MPI Studies in Tax Law and Public Finance 6

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State Aid Law and Business Taxation

Springer

MPI Studies in Tax Law and Public Finance

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MPI Studies in Tax Law and Public Finance

Volume 6

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Kai A. Konrad
Wolfgang Schön

Isabelle Richelle • Wolfgang Schön •
Edoardo Traversa
Editors

State Aid Law and Business Taxation

Springer

Editors
Isabelle Richelle
Tax Institute
HEC-University of Liège
Liège, Belgium

Wolfgang Schön
Max Planck Institute for
Tax Law and Public Finance
Munich, Germany

Edoardo Traversa
Faculté de droit et de crimonologie
Université catholique de Louvain
Louvain-la-Neuve, Belgium

ISSN 2196-0011 ISSN 2196-002X (electronic)
MPI Studies in Tax Law and Public Finance
ISBN 978-3-662-53054-2 ISBN 978-3-662-53055-9 (eBook)
DOI 10.1007/978-3-662-53055-9

Library of Congress Control Number: 2016955414

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Preface

In November 2015, the Max Planck Institute for Tax Law and Public Finance, the Université Catholique de Louvain and the Tax Institute of the University of Liège along with Leiden University and the University of Rennes convened two interlinked events in the Palais des Académies in Brussels to discuss fundamental and specific issues of European competition law in the field of fiscal aid. The open conference "Taxation and EU State Aid Law – Current Practice and Policy Issues" was followed by the closed symposium "State Aid Law and Business Taxation: Selected Issues". This volume consists of papers and presentations delivered in the course of the conference and the symposium. Its goal is to provide the reader with the most current account of where we currently stand with regard to the relationship between "business taxation and state aid law".

It is no secret that this area of European competition law has risen to global prominence due to the procedures initiated by the European Commission against several European Member States in the context of harmful tax competition and aggressive tax planning. But it is also well known that the interaction between state aid discipline and national tax legislation started several decades ago and both extensive Commission practice and highly sophisticated Court jurisprudence in this field have contributed to transform the prohibition on selective aid under Art. 107 (1) of the Treaty on the Functioning of the European Union (TFEU) not only into a substantial constraint to tax sovereignty in the Member States of the European Union but also into a powerful policy tool in the hands of the European Commission (which can take action under Art. 107 and 108 of TFEU, without the necessity to consult with the Council or to establish proceedings in the Court of Justice of the European Union (CJEU)). In April 2016, the European Commission emphasized the high relevance of state aid law in the field of business taxation when it published its long-awaited notice on the notion of state aid under the Treaty.

Against this background, this volume tries to present both foundational questions—regarding central notions like "advantage", "selectivity" and "discrimination"—and recent challenges stemming from the practical application of state aid control, e.g. in highly discussed sectors like energy taxation, research and development incentives or leasing transactions. Given the state of the debate in the European Union and beyond, most contributions in this volume focus on different aspects of international taxation seen through the lens of Art. 107(1) of the TFEU: double taxation and double non-taxation, tax avoidance, beneficial ruling practice, transfer pricing, harmful tax competition, the code of conduct and so on. In this respect, this volume claims to contain not only the most recent account of state aid discipline in fiscal matters at large but also the first extensive multi-voice debate on the interaction between state aid law and international tax cases.

We were happy that many high-level speakers and further participants from the European Commission, academic and judicial institutions and private practice were willing to join us for two days, sharing their views and proposals for the future development of this area. The editors of this book hope that the findings presented in this volume are well received by an international audience, giving rise to further debate on the requirements of the European tax order when Member States are willing to deliver aid through the tax code to the benefit of their national and international business.

The editors express their gratitude to Leopoldo Parada for his diligent work on the publication of this book.

Liège, Belgium — Isabelle Richelle
Munich, Germany — Wolfgang Schön
Louvain-la-Neuve, Belgium — Edoardo Traversa
June 2016

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Part I
Fundamentals

Tax Legislation and the Notion of Fiscal Aid: A Review of 5 Years of European Jurisprudence

Wolfgang Schön

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Abstract State aid discipline under Art. 107, 108 TFEU has established itself as a major constraint to the tax sovereignty of national legislators. By analyzing a great number of CJEU judgments delivered during the last 5 years, this article lays out both the conceptual and the political issues which arise when tax benefits are subject to control under European competition law. This affects the concepts of “advantage”, “selectivity” and “discrimination” as well as special cases like “negative state aid”, “indirect selectivity” or “de-facto selectivity”. The author proposes to apply Art. 107 par. 1 TFEU only if a tax provision deviates beneficially from a “normal” or “benchmark” treatment and rejects the trend to interpret Art. 107 par. 1 TFEU as a general ban on discrimination. Moreover, this article pleads for a limited reading of “selectivity” which is only given when a tax advantage confers a financial benefit on certain branches of the economy or certain individualized enterprises.

W. Schön (✉)
Max Planck Institute for Tax Law and Public Finance, Munich, Germany
e-mail: wolfgang.schoen@tax.mpg.de

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax
Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_1

1 Legislation, Administration, Enforcement

It is a well-known feature of state aid control that the constraints established by Art. 107 and Art. 108 TFEU for Member States who intend to provide financial benefits to economic actors also apply in the area of taxation.[1] The main difference between fiscal aid and (most) other means of subsidization stems from the fact, that any tax as such is just the opposite of a financial benefit. It is a financial burden established under the laws of a Member State and rigorously enforced by domestic tax authorities. Nevertheless, the CJEU has from the very beginning of its jurisprudence concerning state aid discipline pronounced the view that state aid can be provided under the law of taxation as well.[2] This wide approach requires us to turn the perspective upside down: You do not ask whether a Member State has transferred public resources to a private party, you rather ask whether a Member State has decided not to prescribe or enforce the transfer of private funds to the public coffer. State aid measures in the area of taxation look just like the negatives we used to have in photography before the digital age: You immediately recognize the contours of the picture but black and white have been switched. Taking account of this change of perspective is the major task in this province of state aid law.

Taking a closer look, state aid control in the fiscal field can set in at different institutional and procedural levels.

- A fairly straightforward case comes to the fore when a tax claim exists under the law of a given state, i.e. when the tax base has been ascertained, the tax rate has been applied and the tax bill has been sent to the taxpayer. The resulting tax receivable must be enforced by the authorities in accordance with the procedures provided for under domestic law[3]; state aid rules prevent the taxman from granting a more lenient treatment, e.g. deferral of payment or even a fully-fledged waiver of the existing tax claim.[4] In this situation the generosity of the tax authorities can be scrutinized under the "private creditor test", as the extension or the non-enforcement of a tax claim shows substantial similarity to the extension or non-enforcement of any private loan granted to the beneficiary.[5]

[1] For an overview see: Schön (2012), at § 10; Quigley (2015), at Part I.3; for indirect taxation see: Englisch (2013).

[2] Case 30/59 (Gezamenlijke Steenkolenmijnen), judgment of 23 February 1961, ECR 1961, p. 1 (19).

[3] Any favorable general rules under domestic procedural law, e.g. a short limitation period for tax debt, do not qualify as selective advantages (AG Kokott, Case C-105/14 (Taricco) opinion of 30th April 2015 para 61); for a general settlement of all tax claims pending for more than 10 years in the courts see: Case C-417/10 (3 M Italia) judgment of 29 March 2012; European Commission (2016), at para 165–169.

[4] Schön (2012), at para 10-036.

[5] Case C-73/11 P (Frucona Kosice), judgment of 24th January 2013, para 71–72; for a skeptical view of this judgment see Luja (2012), p. 120 at 122 et seq.

- A bit less straightforward but still more in line with general rules on state aid is the examination of the tax authorities' behaviour at the level of the tax assessment. As a rule, tax authorities do not enjoy any leeway when they calculate the tax bill. And the mere application of binding laws as such does not amount to self-standing fiscal aid. Nevertheless there are two situations where state aid examinations may set in with regard to the handling of a tax case by the domestic authorities: the first case concerns the "misapplication" of the law by the tax authorities—here we have to decide whether any "misapplication" favouring the taxpayer can be wiped out by the European Commission under Art. 107/108 TFEU or whether only qualified cases like "intentional" misapplications or "indefensible" deviations from the correct construction of the law or the facts can be attacked.[6] The second case refers to the law granting certain discretionary powers to the tax authorities. While it is evident that some limited leeway will always exist when tax assessments are performed (e.g. to reach settlements on the factual and on the legal side in complex cases[7]) the Court is wary about such discretionary features of fiscal law which allow tax authorities to dole out benefits for reasons outside the practical necessities of the tax system.[8] The current debate on the admissibility of "rulings" for multinational enterprises circles around this fine balance between providing legal certainty and granting illegal benefits to taxpayers.[9]

But the most problematic level to apply state aid rules to is tax legislation. This is due to the well-known fact that (outside harmonized areas like VAT and some excises) there exists no general rule as to which economic events arising within a jurisdiction must be taxed. To the contrary, following democratic principles and the rule of law, unless the competent legislative bodies have decided to levy a tax on a certain economic event, there is no tax.[10] This is a generally accepted emanation of the tax sovereignty granted to all Member States under the European Treaties and this foundational principle cannot be called into question under the flag of state aid control. Non-taxation of economic behavior as such is not an issue under European law. We need additional factors to identify state aid in the area of tax legislation.

[6] Quigley (2015), pp. 10, 106–107; Schön (2012), at 10-014; it is evident that mere reimbursement of illegally assessed taxes does not amount to state aid (Case 61/79 (Amministrazione delle finanze dello Stato) judgment of 27th March 1980 para 29–32).

[7] European Commission (2016), at para 172–173; Quigley (2015), pp. 104–105.

[8] Case C-6/12 (P Oy) judgment of 18th July 2013, para 24–30.

[9] European Commission (2016), at para 169–174; European Commission (2015); De la Blétière (2015), pp. 51 et seq.; Leclercq and du Pasquier (2015a), pp. 60 et seq.; Rossi-Maccanico (2015), pp. 73 et seq.; Luja (2015), p. 379 at 383 et seq.; Lang (2015), p. 391 at 394 et seq.; Gunn and Luts (2015), p. 119; Lyal (2015).

[10] In "Eventech" the Court held that no state is obliged to levy fees for the use of public roads (Case C-518/13 (Eventech) judgment of 14th January 2014, para 43–44; see also AG Wahl, opinion of 24th September 2014 para 29.

2 Fiscal Aid and the Market Economy Actor

The specific character of taxation being an expression of the fundamental sovereignty of each Member State makes it impossible to simply submit tax advantages to the "market economy operator test" as applied in other cases. No private person is able to levy taxes and no private person is able to grant tax relief. But there are hybrid situations. In "Electricité de France", the French Republic had provided for a tax exemption regarding capital gains realized by a large utility company in the context of a restructuring of the commercial and tax accounts. This utility company was wholly-owned by the French state. In his opinion, Advocate General *Mazak* had drawn a clear line between the state as a shareholder and the state as a public authority.[11] In his view, the legislative tax exemption could not be re-characterized as a mere waiver of a tax claim equivalent to a capital injection by a private investor. Both the General Court[12] and the Court of Justice[13] took a different stance.[14] For them, it does not make a material difference whether an existing tax claim is waived (just like any other debt claim) or whether tax legislation prevents the tax claim to come into being in the first place. Against this background the French Republic was heard with the argument that a private investor would have contributed a similar financial benefit to the utility company.

From a legal perspective, this is a slippery line of argument as it requires a material comparison between the fiscal state and a private actor who would never be able to confer to the business a congruent advantage. This can only work by analogy and brings along intricate measurement issues—e.g. when the "cost of capital" principle has to be applied to a tax waiver[15] or when the state is obliged to "prove" having acted in its capacity as a shareholder.[16] The formal view taken by Advocate General *Mazak* seems to be more in line with the necessity to apply strict discipline against subsidies and to provide legal certainty in the area of fiscal aid.[17] In any case the "private investor test" should remain restricted to the narrow field of tax measures initiated by the State in its rare double role as shareholder and legislator.

[11] AG Mazák, Case C-124/10 P (Electricité de France), opinion of 20th October 2011, para 76 et seq.; sympathetic Jaeger (2012), pp. 1 et seq.

[12] Case T-156/04 (Electricité de France), judgment of 15th December 2009, para 221–237.

[13] Case C-124/10 P (Electricité de France), judgment of 5th June 2012, para 79, 92; Debroux (2012), pp. 6–7; Baeten and Gam (2013); Leclercq and du Pasquier (2015b), pp. 9 et seq.

[14] Cornella (2015), p. 553 at 557 et seq.

[15] Nicolaides (2013), p. 243.

[16] Soltesz (2012), p. 134 at 135.

[17] Piernas López (2015), pp. 93 et seq.

3 Advantage, Selectivity and Discrimination

3.1 A Conundrum

It is common ground that state aid in the area of fiscal legislation consists of a specific financial benefit which can be ascertained by way of comparison amongst a sample of economic operators who are potential or actual taxpayers. The functioning of the Internal Market shall not be distorted by “Member States favouring some actors to the detriment of others”.[18] But this is where the consensus stops and where both terminological ambiguities and substantive differences begin. This debate circles around three overlapping concepts: the notion of “advantage”, the notion of “selectivity” and the notion of “discrimination”.

The historical starting point is the concept of “advantage”.[19] According to the wording of Art. 107 par. 1 TFEU, state aid law is about “favours”.[20] Against this background, from its early judgments, the Court of Justice has put forward that an enterprise receives state aid if it is relieved from charges “normally borne” by similar firms.[21] This strand of jurisprudence established the view that any tax exemption, tax deduction or tax deferral which creates a benefit when compared to regular treatment amounts to state aid. This approach requires the definition of a benchmark, an “average sea level” against which preferential treatment can be measured and identified. The Court put it succinctly in the recent “France Telecom” case: fiscal aid constitutes an “exception to the general law regime”[22] and the Commission in their recent guidance on the notion of state aid explicitly requires a “shortfall” in tax (and social security) revenue due to exemptions or reductions granted by the Member State.[23]

[18] European Commission (2012), at para 1.2.

[19] Case 30/59 (Gezamenlijke Steenkolenmijnen), judgment of 23 February 1961, ECR 1961, p. 19; Piernas López (2015), pp. 67 et seq.; European Commission (2016), at para 66 et seq.; Engelen and Gunn (2013), pp. 138 et seq.; Micheau (2014), pp. 189 et seq.

[20] Case C-105/14 (Taricco) judgment of 8th September 2015, para 61–62; Case C-417/10 (3 M Italia) judgment of 29 March 2012, para 37 et seq.

[21] Case C-78/08 – 80/08 (Paint Graphos) judgment of 8th September 2011, para 45; case C-279/08 P (Commission vs. Netherlands) judgment of 8th November 2011, para 61, 86; Case C-73/11 P (Frucona Kosice), judgment of 24th January 2013, para 69; Case C-5/14 (Kernkraftwerk Lippe-Ems) judgment of 4th June 2015, para 71; Case C-522/13 (Navantia) judgment of 9th October 2014, para 22; European Commission (2016), at para 68; Micheau (2014), p. 195; Quigley (2015), pp. 8, 50.

[22] Case C-81/10 P (France Telecom) judgment of 8th December 2012, para 16–18.

[23] European Commission (2016), para 51.

Over the years, both in the jurisprudence of the CJEU,[24] the Advocate Generals' pleadings[25] and in academic writing,[26] this notion of "advantage" has been conflated with another important feature of state aid discipline: the notion of "selectivity".[27] According to Art. 107 par. 1 TFEU only measures which aim at favouring "certain undertakings or the production of certain goods" qualify as unlawful state aid requiring clearance under Art. 107 par. 2 or 3 TFEU. This leads to a distinction to be made between "certain undertakings" or "certain goods" which benefit from the tax measure, and other undertakings or other goods which do not—although they are in a similar factual or legal situation. But in practice, we often find the two-pronged test of "advantage" and "selectivity" merged into the question of whether a taxpayer enjoys a "selective advantage" under the examined tax legislation.

This confusion of "advantage" and "selectivity" is clearly visible in the test applied by the Court to tax benefits since its judgment in "Adria-Wien Pipeline"[28]:

> (41) The only question to be determined is whether, under a statutory scheme, a State measure is such as to favour certain undertakings or the production of certain goods (. . .) in comparison with 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 (. . .).
>
> (42) According to the case-law of the Court, a measure which, although conferring an advantage to its recipient, is justified by the nature or general scheme of the system of which it is part does not fulfil that condition of selectivity (. . .).

Indeed there exist strong similarities between the "advantage" test and the "selectivity" test. Both distinguish between one group of taxpayers enjoying a tax benefit and another group of taxpayers subject to reference treatment.[29] Both tests involve the necessity to identify a benchmark defining the foil against which forbidden state aid can be ascertained. Nevertheless, the recent "Commission Notice on the notion of State aid pursuant to Article 107 (1) TFEU" explicitly separates the two tests from each other.[30] And also the larger part of the Court's recent judgments still adheres to this analytical approach.[31]

[24] Case C-6/12 (P Oy) judgment of 18th July 2013, para 17–19; Case C-78/08 – 80/08 (Paint Graphos) judgment of 8th September 2011, para 49; AG Kokott, Case C-66/14 (Finanzamt Linz) opinion of 16th April 2015, para 74 et seq.; The Court did not address these issues in its final judgment as the judges found the questions raised with regard to state aid law to be inadmissible (Case C-66/14 (Finanzamt Linz) judgment of 6th October 2015, para 16 et seq.

[25] While AG Kokott supra (note 24) does not dwell on the notion of "advantage" any more, she reaches a similar dichotomy by separating from each other the notion of "selectivity" and the notion of "specificity".

[26] Micheau (2015), p. 323 at 236 et seq.; Romariz (2014), p. 39 at 40 et seq.

[27] Kühling (2013), p. 113 at 115; Tomat (2012), p. 462 at 465 et seq.; López López (2010), p. 807 at 808 et seq.; Quigley distinguishes between "economic advantage", "selective advantage" and "competitive advantage". See Quigley (2015), pp. 4 et seq.

[28] Case C-143/99 (Adria-Wien Pipeline GmbH) judgment of 8th November 2001, para 41 et seq.

[29] Nicolaides and Rusu (2012), p. 791 at 792.

[30] European Commission (2016), at section 4 (Advantage) and section 5 (Selectivity); see also López López (2010), p. 809; Quigley (2015), pp. 5–6, 99, 110–111.

[31] Case C-15/14 P (MOL) judgment of 4th June 2015, para 59; Case C-522/13 (Navantia) judgment of 9th October 2014, para 34.

In recent writing, it has been proposed to do away with benchmarking altogether and to reduce the examination of fiscal state aid to a mere "discrimination" test.[32] The core issue shall be whether two groups of taxpayers who are in a comparable factual and legal situation are treated differently without any visible justification. The sometimes aporetic quest for a reference system under national tax legislation should be abandoned and replaced by a rule-of-reason examination of existing differentials. Such a non-discrimination test would also lead to an alignment with the theory behind other tax-relevant provisions of the Treaties like the non-discrimination and non-protection clauses in Art. 110 TFEU and the way the fundamental freedoms are brought to bear in the context of taxation.[33]

3.2 Benchmark Test Versus Discrimination Test

3.2.1 British Aggregates, Sardinian Stopover Tax and Government of Gibraltar

The deeper problem informing the debate on "benchmarking" is related to the ongoing sovereignty of Member States in the tax area. Given the fact that Member States are in principle free to decide which events should be taxed and how to set the tax base and the tax rate, the relevant benchmark treatment cannot be derived autonomously from European law and it cannot be determined by reference to fiscal standards as applied in other States inside or outside the European Union. In order to protect the Member States' prerogative in tax matters, the decisive benchmark for fiscal state aid can only be the tax legislation of the relevant country itself.[34] If and so far as a taxpayer benefits from a lowering of the tax burden in the context of domestic legislation, Art. 107 par. 1 TFEU can be applied. This approach has been criticized as both circular and subcritical. According to critics,[35] once it can be shown that different treatment of two groups of taxpayers cannot be justified in the light of the factual and legal circumstances Art. 107 par. 1 TFEU should intervene. The focus should not be on the often futile search for a real or hypothetical norm level but on the justification of the differential as such.

