Lund University

School of Economics and Management
Department of Business Law

Transfer pricing adjustments derived from state aid cases.
Are corresponding adjustments mandatory for EU Member States?

by

Ruby Rojas

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Supervisor: Cecile Brokelind

Examiner: Sigrid Hemels

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Author's contact information:

Email: rubymi.rojas@gmail.com

Telephone number: +46 730274008

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Summary

In the international tax subject, corresponding adjustments are a standard tool applied to avoid economic double taxation, specifically regarding Transfer Pricing issues. However, for a second jurisdiction to apply them, several formal and technical requirements should be taken into account. The most important is the basis on which the first jurisdiction made the primary adjustment, namely the Arm's Length Principle.

When an EU MS executes a state aid recovery decision, specifically those cases regarding Advance Pricing Agreements (APAs), an economic double taxation issue and a potential TP dispute may arise, which could be generated by the need for the application of a corresponding adjustment. In any case, each jurisdiction has the discretion to determine if the application of a corresponding adjustment should be made. For these purposes, Dispute Resolution Mechanisms (DRM) could be used; however, not all of them ensure that an agreement would be reached between states, only the arbitration procedure.

On this basis, this research explores the possibility of a mandatory corresponding adjustment between EU MS, considering: i) the peculiarities of the state aid cases regarding APAs, mainly the EU ALP, as an argument put forward by the EU Commission. The relevance of this is its claimed legal basis, namely Article 107 TFEU; it is to say primary EU Law, and not the OECD instruments internationally recognized, even by most of EU MS, ii) the principle of sincere cooperation established in Article 43 TEU, and iii) the outcome of the *Achema* chase. The above is specifically analyzed in the arbitration procedure since it is the only DRM that may ensure a final decision and perhaps a mandatory corresponding adjustment between EU MS. This question is answered in the last section and the conclusion of this research.

Preface

I will always be grateful to the people who accompanied and supported me during this time to overcome this challenge, who believed in me in those moments when it was even difficult to believe in myself, family, friends, classmates, and my tutor, Cecile. This has been one of the most challenging but rewarding academic challenges.

One has to be brave enough to be bad at something to reach excellence, and one always needs someone who believes in one's potential even when you are still on your journey to becoming better.

Abbreviation list

ALP	Arm's Length Principle
APA	Advance Pricing Agreement
BEPS	Base Erosion and Profit Shifting
CJEU	Court of Justice of the European Union
Co	Company
DRD	Directive on tax dispute resolution mechanisms, Council Directive (EU) 2017/1852
DRM	Dispute Resolution Mechanism
DTC	Double Tax Conventions
EU	European Union
EU Arbitration Convention	Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises
EU ALP	Arm's length principle in the view of the European Commission
EU Commission	Commission of the European Communities
EGC	European General Court
EU MS	Member State of the European Union
JTPF	Joint Transfer Pricing Forum
MAP	Mutual Agreement Procedure
MEMAP	Manual on Effective Mutual Agreement Procedures
MLI	Multinational Convention to Implement Tax Treaty related measures to prevent base erosion and profit shifting
MNE	Multinational Enterprise
OECD	Organization for Economic Cooperation and Development
OECD ALP	Arm's length principle in the view of the OECD
OECD MTC	Model Tax Convention of the OECD

OECD TP Guidelines	OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
TEEC	Treaty establishing the European Economic Community
TFEU	Treaty on the Functioning of the European Union
TEU	Treaty on European Union
TP	Transfer Pricing
US	United States
VCLT	Vienna Convention on the Law of Treaties

1 Introduction

1.1 Background

From 2014 onwards, the Commission has started initiating procedures against EU MS regarding State Aid and Advance Pricing Agreements (APAs).[1]

State Aid cases related to APAs have been widely discussed and analyzed because of the controversial nature of the arguments put forward by the Commission and the consequences that could arise for Multinational Enterprises (MNE). One of the said consequences, among others, is the transfer pricing adjustments resulting from the Commission's decisions. Their relevance lies in the economic double taxation that may arise from them and how difficult it could be for taxpayers to access a Dispute Resolution Mechanism (DRM) [2] and obtain effective relief.

When it comes to effective relief of economic double taxation,[3] which mainly arises from Transfer Pricing cases, the acceptance of a corresponding adjustment by State B, given that a primary adjustment has been applied by State A, is the critical problem. To begin with, the adjustment by State B may or may not be automatically applied.[4] Once the request for a corresponding adjustment is made,[5] it is accepted only whether State B considers that the adjusted profits in State A correctly reflect the profits if the transactions had been at ***arm's length.***[6] If not, the competent authorities may start a Mutual Agreement Procedure (MAP) to discuss the corresponding adjustments.[7] According to the OECD, the non-mandatory nature of corresponding adjustments is necessary so that one tax administration is not forced to accept the consequences of an arbitrary or capricious adjustment by another State.

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[1] European Commission 'State aid: Commission extends information inquiry on tax rulings practice to all Member States' (17 Dec. 2014, press release).

[2] This topic was discussed previously by the thesis author in 'TP adjustments derived from State Aid cases and potential economic double taxation. Is there any relief?' [2021].

[3] Organization of Economic Co-Operation and Development 'Manual on Effective Mutual Agreement Procedures (MEMAP)' [2007] 8.

[4] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' [2022] OECD Publishing, Paris, Chapter IV: Administrative Approaches para 4.32.

[5] OECD 'Model Tax Convention on Income and on Capital' full version [2017] Article 9(2)

[6] Ibid Commentary on article 9, para 2.6.

[7] Ibid Article 25. See also OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) para 4.33.

Besides, it also is important to maintain the fiscal sovereignty of each OECD member country.[8]

In its state aid investigations, the EU Commission has applied the so-called EU Arm's Length Principle[9] (EU ALP) as a benchmark based on Article 107(1) of the Treaty on the Functioning of the European Union (TFEU). Moreover, its nature and legal basis have been implicitly accepted by the EU General Court.[10] On this basis, TP adjustments resulting from the execution of a state aid decision (primary adjustments) would be applied based on the EU ALP instead of the OECD one.

This becomes relevant since EU MS, except Malta, are Members of the OECD, and consequently, they have accepted and, in most cases, transposed into their local legislation[11] the OECD ALP and OECD principles. Therefore, in the event of being requested to apply a corresponding adjustment, it is more likely that they would accept it if the primary adjustment were made based on the ALP, as it is defined and applied by the OECD. In this event, given the non-mandatory nature of applying the adjustment through a simple claim or the MAP, the double taxation situation may remain for the taxpayer.

Nevertheless, considering that the basis of the EU ALP relies on EU primary Law, the question arises whether the application of a corresponding adjustment, in those cases in which a primary one was made based on the EU ALP, may be mandatory for EU MS. This thesis will analyze the said question, specifically applied in the arbitration procedure.

1.2 Aim

Scholars have previously discussed state aid, transfer pricing adjustments, and double taxation topics. However, their approach has been focused primarily on whether a downward adjustment and the granting of a relief

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[8] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) para 4.35.

[9] So-called by scholars, for differentiation between this standard applied by the Commission and the OECD ALP.

[10] Cases T-760/15 and T-636/16 *Netherlands and Others v Commission* [2019] 2019/C 413/47; and Cases T-755/15 and T-759/15 *Ireland and Others v Commission* [2019] EU:T:2019:670.

[11] OECD 'Transfer Pricing Country Profiles' Updated as of 22 February 2022, <https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profiles.htm> accessed 9 April 2021.

mechanism meet the requirements established in Article 107 TFEU to be considered, at some point, unlawful state aid.

Unlike those analyses, this thesis is aimed to analyze whether MNEs may claim a mandatory acceptance of corresponding adjustments based on EU Law, i.e., Article 107 TFEU, the EU ALP, and Article 4(3) of the TEU.

It is essential to point out that Annika Soom[12] has analyzed the subject in the article *"Does the European Union Primary Law Require the Member States to Make Corresponding Adjustments?"* However, said article does not include the outcome of the case *Slowakische Republik v Achmea BV,*[13] in which the CJEU held that arbitral panels may be called to apply EU Law, such as Article 107 TFEU, the basis of the EU ALP, which is relevant for this topic; therefore, it is one of the cornerstones of the conclusion of this thesis.

1.3 Method and material

This research will apply the traditional legal dogmatic method,[14] analyzing the EU primary and secondary legislation, as well as international instruments and documents internationally recognized and agreed upon. To begin with, to determine the definition, nature, and effects of the transfer pricing adjustments, the OECD Model Tax Convention (MTC) and the OECD Transfer Pricing (TP) guidelines will be analyzed. The relevance of these instruments relies on their principles which were agreed upon and accepted by the international community, including the EU MS as OECD Members, except Malta.

