificially low.

2. Does the use of a State aid ALP breach taxpayers rights?

Even if the Courts find that the tax rulings in question do constitute illegal State aid, then there is still scope for a finding that the aid should not be recovered from the taxpayers. State aid should not be recovered from the beneficiary if to do so would be contrary to a general principle of law. This argument would rely on the closely aligned principles of Legal Certainty and Legitimate Expectations. These principles set out that a legal system should be clear, precise and predictable in their effects. If an EU institution has set out a position on a subject, and a taxpayer relies on this in good faith, then any change in the position should not be applied retrospectively. The EU may change its position, or the Courts may set a new precedent, but the change should only apply going forward.

The legal certainty and legitimate expectations both rely on the argument that the imposition of the State aid ALP is so novel, that taxpayers could not have foreseen its introduction. The introduction of a single, EU-wide ALP is certainly a novel one, but the question for the Courts to decide will be whether the Commission’s previous comments

and rulings on the issue of harmful tax measures would be sufficient notice that a prudent business person would consider that the use of a non-arm's length TP policy was a issue which could give rise to State aid. Although it is certainly the case that an EU wide State aid ALP is a novel approach, I think that there are enough pointers in the EU's approach to TP and tax to indicate that a prudent MNE should have been aware that a non-ALP approach could be problematic.

The concept of a retrospection is also important if considering legal certainty, particularly as in the Apple Case the Commission is seeking to recover State aid dating back to 1991. This is long before the EU began to make public statements about harmful tax measures, and so it is possible that the Courts could limit the recovery of State aid. Some authors have suggested that the ECJ decision in the Belgian co-ordination centres cases in 2006 would be a natural limit because it was the first ECJ case to specifically consider the use of the ALP.

Now finally, my own view is that the EU Courts are likely to endorse the Commission's findings that the tax measures applied to Apple constitute illegal State aid, notwithstanding the controversial aspects of the decision such as the application of the "new" State aid ALP. There are two reasons to support this conclusion. The first of these is the "effects test". The Gibraltar case was an important case in establishing the direction of the selectivity analysis in State aid tax cases. The ECJ took the view that it was necessary to consider the impact or effect of a tax measure rather than focus on the detail of the tax legislation which introduced it. This has also been referred to as a de facto selectivity test. In Apple, the legislation covering the determination of Branch profits would be regarded as a general measure because the legislation as drafted applies to all Branches. In practice, as the legislation is confused and gives scope for Branches to apply non-arm's length allocations, the Courts can focus on the effects of the legislation and determine that it does give rise to a selective tax treatment.

The second key issue concerns the nature of the tax measure, as it arises from an individual tax agreement made between Irish Revenue and Apple. The terms of the agreement were not based on a detailed analysis, and were negotiated by the parties rather than supported by a robust TP analysis. The agreement was also apparently open ended and did not take account of changes in the business over time. These are also strong

indicators of selectivity. In reaching this conclusion, I have been influenced by Mason's comment on the Gibraltar case – that the Courts know State Aid when a case comes before them, and they will find ways of stopping it.

By the time the Commission launched its State Aid investigations in 2014, the joint OECD and G20 Base Erosion and Profit Shifting (BEPS) project was well underway, and was close to producing its 15 reports which have placed significant restrictions on many tax planning measures which were seen to be abusive. As the BEPS recommendations have been implemented by governments around the world, they have reduced the opportunities for MNEs to participate in tax planning schemes. Public opinion in many EU countries has also focussed on many of the global multinationals and the low amounts of tax they pay. The global financial crisis of 2008 and the recessions which most EU countries experienced in the years afterwards impacted the tax take of most Government Finance Departments, and in this climate as citizens felt the impact of austerity measures, they were clear that multinational companies should also make their contribution to Member State's resources.

Whilst it is clear that the Courts are independent of the political process, it is hard to see that they will not also be influenced by the prevailing public and political athmosphere.

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