In the jurisprudence of the Court, the 2006 judgment in the "British Aggregates" case led the way towards this non-discrimination test as the Court simply confirmed the existence of selective state aid when the UK Government was not able to show any justification for the tax differential between a tax levied on different kinds of

[32] AG Kokott, Case C-66/14 (Finanzamt Linz) opinion of 16th April 2015, para 88; Azizi (2013), at XV; Heidenhain (2010), pp. 189 et seq.; Lang (2012), p. 411 at 418 et seq.; Cordewener (2012); Biondi (2013), p. 1719 at 1732; Lyal (2015), pp. 1032 et seq.

[33] AG Kokott, Case C-66/14 (Finanzamt Linz) opinion of 16th April 2015, para 103.

[34] European Commission (2016), at para 134; Hey (2015), p. 331 at 334 et seq.; Ismer and Piotrowski (2015), p. 559 at 561.

[35] Supra note 32.

granular materials.[36] In a similar vein, in the 2009 judgment on the Sardinian luxury tax on stopovers, the Court declared the tax differential between international and domestic air and sea traffic to run foul of Art. 107 par. 1 TFEU without caring about which one defined the "regular" treatment.[37] For many observers, the final breakthrough towards a mere discrimination test came with the "Gibraltar" judgment in 2011.[38] In the national legislation examined in this landmark case, the Government of Gibraltar had replaced its traditional corporate income tax by a corporate tax on expenditure for payroll and property occupation. The major beneficiaries of this tax reform were offshore companies whose payroll and property expenditure was typically small or non-existent. Commercially active local companies were subject to a higher tax base but they benefitted from the rule that the expenditure tax was capped at 15 % of the corporate profit—therefore they were factually treated like under the previous corporate income tax. While both the General Court in its decision[39] and the Advocate General[40] in his opinion failed to identify a reliable "benchmark" within the new tax system of Gibraltar, the Court found the tax system of Gibraltar to confer selective advantages to offshore companies.[41]

While some commentators[42] regard this judgment to herald a change of paradigm towards a mere discrimination test, the European Commission—in their recent "notice"—rightly emphasizes the exceptional nature of the case and the Court's reasoning.[43] Taking a closer view, the Court did not leave behind the concept of advantage and benchmark altogether: the judges rather took a "substance over form" view of how the benchmark should be ascertained.[44] This should not depend—to borrow from the language of the Court—on the "regulatory technique" employed by the legislator.[45] In the Gibraltar case, the fact that the business

[36] Case C-487/06 (British Aggregates) judgment of 22 December 2008, para 82–92; Honoré (2009), pp. 527 et seq.

[37] Case C-169/08 (Presidente del Consiglio) judgment of 17th November 2009 para 59 et seq.; see also AG Kokott, opinion of 2nd July 2009 para 123 et seq.; for a critical analysis see Engelen (2012).

[38] Joined Cases C-106/09 P and C-107/09 P (Government of Gibraltar) judgment of 15th November 2011.

[39] Joined Cases T-211/04 and T-215/04 (Government of Gibraltar) judgment of 18th December 2008, para 171–173.

[40] Advocate General Jääskinen, Joined Cases C-106/09 P and C-107/09 P (Government of Gibraltar), opinion of 7th April 2011, para 155 et seq.

[41] Joined Cases T-211/04 and T-215/04 (Government of Gibraltar) judgment of 18th December 2008, para 85 et seq.

[42] Lang (2011), p. 593 at 596 et seq.; Lang (2012), pp. 414 et seq.; Lyal (2015), p. 1039.

[43] European Commission (2016), para 129–130.

[44] Piernas López (2015), p. 144; Kühling (2013), pp. 118 et seq.; Nicolaides and Rusu (2012), p. 801; Rossi-Maccanico (2012), p. 443 at 446 et seq.; Rossi-Maccanico (2013), p. 39 at 50 et seq.; Dubout and Maitrot de la Motte (2012), pp. 44–54; for a critical assessment of this attempt to create a "hypothetical" benchmark, namely a mainstream corporate income tax see: Temple Lang (2012), p. 805 at 812.

[45] Joined Cases C-106/09 P and C-107/09 P (Government of Gibraltar) judgment of 15th November 2011, para 92; Quigley (2015), pp. 112–114.

expenditure tax was arbitrarily capped at 15 % of the corporate profit clearly showed that from a substantive point of view this tax was still a corporate income tax disguised as an expenditure tax. And against the baseline of a corporate income tax, offshore companies enjoyed huge advantages under this regime. The message to be derived from "Gibraltar" is clear: mere technicalities of legislative drafting and labeling are not relevant when it comes to the definition of the benchmark. But the concept of "advantage" and "normal tax treatment" has not been abandoned and it came up in a good number of other judgments later on.[46]

3.2.2 The Problem of the Missing Benchmark

Yet this reading of the Court's jurisprudence does not solve the fundamental issue whether a pure discrimination test would be superior to a benchmark test. To a large extent, the outcome would be the same anyway: all cases of unequal treatment which can be justified in the light of the inherent logic of the tax system would be in the clear: either because they comply with benchmark treatment or because they can be justified in the light of the legal and factual circumstances of the case. Moreover, it will not be possible to discuss the comparability of taxpayers and taxable events unless one has identified the underlying purpose and system of a given tax regime.[47] So what's the difference?

The test case is the "missing benchmark". Is it conceivable that domestic tax legislation is so chaotic and irregular that it is simply impossible or useless to identify any sort of benchmark? And should this lead to the non-application of Art. 107 par. 1 TFEU? I do not think this is a large problem. Basically, there are two kinds of taxes. Firstly, there are those which merely aim at raising revenue and which tap the ability to pay of taxpayers. For these—purely fiscal—taxes the benchmark is set by the ability to pay principle and the legislator's choice of a suitable indicator for this ability—like income, net wealth or consumption. Any tax rule that does not address ability to pay in this sense is deemed to deviate from the benchmark.[48] And secondly, there are taxes with a primarily regulatory goal. In this case, the achievement of this regulatory goal sets the benchmark for domestic legislation.[49]

One has to admit that there are some doubtful situations. A case currently pending before the European Courts concerns a special German tax provision on corporate loss carry-forward.[50] The German corporate income tax regime provides

[46] Case C-452/10 P (BNP Paribas) judgment of 21st June 2012, para 66–68; Advocate General Szupnar, Case C-5/14 (Kernkraftwerk Lippe-Ems GmbH) opinion of 3rd February 2015, para 68.

[47] Temple Lang (2012), p. 811; Bartosch (2010), p. 12.

[48] Schön (2012), para 10-022; Quigley (2015), pp. 114–115.

[49] European Commission (2016), at para 136, 138.

[50] Case C-102/12 (Germany vs. Commission); there are additional cases brought by individual claimants in the General Court.

in principle for losses to be carried forward in future fiscal years. This carry-forward has been restricted since 2008: when shareholders sell their participations mid-stream leading to a change in control, the loss carry-forward shall be reduced or fully suspended. But this exemption from the rule was meant to suffer a sub-exemption if the share sale was part of an overall restructuring deal saving the viability of the business. The European Commission declared this "exemption from the exemption" to violate Art. 107 par. 1 TFEU as only companies in distress would benefit from this rule.[51] In German academic writing, the majority view seems to be that this legislative technique simply leads back to the starting point, the benchmark of full loss carry-forward.[52] But the outlook for the Commission is good as in 2013, when the CJEU adjudicated on a similar case from Finland ("P Oy"), the Court of Justice sided with the Commission.[53]

This case seems to expose the unhelpfulness of the benchmark test. Under a discrimination test one might simply ask whether the distinction between regular corporate entities and those in distress can be justified in the light of the underlying tax system. Given the fact that this special treatment is meant to achieve non-tax goals of economic policy, it looks probable that Art. 107 par. 1 TFEU should be applied.

Taking a closer look, this is not a satisfying outcome. By definition, any discrimination test merely leads to the result that there exists an unjustified inequality which must be removed. But it is not clear what direction the adjustment shall take. Is it necessary (in the afore-mentioned German case) to extend loss carry-forward to all situations of change-of-control? Or should one abolish the helpful treatment of distressed companies? Art. 107 par. 1 TFEU does not simply address discrimination—it logically starts from a "favour", a "benefit" that can be measured and accounted for. All legal consequences for this "advantage" under Art. 107 and Art. 108 TFEU are built on this clear identification of positive "aid": *Ex ante* such aid has to be notified and it is prohibited to "put proposed measures into effect" (Art. 108 par. 3 s. 3 TFEU); *ex post* the unlawful aid has to be recovered in full.[54] In order to make these provisions operational, each state aid is awarded a "cash grant equivalent" which depends on the nature of the aid—full subsidy, soft loan, bank guarantee etc.—and which reflects the economic value of the benefit received.[55]

[51] European Commission, Decision of 26th January 2011, O.J. 2011, L-235/26.

[52] De Weerth (2012), pp. 414 et seq. (with further references).

[53] Case C-6/12 (P Oy) judgment of 18th July 2013, para 32; critical Lyal (2015), pp. 1034 et seq.; as to the repercussions of this judgment on the German tax provision see: Hackemann and Sydow (2013), p. 786; Ismer and Karch (2014), p. 130; in its recent judgments, the General Court applied the line taken in "P Oy" to the German provision on carry-forward of losses (Case T-620/11 (GFKL Financial Services AG), judgment of 4th February 2016, para 98 et seq.; Case T-287/11 (Heitkamp BauHolding GmbH), judgment of 4th February 2016, para 95 et seq.).

[54] For an account of the procedural rules in place see: Afonso (2013), pp. 57 et seq.

[55] Case C-81/10 P (France Telecom) judgment of 8th December 2012, para 22–27; Joined Cases C-106/09 P and C-107/09 P (Government of Gibraltar) judgment of 15th November 2011, para 47; Engelen and Gunn (2013), p. 140.

In "France Telecom" the Court recently confirmed for a special business tax levied from a public telecommunications company that the "exact amount of aid" has to be verified with hindsight for every given tax year. For this exercise it is essential to start from a benchmark.[56] A mere discrimination test will not be able to provide the necessary information as it will remain unclear where to start the calculation and how to apply the described procedural rules to it.[57]

This problem has been addressed in two highly interesting judgments,[58] which the General Court delivered in February 2015 and which are currently under review with the Court of Justice. These cases concern an Irish tax on air passengers whose rate is dependent on the length of the journey. Flights up to 300 km are subject to a 2 € flat rate; all flights beyond 300 km are subject to a 10 € flat rate. The lower rate benefitted mainly Irish airlines offering domestic flights. The Commission held this to infringe both on the freedom to provide services and the prohibition on state aids. *Pro futuro,* the Irish legislator quickly solved the issue by establishing an overall flat rate of 3 €. But with regard to the past, the matter went to the Court, which had to deal with the intricate question of whether the evident discrimination between domestic flights and international flights should be remedied by an upward or a downward adjustment of the tax rate.

The applicants asked for a downward adjustment as the high rate would be unlawful with regard to the infringement of the freedom to provide cross-border services anyway. But the Court made quite clear that the ascertainment of discriminatory treatment is not self-executing. It offers no guidance to the legislator how to align rates: abolish the low rate or abolish the high rate or choose some middle ground—as happened in reality.[59] Therefore, the Court rejected the applicant's view that the high rate was unlawful *per se*. With regard to state aid law, the Commission had recognized the necessity to identify a "normal tax level" which is not easily done when only two different rates exist without any internal logic of the system offering help. The Commission took recourse to statistics: As only 10–15 % of all flights subject to the airline tax were domestic flights (or flights to the Western part of the United Kingdom) the large majority of flights was subject to the high rate. This high rate, according to the Commission, had to be regarded as the "normal tax rate"[60] and the General Court accepted this view.[61] While this case illustrates

[56] Quigley (2015), p. 104.

[57] See Heidenhain (2010), p. 192 who criticizes this point while adhering to the discrimination test as a matter of principle.

[58] Case T-473/12 (Aer Lingus) judgment of 5th February 2015; Case T-500/12 (Ryanair) judgment of 5th February 2015; Truby (2015), p. 232.

[59] Case T-473/12 (Aer Lingus) judgment of 5th February 2015, para 60; Case T-500/12 (Ryanair) judgment of 5th February 2015, para 85.

[60] Case T-473/12 (Aer Lingus) judgment of 5th February 2015, para 54–55; Case T-500/12 (Ryanair) judgment of 5th February 2015, para 79–80.

[61] Case T-500/12 (Ryanair) judgment of 5th February 2015, para 89.

the insight that it can be (next to) impossible to identify a "normal" tax rate in some cases,[62] we should also accept that a mere non-discrimination test would be unhelpful: just like under the rules governing the fundamental freedoms, one would have to leave open how to adjust the differential. In this situation, some proponents of a discrimination test seem to regard the differential as such to constitute the unlawful "advantage" in any case.[63] But this would lead to an enormously destructive outcome: all cases of discrimination would have to be solved by increasing the tax burden (with retroactive effect and without any protection of legitimate expectations) on those taxpayers who were subject to the more lenient treatment. That would result in an overkill effect under Art. 107, 108 TFEU.[64]

4 Negative State Aid

This controversy around the concept of advantage and benchmark on the one hand and mere discrimination on the other hand comes up again when we focus on situations where the national tax legislator has decided to levy a specifically high tax burden on certain enterprises or industries. This problem has been discussed under the heading of "negative state aid". While the majority of writers share the view that Art. 107 par. 1 TFEU does not prohibit negative deviations from the "benchmark".[65] I have some years ago tried to show that Art. 107 par. 1 TFEU can be applied by way of analogy to specifically burdensome tax rules.[66]

In previous judgments, the Court of Justice has so far not taken an explicit stance on this issue. In a recent German case, the claimants pushed hard for a more forceful approach.[67] The case concerned the "Nuclear Fuel Tax" introduced by the German Government in the aftermath of the Fukushima disaster. The claimants took the view that such an asymmetric high burden on a specific source of energy is not in line with Art. 107 par. 1 TFEU.[68] The Court rejected this view without openly addressing the issue of whether the concept of "negative state aid" can be applied as a matter of principle. Rather, the Court reached the conclusion that there exists no general tax system on energy production in Germany which sets a benchmark

[62] Schön (2012), para 10-029.

[63] Biondi (2013), p. 1734.

[64] Hey (2015), pp. 334 et seq.

[65] For references see Schön (2012), para 10-013; most recently Ismer and Piotrowski (2015), p. 564.

[66] Schön (2006), p. 495; Cordewener (2012), p. 288; Bacon (2013), at § 2.36, 2.90, 2.91.

[67] Case C-5/14 (Kernkraftwerk Lippe-Ems) judgment of 4th June 2015, para 69 et seq.

[68] Englisch (2012), pp. 318 et seq.

against which to test the nuclear fuel tax.[69] Rather, this tax had to be qualified as a self-standing implementation of the "polluter-pays" principle for nuclear waste.[70]

Taking a closer at the Court's findings it turns out that the Court had not really addressed the question of whether an extra burden on nuclear fuel runs foul of Art. 107 par. 1 TFEU; it rather had asked whether the non-taxation of all other fuels leads to an unlawful benefit for energy production outside the nuclear sector[71] a position which has been taken by some academic writers with regard to comparable special levies as well.[72]

In my view, this case is not a good example of what a negative state aid can be. This is due to the fact that the nuclear fuel tax was closely knit; it only affected one single type of economic events, not a range of events or situations which allows comparing tax levels and setting benchmarks.[73] But let us assume for a moment that it is possible to assess within a common framework the tax burden levied on all sorts of energy production. A clear example would be a hypothetical tax provision setting a disadvantageously high corporate income tax rate for companies running nuclear power plants. It would be hard to assume that the application of the mainstream corporate tax rate to profits from non-nuclear energy production amounts to recoverable state aid favoring power plants using coal, gas or petroleum. This would go far beyond the limits of Art. 107 par. 1 TFEU as conceived in the original context of the Internal Market.[74] Rather, the special burden on nuclear power plants requires justification; an infringement of Art. 107 par. 1 TFEU should lead to a restitution claim in the hands of the nuclear power plant's owner and not to a recovery of deemed tax benefits from all other energy producers.

This case shows again: a mere discrimination test would not be of any avail: While it could tell us that nuclear and traditional power plants might deserve equal tax treatment it would leave in the dark the actual consequences for the involved parties.

5 Advantage, Selectivity and General Measures

Once we decide (and the Commission has clearly done so) to keep the notion of advantage alive in the context of state aid law, one has to clarify whether it is necessary and possible to draw a line between the two tests regarding the existence

[69] Case C-5/14 (Kernkraftwerk Lippe-Ems) judgment of 4th June 2015, para 77; AG Szupnar, Lippe-Ems supra (note 46), para 69–73.

[70] Case C-5/14 (Kernkraftwerk Lippe-Ems) judgment of 4th June 2015, para 78–79.

[71] Advocate General Szupnar, Case C-5/14 (Kernkraftwerk Lippe-Ems GmbH) opinion of 3rd February 2015, para 74.

[72] Quigley (2015), pp. 136–138; Metaxas (2010), p. 771; Nicolaides and Metaxas (2014), p. 51.

[73] Kühling (2013), p. 116.

[74] Quigley (2015), pp. 144–145; Hey (2015), pp. 334 et seq.

of an "advantage" and the "selectivity" of this advantage. To make the point clearer: Is it possible to identify tax measures which confer an advantage on the recipients but which are not restricted to certain enterprises or certain sectors of the economy? The Court has for many years accepted such distinction: Advantages which are conferred upon all economic operators are called "general measures" as they try to improve the economic climate in a general fashion.[75] A case in point is a tax benefit for research and development (R&D). Extra deductions for research expenditure or reduced tax rates for income from innovations clearly deviate from the benchmark treatment for investment, business expense and income under mainstream business taxation. The same holds true for a general introduction of accelerated depreciation of fixed assets.[76] These measures aim at achieving non-tax goals and have to be classified as "advantages" in the above-described sense. But if it can be shown that this advantage is available to all economic operators the requirement of selectivity is not fulfilled and Art. 107 par. 1 TFEU does not apply.[77]

There is a certain risk to confuse the borderline between benchmark tax treatment and tax advantages on the one hand with the borderline between selective benefits and general measures on the other hand.[78] Both aim at comparing different groups of taxpayers with each other. But there is a conceptual difference:

- Drawing the distinction between benchmark taxation and advantageous taxation is a purely internal matter of fiscal law—it is designed to put into effect the analogy between a direct subsidy and a tax subsidy. Therefore, the concept of advantage circles around the mechanics of the tax in question in the light of the factual circumstances and in the light of its overall fiscal or regulatory purpose. Here the fiscal sovereignty of the Member State comes to the fore.
- On the other hand, the distinction between general measures and selective advantages refers to the general aims of economic policy and the power of Member States to fuel the economic competitiveness of its tax system as

[75] Joined Cases C-106/09 P and C-107/09 P (Government of Gibraltar) judgment of 15th November 2011, para 73; Case C-417/10 (3 M Italia) judgment of 29 March 2012, para 39; Case C-522/13 (Navantia) judgment of 9th October 2014, para 23, 33; Case C-6/12 (P Oy) judgment of 18th July 2013, para 18; European Commission (2016), para 117–118; Bacon (2013), at para 2.113 et seq.

[76] General Court, Case T-140/13 (Netherlands Maritime Technology Association) judgment of 9th December 2014, para 90–91; the appeal against this judgment was dismissed by the CJEU (Case C-100/15 P (Netherlands Maritime Technology Association), judgment of 14th April 2016); Martinez (2015), pp. 69 et seq.; Nicolaides (2015), pp. 120 et seq.; European Commission (2016), para 177–180.