The commentaries on articles of the OECD MTC and other official publications by the OECD are also considered for this analysis. Even though they are not an official source of law or international agreements, they are taken into account since they provide valuable information regarding the application and interpretation of the OECD instruments.

[12] Annika Soom 'Does the European Union Primary Law Require Member States to Make Corresponding Adjustments?' [2020] 2 EC Tax Review 97.
[13] Case C-284/16 *Slowakische Republik v Achmea BV* [2018] EU:C:2018:158.
[14] Douma Sjoerd, *Legal Research in International and EU Tax Law* (Wolters Kluwer Business 2014) 17 and 18.

Afterward, TP adjustments and double taxation are analyzed in the view of the primary and secondary EU Law and the inclusion of corresponding adjustments in some domestic legislation of EU MS to take into account how they are applied at a local level, if applicable.

In addition, the question of law of this thesis is analyzed considering the case law of the CJEU, cases that were chosen based on the topic at issue, and their relevance to support the primacy of EU Law. Likewise, some of the relevant EU Commission's decisions in State Aid cases are also considered in the analysis, since those are the instruments in which the EU ALP is mentioned for the very first time.

For this research, a judgment was used in its original language, i.e., Italian, since an English version was not found. However, it was consulted articles regarding it to grasp its essential content.

1.4 Delimitation

This research relies on transfer pricing adjustments' effects on MNEs within the EU, specifically economic double taxation and potential relief.

In the tax field, it is known that to resolve economic double taxation generated from transfer pricing adjustments, if State B does not accept a corresponding adjustment, MNEs could initiate a DRM, i.e., a MAP procedure, and a subsequent arbitration process. For this thesis's purposes, it will only be analyzed arbitration processes within the EU Law, namely the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, known as the EU Arbitration Convention, and the Directive on tax dispute resolution mechanisms (DRD), Council Directive (EU) 2017/1852.

The OECD MTC will be mentioned and taken into account as a reference. However, the arbitration process established by it is not part of this analysis.

Moreover, only bilateral disputes between the EU Member States will be taken into account, leaving aside multilateral cases and cases in which third parties would be involved.

It is important to emphasize that this thesis's purpose is not to research in-depth the technicalities of EU ALP or to determine if it is different from the OECD ALP. However, it is mentioned for its relevance and its alleged legal basis, i.e., EU primary law, which is one of the most important aspects of this research. In this line, to conduct this research, the hypothesis that it is different from the OED ALP is considered.

1.5 Outline

The investigation is divided into three sections. To begin with, it is mentioned transfer pricing adjustments as a tool in the transfer pricing practice, their definition, guidelines, and the basis of its application in the view of the OECD. Additionally, the subject is touched upon in the view of EU Law. Subsequently, it is discussed the potential rise of a primary transfer pricing adjustment from State Aid cases and its origin, i.e., the EU Commission's recovery decision. Further on, the research focused on the relevance of the source of the ALP claimed by the Commission, applied explicitly in state aid cases, and its hierarchy in EU Law. Based on the above, corresponding adjustments between EU MS under arbitration are analyzed, answering the research question.

2 Transfer Pricing and corresponding adjustments

2.1 Corresponding adjustments in the view of the OECD TP Guidelines and OECD MTC

The OECD Model Tax Convention on Income and on Capital (OECD Model Tax Convention)[15] and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TP Guidelines) are the international instruments in which it is established, among others, the ALP, as an international standard that should be used for tax purposes by both

[15] OECD 'Model Tax Convention on Income and on Capital' full version (n 5) Article 9

MNEs and tax administrations,[16] the application of Transfer Pricing, and its different adjustments.

Said instruments are relevant, considering that most EU MS[17] are OECD Members; therefore, they all have recognized the OECD ALP.[18] Depending on the legal system of each country, it has been transposed into their local legislation, along with the OECD transfer pricing methods, comparability analysis, etc. In those cases where it is not part of their local legislation, the OECD TP Guidelines are directly applied, including adjustments. This has led to an international fiscal harmonization on this issue[19] conducted by the OECD.

The ALP and TP adjustments have also been incorporated in the Model United Nations Double Taxation Convention between Developed and Developing Nations[20] and the United States Model Income Tax Convention.

Each EU MS might have its definition of Transfer Pricing and ALP. Nevertheless, according to the OECD, *transfer prices* are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises.[21] Those prices must be agreed upon, considering the ALP, which puts associated and independent enterprises on an equal footing for tax purposes.[22] These two concepts are closely linked to each other since ALP is the basis of the application of transfer pricing.

The OECD ALP has a twofold purpose for OECD Members:[23] i) to reconcile their right to tax the profits of a taxpayer that, according to them, has been generated within their territory, where the value of the transaction is created;

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[16]OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) para 1.1.
[17] Except Malta.
[18] Based on the information published on OECD 'Transfer Pricing Country Profiles' Updated as of 22 February 2022, <https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profiles.htm> accessed 15 April 2022.
[19] Jose Calderon 'The OECD Transfer Pricing Guidelines as a Source of Tax Law: Globalization Reaching the Tax Law?' [2007] Intertax 35/1 Kluwer Law International 4, 5.
[20] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Preface para 8.
[21] Ibid para 11.
[22] Ibid para 1.8.
[23] Ibid 4.

and ii) to avoid double or multiple taxation. Regarding the first mentioned, when there is a distortion in the determination of value creation and, consequently, in the host jurisdictions' tax revenues, it is necessary to apply an adjustment.[24] These adjustments are known as primary adjustments.[25] Explicitly, the OECD defines primary adjustments as those *a tax administration in a first jurisdiction makes to a company's taxable profits as a result of applying the arm's length principle to transactions involving an associated enterprise in a second tax jurisdiction.*

Since these transactions involved more than one tax jurisdiction, any adjustment to the transfer price in one jurisdiction implies that a corresponding adjustment[26] in another jurisdiction is appropriate. According to the OECD, corresponding adjustments are defined as those applied *to the tax liability of the associated enterprise in a second tax jurisdiction made by the tax administration of that jurisdiction, corresponding to a primary adjustment made by the tax administration in a first tax jurisdiction, so that the allocation of profits by the two jurisdictions is consistent.*

This is due to how a corporate group generates its income as such, a group, which creates a "fiction" of consolidated income. The treatment of each member as a separate entity for tax purposes is only due to the need to allocate income in each jurisdiction involved.[27] However, if the income is adjusted in State A, the consolidated income and expenses are misadjusted in other

[24] Ibid para 1.3.

[25] Ibid Glossary 24.

[26] Ibid preface para 12. See also: OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Glossary 24.

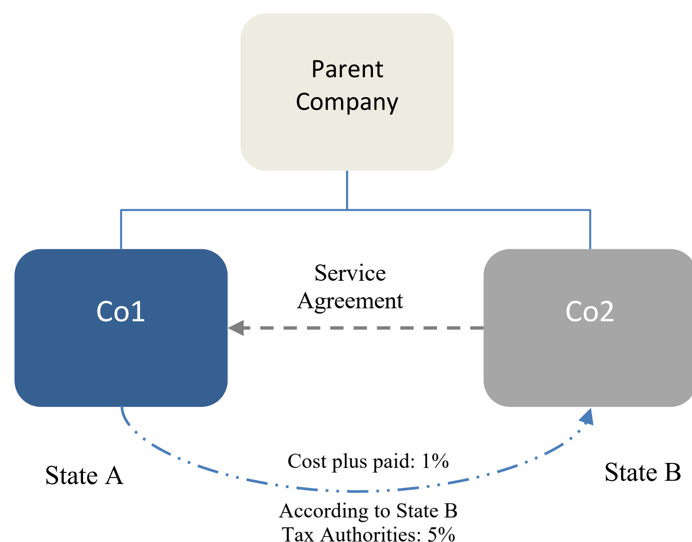
[27] OECD 'Model Tax Convention on Income and on Capital' full version (n 5) Article 7 and Commentary on Article 7 para 3. See also Convention on the Elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) [1990] OJ L 225, 20.8.1990 Article 4(2); OECD 'Report on the Attribution of profits to permanent establishments Part I (General considerations) Part II (Banks) and Part III (Global Trading)' [2006] para 2: "*In order to achieve a greater consensus in this area, the OECD decided to examine how the principles developed in the 1995 OECD Transfer Pricing Guidelines, which address the application of the arm's length principle to transactions between associated enterprises under Article 9 (Associated Enterprises), should apply in the context of the relationship between a permanent establishment and the rest of the enterprise to which it belongs (...).*" And Preface para 3; OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) para 1.6.