[77] Quigley (2015), pp. 9 and 100–103.

[78] European Commission (2016), para 126–128; a new twist has been brought to this debate by AG Kokott, Case C-66/14 (Finanzamt Linz) opinion of 16th April 2015, para 82, who wants to distinguish between derogations justified by the specific norm in question (no selective advantage) and those justified by the overall purpose and principles of the tax in question (no specific advantage).

opposed to the constraints for financial support granted to specific enterprises or certain sectors of the economy.

Last not least, these two issues—both the concept of "economic advantage" and the concept of "selective advantage" should not be confused with yet another notion: the concept of "competitive advantage".[79] This last factor comes in when the effect of a selective advantage on competition has to be assessed. Insofar—and only insofar—one has to ask whether the beneficiaries enjoy a benefit vis-à-vis their local or foreign competitors so that competition in the Internal Market is distorted. To give an example for this distinction: A corporate income tax reduction for German textile industry constitutes a selective advantage if other German sectors of the economy (car manufacturing or banking services) do not participate. It does not matter that there is no direct competition between textiles, cars and financial services. The comparison with competitors, e. g. foreign textile producers, only comes in when the distorting effects on the competitive landscape within the internal market are under review.

6 Dimensions of Selectivity

6.1 Availability to All Economic Operators?

Having identified an "advantage" within the tax system it is therefore necessary to go deeper into the concept of "selectivity" as the meaning of this notion is decisive for the political leeway of Member States in designing their domestic tax legislation.[80]

Unfortunately the starting point employed by the Court and the Commission for this distinction is unhelpful and clearly of a circular nature.[81] They ask whether the fiscal benefit in question is available to all economic operators in a jurisdiction—if not: the measure is regarded to be selective.[82] In my view this concept leads to two equally problematic possible outcomes.

First of all, we have to account for the fact that most tax legislation does not award individualized benefits to individual persons in an explicit manner. This has to be compared with the area of direct subsidies where it is evident that the state awards a specific sum to a specific firm. But tax legislation nearly always defines in a generalized fashion the requirements which have to be met to qualify for a certain tax benefit and it is up to each and every taxpayer to arrange his or her affairs in

[79] Quigley (2015), p. 7.

[80] Nicolaides and Rusu (2012), p. 791.

[81] AG Kokott, Case C-66/14 (Finanzamt Linz) opinion of 16th April 2015, para 80 et seq.

[82] Case C-522/13 (Navantia) judgment of 9th October 2014, para 23; Case C-78/08 – 80/08 (Paint Graphos) judgment of 8th September 2011, para 52; Case C-6/12 (P Oy) judgment of 18th July 2013, at 18; European Commission (2016), para 117.

order to meet those requirements. From an abstract point of view one could therefore say that most tax benefits are available for every taxpayer in a jurisdiction. Such a generous reading would lead to a highly reduced impact of European law for tax subsidies, which does not comply with the underlying competition law understanding of state aid rules. Competition law takes the existing arrangement of the economy as given—including the allocation of different actors to different sectors of the industry and asks whether all or only a limited number of these actors enjoy access to the benefits in question. We therefore have to check whether a specific benefit is available for all taxpayers *given their current economic activity*. To provide an example: If national tax legislation awards specific benefits to textile production, one should not deny selectivity on the grounds that companies running a steel mill or an insurance business can change their line of products in order to reap the benefit.

This does not exclude the possibility that the sheer number of taxpayers representing the "benchmark" is substantially smaller than the number of taxpayers benefitting from a tax break. This was shown by the CJEU in the "Adria-Wien Pipeline" Case where a reduction or exemption from an eco-tax was awarded to the manufacturing industry in general while only some service providers faced the tax bill in the end.[83] The regulatory aim of the eco-tax setting the benchmark was full taxation of energy consumption and the whole manufacturing industry had received advantageous treatment given the fierce competition they face in the global product market.

6.2 Availability to "Certain Enterprises" and "Certain Branches of the Economy"

From another perspective it seems overachieving when the CJEU simply declares all tax benefits to be selective which cannot be enjoyed by all existing taxpayers in the same fashion. Art. 107 par. 1 TFEU only prohibits advantages awarded to "certain enterprises" and "the production of certain goods". This wording does not cover each and every distinction made under national tax law. Such distinctions can refer to the legal form of an enterprise, to the size of its turnover or profit, to the number of the workforce or its previous record, e.g. when tax breaks for start-up businesses are under scrutiny. Does it make sense to prohibit all sorts of distinctions even if they do not aim at individual businesses or certain sectors of the industry?

Given the respect for national tax sovereignty I regard most of these widespread tax breaks to constitute "general measures" in the afore-mentioned sense. Contrary to the CJEU, selectivity should only be confirmed if the beneficiaries can be singled out for representing a certain branch of the economy or even a single business entity. This seems to be more in line with the underlying competition law

[83] Supra (note 28).

framework of state aid control. We should not try to transform state aid control in the field of taxation into a wide-reaching anti-discrimination prohibition streamlining national legislation.

There are three recent cases which clearly address this problem as the tax benefits in question are not related to the economic activity of a firm and rather refer to its corporate structure. These are the Spanish cases "Banco Santander" and "Autogrill España" and the Austrian "Finanzamt Linz" case.

In "Banco Santander" and "Autogrill España", two corporate taxpayers based in Spain acquired shares in foreign companies and made use of the option under Spanish tax law to fully write-off the acquisition cost in the first year.[84] This option does not exist when a Spanish company acquires shares in a local company. It is fair to say that this provision supports Spanish enterprises to extend their activities cross border. But does it constitute a selective advantage or is it simply a feature of the domestic tax system? In its 2014 judgments, the General Court held that the full amortization of acquisition cost does not fall under Art. 107 par. 1 TFEU. While this rule clearly constitutes a derogation from the normal tax regime (and thus an "advantage") it is not available only to "certain enterprises" or "certain branches of activity".[85] It is rather addressed at covering a certain "category of economic transactions".[86] The Court of Justice has not yet decided on the appeal. It will have to draw a fine line between selective advantages (e.g. tax benefits for export-oriented businesses) and general measures.

In "Finanzamt Linz" the Federal Administrative Court in Vienna referred to the CJEU some questions concerning just the opposite legal situation. Under the provisions governing group taxation in Austria, a partial write-off on the good will of acquired companies is only available in case of the acquisition of shares in a local business entity. In principle such a benefit which is restricted to domestic investment is subject to scrutiny under the fundamental freedoms, in particular the freedom of establishment under Art. 49 TFEU. But the referring court also wanted to learn from the CJEU whether such distinction between local and foreign shareholdings amounts to prohibited state aid under Art. 107 par. 1 TFEU. In her pleadings, Advocate General Kokott has devoted an extensive analysis to this situation.[87] While she acknowledges that the Court has practiced a wide concept of selectivity on many occasions she supports the view that the mere distinction

[84] In the related cases "Banco Bilbao and Telefónica" C-571/13 P and C-588/13 P, order of 15th January 2015, the General Court did not adjudicate on the merits as the claimants had no standing.

[85] Case T-399/11 (Banco Santander) judgment of 7th November 2014, para 38–87; Case T-219/10 (Autogrill Espana) judgment of 7th November 2014, para 29–83; Temple Lang (2015), pp. 763–768.

[86] Case T-399/11 (Banco Santander) judgment of 7th November 2014, para 57; Case T-219/10 (Autogrill Espana) judgment of 7th November 2014, para 53; the narrow view taken by the General Court has been rejected by AG Wathelet in his recently published opinion (Joined Cases C-20/15 P and C-21/15 P (World Duty Free Groupo et al.) opinion of 28th July 2016, para 72 et seq.

[87] AG Kokott, Case C-66/14 (Finanzamt Linz) opinion of 16th April 2015, para 111 et seq.

between foreign and domestic shareholdings is not sufficient to fulfil the requirement of benefiting "certain enterprises" or "certain branches of activity". She pleads for a restrictive interpretation of the notion of "selectivity" which is in line with the protection of national sovereignty in tax matters. It was only for procedural reasons that the Court did not address this issue in the final judgment delivered in October 2015.[88]

Another element which showed up in these cases was the constraint as to the legal form of a business. The special elections awarded for the write-off of acquisition costs were only available to corporate taxpayers. This holds true for many features of national tax laws which distinguish between corporations and non-incorporated business in the context of individual income taxation (sole proprietors and partnerships) and corporate income taxation.[89] Does it make sense to bring in Art. 107 par. 1 TFEU if a state lowers the corporate tax rate but not the individual income tax rate? In its Draft Notice on the notion of State aid, the Commission considers "all undertakings having an income (. . .) to be in a similar legal and factual situation".[90] In "Paint Graphos" the CJEU explicitly stated that a special corporate tax benefit awarded to cooperative societies might be justified in the light of the nature of the corporate tax system as cooperative societies are required to distribute their income to the members.[91] Taking a closer look one has to distinguish between benefits which come with a legal form as such (no selectivity) and benefits which are awarded to a particular legal form which itself is materially related to a certain sector of the economy.

6.3 Justification Under the Relevant Tax System

One of the recurrent features of the jurisprudence of the Court in the area of fiscal aids concerns the possible justification of selective tax benefits. In many judgments the Court has stated that selectivity of a tax measure only confirms *prima facie* the existence of forbidden state aid.[92] The Member State in question is invited to show that the selective tax measure is fully in line with the underlying rationale of the tax system itself. Insofar one has to distinguish between selective measures, which introduce non-tax policy purposes into the tax system, and those selective

[88] Case C-66/14 (Finanzamt Linz) judgment of 6th October 2015, para 16 et seq.

[89] AG Kokott, Case C-66/14 (Finanzamt Linz) opinion of 16th April 2015, para 92.

[90] European Commission (2016), para 135, Fn. 195.

[91] Case C-78/08 – 80/08 (Paint Graphos) judgment of 8th September 2011, para 54 et seq.; Tomat (2012), p. 462.

[92] Case C-452/10 P (BNP Paribas) judgment of 21st June 2012, para 101 et seq., para 120 et seq.; case C-279/08 P (Commission vs. Netherlands) judgment of 8th November 2011, para 62; European Commission (2016), at para 128.

measures, which are meant to implement the tax system and its purpose for a specific group of taxpayers.[93] Cases in point are special accounting rules for the corporate income tax levied in the insurance or banking business. While on their face they create a special tax regime for certain sectors of the economy, their true purpose is to measure the profits and losses of these businesses in a fashion that is in line with the underlying principles of corporate income taxation, i.e. measuring the ability to pay of the company.

A confusing feature of this analysis lies in the fact that the European Commission separates two issues from each other: at the first level one has to ask whether two taxpayers are—in the light of the intrinsic purpose of the relevant tax system—in a comparable situation. If they are in a comparable situation, equal tax consequences should follow. At the second level one has to ask whether any derogation in favour of one of the involved taxpayers can be justified by "intrinsic basic or guiding principles of the reference system or where it is the result of inherent mechanisms necessary for the functioning and effectiveness of the system".[94] This distinction is not easy to digest and basically superfluous[95] but it might carry some heuristic value: If your income is lower than the income derived by your neighbour, you are not in a comparable situation in the first place. If your income is equal to what your neighbour earns you should be obliged to pay the same amount of income tax unless there are some very special policy reasons for a tax reduction like the avoidance of double taxation (for granting a foreign tax credit or exemption) or administrative manageability (for applying a reduced flat rate to your income).[96] But one thing should be clear: the "justification" for a selective measure must not be derived from non-tax policies taken by the national legislator.[97]

6.4 "De-Facto-Selectivity" and "Indirect Selectivity"

Lines become blurred even more once we introduce concepts like "de facto selectivity"[98] or "indirect selectivity".[99] In the first case a tax provision which—taken at face value—does not grant a benefit towards a certain enterprise or a certain branch of activity factually does so as the requirements set to enjoy this benefit only can be fulfilled in practice by certain enterprises or sectors of the economy. Insofar one has to make an educated judgment about the practical effects:

[93] European Commission (2016), at para 135; skeptical Moscoso del Prado and Arranz (2013), p. 401 at 403 et seq.

[94] European Commission (2016), at para 138.

[95] Biondi (2013), p. 1736.

[96] Temple Lang (2015), pp. 765 et seq.

[97] Quigley (2015), pp. 119–123.

[98] European Commission (2016), at para 122.

[99] European Commission (2016), at para 115–116.

While it is not sufficient to call a measure "selective" because it is "likely" that some sectors of the economy will benefit more than others, selectivity does not require a clear and explicit distinction between industries in the wording of the tax provision.[100] In the second case a benefit might be awarded to all taxpayers (or consumers) in the first place but will under market conditions be passed on to a selective group of beneficiaries. A tax break for private homeowners might end up with local building industry; a tax break for workers in a certain industry might end up in the hands of their employers.[101] But this concept has its upsides as well: business entities who have received forbidden state aid are heard with the argument that they have passed on these benefits to their customers, thus lowering the amount of recoverable aid.[102]

The grey area which comes up when tax benefits are passed on to certain enterprises has recently been explored in the Spanish "Navantia"[103] case which concerned a naval defense company wholly owned by the Kingdom of Spain. This company performed its activity on a shipyard which it had rented for a symbolic price from its sole shareholder, the Spanish State. Under this rental contract Navantia was obliged to assume all taxes levied on the side of the renter. In Spain, real estate is taxable under a property tax but a tax exemption exists for real estate held by the state itself. As the shipyard was owned by the Spanish state, no property tax arose and no tax was forwarded to Navantia. The CJEU reached the conclusion that the contractual arrangements between the Kingdom of Spain and the wholly-owned company led to a selective state aid favouring the defense business of Navantia as Navantia enjoyed an exemption from property tax normally payable by private entities owning the land where they carry on their business.[104]

Taking a closer look this judgment seems odd. From a state aid perspective the real issue was the fact that the Kingdom of Spain had granted Navantia the right to use the shipyard for a symbolic price. This behavior does not pass the "market economy actor test" on the side of the Kingdom of Spain and clearly conferred a huge benefit on Navantia. But—as the Court stated—this rental contract had not been attacked in the underlying proceedings.[105] If the Commission had scrutinized the rental contract they would have had to establish the market price for the right of use. This market price clearly would have included the amount of regular property tax because the market price for real estate is basically not influenced by property tax exemptions for public ownership.

By leaving out the rent problem, the CJEU focused on the tax issue and held that Navantia had been relieved from tax normally borne by private real estate owners.

[100] Micheau (2015), pp. 325 et seq.; Temple Lang (2015), pp. 766 et seq.

[101] Schön (2012), at para 10-033 et seq.

[102] Case T-473/12 (Aer Lingus) judgment of 5th February 2015, para 78 et seq.; Case T-500/12 (Ryanair) judgment of 5th February 2015, para 131 et seq.

[103] Case C-522/13 (Navantia) judgment of 9th October 2014.

[104] Case C-522/13 (Navantia) judgment of 9th October 2014, para 24 et seq.

[105] Case C-522/13 (Navantia) judgment of 9th October 2014, para 17.

But this is not true. The shipyard is owned by the Kingdom of Spain. The Spanish state is not an enterprise, therefore Art. 107 par. 1 TFEU does not apply to the property tax exemption for public ownership. The mere fact that the Kingdom of Spain did not decide to transfer full ownership in the real estate to the wholly-owned company is not an issue as there is no necessity to do so under tax law or under private law. The only point which is relevant under state aid law is the failure of the owner to extract a full consideration for the value of the right to use from Navantia.

But there is one additional feature about this case. The CJEU seems to be of the opinion that Navantia and the Kingdom of Spain have exploited a loophole in tax legislation, thus creating an arrangement which was aimed at reducing the tax burden of the business. If this line of thinking gets traction, the Commission might start to attack tax avoidance schemes, which exist under national tax law as constituting forbidden state aid. But this can't be true. While it is widely accepted that the existence of state aid does not depend on "aims and motives" on the side of the legislator and only on the "effects" on taxpayer behaviour, one should not go so far and force states under Art. 107 TFEU to implement strong anti-avoidance taxation. In "3 M Italia"[106] the Court rightly said that there exists no general obligation under European law to introduce far-reaching anti-avoidance rules for taxes which are not harmonized in the first place.

7 Conclusions

The application of state aid law in the area of taxation has to find its own path between two fallacies. On the one hand, it is important to exercise state aid control in fiscal matters as governments are easily tempted to use the tax system for steering the economy, in particular by granting benefits to enterprises in a selective fashion. The regulatory technique of taxation and the ensuing difficulties for the identification of state aid should not stand in the way of a strict pro-competition discipline. On the other hand, state aid control is not a panacea which can be used to cure all defects of tax legislation. While the fundamental freedoms only lead to one specific test: whether cross-border taxpayers or situations are treated less favourably than domestic taxpayers or situations, state aid control applies to purely internal situations as well. In order to maintain national sovereignty in fiscal matters, it is therefore important not to expand Art. 107 par. 1 TFEU into a wide-reaching anti-discrimination device which allows the CJEU to constrain domestic tax legislation to a large extent. This restrictive approach requires two steps: The concept of "favour" or "benefit" should not be replaced by a general discrimination test and the concept of "selectivity" should be limited to situations where specific firms or sectors of the industry are affected. Even with such a limited scope, the impact of the state aid provisions on tax legislation is far-reaching and widely underestimated.

[106] Case C-417/10 (3 M Italia) judgment of 29 March 2012, para 32.

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Prof. Dr. Dr. h. c. Wolfgang Schön is Director of the Max Planck Institute for Tax Law and Public Finance in Munich.

State Aid and Taxation: Selectivity and Comparability Analysis

Michael Lang

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Abstract There is a close connection between the criteria of financing from State resources, the given advantage and selectivity relating to the classification of a measure as State aid. The criterion of selectivity is however of superior importance when examining if there is a prohibited State aid. Finally the ECJ is not applying anymore the principle of rule and exception for its selectivity examination. Instead the selectivity examination as such comprises two parts: It must be examined if a measure is selective and if the selective measure is justified and proportional.

1 The State Aid Prohibition under Union Law

The prohibition of State aid under Union law is laid down in Art 107 para 1 TFEU: *"Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market"*. From the case law of the ECJ it is often concluded that the classification of a measure as State aid requires that each of the four cumulative criteria for prohibited State aid is met: The measure has to be granted by the State or

M. Lang (✉)
Vienna University of Economics and Business, Vienna, Austria
e-mail: Michael.Lang@wu.ac.at

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_2

through State resources (first criterion), it has to favour an undertaking or the production of certain goods (second criterion), it has to be selective (third criterion) and it has to affect trade between Member States resulting in a distortion of competition (fourth criterion).[1]

However, two of these criteria are often examined together. This can be illustrated by an analysis of three of the more recent and famous cases in the area of State aid: *Presidente del Consiglio dei Ministri v. Regione Sardegna,*[2] *Paint Graphos Soc. coop. arl ua*[3] and *Commission and Spain/Government of Gibraltar and United Kingdom.*[4] The opinions of the Advocates General and the judgements of the ECJ in these cases clearly show that in assessing whether a tax measure constitutes a prohibited State aid, there is not only a close connection between the criteria of financing from State resources, the given advantage and selectivity, but that they even merge with each other and eventually can be exchanged arbitrarily.[5]

The Advocate General *Kokott* in *Presidente del Consiglio dei Ministri v. Regione Sardegna* ascertained without detailed examination whether the measure was granted by State resources on the basis of the fact that the Autonomous Region of Sardegna had forgone its resources in a manner of *"renunciation of tax revenue by confining the tax liability to non-residents [was] sufficient for the presumption that finance is provided by the State or through State resources for the purposes of Article 87(1) EC"*.[6] Moreover, the different treatment of different tax payers was considered to be an advantage without any further examination.[7] However, the Advocate General then focused primarily on examining if the selectivity criterion was fulfilled.[8] Advocate General *Jääskinen* showed in his conclusions for the two other cases that he actually does not see any conceptual difference between the prerequisite of an advantage and that of selectivity.[9] In his opinion in *Paint Graphos,* he then decided *"to streamline"* his elaborations by merely examining formal aspects in advantage examination, followed by the actually materially relevant aspects in the scope of selectivity. In his opinion in the case *Gibraltar*, Advocate General *Jääskinen* favoured to examine separately if there is an

[1] *See* Lang (2009), pp. 10 et seq.; Jaeger (2011), at m. no. 4 et seq.