State(s). In this sense, it may be necessary to apply an additional adjustment in that other State(s) to avoid a potential economic double taxation.

According to the MEMAP, economic double taxation means the inclusion by more than one state's tax administration of the same income in the tax base when the income is in the hands of different taxpayers. Transfer pricing adjustment cases are considered the best example of economic double taxation.[28]

To exemplify this, it can be seen the following example:

- Company 1 (Co1), resident in State A for tax purposes, and Company 2 (Co2), resident in State B for tax purposes, are associated enterprises, members of the same corporate group.
- Co1 and Co2 have a service agreement through which Co2 provides administrative services to Co1. Their TP analysis established that, based on the ALP, cost plus 1% would be appropriate.
- After carrying out an audit process, the tax authorities in State B have determined that the price paid by Co1 was not established based on the ALP, i.e., the value creation in State B is not correctly calculated. According to said authorities, a reasonable cost plus for this transaction must be 5%, and therefore an upward adjustment is applied to the income obtained by Co2.

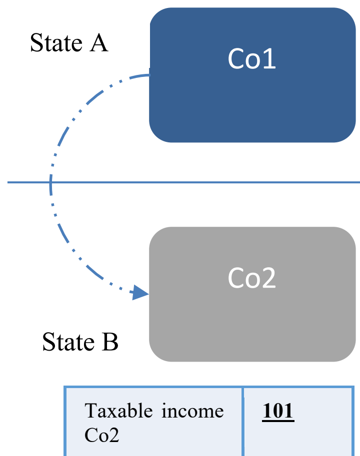


[28] Organization of Economic Co-Operation and Development 'Manual on Effective Mutual Agreement Procedures (MEMAP)' [2007] 8.

Based on this information, if the upward adjustment is applied, it could generate the following scenario:

Original scenario

Net income Co1	1000
Expenses Co1	101
Taxable income Co1	**899**

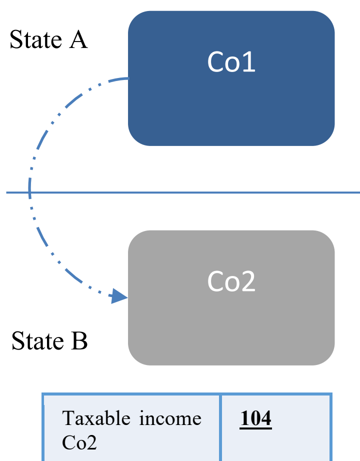


Taxable income Co2	**101**

1. Co1 paid to Co2 originally 100+1% = 101
2. Tax Authorities of State B applied an upward adjustment to Co2, determining that the correct amount must be 100+5%=105. Consequently, Co2 taxable income is increased by four units.
3. If Co1 net income had been 1000 and said 101 applied as a deductible expense, its taxable income in State A was 899. The increase of four units resulting from the upward adjustment conducted by State B to Co2 had been considered part of its net income and, therefore, taxed in State A.

After the upward adjustment

Gross income Co1	1000
Expenses Co1	101
Taxable income Co1	**899** **-4 (?)**



Taxable income Co2	**104**

1. Based on the above, when State B applied an adjustment of four on the income of Co1, it could be said that those four units have previously been subject to taxation in the hands of a different taxpayer. Hence, an issue of economic double taxation arises.
2. If State A does not agree to make a corresponding adjustment, either by a simple claim or a MAP, the MNE group will be taxed twice on this part of its profits.

Corresponding adjustments aim to allocate the value created in the territory that may correspond. In the previous example, an upward adjustment, i.e., a primary adjustment must be conducted by the host State, State B. Theoretically, State A does not have a real problem if the value creation within its territory has been considered correctly calculated. However, the right of OECD Member States to tax profits based upon *income* and *expenses* that can reasonably be deemed to arise within their territory needs to be reconciled with the need to avoid the taxation of the same item of income by more than one tax jurisdiction.[29]

The "liability of applying a corresponding adjustment" was mentioned explicitly for the first time by Article 17 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI), which added Article 9(2) in the OECD Model Tax Convention and modified all Covered Tax Agreements.[30] Likewise, the commentary on Article 9 states that State B is ***committed*** to applying an adjustment, ***provided*** it considers that the adjustment made in State A is justified both in principle (ALP) and as regards the amount.[31]

Specifically, Article 9(2) of the OECD Model Tax Convention establishes that a corresponding adjustment may be applied when one tax administration increases the taxable profit of an MNE by making a primary adjustment. However, this is not applied automatically, but only whether the second jurisdiction considers that the adjusted profits correctly reflect the profits if the transactions had been at arm's length.[32] It is to say that Article 9(2) allows but ***does not obligate*** tax authorities to apply a TP adjustment on taxpayers' tax bases.

[29] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Preface para 4.
[30] Multinational Convention to Implement Tax Treaty related measures to prevent base erosion and profit shifting (MLI) [2016] Article 1.
[31] OECD 'Model Tax Convention on Income and on Capital' full version (n 5) Commentary on Article 9 para 6.
[32] Ibid para 2.6; See also Aitor Navarro 'The Multilateral Instrument (MLI) and Transfer Pricing' [2021] 49 Intertax, Kluwer Law International BV, The Netherlands 803, 812.

According to the OECD, no adjustments should be made if the primary adjustment does not follow the arm's length principle, nor should any adjustment go further than required by the arm's length principle.[33] Otherwise, this could distort the tax liabilities of associated enterprises and the tax revenues of the host jurisdiction[34] by creating tax advantages or disadvantages that may distort the competitive positions of the MNE.[35]

It is essential to point out that some EU MS made reservations on Article 17 of the MLI. Therefore, there are Covered Tax Agreements that have not included 9(2), such as the case of the Czech Republic, which reserves the right not to insert paragraph 2 in its conventions. Additionally, Hungary and Slovenia reserve the right to specify in paragraph 2 that a correlative adjustment will be made only if the primary adjustment is justified.[36] However, most OECD Members consider that corresponding adjustments could be requested, even in the absence of a provision comparable to paragraph 2 of Article 9.[37] It is important to emphasize that the corresponding adjustment may be requested, but that does not imply that it will be accepted, as previously mentioned.

In any case, said Article leaves open how the adjustment should be made. Nevertheless, Article 9 is not an independent legal basis for any adjustment. It requires a domestic provision to be enforceable as the tax treaty itself does not create any taxing rights. Therefore, the exact method for a corresponding adjustment is up to the state's domestic legislation.[38] However, as mentioned, in the face of a lack of domestic legislation, OECD Members apply the OECD

[33] OECD 'Model Tax Convention on Income and on Capital' full version (n 5) Commentary on Article 9 para 6.
[34] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) para 1.3.
[35] Ibid para 1.8.
[36] OECD 'Model Tax Convention on Income and on Capital' full version (n 5) Commentary on Article 9 para 16 and 19.
[37] Ibid Commentary on Article 25 para11 and 12; See also OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Administrative Approaches para 4.33.
[38] Annika Soom (n 12) 98.

international instruments and reports as a reference, which are not enforceable by themselves.

2.2 Corresponding adjustments in the view of EU Law

EU primary law does not provide taxpayers with an alternative to eliminate the double taxation resulting from transfer pricing adjustments. Hence EU taxpayers have to rely on the measures introduced by the OECD MTC and secondary EU Law.

Due to the increasing cases of TP disputes, the European Union has enacted the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, known as the EU Arbitration Convention and the DRD.[39]

In contrast to the OECD instruments, these do not define *primary* and *corresponding adjustments*. However, the EU Arbitration Convention has established that the ALP is a principle that should be observed in the application of said Convention,[40] and the *importance*[41] of applying an adjustment to avoid double taxation in TP cases, without providing it a specific denomination, e.g., primary or secondary.

In any case, it should be noted that the main objective of the EU Arbitration Convention. Specifically, Article 1 states that said instrument shall apply where profits included in the profits of an enterprise of an EU MS are also included or *are also likely* to be included in the profits of an enterprise of another EU MS. The Convention provides for both a MAP and arbitration procedure for these purposes.

As with the OECD MTC, the ALP is the basis for the adjustment to be accepted, and Competent Authorities are not obliged to reach an agreement since Article 6(2) says:

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[39] Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms [2017] OJ L 265/1.

[40] Convention on the Elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) [1990] OJ L 225, 20.8.1990 Article 4.

[41] Ibid preamble of the Convention, Article 1. It is important to mention that it is not mention any "obligation" of applying an adjustment, instead, it is used the word "shall."

> *"If the complaint appears to it to be well-founded and if it is not itself able to arrive at a satisfactory solution, the competent authority* ***shall*** *endeavour to resolve the case by mutual agreement with the competent authority of any other Contracting State concerned, with a view to the elimination of double taxation on the basis of the principles set out in* ***Article 4*** **(ALP)** *(…)"* (Emphasis added)

Moreover, Article 11 states that the opinion issued by the Advisory Commission in the subsequent arbitration procedure *must* be based on Article 4, it is to say, on the ALP.

When it comes to the DRD, it is intrinsically linked to bilateral agreements[42] and the EU Arbitration Convention. Unlike the Convention, this instrument defines double taxation[43] explicitly as the imposition by two or more EU MS of taxes covered by an agreement or convention referred to in Article 1 in respect of the same income or capital when it gives rise to, among others, an increase in tax liabilities, e.g., upward adjustments in TP cases.

Even though the DRD does not have a provision referring to the ALP, such as the OECD MTC[44] and the EU Arbitration Convention,[45] Article 2(2) states that any term not defined by it has the meaning that it has at that time under the relevant agreement or convention invoked by the taxpayer. On this basis, if the affected taxpayer is invoking an OECD agreement, the definition of ALP and TP to be applied may be the OECD's. However, this article explicitly says, "unless the context requires otherwise", keeping open the possibility of applying others, depending on the nature of each case.

Regarding TP adjustments, specifically corresponding adjustments, the DRD does not provide any definition or guidance to apply them. Nevertheless, as it was mentioned, based on Article 2(2), when invoking this instrument, EU MS may apply the definition and guidance provided by the OECD, unless the context requires otherwise.

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[42] Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms (n 39) Article 1.
[43] Ibid Article 2(1)(c).
[44] OECD 'Model Tax Convention on Income and on Capital' full version (n 5) Article 9.
[45] Convention on the Elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) (n 40) Article 4.

2.2.1 Corresponding adjustments in EU domestic legislation

Some EU countries have implemented domestic provisions regarding corresponding adjustments. For instance, Italy has enacted Law Decree No. 50 of 24 April 2017, introducing a new rule to broaden the circumstances under which corresponding adjustments can be made. What is relevant is that the said adjustments may be applied not only in the execution of agreements concluded by MAPs,[46] but taxpayers could request them by a simple filing following a final primary adjustment made by a state with which a convention for the avoidance of double taxation on income is in force. Moreover, the primary adjustment had to be applied in accordance with the ALP.

In the same line, Ireland has established in the Guidelines for Article 9 Correlative Adjustment[47] that a corresponding adjustment does not require negotiation or agreement between the Irish and treaty partner Competent Authorities. Likewise, if the corresponding adjustment is refused, the taxpayer may file either appeal before the Tax Appeal Commissioners or request the initiation of the MAP.[48]

Whether the EU MS does not have legal provisions to regulate corresponding adjustments, it will likely apply and accept them based only on the interpretation of principles and provisions established by the OECD and EU Law and principles, if applicable.

In addition, there are other adjustments known as *compensating adjustments*.[49] In those countries where the tax is self-assessed, the application of an adjustment could be applied directly by the taxpayer to amend a previously- filed tax;[50] it is to say that the direct involvement of the

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[46] Aurelio Massimiano and Mirko Severi 'The New Italian Transfer Pricing Provision Concerning Unilateral Corresponding Adjustments' [2019] International Transfer Pricing Journal January/February IBFD 70, 71.

[47] '*Correlative adjustments'* is another way of naming '*corresponding adjustments'* according to Section 2 of the Guidelines of Ireland.

[48] Irish Office of the Revenue Commissioners 'Guidelines for Article 9 Correlative Adjustment claims' Tax and Duty Manual Part 35-02-09 [2020].

[49] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Glossary 21.

[50] Ibid para 6.1.

tax authorities is not required either their previous authorization.[51] Their nature is different from the corresponding adjustments; nevertheless, it could be applied to adjust the price for a transaction between associated enterprises, that is, in the taxpayer's opinion, an arm's length price. However, they are not recognized by most OECD member countries.

In June 2010-2011, the Joint Transfer Pricing Forum (JTPF)[52] carried out a survey on *compensating adjustment* practices. Regarding domestic legislation on compensating adjustments and operating guidelines on their implementation, eight EU MS have at least some kind of specific operating guidelines in place. In comparison, 19 EU MS do not have any particular regulation or practical guidance. Of these 19 EU MS, only the Czech Republic planned the introduction of specific guidelines.[53]

In practice is not rare to see cases in which associated enterprises apply *internal adjustment*[54] based on their own ALP analysis, used commonly as a prevention technique. However, it may generate a risk for taxpayers since tax authorities could challenge it, considering it an abusive recourse designed to reduce taxable profits between associated parties and not an *internal adjustment*. For instance, the Italian case 164/4/09[55] by the Italian Supreme Court. Nevertheless, these adjustments are out of the scope of this thesis.

[51] OECD 'Transfer Pricing and Multinational Enterprises. Three Taxation Issues' [1984] Paris, France para 20.

[52] EU Joint Transfer Pricing Forum 'Future Work Program. Business Contributions on: is the protection of a (EU) Taxpayer to double taxation subject to limitation? Compensating adjustments and year end adjustments; secondary adjustments, a risk of double taxation within the EU' DOC: JTPF/15/2010/EN Brussels, 29 September 2010.

[53] Dick Barmentlo and Piergiorgio Valente 'Voluntary Payment of Taxes and Voluntary Adjustments of Transfer Prices from an EU Perspective' [2013] International Transfer Pricing Journal July/August IBFD 243, 250.

[54] It is called '*Internal adjustment'* for this thesis purposes, however, it is not defined or recognized by the OECD or any other international instrument in the matter.

[55] Aurelio Massimiano and Mirko Severi (n 46) See also Corte di Cassazione, sez. trib. 13 luglio 2012, sent. n. 11949, para 2.3.4 [This document was found only in its original language].

3 Transfer pricing adjustments from APA State Aid Cases

3.1 Origen of the TP adjustment: Recovery decision

Advance Pricing Agreements (APA) are arrangements that determine, in advance of controlled transactions, an appropriate set of criteria for determining the transfer pricing for those transactions over a fixed period.[56] They are a tool first implemented by the US to prevent TP disputes.[57] In the same line, according to the OECD, APAs are intended to ***supplement*** the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues.[58]

These instruments may be unilateral, bilateral, or multilateral.[59] However, unilateral APAs are the most common since not all EU MS have implemented bilateral and multilateral ones in their local legislation. In addition, reaching an agreement between two or more authorities is more complicated. For instance, at the end of 2019, they were 905 (EU) and 443 (non-EU) unilateral APAs in force in EU MS. In contrast, 136 (EU) and 150 (non-EU) bilateral or multilateral APAs in force in EU MS.[60]

Nevertheless, in some cases, the EU Commission has considered that said agreements were granted as State Aid[61] since they meet the two requirements to be considered as such:[62] (i) an advantage has been granted, and (ii) the advantage is selective. Accordingly, the EU Commission has requested the supposed unlawful state aid recovery. Such decisions are of its exclusive

[56] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Glossary 9.
[57] V. Solilová 'Transfer Pricing Rules in EU Member States' [2010] LVIII Acta univ. agric. et silvic. Mendel. Brun 243, 244.
[58] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) para 4.134.
[59] Ibid Glossary 9.
[60] European Commission 'Statistics on APA's (Advance Pricing Agreements) in the EU at the End of 2019' [2021] Ref. Ares(2021)1802078 – 12/03/2021.
[61] The Starbucks case, the Fiat case and the Apple case.
[62] According to the Consolidated Version of Treaty on the Functioning of the European Union (TFEU) [2012] OJ C 326/47 Article 107(1).

competence, under the control of the EU Court,[63] and subject to review by the Court of Justice.[64]

The recovery of unlawful State Aid is not explicitly mentioned in Article 107. Still, the EU Council stated its process and principles through the Regulation (EU) 2015/1589,[65] in line with the European Court of Justice case law.[66] According to said Regulation, the Commission must order the recovery of unlawful and incompatible aid. Besides, the ***EU MS involved must take all necessary measures to effectively recover it***, according to the procedures established in their domestic legislation. It is to say that national courts must not block the implementation of a decision of this nature; otherwise, in case of non-compliance, the Commission may refer it to the Court of Justice of the European Union (CJEU).[67]