[2] Case C-169/08 (*Presidente del Consiglio dei Ministri v. Regione Sardegna*), judgement of 17 November 2009.

[3] Joined Cases C-78/08 to C-80/08 (*Paint Graphos and others*), judgment of 8 September 2011.

[4] Joined Cases C-106/09 P and C-107/09 P (*Commission and Spain v. Government of Gibraltar and United Kingdom*), judgment of 15 November 2011.

[5] Lang (2012), p. 418; *see* in detail, and with critical reflections Schön, Tax Legislation and the Notion of Fiscal Aid—a Review of Five Years of European Jurisprudence in this volume.

[6] AG Kokott, Case C-169/08 (*Presidente del Consiglio dei Ministri v. Regione Sardegna*), Opinion of 2 July 2009, para. 145.

[7] Lang (2012), p. 412.

[8] Lang (2012), p. 412.

[9] Lang (2012), p. 418.

advantage conferred and if the selectivity criterion is fulfilled, but in the end, the same arguments on both levels were put forward after all.[10]

The ECJ limited itself to a cursory examination of whether favouring certain undertakings was present in its judgement *Presidente del Consiglio dei Ministri v. Regione Sardegna.*[11] The selectivity examination was decisive. If selectivity applies, favouring is present in any case. In *Paint Graphos,* the ECJ also focussed on the examination of the selectivity criterion.[12] The question of whether there is an advantage was not answered at all. After a similar general examination, based on which it found an advantage to be present, in *Presidente del Consiglio dei Ministri v. Regione Sardegna*, the ECJ determined that the measure was granted by State resources due to the financial benefits of individual entities subject to taxation.[13] In *Gibraltar* the question whether an advantage was conferred was not answered at all. Instead, it was only examined if there was any selective advantage.[14] All of this shows that the independent examination of the criteria of financing from State resources, favouring and selectivity of the measure cannot be consistently applied in tax-law situations in any case. The first criteria merge with selectivity, which is of superior importance when examining if there is a prohibited State aid.

2 Selectivity in the Case Law of the ECJ

The criterion of selectivity is therefore extremely important: Often selectivity is described by defining a reference system and identifying an exceptional rule which is derogating from the general rule. At first glance the judgment in *Presidente del Consiglio dei Ministri v. Regione Sardegna* gives this impression as well. In this judgement the ECJ examined the question of tax benefits in the context of the criterion of the use of State resources and stated that the waiver of tax revenues which could have normally been generated may constitute State aid.[15] It seems that the ECJ asks about the rule-exception relationship when assessing whether there is any favouring at all.[16] A more precise analysis of the judgement, however, shows that the ECJ considers "*exemption of the operators of aircraft intended for private transportation of people and leisure boats with tax residence in the area of the region from the regional landing tax*" to be sufficient already to assume a use of

[10] Lang (2012), p. 418.

[11] Lang (2012), p. 418.

[12] *Paint Graphos* supra (note 3)*,* para. 48 et seq.

[13] *Presidente del Consiglio dei Ministri v. Regione Sardegna* supra (note 2), para. 55 et seq.

[14] Lang (2012), p. 418.

[15] *Presidente del Consiglio dei Ministri v. Regione Sardegna* supra (note 2), para. 55 et seq.

[16] Lang (2010), p. 577.

public resources.[17] The ECJ apparently did not consider a more detailed examination to be necessary.[18] It did not perform any more detailed inspection of which tax income Sardinia "*usually could have achieved*". The question of whether the majority of the aircraft and leisure boats arriving in Sardinia were operated by persons also resident there or by persons resident outside of Sardinia was not examined by the ECJ. Moreover, also the submitting court did not have to answer this question. Therefore, the examination of the selectivity criterion was decisive: If there is a different treatment of comparable situations according to the selectivity examination, it must be assumed that there is a tax benefit.

The reasoning of the Court in *Paint Graphos* is structured similarly*: "In order to classify a domestic tax measure as 'selective', it is necessary to begin by identifying and examining the common or 'normal' regime applicable in the Member State concerned. It is in relation to this common or 'normal' tax regime that it is necessary, secondly, to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it 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 [...]".*[19] The ECJ then assumed that *"[...] corporation tax must therefore be regarded as the legal regime of reference for the purpose of determining whether the measure at issue may be selective".*[20] After the ECJ has developed the criteria for the comparability examination, it stated: *"In the final analysis, it is for the referring court to determine, in the light of all the circumstances of the disputes on which it is required to rule whether, on the basis of the criteria set out at paragraphs 55 to 62 above, the producers' and workers' cooperative societies at issue in the main proceedings are in fact in a comparable situation to that of profit-making companies liable to corporation tax".*[21] The ECJ then ordered the national court: *"If the national court concludes that, in the disputes before it, the condition set out in the preceding paragraph is in fact met, it will still be necessary to determine, in accordance with the Court's case-law, whether tax exemptions such as those at issue in the main proceedings are justified by the nature or general scheme of the system of which they form part [...]".*[22] This justification examination is followed by the examination of proportionality: *"In any event, in order for tax exemptions such as those at issue in the main proceedings to be justified by the nature or general scheme of the tax system of the Member State concerned, it is also necessary to ensure that those exemptions are consistent with the principle of*

[17] *Presidente del Consiglio dei Ministri v. Regione Sardegna* supra (note 2), para. 57; Lang (2012), p. 413.

[18] Lang (2010), p. 577.

[19] *Paint Graphos* supra (note 3), para. 49.

[20] *Paint Graphos* supra (note 3), para. 50.

[21] *Paint Graphos* supra (note 3), para. 63.

[22] *Paint Graphos* supra (note 3), para. 64.

proportionality and do not go beyond what is necessary, in that the legitimate objective being pursued could not be attained by less far-reaching measures".[23]

In *Gibraltar* Advocate General *Jääskinen* insisted on identifying rule and exception: However, Advocate General *Jääskinen* also agreed *"that derogation-based approach has been criticised in the legal literature since neither the Commission nor the Court of Justice has succeeded in determining precisely what is covered by the term 'derogation from the norm' or what constitutes the 'norm' or 'a general system'. Writers have also emphasised the difficulty in determining a 'normal' tax rate in order to establish the rate which may be regarded as departing from the norm"*.[24] Subsequently, the Advocate General discussed possible alternatives:[25] "*Apart from a derogation-based approach, the idea has been put forward that a measure should be regarded as general when it derives from the internal logic of the tax regime or where it is intended to achieve equality between economic operators. Among the approaches proposed by academic writers, it has been suggested in particular that a measure is general as long as any undertaking, in any sector, is eligible to benefit from it. Under this approach it is necessary to carry out a two–stage test, the first stage comprising identification of the targets of the measure ('revealed potential targets'), and the second being intended to identify the scope of the measure ('revealed potential scope'). It would be at the second stage that it would be possible to identify the reasons underlying the measure proposed by the Member State. According to another suggestion, an analysis in three successive stages would involve, first, seeking to ascertain whether the measure is capable of applying to all undertakings that are in a comparable factual and legal situation, second, verifying whether certain undertakings enjoy more favourable treatment (discrimination) and, finally, ascertaining that the measure can be justified by the nature or structure of the tax regime"*.[26]

In the end, Advocate General *Jääskinen* still was of the opinion that the question to be asked was that about the generally applicable tax system and the deviation from it: *"Notwithstanding the criticisms mentioned above, the derogation-based approach seems to me to be the one most consonant with the allocation of powers between the Member States and the Commission. Whilst accepting that Member States retain competence to organise their tax regimes, it seems to me to be justified to take the view that the authority which the Commission derives from Article 87 (1) EC must be circumscribed so as to apply only to measures that amount to a derogation from the generally applicable system"*.[27] He also argues as follows: *"Furthermore, I am of the opinion that the justification for the approach of seeking to identify, initially, a general regime and, subsequently, derogation from that*

[23] *Paint Graphos* supra (note 3), para. 75.

[24] AG *Jääskinen*, Joined Cases C-106/09 P and C-107/09 (*Commission and Spain/Government of Gibraltar and United Kingdom*), Opinion of 7 April 2011, para. 184.

[25] AG *Jääskinen* supra (note 24), paras. 184 et seq.

[26] AG *Jääskinen* supra (note 24), para. 185–187.

[27] AG *Jääskinen* supra (note 24), para. 189.

regime stems from the logic underlying the concept of State aid, which requires the existence of an advantage to be established".[28] The Advocate General eventually based his opinion on selectivity on his earlier statement on the advantage situation, even though he demanded that the two criteria of the term of State aid be kept apart and reviewed separately. Apparently, based on the assumption of the Advocate General both the determination of the generally applicable tax system and the deviation from it are required to verify whether there is any advantage at all and to assess whether this advantage is selective.

In the *Gibraltar* judgement the ECJ chose an entirely different approach: *"As regards appraisal of the condition of selectivity, it is clear from settled case-law that Article 87(1) EC requires assessment of whether, under a particular legal regime, a national measure is such as to favour 'certain undertakings or the production of certain goods' in comparison with others which, in the light of the objective pursued by that regime, are in a comparable factual and legal situation"*.[29] The ECJ based this on its consistent case-law.

In the same judgement in respect to *"normal taxation"*, the ECJ stated as follows: *"The Court admittedly held in paragraph 56 of Portugal v Commission that the determination of the reference framework has a particular importance in the case of tax measures, since the very existence of an advantage may be established only when compared with 'normal' taxation. However, contrary to the General Court's reasoning and the proposition put forward by the Government of Gibraltar and the United Kingdom, that case-law does not make the classification of a tax system as 'selective' conditional upon that system being designed in such a way that undertakings which might enjoy a selective advantage are, in general, liable to the same tax burden as other undertakings but benefit from derogating provisions, so that the selective advantage may be identified as being the difference between the normal tax burden and that borne by those former undertakings. Such an interpretation of the selectivity criterion would require, contrary to the case-law cited in paragraph 87 above, that in order for a tax system to be classifiable as 'selective' it must be designed in accordance with a certain regulatory technique; the consequence of this would be that national tax rules fall from the outset outside the scope of control of State aid merely because they were adopted under a different regulatory technique although they produce the same effects in law and/or in fact"*.[30]

The ECJ's judgment *P Oy* fits in this line of reasoning.[31] At first glance, the ECJ gives the impression that everything depends on distinguishing the rule from the exception: *"The Court has held that in order to classify a domestic tax measure as 'selective', it is necessary to begin by identifying and examining the common or*

[28] AG Jääskinen supra (note 24), para. 190.

[29] *Gibraltar* supra (note 4), para. 75.

[30] *Gibraltar* supra (note 4), paras. 90–92.

[31] C-6/12 P (*P Oy*), judgement of 18 July 2013.

'normal' tax regime applicable in the Member State concerned".[32] However, then the Court continues by referring to the comparability analysis: *"It is in relation to this common or 'normal' tax regime that it is necessary, secondly, to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it 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"*.[33] A few paragraphs later the ECJ confirms this approach: *"[...] if the competent authorities have a broad discretion to determine the beneficiaries or the conditions under which the financial assistance is provided on the basis of criteria unrelated to the tax system, such as maintaining employment, the exercise of that discretion must then be regarded as favouring 'certain undertakings or the production of certain goods' in comparison with others which, in the light of the objective pursued, are in a comparable factual and legal situation*".[34]

In *Kernkraftwerke Lippe Ems GmbH*[35] it was only briefly summarized what had become obvious for the ECJ: *"As regards appraisal of the condition of selectivity, it is clear from settled case-law that Article 107(1) TFEU requires assessment of whether, under a particular legal regime, a national measure is such as to favour certain undertakings or the production of certain goods in comparison with others which, in the light of the objective pursued by that regime, are in a comparable factual and legal situation"*.[36]

However, since the ECJ often confusingly repeats statements about the *"normal"* tax regime and the derogations thereof, it does not come as a surprise that still until today lower courts sometimes give the impression that they do not follow a clear line when deciding State aid cases and occasionally combine the outdated "rule-exception" logic with the much more convincing comparability reasoning: Just recently the General Court in the case *GFKL Financial Services AG v. Commission* dealt with the issue, as to whether Section 8c(1) of the German Corporate Income Tax Act should be classified as a measure that is prohibited under EU State Aid Law.[37] In this context the court referred to statements of the ECJ made in previous cases and stated that it is necessary to identify the *"normal"* tax regime in a first step. And in the second step it needs to be assessed, whether "*the tax measure may be selective by demonstrating that the measure derogates from that common regime inasmuch as it 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*".[38]

[32] *P Oy* supra (note 31), para 19.

[33] *P Oy* supra (note 31), para 19.

[34] *P Oy* supra (note 31), para 27.

[35] Case C-5/14 (*Kernkraftwerke Lippe-Ems*), judgment of 05 June 2015.

[36] *Kernkraftwerke Lippe-Ems* supra (note 35), para. 74.

[37] T-620/11 of 4 February 2016, para. 100.

[38] Case T-620/11 (GFKL Financial Services AG/Commission), judgement of 4 February 2016, para. 100.

3 Conclusions

The approach of using *"normal taxation"* and the deviation from it as a basis, which is not preferred by the ECJ, is the effort to determine the rule and identify the exception from it.[39] The approach properly discarded by the Grand Chamber of the ECJ does not lead to satisfactory results. Differentiation of *"normal taxation"* from exceptions where different tax provisions are applied actually differentiates between at least two provisions that have a different scope and intend different legal consequences.[40] What criteria can be used to determine which one of these provisions is the rule and which one is the exception? Coincidences of legislative techniques must not be decisive.[41] Searching for the legislator's intention also cannot lead to any result[42]: Notwithstanding the terminology used by legislators, the legislator in the end only wishes to apply one legal consequence under certain conditions and another one under different ones.[43] Asking about which one of the provisions has the larger and which the smaller area of application with a view of differentiating the rule from the exception that must be justified on the basis on this assessment will cause the problem that general provisions abstractly circumscribe their addressees and the number of concretely affected tax payers cannot be foreseen.[44] Even if the corresponding forecasts exist, there is no reason to perform the selectivity examination only under the prerequisite that the minority has a privilege as compared to the majority. The ECJ therefore rightfully did not let this in the *Gibraltar* judgement from classifying the tax-exemption of offshore companies as selective, even though the conclusions of the Advocate General noted that the provisions suggested by Gibraltar lead to a situation where *"[. . .] less than 1 % of companies are actually taxed"*.[45] The question about the *"regular burden"* therefore is not sensible since the stipulation of rule and exception is, in the end, arbitrary.[46] Once a specific provision is considered the rule, however, the favouring exception deviating from it is automatically *"suspected of being State aid"*.[47] If the examination scale depends on an advance decision on which provision is the rule and which one is the exception, this does not increase rationality. Rather, concealed valuation is usually performed when specifying the rule and coated in an

[39] *See, e.g.* Pistone (2012), p. 87; critical in respect of this approach, *see* Lang (2009), pp. 25 et seq; also Lang (2010), pp. 574 et seq.

[40] *See* Lang (2009), pp. 25 et seq.

[41] *See* Sutter (2004), p. 43.

[42] Lang (2010), pp. 574 et seq.

[43] Lang (2009), p. 26.

[44] Lang (2009), p. 25.

[45] AG Jääskinen supra (note 24), para. 239.

[46] *See* for a different opinion Schön (2010), pp. 28 et seq.

[47] Lang (2010), p. 577.

appearance of rationality.[48] The ECJ therefore did well in finally not applying the principle of rule and exception for its selectivity examination.[49]

In the *Gibraltar* judgement the ECJ has noted that even its older case-law on State aid law is not entirely targeted at *"normal taxation"*.[50] The accusation of Advocate General *Jääskinen* that was already raised regarding the Commission's decision, according to which an approach not targeted at the exception from *"the generally applicable tax regime"* for applying the prohibition of State aid *"would be tantamount to triggering a methodological revolution"*[51] therefore is not justified. Advocate General *Mengozzi* already summarized the case-law until that time correctly in his conclusions in *British Aggregates v. Commission*: *"With particular reference to State measures of a fiscal nature, the case-law shows, however, that even measures which are selective, in that they differentiate between undertakings, may escape being classified as aid, if that differentiation is justified by the nature or structure of the tax regime of which they form part. It follows, according to the Court, that, in order to determine whether or not a measure is selective for the purposes of applying Article 87(1) EC, 'it is appropriate to examine whether, within the context of a particular legal system, that measure constitutes an advantage for certain undertakings by comparison with others which are in a comparable legal and factual situation'"*.[52]

A selectivity examination as such comprises two parts:[53] On the one hand, it must be examined if a selective measure is present. On the other hand, it must be examined whether the selective measure is justified and proportional. The necessity of proportionality examination was emphasised by the ECJ particularly in *Paint Graphos*. In the first step mentioned, it must be inspected if specific companies are treated differently - namely better -by tax provisions than other companies. Therefore, two provisions must be compared: the beneficial and the less beneficial one, or the tax provisions and the relief from or lack of a provision. Favouring of specific companies or entire industry branches only meets the selectivity criterion if the companies treated differently under tax provisions are actually *"in a comparable factual and legal situation"*.[54]

[48] In this vein *see* Lang (2009), p. 25; Lang (2010), p. 577; similar opinion Pöschl (2008), p. 189, with criticism on the court of administration's jurisprudence relating to the use of the principle of equality.

[49] Lang (2009), p. 29; Lang (2012), p. 419.

[50] Lang (2009), p. 28.

[51] AG *Jääskinen* supra (note 24), para. 202.

[52] AG *Megozzi,* Case C-487/06 (*British Aggregates v. Commission*), Opinion of 17 July 2008, at para. 83 reference is made to para. 56 of Case C-88/03 (*Portugal v.* Commission); *see also* Case C-143/99 (*Adria Wien Pipeline*), judgement of 8 November 2001, para. 41.

[53] Lang (2009), pp. 25 et seq.

[54] Case C-75/97 (*Belgium v. Commission (Maribel)*), judgment of 17 June 1999, para. 28; Case C-143/99 (*Adria Wien Pipeline*), judgement of 8 November 2001, para. 41; Lang (2012), p. 420.

The selectivity examination therefore turns out to be a version of equality examination.[55] For purposes of the State aid provision, it is essential whether the companies treated differently under tax provisions *"are in a comparable factual and legal situation"*.[56] Whether or not a situation is legally or factually comparable cannot be assessed in isolation but requires a benchmark. Any equality inspection is not about arbitrary, but about essential joint features and differences according to the respective context. The basis on which these essential features are determined, ie the *tertium comparationis* according to which the comparison must be made, is important.[57] The prohibition of State aid under Union law is not a general requirement of equal treatment, but a prohibition of providing for unequal treatment that may cause distortion of competition under the proviso of Article 107 et seq TFEU.[58] According to the opinion of the ECJ, all companies of a specific region, for example, are also possibly *"certain undertakings"*.[59] In the light of this, all companies that are in considerable competitive relationships according to Article 107 et seq TFEU may be considered comparable.[60]

However, this does not automate the comparability examination under State aid law.[61] Whether a competitive relationship between companies is essential for the purposes of the provisions of Article 107 et seq TFEU must be interpreted according to the intensity of the competitive relationship. In the end, this must be determined by a decision of a judge.[62] The direction of the comparability examination, however, is provided for by this. Not every case of differentiation therefore is forbidden. Companies that are not even in a potential competition with each other may be treated differently. The intensity of the competition must be examined in the scope of proportionality. In case of different tax law consequences, it does not matter whether the more beneficial provision refers to the larger or the smaller number of companies in a comparable situation.[63]

Once, a different treatment has been proven for companies in a comparable situation, this does not necessarily constitute State aid: *"However, according to settled case-law, the concept of State aid does not refer to State measures which differentiate between undertakings and which are, therefore, prima facie selective where that differentiation arises from the nature or the overall structure of the*

[55] *See* Schön (2001), p. 111; *see* also Kube (2004), p. 244; in detail *see* Lang (2009), pp. 25 et seq; Lang (2012), pp. 577 et seq; legal comparability considerations are also discussed by Jaeger (2011), at m. no. 70.