Each EU MS may designate the entity responsible for implementing the recovery decision.[68] In the specific case of the Commission's decisions on state aid cases related to APAs, since the subject of matter are taxes, Tax Authorities are usually designed to do so. Suppose the EU Commission has not quantified the precise amount of aid to be recovered in the recovery decision, such as in APAs cases. In that case, the EU MS must quantify the aid based on the methodology set out in the recovery decision.[69] In this regard, the CJEU[70] has indicated that the EU Commission is not required to fix the exact amount of the aid to be recovered. It is sufficient for the decision to include information enabling the addressee of the decision to work itself out. Further, the obligation on a Member State to calculate the exact amount of aid to be recovered forms part of the more general reciprocal obligation

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[63] Case C-39/94 *SFEI* [1996] EU:C:1996:285, para 42; Case C-143/99 *Adria-Wien Pipeline* [2001] EU:C:2001:598, para 29.
[64] Case C-354/90 *FNCE* [1991] EU:C:1991:440, para 14.
[65] Council Regulation (EU) 2015/1589 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (codification) (Text with EEA relevance) [2015] OJ L 248/9.
[66] Case C-348/93 *Commission* v *Italy* [1995] EU:C:1995:95, para 27; Case C-610/10 *Commission v Spain ('Magefesa II')* [2012] EU:C:2012:781*,* para 105.
[67] Consolidated Version of TFEU (n 63) Article 108(2).
[68] Communication from the Commission (2019/C 247/01) Commission Notice on the recovery of unlawful and incompatible State aid [2019] OJ C 247/1, para 70.
[69] Ibid para 99.
[70] Case C-403/10 P *Mediaset v Commission* [2011] EU:C:2011:533, para 126.

incumbent upon the Commission and the Member States of sincere cooperation in implementing Treaty rules concerning State aid.

For tax measures, the competent authorities must go back into the tax assessment, which contains the relevant undue advantage and amends that tax assessment to trigger a repayment obligation.[71] The Tax Authorities of EU MS involved in a state aid case related to APAs necessarily carry out an evaluation through an audit process or the corresponding process established in its domestic legislation, applying the methodology indicated by the Commission.[72] Since, in these cases, the EU Commission has argued that EU MS has misapplied the ALP,[73] which results in a lower amount of taxes, the execution of an EU Commission's recovery decision necessarily leads to an upward transfer pricing adjustment.

On this basis, it may be argued that since the primary adjustment was applied based on an EU Commission's decision, and that TP-related issues should always be handled bilaterally, the second EU MS **must** apply a corresponding adjustment. Nevertheless, it should be considered that i) the recovery decision issued by the Commission does not have *erga omnes* effects. It is to say that it is only addressed to the involved EU MS in that specific case. Consequently, it does not generate obligations for other EU MS, namely EU MS indirectly linked to the case, and ii) the aim of the said decision is only the recovery of unlawful state aid and not the potential implications that this might generate.

However, in those cases in which the EU MS indirectly involved[74] does not agree to make a downward adjustment (corresponding adjustment), the MNE

[71] Axel Cordewener 'Recovery of unlawful State aid' [2020] 70 Algemeen Fiscaal Tijdschrift 34, 40.
[72] As reference, see *Commission v Luxemburg* (2014/C ex 2014/NN) Commission Decision on State Aid SA.38375 [2015] 7152 final, para 311; *Commission v The Netherlands* (2014/C ex 2014/NN) Commission Decision on State Aid SA.38374 [2015] 7143 final, para 339 and 341, and *Commission v Ireland* (2014/C ex 2014/NN) Commission Decision on State Aid SA.38373 [2016] 5605 final, para 319.
[73] As reference, see *Commission v Luxemburg* (n 72) para 301, *Commission v The Netherlands* (n 72) para 400, *Commission v Ireland* (n 72) para 412.
[74] Considering that only cases between EU MS are being considered in this thesis.

group will be taxed twice on this part of its profits, generating a problem of economical double taxation,[75] as was explained in Section 2.1.

3.2 Basis of the TP adjustment in State Aid Cases: EU Arm's Length Principle

As mentioned in section 2, primary and secondary transfer pricing adjustments are based on the ALP, the internationally agreed standard defined by the OECD in Article 9 of the OECD Model Tax Convention and the OECD Transfer Pricing guidelines. As mentioned in said section, even the EU Law instruments refer to the ALP to apply and accept a TP adjustment.

At first sight, it might be considered that the Commission has accepted the OECD ALP as a central reference system for state aid cases, as it is stated in the Notice of State Aid.[76] It mentions that even though OECD guidelines do not deal with State aid matters, they capture the international consensus on transfer pricing and provide helpful guidance to tax administrations and multinational enterprises. It is even mentioned that if a transfer pricing arrangement complies with the advice provided by the OECD Transfer Pricing Guidelines, ***it is unlikely to give rise to State aid*** (Emphasis added). This means that the endorsement of the use of the OECD Guidelines constitutes the endorsement of a valuation standard that is compatible with article 107 of the TFEU.[77]

Notwithstanding, the EU Commission seems to contradict what is stated in the Notice when it says that the origin of the ALP is Article 107 TFEU;[78]. Thus, it should be considered that said principle would be a derivative of EU Law, specifically state aid and fair competition principles. If that is the case, then the EU concept may be different from the regular fiscal understanding

[75] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) para 4.140.
[76] Communication from the Commission (2016/C 262/01) Commission Notice on the Notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, para 173.
[77] Stefano Castagna 'On the European Commission's Understanding of the Arm's Length Principle in International Taxation versus State Aid Matters – Treaty Violations and High Stakes in Play' [2021] World Tax Journal IBFD 481, 484.
[78] *Commission v The Netherlands* (n 72) para 264; *Commission v Luxemburg* (n 72) para 228.

of the ALP precisely because of its different objectives, i.e., internal market interest and fair competition[79] v. allocation of taxing rights/avoiding double taxation.[80] Therefore, we may be looking at an autonomous EU ALP flowing from the internal market imperative of free competition.[81] Consequently, the Commission does not recognize that the OECD TP Guidelines are the basis of the EU ALP.[82]

The existence of the so-called EU ALP was implicitly accepted for the first time by the Court of Justice in Forum 187 case.[83] Then, the General Court implicitly accepted it in the Starbucks case.[84] Nevertheless, the Commission's interpretation of the ALP in state aid cases involving APAs has been viewed as confusing and lacking clarity.[85] Besides, it should be considered that, unlike the OECD ALP, the EU ALP does not have extensive guidelines on how to apply it.

For some authors, the application, principles, and scope of the EU ALP and OECD ALP are the same[86] resulting in similar outcomes, whereas, for some others, it may deviate from the traditional OECD understanding of that principle.[87] Nevertheless, as mentioned in the limitation of this research, its aim is not to analyze in-depth the technicalities of the EU ALP v. OECD ALP, but to emphasize the origin claimed by the EU Commission of the EU ALP, i.e., primary EU Law, and the likely different results applying each of them.

As described in section 2, the ALP is a key element for corresponding adjustments since the second jurisdiction must agree that the primary adjustment was made based on the ALP, the one that said jurisdiction may

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[79] Consolidated Version of the TFEU (n 62) Article 107(1).
[80] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Preface para 7.
[81] Peter J. Wattel 'Stateless Income, State Aid and the (Which?) Arm's Length Principle' [2016] 44 Intertax Kluwer Law International BV, The Netherland 792.
[82] Stefano Castagna (n 77) 494.
[83] Cases C-182/03 and C-217/03 *Forum 187 v. Commission* [2006] EU:C:2006:416.
[84] Cases T-760/15 and T-636/16 *Netherlands and Others v Commission* [2019] 2019/C 413/47.
[85] Jérôme Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (Wolters Kluwer 2018) 31.
[86] Stefano Castagna (n 77) 494; see also Ruth Bonnici 'The European Commission's Arm's Length Standard: Relationship and Compatibility with the Arm's Length Principle under Transfer Pricing' (2019) International Transfer Pricing Journal January/February IBFD 61
[87] Peter J. Wattel (n 81) 801

recognize and according to its interpretation. The peculiarity in State Aid cases is that the primary adjustment is based on the EU ALP[88] instead of the OECD ALP.

Hypothetically speaking, it could be the case that State A has carried out an audit process to Co1. As a result, it is determined that the OECD ALP and its local legislation were correctly applied. Then, Co2 in State B is subject to a TP upward adjustment due to a state aid case. Thus, the adjustment is applied based on the EU ALP. Suppose Co1 requests the competent authority of State A to carry out a corresponding adjustment. In that case, likely, it will not be accepted for, among others: i) the primary adjustment in State B was not made according to the OECD standards and consequently the results may differ, and ii) State A already audited Co1, and it was considered that the transactions are at ALP, so there is no need for an adjustment, i.e., corresponding adjustment, in State B. In both cases, it is necessary to substantiate that a transaction is not at ALP.