[56] *Belgium v. Commission (Maribel)* supra (note 53), paras. 28–31; *Adria Wien Pipeline* supra (note 51), para 41; *Gibraltar* supra (note 4), para. 75 with further references.

[57] *See* Pöschl (2008), p. 155.

[58] *See* in this volume Schön, Tax Legislation and the Notion of Fiscal Aid - a Review of Five Years of European Jurisprudence.

[59] To this opinion, *see* Arhold (2006), p. 720.

[60] Lang (2012), p. 420.

[61] Lang (2009), p. 27.

[62] Lang (2009), p. 27; for different opinion *see* Schön (2010), pp. 80 et seq.

[63] Lang (2009), pp. 26, 28 et seq; Lang (2012), p. 420.

system of charges of which they are part [. . .]".[64] A measure may, according to the ECJ, be justified by the nature and the inner structure of the tax system *"if the Member State concerned can show that that measure results directly from the basic or guiding principles of its tax system. In that connection, a distinction must be made between, on the one hand, the objectives attributed to a particular tax scheme which are extrinsic to it and, on the other, the mechanisms inherent in the tax system itself which are necessary for the achievement of such objectives"*.[65]

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[64] *See* Case C-88/03 (*Portugal v. Commission*), judgment of 6 September 2006, para. 52; Case C-173/73 (*Commission v. Italy*), judgment of 2 July 1974, para. 33; Case C-148/04 (*Unicredito Italiano*), judgment of 15 December 2005, para. 51; Lang (2012), p. 420.

[65] *See* Case C-88/03 (*Portugal v. Commission)*, judgement of 6 September 2006, paras. 52 and 81; for a detailed analysis of the meaning of immanence of tax system *see* Mamut (2008), pp. 177 et seq.

Prof. Dr. Dr. h.c. Michael Lang is Head of the Institute for Austrian and International Tax Law of WU (Vienna University of Economics and Business) and Academic Director of the LLM Program in International Tax Law and of the interdisciplinary “Doctoral Program in International Business Taxation” (DIBT) at WU. I would like to thank Maryte Somare and Andreas Langer for the discussion of this manuscript and for their helpful suggestions and support with drawing up the annotations and galley proofing.

Tax Incentives Under State Aid Law: A Competition Law Perspective

Thomas Jaeger

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Abstract Respecting the line between the policy areas of taxation and state aid law is important not only from the Member States' perspectives, but also from the points of view of the European Parliament and the protection of individual rights. State aid law's current approach to tax measures and their assessment is not in balance: The borderline to the tax policy area is blurred. It is at a constant risk of being crossed by the Commission in its effort to be the wingman of a sluggish EU tax legislator in the quest against harmful tax competition. This contribution explains why safeguarding the balance between state aid and taxes is important, what the flaws in the current approach are, how they can be modified and in how far this would make a difference for future state aid tax cases.

T. Jaeger (✉)
University of Vienna, Austria
e-mail: thomas.jaeger@univie.ac.at

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax
Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_3

1 Overview

The state aid control of taxes sees many jobsites, which stretch across the board—from the very definition of tax (particularly vis-à-vis parafiscality) via the peculiarities in the assessment of the various elements of the state aid prohibition (e.g. the applicability of the so-called private investor test and state character) to the justification test (e.g. regarding the admissibility of public policy and steering objectives) and aid recovery (particularly hypothecation).[1] This article will focus on just one of these issues, which is however also the central one: Is the relationship between tax and state aid balanced? In particular: Does state aid control recognize limits posed by the other policy area?

The crux here is competition law's general effects-based approach.[2] The term describes the principle of always looking at the effects and never the pure form of a measure. Accordingly, taxes by the mere virtue of their public nature do in principle not benefit from any special rules or treatment in the state aid regime.[3] As a measure will therefore fall under the state aid prohibition irrespective of its tax nature, state aid law is quite invasive into member states' tax policies. This creates an obvious and much-lamented[4] conflict with the principle of national tax sovereignty, which state aid policy, like EU law in general, is called to respect.

So is the effects-principle the right approach for taxes? As we will see, case law and practice have already chipped away at it here and there in relation to tax measures, so that some specific assessment principles do already apply. But as we will also see, they are not fully workable and sometimes create more confusion than clarity. This contribution is set to explore these issues and will try to help to better define the line between state aid policy and tax policy: Why is it important, where is it to be drawn and do state aid practice and jurisprudence respect that line sufficiently?

2 A Line Between State Aid and Tax Policy

The delicacy of the balancing exercise to which this contribution is dedicated can be nicely illustrated by the current example of the LuxLeaks affair—the system of favourable advance tax rulings uncovered by journalists in 2014.[5] Through it, Luxembourg sought to attract large multinational undertakings. It soon became evident, that several member states alongside Luxembourg, Ireland, Belgium, the

[1] Comprehensively also Jaeger (2015), p. 345 *passim*; Haslehner (2011), p. 278.

[2] For more Rüffler and Steinwender (2013), p. 560.

[3] Schön (2012), para. 10-001.

[4] *See*, e.g. Musil (2014), p. 957; Quigley (2009), p. 65; Jaeger (2011), para. 1; Mamut (2008), p. 178.

[5] For more Jaeger (2015), p. 345 *passim*.

Netherlands and others, also employed advance tax rulings as part of their effort to attract multinationals.

2.1 The Commission: Filling-in for the Legislator?

When it emerged that advance tax rulings were a widespread practice among Member States, competition Commissioner *Vestager* immediately decided to open a large-scale investigation: "We need a full picture of the tax rulings practices in the EU to identify if and where competition in the Single Market is being distorted through selective tax advantages. We will use the information received in today's enquiry as well as the knowledge gained from our ongoing investigations to combat tax avoidance and fight for fair tax competition."[6]

Is that perception correct? Is it really part of competition policy and the Commission's task tackle tax competition between the Member States? Is the Commission here filling in for absent EU legislation, such as the Common Consolidated Corporate Tax Base (CCCBT), a single European way to calculate taxable income, proposed already in 2011 but never approved by the States,[7] or enhanced tax information and transparency rules, e.g. the ones finally proposed under the Tax Transparency Package[8] in 2015?

The EU institutions take a relatively inclusive approach towards drawing a line between state aid and taxation: Already at the occasion of the 1997 Code of Conduct for Business Taxation, the ECOFIN Council requested the Commission to flank its (ineffective) fight against tax competition via recourse to the much more effective means of state aid law. The Commission readily followed suit with its 1998 Business Taxation Notice and has since tried to "contribute through . . . to the objective of tackling harmful tax competition".[9] Since then and up to the so-called LuxLeaks affair and its aftermath, the Commission has been committed to that job: Filling in EU tax policy blanks via state aid.

But while the Commission was very active in taking on tax mechanisms for multinationals through state aid means all over Europe, from Gibraltar to the Netherlands and from the Acores to Cyprus, the Council lagged behind in terms of coordinating and harmonizing corporate tax rules. Only recently, in the wake of the financial crisis and heavy efforts on the part of the US in particular to fight tax evasion and force overseas partners into information cooperation, legislative activities in the EU regained some momentum.

[6] European Commission (2014b). *See also* European Commission (2015c).

[7] European Commission (2014a). Consultations on the proposal were re-launched at the turn of 2015/16.

[8] European Commission (2015a).

[9] European Commission (1998), rec. 1.

2.2 Know Limits

The Commission is clearly an attractive partner in fighting tax evasion and tax competition: State aid law is swift and effective. Yet, shouldn't the EU institutions be more careful when employing the Commission as the wingman of a sluggish EU legislator?

Blurring the line between tax policy and state aid risks using state aid as a disguise to conduct tax policy—that is to indirectly harmonize member states' tax rules on the EU level. However, such harmonization is neither the objective of the state aid chapter nor in the competence of the Commission.

Safeguarding the line between the two policy areas first of all amounts to safeguarding institutional balance. Secondly, it means shielding tax law policy from the "executive dominance" of competition law. Thirdly, blurring the line is a problem for individual rights protection.

2.2.1 Institutional Balance

The first concern relates to the distribution of vertical competences between the EU and its Member States and of horizontal competences between the institutions and the institutional balance between them. Given that tax harmonization under Art. 115 TFEU requires unanimity in the Council and involves the Parliament, swift Commission action under the state aid chapter is a handy way around disagreement.

2.2.2 Executive Dominance

Institutional balance leads over to the second aforementioned concern of a risk of so-called executive dominance by the Commission over other institutional players. The term was coined by Quintin Hogg, Lord High Chancellor of Great Britain in the 1970s, who, drawing upon writings of the late Italian politician Giuseppe Garibaldi, described the domestic UK policies of his time as a characterized by a state of overriding *de facto* dominance of the executive branch over the legislative and judicial branches of government.[10]

In competition law, such executive dominance is the rule for a number of reasons not elaborated here. It is present both on the level of the relationship of the Commission vis-à-vis the other EU institutions and on the level of the Commission's relationship with member states.

If tendencies to stretch the limits of the field are not countered, competition law's executive dominance would be exported into the tax area, making the Commission the dominant institutional player. This would be an unfortunate development in

[10] *See* Lane and Ersson (1999), p. 217.

many respects, EU law's principles of democracy and rule of law being just two of them.

2.2.3 Individual Rights Protection

Safeguarding the borderline finally means protecting individual rights from competition law's very invasive tools. State aid tools are designed to repress and correct state action that distorts competition in a swift and effective manner. They are therefore very invasive both in terms of what the Commission can do and how.

Apart from its power to issue directly applicable individual decisions that take precedence over any national tax rules, the Commission enjoys a large amount of discretion in applying the prohibition.[11] It is free to decide which cases to take up and may issue directly applicable individual decisions. And it also enjoys discretion to fill in the details for applying the state aid rules by way of a large amount of delegated hard law (e.g. block exemption Regulations) and interpretative soft law (e.g. notices, communications or guidelines).

At the same time, the European courts undertake only a limited review of certain aspects Commission discretion. This is so not only as regards the question of compatibility of the aid, where the Commission enjoys the pronounced discretion just mentioned, but already on the level of the scope of the prohibition where complex economic issues are decided.[12] There, the Court refuses to substitute the Commission's discretion for its own.

Hard and soft law created by the Commission finally also plays a role where complaints are brought directly before national courts. There, infringements give rise to all sorts of civil and public law consequences, including liability of the infringer.[13] At the same time, it may be extremely hard for the legislator as well as for national courts to foresee the conflict of a given tax norm with state aid law.

In sum, therefore, the instruments of state aid law are as effective as they are invasive. Allowing for independent, swift and immediately executable action that changes the facts on the ground, there is a certain strong incentive on the part of the Commission to resort to state aid law instead of tax harmonization and to keep pushing the limits.

[11] Sutter (2014), para. 5.

[12] Cf., e.g. Jaeger (2013), p. 693.

[13] For more, *see* Knade-Plaskacz (2013), p. 119.

2.3 Defining the Line

Respecting the balance does not command keeping all tax rules clear from state aid law control. It only requires keeping state aid law within the confines of its purpose (i.e. its teleological limits).

2.3.1 Where Is the Limit?

State aid law is a repressive policy field, not a proactive one. It aims at the swift and effective correction of distortions of competition. Where that distortion is corrected, state aid law ends. Accordingly, state aid law is always concerned with individual behavior. This is also evidenced by the state aid prohibition's selectivity element. By contrast, state aid law is not about setting general norms to govern the conditions of competition in a given sector beyond the individual case. State aid control should repress excessive effects of tax norms in their individual application, not proactively shape tax policies. Admittedly, the line between a legitimate repression of misbehaviour and an illegitimate proactive *de facto* norm-setting is delicate.

However, state aid policy and enforcement are clearly outside of their confines where state aid measures amount to general norm setting. Proactively shaping the conditions of taxation for a whole sector means overstepping the line. State aid decisions or Commission legislation may not target the conditions of competition beyond individual cases or case-clusters and thereby mutate to legislative measures. Where, therefore, state aid measures fill in or substitute for the absence of tax legislation on the EU level, those measures presumably go too far.

Be it added just as a footnote here that the problem of missing the right balance and misuse of state aid as a proactive instrument is not confined to the tax area, but is also prominent vis-à-vis sector regulation: The line between correcting the competitive effects of state measures and restructuring the whole sector via extensive structural and behavioural remedies in state aid decisions is a delicate one. For an example, we may simply look at the Commission's handling of state aid to banks during the past global financial crisis, where state aid decisions for quite some time filled in for absent and only successively enacted regulatory measures for the sector.[14] Other examples are the transport, telecom, energy or agriculture sectors, where regulation and state aid law likewise go closely—sometimes too closely—hand in hand.

2.3.2 What Is the Tool for Balancing?

The key to understanding state aid law is its aforementioned effects-based approach: Because state aid law never looks at the form, but only at the effects of

[14] *See*, e.g. Jaeger (2012), p. 173.

a measure, it doesn't make a difference for the application of the state aid prohibition whether a given norm belongs to the tax field. This means that the effects-based approach is the key to balancing the relationship.

For a better balance, we do not need to abandon the effects-based approach. Instead, the effects-based approach should be fine-tuned for a better understanding of the effects of tax provisions within the existing effects-based approach.

This calls for a better understanding of the typical characteristics and effects of tax norms and a better distinction of those effects vis-à-vis the effects of other, common state aid measures. For such typical characteristics, a safe haven presumption might apply in the sense that they do not trigger concerns of a presence of state aid-relevant selectivity or advantage in particular: Tax-typical effects would not trigger concerns of a presence of state aid.

The ECJ has in the past created such a safe haven in the context of territorial selectivity under the so-called *Azores*-criteria.[15] The signal vested in that jurisprudence is a good starting point for carrying the safe haven approach on to other areas.

3 The Example of System Immanence

The introductory assumptions above can be illustrated by looking at the so-called system immanence test. System immanence is about dealing with the fact that tax norms typically differentiate in the distribution of the tax burden. Clearly, not all unequal economic effects of a tax norm are state aid relevant, but how to single out the ones that are?

The system immanence test was developed in jurisprudence.[16] It modifies the regular effects-based approach for the tax area. Where it is shown that a tax differentiation is in line with tax logical principles, the norm in question is cleared from state aid suspicion. State aid law does then not interfere with a tax policy decision.

3.1 What Is the Logic?

The intention of jurisprudence to cut back the scope of application of the state aid prohibition vis-à-vis tax policies is noble. However, the way the test is currently construed creates some confusion and leads to more or less arbitrary results.

[15] Case C-88/03, *Portugal v Commission* EU:C:2006:511, para. 20.

[16] E.g. Case C-452/10 P, *BNP Paribas v Commission* EU:C:2012:366, para. 121; Case C-159/01 *Netherlands v Commission* EU:C:2004:246, para. 43; Case C-279/08 P *Commission v Netherlands* EU:C:2011:551, para. 77; Joined Cases C-106/09 P and C-107/09 P, *Commission and Spain* v *Government of Gibraltar and United Kingdom* EU:C:2011:732, para. 146.

Questions that arise here, and that the jurisprudence only insufficiently answers, are: What exactly are the tax logical principles, i.e. what objectives of a tax norm are permissible for the test, what objectives are not? What is the reference framework for assessing those objectives—just the individual law, all laws governing a given field (for example all environmental laws) or, perhaps, even just horizontal principles of taxation (ability to pay, revenue generation etc.)? Who decides on what the reference framework is? Is the Member State? And finally, what role remains for the discrimination test? Where in the state aid assessment does it belong and how does it relate to the objectives of a tax norm?

3.1.1 Example: British Aggregates

These questions can be illustrated by looking at the *British Aggregates* saga. The facts concerned a British levy on the commercial exploitation of granular materials, coupled with an exemption for some, such as slate, clay and the like. Is the question, what materials to tax and what not, prohibited state aid or legitimate tax policy?

The Commission and the GC initially took a generous approach by accepting that the tax in question was motivated by environmental objectives and that those objectives could be found back logically in the provisions: “An environmental levy is thus an autonomous fiscal measure which is characterised by its environmental objective and its specific tax base. It seeks to tax certain goods or services so that the environmental costs may be included in their price and/or so that recycled products are rendered more competitive and producers and consumers are oriented towards activities which better respect the environment. . . . It must be emphasised in that regard that it is open to the Member States, which, in the current state of Community law, retain, in the absence of coordination in that field, their powers in relation to environmental policy, to introduce sectorial environmental levies in order to attain those environmental objectives referred to in the preceding paragraph.”[17]

However, the GC was overturned on appeal in 2008. The ECJ refuted the notion that environmental protection was a valid fiscal objective that could justify the selection of a specific tax base: The GC had “disregarded Article [107 para. 1] . . . by holding . . . that Member States are free, in balancing the various interests involved, to set their priorities as regards the protection of the environment and, as a result, to determine which goods or services they decide to subject to an environmental levy, with the result that . . . similar activities, which are not subject to the levy, benefit from a selective advantage. . . . that approach, which is based solely on a regard for the environmental objective being pursued, . . . cannot be justified by the nature or general scheme of the system of which it forms part”.[18]

[17] Case T-210/02, *British Aggregates v Commission* EU:T:2006:253, paras. 114, 115.

[18] Case C-487/06 P, *British Aggregates v Commission* EU:C:2008:757, paras. 86–88.

3.1.2 Core Tax Principles Only

British Aggregates thus tells us that state aid law's effects-based approach will only yield to core tax logics. According to the ECJ, the selection of some aggregates for taxation on the grounds of their environmental impact was thus not "tax logical".[19] The ECJ instead held that the only valid logic here could be the taxation of commercial activity. This would inevitably have meant taxing all aggregates in an equal manner, without any steering possibilities for the Member State as regards the use of resources.

Of course, the GC in its 2012 follow-up decision in British Aggregates implemented a strict effects approach and found the levy to be in breach of the state aid prohibition.[20] This was repeatedly confirmed subsequently.

Take, for example, this quote from the 2014 *Ryanair* judgment, concerning exemptions from an air travel tax: That measure "differentiate[d] between economic operators ... in light of the objective assigned to the tax system of the Member State concerned . . . Thus, a measure which constitutes an exception to the application of the general tax system may be justified if it is shown that that measure results directly from the basic or guiding principles of the tax system of the Member State concerned".[21]

3.1.3 Critique: Substituting the National Legislator's Discretion for the Court's

The GC in *Ryanair* thus clearly states that only the guiding principles of the tax system of the Member State concerned are safe from the reach of the state aid prohibition and that differentiations had to be judged "in the light of the objective assigned to the tax system".[22] This is a very strict standard that penetrates deeply into Member States' freedom to use tax policy for behavioural steering and to select tax bases accordingly.

Core tax principles may tell you how to tax, but they cannot tell you what to tax. The Court's approach in British Aggregates thus means that differentiations in the tax base will always be within the reach of state aid law.

This is not a sensible approach: What the Court does here in fact is to substitute the national tax legislator's discretion to define the tax base for its own. There is no way to decide on the sensibility of decisions on the tax base without taking into account the objective of a tax provision.

[19] On the existence of selective state aid, *see* contribution by Schön, Tax Legislation and the Notion of Fiscal Aid—A review of Five Year of European Jurisprudence, in this volume.