This would impede the MNE group from obtaining a double taxation relief. More importantly, the adjustment would only be one-sided, causing a violation of the taxpayer's rights.[89] For instance, the local legislation of Greece provides that[90] if the competent authority of another contracting state makes a MAP request concerning TP adjustments, a tax audit on the subject must be conducted so that the claims put forward by the competent authority of the other contracting state are examined based on their substance.[91] This would clearly cause the problem previously mentioned.

3.2.1 Hierarchy of the EU Arm's Length Principle

Scholars have widely discussed the difference or similarities between the OECD ALP and the EU ALP. Since it is not the aim of this thesis, this

[88] *Commission v The Netherlands* (n 73) para 264; *Commission v Luxemburg* (n 72) para 228.
[89] Stefano Castagna (n 77) 496.
[90] Decision A. 1226/2020 concerning the "Regulation of issues related to the Mutual Agreement Procedure under bilateral Agreements for the Avoidance of Double Taxation on Income" [2020] OJ Folio B' 4504 [This document was found only in its original language]. See also Karina Perrou 'Making the Mutual Agreement Procedure More Effective in Greece: A Commentary on the Guidelines for the Conduct of MAPs' [2021] European Taxation February/March IBFD.
[91] Karina Perrou (n 90) 96.

research relies on the hypothesis that they are different. Specifically, their different origin and basis, namely the origin of the EU ALP, i.e., EU primary law. It has been emphasized the essential role of the ALP in previous sections. Now, its hierarchy is analyzed due to the mandatory application of corresponding adjustments resulting from state aid cases between EU MS could depend on this, as it will be exposed below.

It should be taken into account that the peculiarity of the application of the EU ALP is a hallmark of state aid cases, so what is described below may not be applicable to state aid cases in which transfer pricing is not involved or in other cases of corresponding adjustments not arising from a recovery decision of unlawful state aid.

Having said those above, to determine the hierarchy of the EU ALP within the EU MS tax systems, it should be taken into account, apart from the principle of primacy of the EU Law,[92] the hierarchy of the international instruments that develop the standard ALP, i.e., the OECD Model Tax Convention and the OECD TP Guidelines.

As previously mentioned, Article 9 of the OECD Model Tax Convention is not binding by itself. Accordingly, the ALP principle needs to be transposed to local legislation. In some EU MS, their domestic law explains extensively how to apply the ALP; in some others, it does not develop the principle but refers directly to the OECD TP guidelines, and there are other cases in which tax authorities have generally adopted the ALP and methods provided by OECD TP guidelines, being borrowed as official regulations, without any direct mention in domestic provisions.[93] Nevertheless, they are generally not a binding instrument for EU MS and the Commission.[94]

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[92] Case 6/64 *Flaminio Costa v ENEL* [1964] EU:C:1964:66.

[93] Based on the information published on OECD 'Transfer Pricing Country Profiles' Updated as of 22 February 2022, <https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profiles.htm> accessed 15 April 2022.

[94] Stefano Castagna (n 77) 482.

In *Starbucks*[95] and *Fiat*[96], the Commission acknowledges that the OECD Guidelines lack any binding force and proceeds to list their attributes and their influence in the tax arena. Nonetheless, the EU ALP that the Commission applies in State aid assessments is not the one derived from Article 9 of the OECD MTC. On the contrary, it falls within the application of Article 107(1) of the Treaty, which binds EU MS[97] according to the principle of EU Law primacy. This implies an obligation to tax MNE according to the ALP, regardless of whether an EU MS has incorporated this principle into its national legal system,[98] to provide equal treatment between MNE.[99]

Although not expressly mentioned, the OECD ALP has been almost transposed in secondary EU law. The EU Transfer Pricing Arbitration Convention copied Articles 7(2) and 9(1) of the OECD MTC on the ALP. The DRD does not transpose the principle. However, this is a legal instrument intrinsically linked to tax treaties,[100] thus related to the OECD ALP. Moreover, Article 8(2) of the Anti-Tax Avoidance Directive (ATAD)[101] also refers to ALP.

An argument that may be used in order to apply the OECD ALP is its potential binding value as a consequence of being part of customary international law.[102] Yet, as a counterargument, no international court has found a principle of taxation to be part of binding customary international law. There is no binding customary international tax law for EU MS applicable to direct taxation.[103]

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[95] *Commission v The Netherlands* (n 72) para 62.
[96] *Commission v Luxemburg* (n 72) para 84.
[97] *Commission v The Netherlands* (n 72) para 264; *Commission v Luxemburg* (n 72) para 228; *Commission v Ireland* (n 72) para 257; *Commission v Belgium* (2015/C ex 2015/NN) Commission decision on the excess profit exemption State Aid scheme SA.37667 [2017] 6740 final, para 150.
[98] Jérôme Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (n 85) 26.
[99] Ibid 30.
[100] Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms (n 39) Article 1.
[101] Council Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L 193, 19.7.2016, para 1.
[102] Jérôme Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (n 85) 35.
[103] Ibid 36.

When it comes to the Law of Treaties, Double Taxation Conventions (DTC) must be viewed separately and autonomous,[104] whose principles of interpretation and application are established in Articles 30 and 31 of the Vienna Convention on the Law of Treaties (VCLT). Those Articles would be relevant if one of the subjects involved in the dispute is a third country. However, since this thesis is only focused on cases between EU MS, it should be noted that EU MS must comply with EU law when enacting domestic legislation and concluding tax treaties and when interpreting and applying them.[105] Therefore, in case of collision, the EU Law takes precedence.

If, as the Commission has argued, the EU ALP indeed forms part of Article 107(1) TFEU, it ranks at the very top of the EU Law hierarchy, and all secondary law and domestic rules have to adhere to it,[106] as well as the interpretation of tax treaties. This causes a paradox since all MS have to follow the Commission's ALP, even whether the OECD ALP has been legally accepted by domestic law, which may collide with the principle of subsidiarity[107] and sovereignty.[108] This is also an argument against the Commission Decisions presented by the companies involved in such litigations. Nevertheless, it is not the focus of this thesis research.

Based on the above, in the event of a collision between domestic legislation, provisions of a tax treaty, and EU Law, it is clear enough that EU MS must comply with the latter, which is to say with EU ALP. This is relevant not only for applying the EU ALP as a benchmark by itself, but this raises the question of whether an EU MS could claim it against another EU MS to make them apply a corresponding adjustment based on Article 4(3) TEU.

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[104] M. Lang, *Introduction to the Law of Double Taxation Conventions* (Second Revised Edition IBFD 2013) Books IBFD para 69.

[105] Ilaria Panzeri 'Tax Treaties versus EU Law: Which Should Prevail?' [2021] European Taxation IBFD 147, 148; See also *Flaminio Costa v ENEL* (n 92).

[106] Ruth Bonnici (n 86) 58.

[107] Consolidated Version of Treaty on the European Union (TEU) [2012] C 326/13 Article 5(3).

[108] Ibid Article 4(1).

4 Corresponding Adjustments between EU Member States

4.1 Double taxation in the view of EU Law

EU primary Law does not provide uniform or harmonization measures to eliminate juridical or economic double taxation.[109] It is important to note that the second paragraph of former Article 293 of the Treaty establishing the European Economic Community (TEEC) explicitly stated that '*Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals ... the abolition of double taxation within the Community*.' Nevertheless, the TEU and the TFEU do not explicitly provide a provision like those mentioned.

The EU Commission has enacted EU Directives[110] to eliminate or alleviate international double taxation in some specific areas. The CJEU has held that in areas not harmonized by EU law, the Member States are not obliged to eliminate the international double taxation caused by simultaneous taxation in several states, provided that such taxation does not constitute prohibited discrimination.[111] Based on the above, some scholars have argued that the economic double taxation resulting from the lack of a corresponding adjustment in transfer pricing cases is not a breach of EU Law as it is a result of either pure disparity or a consequence of the parallel exercise of taxing rights.[112]

However, the CJEU has stated that in the absence of unifying measures in this regard, it is for the EU MS to take the measures necessary to prevent double taxation by applying, in particular, the apportionment criteria followed in

[109] C-298/05 *Columbus Container Services* [2007] EU:C:2007:754, para 45.
[110] EU Merger Directive: Council Directive 2009/133/EC of 19 October 2009 on the Common System of Taxation Applicable to Mergers, Divisions, Partial Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States and to the Transfer of the Registered Office of an SE or SCE between Member States (Codified Version) [2009] OJ L310; EU Parent-Subsidiary Directive: Council Directive 2011/96/EU on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States [2011] OJ L345; EU Interest and Royalties Directive: Council Directive 2003/49/EC on a Common System of Taxation Applicable to Interest and Royalty Payments Made between Associated Companies of Different Member States [2003] OJ L 157.
[111] Case C-67/08 *Margarete Block v. Finanzamt Kaufbeuren* [2009] EU:C:2009:92, para. 31.
[112] Annika Soom (n 12) 99.

international tax practice, especially the OECD MTC.[113] Even though EU MS have entered into several bilateral conventions designed to eliminate or mitigate double taxation, based on the OECD MTC, the fact nonetheless remains that the CJEU has no jurisdiction to rule on the possible infringement of the provisions of such conventions by a contracting EU MS.[114] That principle is enshrined in particular in Article 344 TFEU, under which the EU MS undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for in the Treaties.[115] In this sense, the CJEU has no jurisdiction to rule on double taxation issues derived from those treaties and consequently on corresponding adjustment cases.

Considering the hierarchy of EU Law, Tax treaties[116] are a secondary means of eliminating international double taxation[117] since they are not part of EU law in their narrow meaning. The EU directives, issued by the Commission in accordance with article 115 of the TFEU and other EU instruments, are the primary means available for eliminating international double taxation.[118] On this basis, it could be determined that in the event of disputes related to economic double taxation arising from TP adjustments between EU MS, the DRD and EU Arbitration Convention must be the primary means for eliminating it. However, OECD treaties have great relevance to the tax treatment applied by EU MS, so they may be applied as a secondary basis. In any case, the interpretation and application of these conventions must comply with the principles and provisions of EU law.[119]

[113] C-524/04 *Thin Cap* [2007] EU:C:2007:161, para 49. See also C-336/96 *Gilly* [1998] EU:C:1998:221, para 21 and 30; *N* C-470/04 [2006] EU:C:2006:525, para 44.
[114] *Columbus Container Services* (n 109) para 46.
[115] *Slowakische Republik v Achmea BV* (n 13) para 32.
[116] OECD Tax Treaties between EU MS.
[117] Marjaana Helminen *EU Tax Law – Direct Taxation – 2021* (edition IBFD 2021) 14.
[118] Marjaana Helminen 'The Principle of Elimination of Double Taxation under EU Law – Does it Exist?' (2014) in Principles of Law: Function, Status and Impact in EU Tax Law (C. Brokelind ed.) IBFD 391, 392.
[119] Marjaana Helminen *EU Tax Law – Direct Taxation – 2021* (n 117) 14.

4.2 Dispute resolution mechanism to eliminate the double taxation under EU Law

When it comes to transfer pricing disputes, according to the OECD, there are two primary types of issues that may be brought to the competent authorities:[120] i) when a primary adjustment does not reflect an ALP outcome, and ii) the non-performance of a corresponding adjustment in those cases in which the applicable tax treaty contains a corresponding adjustment rule.

As the first step to solving said disputes, both the EU Arbitration Convention[121] and the DRD[122] provide that the competent authorities shall consult each other if necessary to determine appropriate corresponding adjustments through a Mutual Agreement Procedure (MAP). Such procedure enables the competent authorities to determine whether the initial adjustment met the ALP[123] to relieve the double taxation.

Notwithstanding, the MAP does not provide an obligation to apply a corresponding adjustment. The non-mandatory nature of corresponding adjustments is necessary so that one tax administration is not forced to accept the consequences of an arbitrary or capricious adjustment by another State.[124]

The MAP request regarding a corresponding adjustment in TP cases could be submitted to either authority under the EU Arbitration Convention;[125] or to all the authorities involved, according to the DRD.[126] The required authority

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[120] OECD 'Model Tax Convention on Income and on Capital' full version (n 5) Article 25; see also OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Chapter IV: Administrative approaches 18; and Aitor Navarro (n 32) 803, 814.

[121] Convention on the Elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) (n 40) Article 6(2).

[122] Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms (n 39) Article 4.

[123] Since it is an essential requirement to accept a corresponding adjustment, under OECD MTC. Due to the EU Law instruments do not define corresponding adjustments and their application, for this thesis purposes, it is used the OECD MTC as a reference.

[124] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Chapter IV: Administrative approaches para 4.35.

[125] Convention on the Elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) (n 40) Article 6(2).

[126] Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms (n 39) Article 3(1).

may apply the corresponding adjustment when it receives the MAP request;[127] otherwise, the competent authorities may start the discussions within the MAP. However, for a MAP to begin, both authorities may accept the initial complaint.[128]

In practice, the MAP is time-consuming,[129] and the results are uncertain[130] since it does not impose an obligation to reach an agreement. Such an obligation will exist only under the arbitration process.[131] For this reason, several EU MS have entered into treaties[132] that contain a clause under which if the authorities of the two contracting states cannot reach an agreement within a fixed period, the question is referred to an arbitration committee that will rule on the issue.[133] Additionally, the EU MS can start arbitration procedures provided by the EU Arbitration Convention and the DRD.

When it comes to transfer pricing adjustments derived from the recovery of state aid, as explained in Section 2, the primary adjustment would be made based on the EU ALP. Since none of these two legal instruments provide clear guidelines to apply the ALP, and considering that EU MS are OECD Members,[134] the competent authority requested to accept a corresponding adjustment might use the OECD ALP in its assessment. Therefore, competent authorities involved in a said dispute would not reach an agreement by means

[127] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Chapter IV: Administrative approaches para 4.32.
[128] Convention on the Elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) (n 40) Article 6; see also Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms (n 39) Article 4(1).
[129] According to the statistics published by EU Commission, a MAP process under the EU Arbitration convention can take an average time of 35 months and up to 84 months (in the Czech Republic). The statistics cover only MAPs between EU MS: Overview of numbers submitted for Statistics on Pending Mutual Agreement Procedures (MAPs) under the Arbitration Convention (AC) at the End of 2019, issued in March 2021, Ref. Ares(2021)1802078 – 12/03/21. Up to date, the EU Commission does not have available statistical data on disputes under the Council Directive EU 2017/1852.
[130] OECD 'Model Tax Convention on Income and on Capital' full version (n 5) Transfer Pricing, Corresponding adjustments and the Mutual Agreement Procedure para 36.
[131] Aitor Navarro (n 32) 803, 816.
[132] Under the MTC of the OECD.
[133] M. Lang (n 104) para 515.
[134] Except for Malta.

of a MAP.[135] Consequently, the dispute would escalate to the arbitration from which an outcome must emerge, no longer optional but mandatory.

Since this thesis aims to analyze mandatory corresponding adjustment between EU MS derived from state aid cases, an issue that is outside the CJEU jurisdiction and whose solution may not be found in the MAP,[136] the possibility to reach said adjustment by the arbitration procedure according to the EU Law instruments would be touched upon below.

4.2.1 Corresponding adjustments in Arbitration under EU Law

The OECD implemented the Arbitration procedure due to the work on Action 14 of the BEPS Action Plan, which directly addressed concerns related to the denial of access to the MAP concerning transfer pricing adjustments[137] and the increasing number of said cases without a positive outcome.

The MLI, which introduced Article 25 to the OECD MTC, and the DRD are the two significant instruments providing the legal framework for post-BEPS international tax arbitration. Both establish mandatory binding arbitration.[138]

Apart from that, the EU Arbitration Convention provides an arbitration procedure; however, it is subject to a previous MAP. It is to say that if the competent authorities do not agree to start the MAP, the arbitration procedure cannot be started. On the contrary, the arbitration procedure under the DRD does not need a previous MAP; it is sufficient that one of the competent authorities involved rejected the complaint to raise the right for the taxpayer to access the arbitration procedure.[139]

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[135] Please refer to the example in section 2.1.
[136] Considering that there is not an obligation to reach an agreement under the MAP.
[137] OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (n 4) Chapter IV: Administrative approaches para 4.43.
[138] Ana Paula Dourado General Editor 'Post-BEPS International Tax Arbitration' 47, Issue 8 & 9 (2019) Kluwer Law International BV, The Netherlands 671.
[139] Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms (n 39) Article 6(1)(a) and (2) DRD.

Under both instruments, a mandatory arbitration procedure must be started if no agreement is reached after two years within the MAP stage.[140] This is aimed to secure an outcome whether the MAP does not reach it.