[20] Case T-210/02 RENV, *British Aggregates v Commission* EU:T:2012:110, paras. 52, 102.

[21] Case T-512/11, *Ryanair Ltd. v Commission* EU:T:2014:989, paras. 80, 81.

[22] Case T-512/11, *Ryanair Ltd. v Commission* EU:T:2014:989*,* para. 80.

3.2 Burden of Proof: In dubio contra reum

The Court's invasiveness vis-à-vis tax objectives is aggravated by the fact that the burden of proof automatically shifts in tax cases: Under consistent jurisprudence, any differentiation in the tax burden automatically triggers a suspicion that the measure is selective. It is then not for the Commission to prove that the measure is aid, but for the Member State to prove that it is not.

The following excerpt is from the 2015 *Austrian Eco-Energy* case on green energy surcharge exemptions, but the principle figures in consistent case law[23]: "In particular, it is not shown that the exemption measure at issue would be the direct result of the founding or guiding principles of the Austrian tax system or that it would be indispensable for the purpose of ensuring fairness. In that regard, it has consistently been held that it is for the Member State which has introduced a differentiation between undertakings in relation to charges to show that it is actually justified by the nature and general scheme of the system in question".[24]

Given that all tax norms except flat taxes differentiate between taxpayers, this jurisprudence thus establishes what I have elsewhere[25] called a principle of "*in dubio contra reum*"—if in doubt, quash the tax norm.

3.3 Inconsistency of a Strict Standard for Tax Logics

The strict standard for the admissibility of tax logics is also inconsistent compared with the approach taken in neighbouring areas. For fees and fines relating to the use of public infrastructure or rights for example, the Court also draws upon the system immanence test to check the effects. However, with the usual tax principles unavailable there, the Court opened up its test for the logics of the field at issue.

One example here is the Dutch *NOx* case of 2011, which involved emissions certificates issued for free and tradable and fines where emissions limits were exceeded. The Court there based its finding of selectivity inter alia on a comparison with other environmental laws: "It is for the Member State which has introduced such a differentiation between undertakings in relation to charges to show that it is actually justified by the nature and general scheme of the system in question . . . The Commission has referred to the existence, in the Member State concerned, of laws concerning environmental management and atmospheric pollution which do not contain the measure in question."[26] The Court in *NOx* thus acknowledged that the

[23] Cf. Case C-279/08 P, *Commission v Netherlands* EU:C:2011:551, para. 77; Case C-452/10 P, *BNP Paribas v Commission* EU:C:2012:366*,* para. 121.

[24] Case T-251/11, *Austria v Commission* EU:T:2014:1060, para. 117.

[25] *See* Jaeger (2015), pp. 356 et seq.

[26] C-279/08 P, *Commission v Netherlands* EU:C:2011:551, paras. 62, 67.

Member State could use a system of fines for behavioral steering, but that the steering mechanism had to be checked for systemic consistency.

Another example is the *London cabs* case decided in 2015, concerning the right of taxis to use bus lanes for free. There too, the Court recognized that in differentiating between undertakings regarding fees and fines, the Member State concerned was free to pursue its own policy objectives, as long as no discrimination is involved: "[T]he identification of the objective pursued is, in principle, a matter within the prerogative of the competent national public authorities alone and they must have a degree of discretion both as regards whether it is necessary, in order to achieve the regulatory objective pursued, to forgo possible revenue and also as regards how the appropriate criteria for the granting of the right, which must be determined in advance in a transparent and non-discriminatory manner, are to be identified."[27]

If a broad effects-based approach, open for the specific steering objectives of the field, is tenable in relation to fees and fines, why not also for taxes proper? This is neither consistent nor convincing.

3.4 What Is the Role for Discrimination?

The *London cabs* case leads over to the final problem discussed here: What about discrimination? Does it make a difference whether a tax provision is discriminatory or not?

In *London cabs*, the Court basically says that any objective is fine as long as that objective is pursued in a manner that is consistent with the specific logic and non-discriminatory. Discrimination is also the starting point of the system immanence test, which under current jurisprudence forms part of the selectivity criterion.[28]

However, under that jurisprudence, discrimination is devoid of a function of its own. Instead, it is wrapped into one with the system immanence test: If a tax norm differentiates, it is presumed that it is discriminatory, unless the strict system immanence test is passed. At the same time, differentiation that does not pass the system immanence test will always fulfill the criterion of advantage.

In sum therefore, current jurisprudence—even the more balanced recent judgments such as *London cabs* and *Austrian Eco-Energy*, the starting point is flawed: The Court takes the finding of unequal treatment as a starting point for prima facie selectivity.[29] Then, burden of proof shifts and the Member State is left to prove all the rest. In addition, the Court takes relatively large freedom to determine the

[27] Case C-518/13, *Eventech v The Parking Adjudicator* EU:C:2015:9, para. 49.

[28] *See*, e.g. *Case C-452/10 P, BNP Paribas v Commission* EU:C:2012:366*,* para. 121.

[29] Including the effect of a shift in the burden of proof, *see* C-279/08 P, *Commission v Netherlands* EU:C:2011:551, para. 77.

reference framework on its own. The following excerpt, taken from the GC's second judgment in the British Aggregates case, nicely illustrates that flawed assessment structure: The Court defines an "... advantage, [w]ith regard to tax, [is] ... a tax exemption which places the recipients in a more favourable financial position than other taxpayers amounts to State aid. ... [S]electivity of the advantage, ... is ... [a] favour ... in comparison with other undertakings in a comparable legal and factual situation ... However, a measure which, although conferring an advantage on its recipient, is justified by the nature or general scheme of the tax system of which it is part does not satisfy that condition of selectivity".[30]

In this way, current jurisprudence wraps three elements of the state aid prohibition which would merit separate examination, discrimination, selectivity and advantage, into one—thereby depriving parties of room for argumentation. All three are determined and topped by the system immanence test. If a tax norm differentiates, that is seen as an indication that it confers an advantage and that it is selective and discriminatory—unless the system immanence test is passed. If that test is failed, all three elements are deemed to be fulfilled.

Also, the reversal of the burden of proof *de facto* extends to all three elements, as one is inferred from the other.

On the level of implementation of the aid, therefore, there is no possibility for Member States to show that, although perhaps not in line with basic tax principles, the measure is nonetheless not selective, because it incorporates other objectives and implements those in a stringent, non-discriminatory manner. That cluster approach means that discrimination has no more function of its own. This deprives parties of room for argumentation.

3.5 Interim Summary: Deficits of the Current Approach

In a short summary, the current approach lacks balance. It truncates the state aid assessment by blending the separate issues of advantage, selectivity and discrimination into one: All three culminate in the system immanence test. If that test fails, you lose on all three levels.

At the same time, the test has a too narrow focus: Instead of looking at the objectives of the law in question, only basic tax principles will pass. Any other differentiation falls under the state aid prohibition.

In addition any tax norm that includes a differentiation is under a prima facie suspicion of contravening the state aid prohibition. The Commission doesn't need to prove that the norm is not a genuine tax norm.

[30] Case T-210/02 RENV, *British Aggregates v Commission* EU:T:2012:110, paras. 46–48.

4 Possible Modification to Re-Balance the System

4.1 *Restructuring the State Aid Assessment of Taxes*

What can be done to remedy these deficits? Clearly, the effects-based approach, which is at the core of the problem, does not need to be abandoned. Yet it needs to be restructured.

4.1.1 Separate the Advantage and Selectivity Assessments

The most important part of the restructuring exercise is to free up the individual components of the test: The advantage and selectivity assessments must be separated. This involves moving the system immanence test from the selectivity test, where it currently is, to the advantage test. After all, differentiated taxation seeks to establish equity among taxpayers. If equitable, a relatively lower tax burden is, if in line with tax logics, no advantage. This frees up selectivity to give it a different content.

4.1.2 Within Advantage: Restructure System Immanence

Within the advantage test, the system immanence test should be restructured. This would involve a three-prong approach.

First, the test should be opened to all objectives typical for the system of which the norm forms part of. This requires that the strict, tax-principles-only-approach should be abandoned in favour of allowing all objectives typical for the system of which the norm forms part of. This means that one would always be looking at the wider legal context of the norm, not just singular measures. It is to be avoided that a singular law would form its own, isolated reference standard. There will be, of course, be objectives that are outright incompatible with the objectives of EU law. Similarly, as in the area of fundamental freedoms, these would never be admissible without further question. For any other non-tax objectives, such as environmental or social: Any form of behavioural steering by means of tax law should be admissible. That objective should be tested for—first—its sensibility, that is its compatibility with EU objectives, and—second—its stringent implementation in the actual provisions of the norm. The way that these objectives are implemented elsewhere in the laws of the field can serve as a reference standard.

Second, the stringent implementation at hand should be measured against these system-specific objectives. This means that their implementation in the norm at hand is tested.

Third, and finally, the prima facie suspicion that tax differentiations are state aid-relevant should be abandoned. This means that it would be for the Commission to sufficiently reason its choice of the relevant reference framework, the principles applicable there and why those principles were missed for the norm at hand. Cases of doubt would go in favour of tax sovereignty.

4.1.3 Within Selectivity: Create Room for Discrimination

Within the selectivity assessment, the actual implementation should be checked for effects that may be in line with the logic of the field, but still unacceptable. This may particularly be so where the measure entails discriminatory effects.

4.2 Some Hope for That Modified Approach

There is some jurisprudence providing hope that the changes proposed here to modify the state aid assessment for taxes are not entirely unrealistic.

4.2.1 Santander

One sign of hope is the 2014 *Santander* judgment, concerning the tax treatment of company goodwill. The GC held that "where the measure at issue, even though it constitutes a derogation from the common or 'normal' tax regime, is potentially available to all undertakings, it is not possible to compare, in the light of the objective pursued by the common or 'normal' regime, the legal and factual situation of undertakings which are able to benefit from the measure with that of undertakings which cannot benefit from it. It follows from the foregoing that for the condition of selectivity to be satisfied, a category of undertakings which are exclusively favoured by the measure at issue must be identified in all cases and that, in the situation referred to . . . above, the mere finding that a derogation from the common or 'normal' tax regime has been provided for cannot give rise to selectivity."[31]

Santander thus contains three important findings: First, the GC underlined that failure of the system immanence test alone was not enough to confirm selectivity. Second, selectivity means clarity as to the precise beneficiaries of a measure. Third, selectivity involves a discrimination assessment, where those beneficiaries are compared to undertakings not benefiting from the measure. Where the measure's objective explains the differentiation, there is no selectivity.

Santander thus nicely dissects the different components of the effects-based approach for taxation that is advocated here. The GC stopped short of stating that, in

[31] Case T-399/11 *Banco Santander, SA v Commission* EU:T:2014:938, paras. 52 and 53; Case T-219/10 *Autogrill v Commission* EU:T:2014:939, paras. 48 and 49; Appeal Case before the Court of Justice C-21/15 P.

view of its understanding of selectivity as a discrimination assessment, system immanence would have to be checked elsewhere, namely under advantage. Nonetheless, this is the logical consequence of the Santander argument. And just as a footnote: We do find the test structured this way in practice already, for example in the Commission's 2007 Swiss Company Tax Decision.[32]

4.2.2 *MOL*

A similar, although less straightforward, wording can also be found in the CJEU's 2015 *MOL* judgment, concerning favourable rates on mining fees. There too, the Court highlights the fact that advantage and selectivity must be separated: "[T]he selectivity requirement differs depending on whether the measure in question is envisaged as a general scheme of aid or as individual aid. In the latter case, the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective. By contrast, when examining a general scheme of aid, it is necessary to identify whether the measure in question, notwithstanding the finding that it confers an advantage of general application, does so to the exclusive benefit of certain undertakings or certain sectors of activity."[33]

Although an advantage may be presumed, because the system immanence test was failed, there is still room for a separate selectivity assessment where the beneficiaries of a measure are not clear. As per the GC case law, the CJEU in *MOL* also stopped short of concluding that therefore, the system immanence test was actually a matter of advantage.

It actually does not even matter all that much, whether system immanence is formally seen as an advantage component or whether simply the selectivity requirement is reinforced by a mandatory discrimination assessment. It is the outcome that matters: Firstly, that room for a separate mandatory discrimination argument is created. And secondly, that the test conducted is open for the objectives of the field of law at hand, not just tax logics proper. Unlike the GC, the CJEU does not also mention this latter point.

4.2.3 Modification Potential Vested in That Jurisprudence

The mentioned judgments tell us that the system immanence test has a plainly limited role within selectivity. The discrimination element is the eventually decisive criterion to find selectivity.

They also tell us that discrimination is slightly different and broader in substance than system immanence. The latter looks at tax principles and their implementation, i.e. the objectives of the field of law that the respective norm forms part of—tax law

[32] European Commission (2007), paras. 31 and 35.

[33] Case C-15/14 P *Commission v MOL* EU:C:2015:362, para. 60.

principles in a classic reading, any typical objectives of a field in the reading suggested here. Discrimination, by contrast, asks about the unequal treatment of equal facts. It thus looks at any due justification, i.e. also at reasons of public interest which may be singular or unique to the norm looked at.

All this evidences that system immanence is insufficient for assessing selectivity, because the absence of discrimination overrides the results of the system immanence test. Indeed, we see from the cited jurisprudence that system immanence is actually irrelevant in selectivity. The consequence is that the system immanence test might be thrown out of selectivity altogether.

Thus, the modification potential vested in that recent jurisprudence is an upgrade in quality for both the selectivity and the advantage assessments for tax measures by dissociating one element from the other.

4.3 Application to the LuxLeaks *Example*

Coming back upon the *LuxLeaks* affair, the aforementioned recent jurisprudence and the restructured assessment proposed here might stimulate a refined approach to distinguishing legitimate and illegitimate tax competition.

The starting point is the finding that tax competition based on differences between national tax systems is legitimate, while special regimes for off-shorers might be illegitimate. Advance tax rulings will in many cases likely be discriminatory and not justified by reasons of public interest. It is to be highlighted in that context that, as also the Commission observes in its press release on the *Fiat* and *Starbucks* decisions[34] (the first state aid decisions to come out of the *LuxLeaks* context), not advance tax rulings as such are the problem, but the exercise by authorities of discretion accorded to them in the tax law. Misuse of discretion is actually quite a banal problem that has nothing to do with delineating the line between taxation and state aid or readjusting the balance. It the law is misapplied or discretion is misused to divert funds away from normal taxation, that will always be (among other things) state aid relevant.[35]

A refined approach does therefore not mean exculpating such practices altogether. It simply aims at leaving untouched regimes which merely seek to render the national tax system more internationally competitive. Whether such regimes are present in the advance tax rulings context remains yet to be seen as the individual decisions emerge.

However, cases such as *London cabs* and *NOx* tell us that the test to check for the presence of measures of normal tax competition resulting from a mere difference in

[34] European Commission (2015b).

[35] Cf. Case C-431/14 P *Greece v Commission* EU:C:2014:2418, para. 10; Joined Cases C-533/12 P and C-536/12 P *SNCM v Corsica Ferries* EU:C:2014:4, paras. 37 and 58, regarding the misuse of discretion.

the tax laws of the Member States would have to be structured threefold: First, what is the reference framework? *NOx* states that this will typically be the relevant legislation in the field. Second, is the differentiation in line with the logics of that framework or does it show unusual exceptions? Third, as is nicely done in *London cabs*, does the differentiation, although in principle in line with the system, entail discriminatory effects in the specific context?

Examples from jurisprudence such as *Santander*, *Azores* or *Gibraltar*[36] show that cases exist, which might fall outside the prohibition under a refined test. *Fiat* and *Starbucks* might or might not be such examples. Yet the effort is worthwhile to improve the assessment standard in a general manner to now and in the future save the few cases among the crowd that might entail legitimate differentiations in tax norms.

5 Conclusions: A "More Fiscal Approach"

For reasons of tax sovereignty, institutional balance and individual rights protection it does matter whether state measures are checked under state aid or tax policy. State aid law has a clear and limited focus. It is not to be employed to substitute the absence of tax harmonizing EU legislation.[37]

The fight against tax competition is an area where the risk of overstepping the limits of state aid policy is particularly great. Safeguarding those limits means introducing more sensitivity for the peculiarities of tax measures in the state aid assessment—that is a "more fiscal approach".

This particularly means fine-tuning state aid law's effects-based-approach to better understand the effects of tax measures and to filter out measures which from a state aid perspective look problematic, but from a tax perspective are not. Notwithstanding other jobsites in the tax aid area, such as parafiscality, the private investor test etc., a starting point is the system immanence test that was looked at here.

In the current *LuxLeaks* aftermath and the Commission's quest to tackle the advance tax rulings practice, a fine-tuned approach would mean, first, no longer regarding any tax differentiation automatically as state aid relevant, second, opening in terms of permissible objectives and, third, dissociating it from the—additionally required—selectivity and discrimination assessments.

Even under that refined approach, advance tax rulings could validly be caught by Art. 107 TFEU, because they may not be in line with any legitimate over-arching logics and might discriminate against comparable undertakings. The *Fiat* and *Starbucks* cases from the *LuxLeaks* cluster could figure here, if as transfer pricing

[36] Joined Cases T-195/01 R and T-207/01 R, *Government of Gibraltar v Commission* EU: T:2002:111, para 12. *See also* Haslehner (2012), p. 303.

[37] Schön (1999), p. 915.

rules were apparently applied in a discriminatory and arbitrary manner. However, it is worth to save any of those state measures that should not be caught.

Thus, a refined approach in state aid more true to tax characteristics than the current one should not give rise to concerns. State aid control over taxes won't collapse just because the current approach of better catching too much than too little was adjusted for a more balanced one.

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Thomas Jaeger is professor of European Law at Vienna University.

Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities

Peter J. Wattel

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Abstract This article compares the reach of and criteria for application of four negative integration mechanisms in direct tax matters: the State aid rules (Arts. 107 and 108 TFEU), the free movement rights (Arts. 28–37 and 45–65 TFEU), the non-binding Code of conduct to curb harmful tax competition, and the treaty rules for eliminating market distorting disparities (Arts. 116 and 117 TFEU). It presents a diagram for comparison of the criteria and for identification of areas of overlap. All four negative market integrators discussed apply criteria which are concerned with three main issues: (i) is there some sort of inequality or departure (discrimination; advantage; lower tax level; disparity)? (ii) Does it (significantly) affect intra-Union economic activity or conditions of competition? (iii) Can it be justified? The four integrators overlap to a certain extent, which is not surprising, given their common overarching goal of establishing a free internal market with a level playing field. Especially the ECJ's selectivity and discrimination analysis and its justifiability analysis in fiscal State aid and fiscal treaty freedoms cases are very similar. The

P.J. Wattel (✉)
University of Amsterdam, Amsterdam, The Netherlands
e-mail: P.J.Wattel@uva.nl

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax
Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_4

Code of Conduct even seems legally redundant, as its criteria may be subsumed under Articles 116 and 117 TFEU, but politically it appears to be expedient, even though the Commission is stretching its State aid powers to tackle tax rulings and smart tax competition.

1 Four Negative Market Integrators

The EU State aid rules prohibit certain national measures jeopardizing free competition in the EU internal market. The EU free movement rights serve the same overall goal of market *equality*, but they have a wider scope than State aid, as they also grant not only market *equality* rights, but also market *access* rights, and not only to undertakings, but also to individuals, even to individuals who are not economic operators, such as pensioners (the right to freely move and reside). Both sets of rules express the basic rules of non-discrimination, non-restriction and non-distortion in the market, and are therefore the expressions of the most basic of international capitalist maxims: an EU-wide free market.

The State aid and free movement rules differ in that: (i) State aid rules prohibit positive discrimination (the favouring of certain undertakings or production of certain goods), whereas the free movement rights prohibit negative discrimination (the disadvantaging of cross-border movement operation as compared to similar domestic movement or operation), and (ii) State aid concerns mostly intra-State distinctions between economic operators (within the same State), whereas the free movement rights mostly concern interstate distinctions between individuals and undertakings (distinctions between residents and non-residents or between cross-border income and domestic income).