At this stage is where the relevance of the EU ALP arises. The principle of sincere cooperation set out in Article 4(3) TEU states that EU MS must ensure in their respective territories the application of and respect for EU law and to take for those purposes any appropriate measure, whether general or particular, to ensure fulfillment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the EU. Specifically, EU MS must exercise their competence in direct taxation in compliance with EU law.[141] This includes provisions regarding State aid, particularly Article 107 TFEU, the origin of EU ALP, and consequently, said ALP by itself and the results of its application must be considered for the application of primary adjustments. Additionally, the EU MS must give full force and effect to EU law as interpreted in the decisions of the CJEU.[142] Such as the case of the implicit acceptance of the EU ALP and its origin in EU primary Law by the General Court.

It should be recalled that, according to the settled case-law of the CJEU, ***an international agreement cannot affect the autonomy of the EU legal system***.[143] In this sense, the OECD provisions cannot affect the autonomy of the EU law and the primacy of applying the EU instruments over the OECD Tax treaties. On this basis, Article 107 and EU ALP must be applied with primacy over the OECD ALP.

On the one hand, it is important to note that given the nature of the DRD, the principles of EU Law must be considered when applying it. On the other hand, the EU Arbitration Convention is an international instrument signed by EU MS but not a legal instrument from the European Legal System by itself. In

[140] Convention on the Elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) (n 40) Article 7. See also and Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms (n 39) Article 6(1)(b).
[141] Case C-337/19 P *Excess profit exemption* [2021] EU: C:2021:741 para 162.
[142] Case 106/77 *Simmenthal* [1978] EU:C:1978:49, C-453/00 *Kühne and Heitz* [2004] EU:C:2004:17, para 20.
[143] *Slowakische Republik v Achmea BV* (n 13) para 32.

this regard, the CJEU[144] has stated that given the nature and characteristics of EU law, it must be regarded as forming part of the law in force in every EU MS. Consequently, it should be considered when interpreting international agreements between EU MS. Although the EU Arbitration is not either an international agreement, it could be construed that based on the above, when applying the EU Arbitration Convention, EU MS must consider the principles and provisions of EU Law.

In this same line, the CJEU has held that an arbitral tribunal may be called on to interpret or indeed apply EU law.[145] Even though treaties do not create tax liabilities by themselves but serve as limitations on the application of domestic provisions, which according to the Court include EU Law.[146] Consequently, in the cases at issue, Article 107 TFEU as the origin and legal support of the EU ALP must be applied in the arbitration procedures provided by the EU Arbitration Convention and the DRD.

Even though the CJEU does not have jurisdiction in these subjects, since arbitral tribunals may be applying EU Law, a preliminary ruling may be raised,[147] to ensure the complete application of EU and protect the rights of individuals and MNE, and to ensure consistency and uniformity in the interpretation of EU law.[148] In the *Achmea* case, the CJEU held that the arbitration panel established under the bilateral investment treaty between the Netherlands and the Slovak Republic had to apply EU law. Yet, as it is required by Article 267 TFEU, the question arose whether the arbitral tribunal is situated within the judicial system of the EU and consequently, if it is entitled to raise a preliminary ruling, if needed. In this case, it was argued that the competence of the arbitration panel was created by an agreement that was concluded by EU MS rather than the EU.[149]

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[144] Ibid para 58 & 60.
[145] Ibid para 42.
[146] Jérôme Monsenego 'Does the Achmea Case Prevent the Resolution of Tax Treaty Disputes through Arbitration?' (2019) Volume 47 Kluwer Law International BV, The Netherlands 725, 730.
[147] According to Consolidated Version of the TFEU (n 62) Article 267.
[148] Opinion 2/13 (Accession of the EU to the ECHR) of 18 December 2014, EU:C:2014:2454, para 174.
[149] *Slowakische Republik v Achmea BV* (n 13) para 48 & 49.

Notwithstanding those mentioned above, in the cases at issue, the arbitral panels are created either by the DRD, an EU legal instrument, or the EU Arbitration Convention. Although in the case of the latter, it was only concluded within EU MS and the EU is not precisely part of the agreement, the EU authorities have recognized the instrument.[150] Based on the above, the position of the CJEU in the *Achmea* case may be challenged, and the arbitral panel might raise a preliminary ruling, if necessary. To conclude in this respect, it should be taken into account other elements and should be conducted an in-depth analysis.

In this sense, in the case of an arbitration procedure, the MNE affected may invoke EU law to make the competent authorities of an EU MS apply a mandatory corresponding adjustment, namely Article 4(3) TEU and 107 TFEU. In addition, EU MS must take the necessary actions to prevent international double taxation,[151] which may be prevented by applying a corresponding adjustment, if needed and requested.

5 Conclusion

As described in section 2.1, an upward primary adjustment applied due to an EU Commission recovery decision might cause economic double taxation and a subsequent need for a corresponding downward adjustment. It should be recalled that for a corresponding adjustment to be applied, the second jurisdiction needs to assess the primary one. If it considers that it was made on the ALP basis, it shall accept the application of a corresponding adjustment, otherwise a TP dispute could begin.

[150] The origin of the Arbitration convention was the Commission's 1976 proposal for a directive to eliminate double taxation in the case of transfers of profits between associated enterprises in different Member States (Official Journal C 301 of 21 December 1976) and the White Paper of 1985 on the completion of the Internal Market. After long negotiations in the Council, the Commission proposal was transformed from a Directive into an inter-governmental Convention, and it was signed on 23 July 1990. Information obtained from the website of the EU Commission 'Transfer Pricing and the Arbitration Convention' (Taxation and Customs Union) <https://ec.europa.eu/taxation_customs/transfer-pricing-and-arbitration-convention_en> accessed 12 May 2022.

[151] *Excess profit exemption* (n 141) para 166; *Gilly* (n 113) para 31, *N* (n 113), para 45 & 49, and *Thin Cap* (n 113), para 49.

Even though DRM have been implemented to solve said disputes, both by the OECD and within the EU, not all DRM provide an effective solution, namely the MAP. This mechanism does not obligate the jurisdictions to apply a corresponding adjustment, and consequently, the economic double taxation issue might not be solved. However, both the OECD and the EU instruments provide for arbitration, another DRM through which reaching an agreement is not optional.

The basis for requesting a corresponding adjustment is stated in Article 9(2) of the OECD MTC, a provision that the MLI included. Even in those cases where EU MS have made reservations on it, such as the Czech Republic, this does not impede applying a corresponding adjustment, according to the OECD, mainly if the dispute occurs between EU MS. The above since EU MS may use the DRM provided by the EU Law, and they must adhere to the EU principles, given the primacy of the EU Law.

Regarding the origin of the primary adjustment that may be applied due to the recovery of state aid, namely the EU ALP and Article 107 TFEU, it must be considered its origin in EU primary Law and consequently primacy over the OECD ALP. Besides, the recovery, i.e., primary adjustment, is executed following the methodology provided by the EU Commission; therefore, this does not provide much scope for the arbitrary application of the ALP by the first jurisdiction.

In the case of the EU Arbitration Convention, it defines the ALP as a principle to be observed in the application of said convention;[152] however, being an instrument agreed upon within the EU MS, it must be understood that its subjection is to the EU ALP. Besides, the DRD[153] is not bonded to the application of the OECD ALP, especially TP disputes derived from state aid cases. As a result, when it comes to TP disputes between EU MS, they should apply and recognize the EU ALP and any primary adjustment made using it as a basis.

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[152] Convention on the Elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) (n 40) Article 4(1).

[153] Council Directive (EU) 2017/1852 on tax dispute resolution mechanisms (n 39) Article 2(2).

As a result, in the event that an EU MS refuses to apply a corresponding adjustment under the argument that the primary adjustment was not made based on the (OECD) ALP, the requesting EU MS may claim the primacy of EU Law. EU MS are subject to the principle of sincere cooperation set out in Article 4(3) TEU, which states that EU MS must ensure in their respective territories the application of and respect for EU law and to take for those purposes any appropriate measure, such as Article 107 and the EU ALP. Although it is allowed unfavorable treatment derived from parallel tax systems, according to CJEU case law EU MS must apply measures to avoid double taxation, such as applying corresponding adjustments.

Based on the above, the author's opinion is that the exact origin of the dispute, i.e., a primary adjustment made on the EU ALP, is the potential legal basis for an EU MS to request a mandatory corresponding adjustment to another EU MS.

It is important to emphasize that this is something specifically for cases in which the following conditions are met: i) the jurisdictions involved are EU MS; ii) the dispute has originated from state aid cases; iii) a corresponding adjustment in TP is requested; iv) the primary adjustment has been applied based on the EU ALP by the first EU MS. Whether one of the said conditions is not met, the request for a mandatory corresponding adjustment might not be possible.

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