Both the State aid rules and the free movement rules are prohibitions. They are therefore examples of negative integration. They are particularly important in the field of direct taxes, as the member States are unable or unwilling to bring about positive integration in that field, all of them having a veto right according to Article 114(2) TFEU. In general, only bare economic necessity will prevail upon them to adopt measures at EU level, as in the fields of (automatic) cross-border exchange of tax information, cross-border recovery of taxes and possibly, shortly, a Directive providing for minimum harmonization of anti-abuse measures.[1]

As there is thus hardly any positive integration of direct taxation, especially company taxation, there are many disparities and many opportunities for policy competition. That is exactly why member States do not want to harmonize. On the other hand, they do not wish to lose a policy race to the bottom from their fellow Member States either, so they needed to create a mechanism to avoid fiscal degradation as a result of excessive (harmful) tax competition while at the same

[1] European Commission (2016).

time retaining their much-cherished tax sovereignty. That mechanism is the non-binding Code of Conduct for Business Taxation,[2] a political rather than a legal instrument. This soft law peer pressure instrument in principle targets horizontal (non-selective, and therefore in principle State aid control immune) national tax measures benefiting especially mobile foreign investors and not reflecting the true balance of taxes and public service. Legally, the most appropriate base to tackle unfair tax competition would seem to be engaging Articles 116 and 117 TFEU. Indeed, unfair tax competition which needs to be eliminated to avoid fiscal degradation is clearly a serious market distortion caused by disparities between national tax legislations. Articles 116 and 117 TFEU would therefore seem to be the perfect legal basis for curbing excessive tax competition and BEPS (base erosion and profit shifting) within the EU. These provisions moreover have the advantage that their application does not require unanimity, as all other fiscal decision-making procedures do, but only a qualified majority. However, the Commission has never engaged Article 116 in direct tax matters (and hardly in other matters), possibly because it estimated that no qualified majority is attainable because no member State fancies to be the next one to be tackled by all others, and all member States will vote against any such proposal from the Commission, even if they are in favour of its content. After all, their (perceived) fiscal sovereignty is sacrosanct to the member States.

If national tax measures are (positively) selective, they may be eliminated by Commission action under the State aid rules. If they are (negatively) discriminating against cross border situations as compared to similar domestic situations, they may be tackled by the disadvantaged individual or company or by a Commission infringement action. If they are neither selective nor discriminatory but still distorting a level playing field in the internal market (disparities), they may be eliminated either by positive integration (harmonization) or by negative integration, in the latter case either by hard law (Articles 116 and 117 on market distortions as a result of disparities) or by soft law (roll back as a result of peer pressure within the Code of Conduct group). All of these market integrators obviously have criteria for establishing whether a national (tax) measure is selective, discriminatory, distorting or harmful. The next paragraph compares these criteria.

2 Comparing the Criteria of the Four Negative Market Integrators

2.1 State Aid

For State aid to be present, the following criteria must be met (Article 107 TFEU):

(i) there is an advantage;

[2] ECOFIN (1998), p. 1.

(ii) from State resources;
(iii) which (potentially) affects competition and intra-Union trade; and
(iv) which is selective by favouring certain operators or activities.

The result is prohibited, unless:

(v) the measure involved is justified by the inner logic of the—in itself legitimate—tax policy of the Member State involved. The Commission calls such possibly justifying inner logic "objectives inherent to the tax system itself", such as a progressive rate (serving a general and inherent redistributive objective), as opposed to external (non-fiscal) objectives, such as social or regional objectives.[3]

2.2 Rule of Reason

The free movement criteria (Articles 28, 29, and 45–66 TFEU), as interpreted by the ECJ,[4] are the following:

(i) there is a *prima facie* discrimination against the cross-border position as compared to the comparable domestic position (resident/nonresident, foreign-source income/domestic-source income, emigrant/non-emigrant, etc.),
(ii) which is not explained by objective differences between these positions in the light of object and purpose of the impugned national measure, and which is therefore prohibited unless
(iii) it is justified by mandatory public interest requirements such as coherence of the tax system, a balanced allocation of taxing rights or the need to curb abuse, and
(iv) the national measure taken is appropriate to protect that public interest and
(v) also proportional in that it does not go any further in limiting free movement than strictly necessary to attain protection of that public interest.

The ECJ's case law shows that the State aid criteria of "advantage" and "selective" are often taken together, or at least they are not clearly distinguished. Then, if positive discrimination of certain undertakings or products is found to be present, (potential) effects on competition and on interstate trade are more or less presumed. Therefore, both State aid and free movement pivot around two main criteria: (i) a comparability/discrimination analysis and (ii) a justification inquiry. In free movement cases, the comparability analysis targets *dis*advantages in the cross-border situation as compared to the domestic situation. In State aid cases, by contrast, the comparability analysis is aimed at identifying unjustified *benefits* for certain

[3] European Commission (1998).

[4] The ECJ itself summarized its case law aptly in, e.g. Case C-55/94, *Gebhard*, paragraph 37.

operators or operations. Both analyses look at legal and factual comparability of the assessment object and its comparator in the light of *object* and *purpose* of the tax measure concerned (what is its policy objective?).[5] Certain national tax measures may therefore be caught by both prohibitions.[6]

2.3 Code of Conduct

The two main criteria the Code of Conduct for Business Taxation lays down for identifying harmful tax competitive measures are:

(i) a significant influence on business location ((re-)location test)
(ii) by providing for a significantly lower effective tax level than the general level (derogation test).

As the Code is in principle aimed at harmful national tax competitive measures which cannot be tackled under the State aid or free movement rules because they are neither selective nor discriminatory, one would expect very little overlap between the Code criteria and the criteria under these two other market integrators. The selectivity criterion and the discrimination criterion do seem to be missing in the Code, but still there is overlap, especially with the State aid prohibition, if one looks at the more detailed assessment criteria in the Code. It specifies that the following characteristics make a national tax measure suspect:

(a) aiming at offshore companies,
(b) ring fencing (protecting one's existing tax base against one's own competitive measures),
(c) lack of economic substance in the Member State concerned,
(d) lack of arm's length profit determination, and
(e) non-transparency of administrative practice, especially of individual revenue rulings.

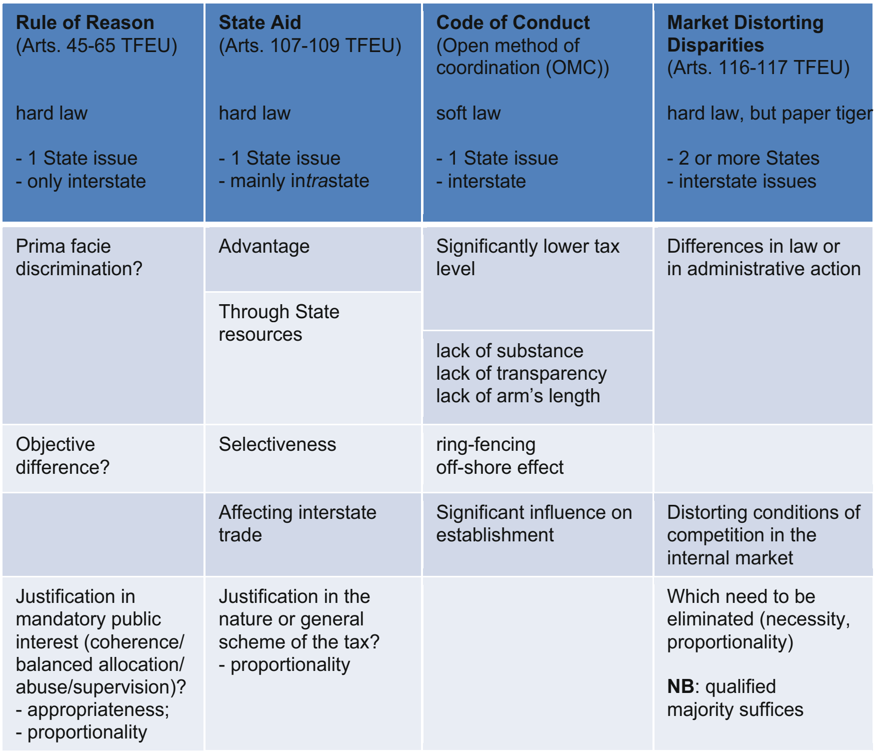
2.4 Market Distortion Rules

The criteria for application of the treaty rules on market distorting disparities (Articles 116 and 117 TFEU) are rather vague:

(i) a difference between the provisions of law or administrative action in member States, which results in

[5] For the comparability analysis in fiscal free movement matters, see, e.g. Cases C-168/01, *Bosal Holding BV*, and C-337/08, *X. Holding BV*. For the comparability analysis in fiscal State aid matters, see, e.g. Case C-143/99, *Adria-Wien Pipeline*.

[6] *Infra* Sect. 3.1.



Rule of Reason (Arts. 45-65 TFEU) hard law - 1 State issue - only interstate	**State Aid** (Arts. 107-109 TFEU) hard law - 1 State issue - mainly in*tra*state	**Code of Conduct** (Open method of coordination (OMC)) soft law - 1 State issue - interstate	**Market Distorting Disparities** (Arts. 116-117 TFEU) hard law, but paper tiger - 2 or more States - interstate issues
Prima facie discrimination?	Advantage	Significantly lower tax level	Differences in law or in administrative action
	Through State resources	lack of substance lack of transparency lack of arm's length	
Objective difference?	Selectiveness	ring-fencing off-shore effect	
	Affecting interstate trade	Significant influence on establishment	Distorting conditions of competition in the internal market
Justification in mandatory public interest (coherence/ balanced allocation/ abuse/supervision)? - appropriateness; - proportionality	Justification in the nature or general scheme of the tax? - proportionality		Which need to be eliminated (necessity, proportionality) **NB**: qualified majority suffices

Fig. 1 Criteria for applying four negative market integrators in direct tax matters

(ii) distorting the conditions of competition in the internal market and
(iii) which needs to be eliminated.

As observed, these provisions have never been applied in tax cases. They have hardly ever been applied, and only a very long time ago. Therefore, there is no relevant ECJ case law or Commission policy document clarifying the reach and possibilities of these provisions. In political practice, these possibilities appear to be non-existent, as neither the member States nor the Commission seem to fancy applying them, even though especially in direct tax matters, they would seem to be cut out for eliminating market distorting excessive and harmful tax policy competition between member States.

Figure 1 allows easy comparison of the criteria for application, as well as identification of areas of overlap between the four negative market integrators discussed.

As the Fig. 1 shows, all four assessment frameworks are concerned with three main issues: (i) is there some sort of inequality or departure (discrimination; advantage; lower tax level; disparity)? (ii) Does it (significantly) affect intra-Union economic activity or conditions of competition? (iii) Can it be justified? Only the Code of Conduct does not seem to allow justifications, let alone a necessity or proportionality assessment. Apparently, measures within the criteria of the Code cannot be justified. One may also reason, however, that possible justifications have been incorporated in the Code criteria: if the arrangement is transparent, produces enough economic substance and does not depart too much from OECD transfer pricing recommendations, it is justified, even if it significantly influences establishment.

3 Overlap

As observed, the criteria of the four market protection mechanisms may overlap, resulting in some national measures being caught by two or more of the four prohibitions. This is not surprising, as they all serve the same overarching goals of a free market and a level playing field. Some examples of such overlap will be discussed below.

3.1 State Aid and Free Movement Restrictions

The ECJ's selectivity/advantage analysis and its justifications analysis in fiscal State aid matters looks much like its discrimination and justification analysis in fiscal free movement cases. Its selectivity analysis is in some cases in fact a discrimination analysis, in which comparability (of the economic operators involved) and justifiability (of the national measure distinguishing between economic operators) are separated, just as they are in its analysis in free movement cases.

In the *Gibraltar* case,[7] the ECJ considered the Gibraltar corporation tax system to be selective and therefore to amount to State aid, verbally because that system "in practice *discriminates*" (emphasis added) against domestic undertakings. That case also shows that for a finding of selectivity it is not necessary that only a few or a minority of the undertakings is advantaged (99 % of the domiciled—but offshore—companies were effectively not paying corporate income tax). This illustrates that selectivity (certain economic operators are favoured) and discrimination (certain economic operators are disadvantaged) are conceptually identical. Other examples of tax cases in which the Court's selectivity analysis is very similar to its discrimination analyses under the free movement rights are, e.g.: (1) the NOx Case (in which the 250 largest undertakings could monetize their emission reduction

[7] Joined Cases C-106/09 P and C-107/09 P, *Commission v. Government of Gibraltar*.

efforts and all other undertakings could not, which did not make sense in the light of the ecological goal of the levy)[8]; (2) the *GIL Insurance* case,[9] which also shows that, as in free movement cases, in State aid cases anti-tax avoidance measures which seem to be selective (seem to discriminate) may be justified if their effects are inherent to the tax system; the UK's replacement of an insurance tax for VAT, restoring a level playing field, was justified by "the nature and general scheme of the tax system", which closely resembles the "coherence of the tax system" in free movement cases, (3) the *Adria-Wien pipeline* Case,[10] in which an energy consumption tax rebate was only available for companies producing goods, which did not make sense in the light of the ecological goal of the tax; (4) the *Paint Graphos* Cases,[11] in which the ECJ held that cooperative societies, which were exempt from corporation tax, were nevertheless not necessarily aided, as they were *not comparable* to ordinary companies (but in principle transparent) under the Italian corporate tax system, and (5) the *British Aggregates* cases,[12] in which the ECJ held that, given the environmental goal of a UK environmental levy on aggregates, *all* producers of aggregates were in principle *comparable* and should, therefore, in principle all be taxed, but an exemption or reduction for non-virgin aggregates producers might be *justified* by the nature or general scheme of the system, or be compatible with the internal market on environmental grounds.

The Court also introduced in the State aid area, specifically in the *Azores* Case, a *Keck et Mithouard*-like exclusion from the reach of the State aid rules for regional tax breaks for undertakings in that region if: (i) the regional taxing authority has a constitutional, political and administrative status separate from that of the central government; (ii) the central government is not able to directly intervene as regards the content of the tax break, and (iii) the financial consequences of it are borne entirely by the regional authority. [13] This exclusion resembles the *Keck et Mithouard* judgment,[14] which excluded from the scope of the free movement rules trade restrictions such as selling arrangements, which, although restricting trade, affect in the same manner, in law and in fact, the marketing of domestic products and of products from other Member States. The *Azores* case shows that (regional) selectivity may be neutralized by regional fiscal autonomy, as that autonomy restores the level playing field, and *Keck et Mithouard* shows that intra-Union trade restrictions may be pardoned if they are neutral in the sense that they do not in any way affect the level playing field for both domestic and cross-border traders.

[8] Case C-279/08 P, *Commission v. Netherlands* (NOx).

[9] Case C-308/01, *GIL Insurance.*

[10] Case C-143/99, *Adria-Wien pipeline.*

[11] Joined Cases C-78/08 to C-80/08, *Paint Graphos.*

[12] Cases C-106/09 P and C-107/09 P, *British Aggregates.*

[13] Case C-88/03, *Portugal v Commission* (Azores).

[14] Joined Cases C-267/91 and C-268/91, *Keck et Mithouard.*

Given the similarities between the State aid and the free movement right analyses,[15] it is surprising that there are not many tax cases in which the concurrence of the State Aid prohibition and the prohibition of free movement restrictions come to the surface.

The *Aer Lingus* and *Ryanair* cases[16] concerned an Irish air passenger tax of €3 or €10, depending on the flight distance. This could be considered State aid for Irish carriers, but also discriminatory taxation of non-Irish carriers, raising the question of whether € 7 euro per passenger should be refunded to non-Irish carriers, or € 7 euro per passenger should be additionally collected from the Irish carriers.

In the recent *Finanzamt Linz* case,[17] the ECJ dodged the question of whether an Austrian tax write-off for the acquisition of domestic subsidiaries was State aid. It confined itself to finding that is was discriminating against groups of companies acquiring non-Austrian subsidiaries and declared the preliminary question on State aid inadmissible, holding that even if it were (unnotified) State aid, the claimants could not rely on any illegal measures anyway. Advocate-General Kokott had opined that the Austrian measure was violating only the freedom of establishment but not the State aid rules as it benefited all domestic groups, regardless of their business, acquiring domestic subsidiaries, but that would seem contradictory: the measure would at the same time discriminate against cross-border takeovers but not selectively benefit domestic takeovers.

Possibly the Court did not wish to be drawn into such discussion, as it still needs to decide the appeals in the inverse cases of *Autogrill España* and *Banco Santander*.[18] These cases concern reverse discrimination. Spain applies the opposite of the Austrian rule: Spain only provides a write-off for the acquisition of *foreign* subsidiaries. The General Court did not consider this to be State aid, as any undertaking in whatever trade can benefit from this scheme, but the Commission appealed that decision, as it considers the measure to amount to an export subsidy for capital, while export subsidies for goods and services are not accepted under the State aid prohibition.

The *Regione Sardegna* case[19] concerned a regional tax on touristic stopovers by private boats and aircraft. Local rental and tour undertakings were exempt. The Italian constitutional Court was confronted with the question of whether this regional tax was constitutional (was within the autonomous taxing power of the region) and compatible with EU law (as it also disadvantaged touristic operators from other Member States such as France). The *Corte constituzionale* asked the ECJ whether this tax and its exemption violated either the EU State aid prohibition or the EU freedom to provide and acquire services. The ECJ's answer was

[15] See for a comparison between the ECJ's selectivity assessment and its discrimination assessment in direct tax matters. *See* Lenaerts (2009).

[16] Cases T-473/12, *Aer Lingus*, and T-500/12, *Ryanair*.

[17] Case C-66/14, *Finanzamt Linz*.

[18] Cases T-219/10 *Autogrill España*, T-399/11 *Banco Santander*.

[19] Case C-169/08, *Presidente del Consiglio dei Ministri v. Regione Sardegna*.

affirmative on both counts: the impugned tax measure was both benefiting certain undertakings as compared to other (domestic) undertakings *and* discriminating against foreign undertakings.

An old Case, C-18/84, *Commission v. France*, concerned a tax deferral for press undertakings which had their printing done in France. The ECJ held this tax break to have the same effect as a quantitative import restriction on printed paper, violating therefore the free movement of goods. However, it might have held also that the tax deferral was State aid for the national printing business or for the press undertakings receiving the tax break, or for both.

Another case of concurrence of State aid and restriction of free movement rights is the Case C-156/98, *Germany v. Commission*. After the wall fell, the German federal government introduced tax incentives for the acquisition of small and medium-sized enterprises in former East Germany. The ECJ held that these tax breaks simultaneously violated the right of establishment and the State aid prohibition.

Finally, in the Case C-451/03, *Servizi Ausiliari Dottori Commercialisti*, the ECJ censured an Italian measure providing for payments to tax consultants assisting undertakings in filing their returns as violating both the State aid rules and the free movement of services and of establishment.

On the basis of the above case law of the ECJ, one could rewrite the treaty criteria for State aid as follows:

(i) Which undertakings are in a legally and factually comparable position in the light of the tax system (its policy objective) at issue?

(ii) Is there a derogation or exclusion from that tax system to the benefit of an identifiable specific group of undertakings, or a cunning choice of a seemingly indiscriminate tax base which nevertheless produces a selective effect?

(iii) Is the derogation/selective effect justified by the nature or general scheme of that system? Is there an "inner logic" to that derogation, of, framed inversely: is there an "alien selective element" in the system, which cannot be explained by the (in itself unobjectionable) fiscal goal of the tax measure? (e.g. a progressive rate, anti-abuse measures, tax base distinctions based on environmental facts.)

This restatement brings the State aid criteria close to the *rule of reason* test in (fiscal) free movement cases. The main issue in both fields of EU law seems to be whether a distinguishing effect is justified by the logic of the fiscal policy objective pursued. *Other* than fiscal (revenue or generally redistributive) objectives are at the outset suspect and need justification. The most interesting question is whether there is room for a proportionality test in State aid tax matters as there is in free movement tax cases.

3.2 State Aid and the Code of Conduct

Although dogmatically, overlap between the EU State aid rules and the Code of Conduct does not seem likely, as State aid is mainly concerned with (positive) discrimination within one national market and the Code of Conduct with excessive cross-border policy competition, it was demonstrated immediately after the first report of the Code of Conduct Group in 1999, which blacklisted 66 national tax measures. The Commission studied that blacklist and in 2001 launched a large-scale State aid initiative against 15 national tax measures of which 13 were also on the Code of Conduct group's blacklist. This means that 20 % of the tax measures under scrutiny were caught by both sets of rules.

The overlap between the two sets of rules is presently demonstrated by the fact that the Commission has started a large scale State aid investigation into member States' individual tax rulings for multinationals such as Starbucks, Fiat, Amazon, McDonald's and Apple, as well as into seemingly horizontal measures such as the Belgian excess profits regime, even though such rulings and measures are clearly material which should have been submitted to and discussed within the Code of Conduct Group. It is quite possible that the recent State aid investigations into member States' tax ruling practices were triggered by the fact that the Lux leaks affair showed that agreements reached within the Code of Conduct Group, such as the agreement to exchange information on cross-border tax rulings within the scope of the Code criteria, are not always loyally observed.

One is even inclined to think that the Code of Conduct was originally introduced to keep the Commission from using its State aid investigation powers also to scrutinize member States' harmful tax competitive measures. If the member States would clean their houses themselves through peer pressure within the Group, then that would save the Commission considerable investigation efforts, and if the Commission were to be the general secretariat of the Code of Conduct Group, which functions on the basis of confidential self-reporting, the Commission would anyway be well informed automatically.

3.3 The Code of Conduct and Free Movement Restrictions

Overlap between these two sets of rules is far less likely than the two overlaps already mentioned, as tax competitive measures aim at the opposite of restricting establishment and investment: they are aimed at *attracting* foreign investment and establishment. A measure which constitutes harmful tax competition but no State aid (as no particular undertaking or production is favoured), may nevertheless under certain circumstances also fall foul of the prohibition to restrict free movement. One example was at issue in Case C-478/98, *Commission v. Belgium*: Belgium issued DEM 1 billion (it was before the introduction of the Euro, and apparently, the Belgian franc was not attractive for non-Belgian investors) of State bonds on the

Eurobond market, the interest on which was exempt from Belgian interest withholding tax, unlike all other Belgian-source interest. Moreover, Belgian residents were flatly prohibited to buy these bonds. Clearly, such a measure would fall foul of the Code of Conduct criteria if that Code would extend to other areas than company taxation, which it does not as yet, as the measure offends both the offshore criterion and the ring-fencing criterion. Obviously, the Commission and the ECJ considered this Belgian measure to be incompatible with the free movement of capital.

3.4 The Code of Conduct, Market Distorting Disparities and State Aid

As observed, the Code of conduct seems to have been introduced to avoid hard law to be applied by the Commission, especially the State aid rules and the market distortion rules of Article 116 TFEU. The Commission does not seem to be very satisfied with that gentlemen's arrangement anymore, considering its State aid initiatives as regards tax rulings and tax competitive measures. As harmful tax competition is only harmful because it distorts the conditions of competition in the internal market, the legally most appropriate way of dealing with it, is through the procedure of Articles 116 and 117. Legally, the Code of Conduct is redundant: there is a perfect legal basis for tackling harmful tax competition among the member States. Its criteria could easily be subsumed under the terms of Article 116 TFEU. The Commission has not chosen that path, however. One may speculate why not, and some such speculation was presented in paragraphs 1 and 2. Here, some speculation is added. Even though Articles 116 and 117 TFEU allow harmful tax competitive national measures to be outlawed by qualified majority, they make the Commission dependent on changing political coalitions of member States which may not be interested at all in binding measures at EU level encroaching upon their (perceived) tax sovereignty (which they left long ago already to the tender mercy of the market). Using its exclusive State aid powers, allows the Commission to operate independently from everyone, especially the member States: in State aid matters, it is the master of the game. This may explain why the Commission issues State aid decisions in cases such as the Starbucks case, which would not seem to be so much State aid cases, but rather tax competition—and therefore market distortion—cases.

4 Concluding Remarks

All four negative market integration mechanisms discussed contain criteria which are concerned with three main issues: (i) is there some sort of inequality or departure (discrimination; advantage; lower tax level; disparity)? (ii) Does it (significantly) affect intra-Union economic activity or conditions of competition?

(iii) Can it be justified? The criteria for application of the treaty freedoms and those for application of the State aid rules overlap to a large extent, bringing certain tax measures within the ambit of both prohibitions. This is even more evident for the Code of Conduct criteria and the market distortion rules. The former could be entirely subsumed under the latter. Only for political and practicability reasons the Commission does not use Articles 116 and 117 TFEU to tackle harmful tax competition. It would seem that especially the larger member States rather like the Code of Conduct Group: they do not care for binding rules at EU level, but would like to have an OMC[20] forum in which the smaller member States can be diplomatically pressed to refrain from assertive tax competition. Rumour has it the large member States want to upgrade the Code of Conduct Group to also cover two-country issues such as mismatches and cross-border rulings, although the latter will be incorporated in DAC2 (the Directive on administrative cooperation between the tax administrations of the member States). Smaller MS's want hard law integration.

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Peter J. Wattel is professor of EU Tax Law at the ACTL of the University of Amsterdam and Advocate-General in the Netherlands Supreme Court.

[20] Open method of coordination.

Part II
International Taxation and Harmful Tax Competition

Reforming the Code of Conduct for Business Taxation in the New Tax Competition Environment

Valère Moutarlier

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Abstract The article notes the development of tax competition and the growth of preferential tax measures which favour certain mobile investments. In establishing the Code of Conduct on business taxation in 1997, Member States were recognising that EU wide political coordination was necessary to combat harmful tax competition and reduce distortions in the single market. After summarising the criteria used in the Code, the article notes the differences between State aid and the Code and discusses some of the work done under the Code, such as on patent boxes and rulings. The Commission's conclusion is that the Code needs to be reformed so that it remains effective and addresses public concerns about its lack of transparency.

The findings, interpretations, and conclusions expressed in this paper are entirely those of the author. They should not be attributed to the European Commission. Possible mistakes and interpretations are his and his only.

V. Moutarlier (✉)
European Commission, Brussels, Belgium
e-mail: Valere.Moutarlier@ec.europa.eu

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax
Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_5

1 Tax Competition

Tax competition can be defined as the interdependence in tax settings to attract a mobile tax base. So far, tax competition has been mainly discussed in the context of corporate income taxation, even though forms of tax competition can arise in VAT, in personal income taxation of high-income individuals or even in local taxation between municipalities. The reason is that governments consider that they are competing through this tax for internationally mobile resources.

While there are diverging views on the benefits of tax competition, there has been increasing recognition of the costs tax competition creates for the common good at national and EU level.

At the same time tax competition has intensified due to changes in the economic and business environment over the last decades, including the growing importance of intangible assets and the digital economy. As a consequence, Member States increasingly struggle to tax profits which derive from economic activity carried out by international companies on their territory.

This has led to two types of tax reforms, between the 1980s and the beginning of the 2007–2008 financial crisis, rates have been cut—the so-called race-to-the-bottom (see Fig. 1)—and bases have been broadened; Since 2007–2008, there is an increase in preferential regimes where governments tax specific mobile bases at a lower rate that than domestic bases[1].

Tax competition can therefore be divided into two categories. The first is competition between tax systems as a whole (covering the overall level of business taxation) and competition based on special arrangements for particular activities or administrative practices—such as rulings—which lead to a lower level of effective taxation than the general level of taxation in the Member State concerned. This last criterion is crucial because whereas the value of promoting competitive general tax systems is arguable, there is a problem with tax measures departing from the normal tax system, favouring certain mobile investment.

2 The Code of Conduct

The Code of Conduct for business taxation was part of the “tax package”, which also included the Directive on savings and the Directive for interest and royalty payments between associated companies.[2] It was established by a resolution of the ECOFIN Council on 1 December 1997. The Code of Conduct Group itself was set up in March 1998 by a separate Council decision.[3]

[1] See e.g. European Commission (2015d), p. 18.

[2] For the tax package, *see* Cattoir (2006).

[3] ECOFIN (1997, 1998).

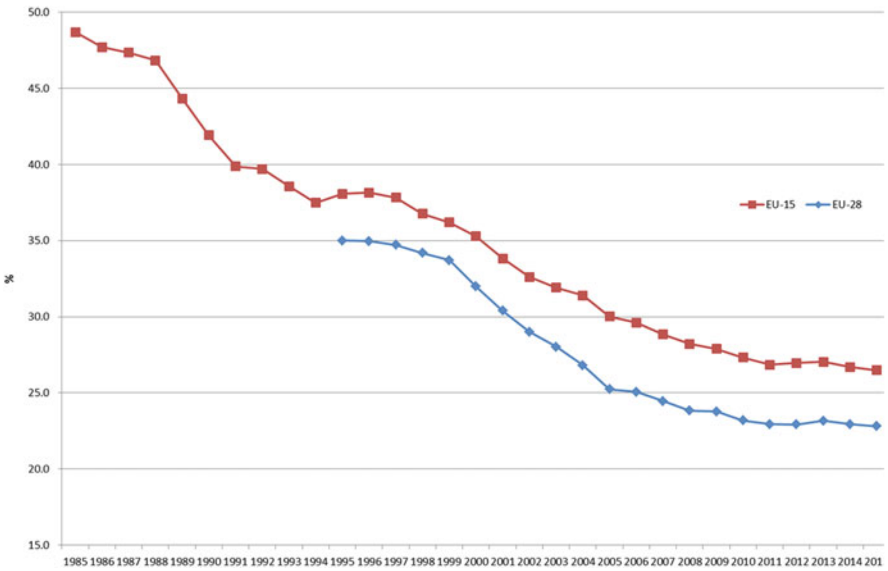

Fig. 1 Statutory corporate tax rates. *Source*: European Commission service. Arithmetic average, including local taxes and surcharge

By consenting to the Code, Member States acknowledged that unilateral or bilateral countermeasures could only partly solve the problem of harmful tax competition and that EU wide political cooperation is necessary. The Code aims to reduce distortions in the Single Market between countries affecting the location of business activities and prevent losses of tax revenue.

The purpose of the Code was to curb tax competition in the EU and the dependencies and overseas territories of the Member States in the area of company taxation, to the extent that it is considered “harmful”. In the context of the Code of Conduct tax competition is “harmful” when a particular measure meets the criteria set out in the Code. The Code in its current form is concerned only with competition based on special arrangements. This is obvious from its focus on measures providing for a significantly lower level of tax to that which generally applies in a particular state. The Code process therefore provides a political answer to the question of when preferential regimes should be considered as harmful competition.[4]

The Code is not a legally enforceable set of rules but instead a political document containing political commitments. Its two central features are:

[4] This has to be distinguished from the approach to competition taken in state aid, which aims at removing distortions between enterprises (‘selectivity’). State aid and harmful tax competition are two separate issues, even though they can affect the same tax measures.

- a commitment from Member States to amend their laws and practices as necessary with a view to eliminating any harmful measures as soon as possible ("rollback"), and;
- a commitment from Member States to refrain from introducing any new tax measures which are harmful within the meaning of the Code ("standstill").

3 The Code Criteria

The Code regards tax measures which provide for a lower level of taxation than normally applied in the Member State concerned and which affects or may affect in a significant way the location of businesses within the European Union as potentially harmful.

This 'gateway criterion' is used to identify measures falling within the scope of the Code. Thus, if e.g. the normal company tax rate of 20 % is reduced to 10 % for all companies, the gateway criteria would not apply. If instead, this rate is reduced to 10 % by a special tax provision for a specific set of companies, the gateway criterion is fulfilled and the measure is considered as "potentially" harmful. In practice, the requirement that a measure significantly affects the location of business activities is given less emphasis than the lower level of tax test.

If a measure is identified as potentially harmful, the Code Group then reviews it further to check whether it fulfils at least one of the additional criteria covering;

- Whether or not a regime is "ring-fenced", that is tax benefits are generally given to non-residents whilst the domestic tax base is protected;
- Whether or not a regime grants benefits to companies which do not actually carry on any substantial economic activity ("the substance criterion").
- Whether or not a regime respects internationally agreed standards, in particular the arm's length principle, and
- Whether or not a regime is transparent.

Assessments of particular measures made in the Code Group are based on unanimity minus one (the Member States whose regime is being examined).[5] It is important to remember that the Group is a meeting of Member States within the Council and it is ultimately the Council that makes the decisions, based on the Group's reports of its meetings. The European Commission's role in the Group is to assist Member States in carrying out the necessary preparatory work for the meetings and to facilitate the provision of information and the review process.

[5] Procedures relating to the way conclusions are reached in the Code of Conduct Group. *See* Council of the European Union (2008).

4 Differences and Similarities Between State Aid and the Code

The main differences between state aid and the Code are that (a) the state aid rules are legally binding; and (b) that the Code is a political commitment by Member States Therefore, the European Commission has the initiative in state aid whilst the Code Group is a meeting of Member States operating by consensus in the Council with the Commission assisting.

Of course, some tax measures may constitute both state aid and harmful tax competition measures. The EU Commission Services, with responsibility for Competition policy and Taxation policy, cooperate closely in this area with a common aim: the removal of distortions in the internal market.

5 Achievements of Code of Conduct Group

The Group has achieved many successes in the past. For example, in November 1999 the Group identified 66 tax measures with harmful features (40 in EU Member States, 3 in Gibraltar and 23 in dependent or associated territories), which forced Member States and their dependent and associated territories to introduce revised or replacement measures in substitution for these 66 measures. The Code of Conduct Group has also been monitoring standstill and the implementation of rollback and reported regularly to the Council.

Many new tax measures are referred to the Code of Conduct Group, which then examines them in the light of the criteria described above. Two current areas of the Group's work are relevant to this discussion. These are patent boxes and rulings.

5.1 Patent Boxes

The Group began reviewing patent boxes in 2013. Patent boxes have been heavily debated for their role in corporate tax competition. Research shows that patent boxes have a strong effect on attracting patents mostly due to their favourable tax treatment.[6]

However, as it reported to the Council, the Group was at the time unable to reach a consensus about the interpretation of the substance criterion of the Code of Conduct.[7] The ECOFIN Council therefore asked the Group to analyse how the substance criterion in the Code of Conduct should be applied as well as an EU-wide

[6] Alstadsaeter et al. (2015).

[7] Council of the European Union (2013).

review of such measures. This work was carried out in 2014 and resulted in an agreement at the end of the year that Member States would rely on the "nexus approach" which had been developed as part of the G20/OECD Base Erosion Profit Shifting ('BEPS') Project.[8] The European Commission welcomed the Group moving rapidly on this issue. This is an approach that it had first called for in its 2012 Action Plan.[9]

The main result of this decision was an agreement that the existing patent box measures should change. They will be unavailable to new entrants as from the end of June 2016 and all benefits will have to cease by July 2021. According to the usual process Member States will have to notify the Group under their "standstill" and "rollback" obligations both of the closure of their existing patent boxes as well as the introduction of new ones, which the Group will examine in due course. It is clear that the common approach on patent boxes reduces harmful tax competition.[10]

5.2 *Rulings*

The tax administration from one Member State usually has very little information about what is agreed between tax authorities of other Member States and specific companies when it comes to tax rulings. The spontaneous exchange of information can therefore help them understand what is happening and why.

The Code Group has worked for some time on spontaneous exchange of rulings given to businesses by tax authorities covering both unilateral advance pricing agreements and other rulings involving a cross-border transaction or structure.

In 2012 Member States' commitments were taken forward with the development of a "Model Instruction" that could be used as a reference by the Member States to ensure consistency in their exchanges of information. A final version of the Model, together with proposals for its effective monitoring was agreed at the beginning of 2014.[11]

Of course, although this agreement was important, it represented only a "soft law" solution, that is a non-legally-binding instrument and, unfortunately, previous agreements had not resulted in any noticeable exchanges of information. The European Commission's view has been from the beginning that increasing transparency for tax rulings between Member States' tax authorities is an important step in ensuring a level playing field for companies and states in the internal market. To

[8] Council of the European Union (2014).

[9] European Commission (2012). In October 2015 the final reports of the G20/OECD Base Erosion and Profit Shifting ("BEPS") Project, including the final version of the report setting out the nexus approach was published. This included important detail on a number of issues but no fundamental changes. *See* OECD (2015).

[10] Alstadsaeter et al. (2015) conclude that: "the nexus approach hence offers some potential to mitigate the role of patent boxes as new tax competition tools".

[11] Document 10608/14 FISC 95; Model instruction for cross-border rulings and unilateral APAs (CACT 036); Statistics: guidelines and tables (CACT 037).

this aim, the Commission presented an ambitious proposal in March 2015 for the automatic exchange of information in this area.[12] An agreement was reached on this matter in the Council the following October. The timing of the political agreement was excellent in view of the OECD's publication of the final conclusions of the BEPS Project. Reaching political agreement has been a very strong signal from the EU of its commitment on these files.

The adoption of the Directive hopefully means an end to obscure tax agreements between companies and authorities, which can facilitate tax abuse. It also means more openness and cooperation between Member States on corporate tax rulings—without any scope for discretion on what information is shared and with whom. It is not only important for the fight against tax avoidance but also to ensure fairness in taxation and competition between companies that potentially have access to specific tax schemes and those that do not.

It must be stressed, however, that the detail of the Directive was based on the work done by Member States on the "Model Instruction" and this is one of the reasons why a political agreement could be reached so rapidly. Although the European Commission took the initiative to put a legal proposal on the table of the Council, the earlier work in the Code Group resulted in that its content did not come as a surprise to Member States. This could provide a useful model for the future work of the Code Group.

6 Criticisms of the Code

Although for many years the Code has been considered by Member States to be an effective tool for addressing tax competition, as corporate tax planning has become more sophisticated and competitive forces between Member States have increased, the tools at the disposal of the Group for ensuring fair tax competition within the EU are slowly reaching their limits and the time for a rethink has come.

A number of Member States and stakeholders have supported the idea of extending the mandate of the Code and changing the working methods of the Group to enable it to react more efficiently to the challenges of harmful tax competition. The Commission believes that the Group should also increasingly provide guidance on how to implement non-legislative EU measures against corporate tax avoidance.

The Commission is also mindful of the need to ensure and, where necessary, re-establish the link between taxation and economic activity, in order to secure fairer and more effective taxation in the EU. To this end the Commission has recommended that the Code criteria be modified so that the Group can give the highest priority to ensuring effective taxation.[13]

[12] European Commission (2015a).

[13] European Commission (2015b), p. 9.

In fact, the Code and harmful tax practices in general, have come in for a great deal of public scrutiny following the so-called “Lux Leaks” affair and the European Parliament’s decision to establish a special committee to look at tax rulings.[14] The TAXE Committee has been particularly critical about what it sees as the Group’s loss of momentum and lack of transparency.[15]

It is therefore clear to the Commission that changes need to be made to the way the Code Group operates. It needs to be more efficient and it needs to be more effective at monitoring the implementation of its own conclusions. It also needs to publicise its activities more transparently and, of course, its work should be directed to help ensure that profits are taxed where they are generated.

7 Summary and Future Work

Summarising the work of the Code Group, one can say that for nearly 10 years its work was dominated by the examination of Member States’ tax measures. It has so far looked at over 400 measures with around a quarter of them being abolished or reformed as a result.

The recent work on patent boxes shows that the Group’s core function of reviewing tax measures continues to be very important. However, in recent years the Group has increasingly dealt with horizontal issues of which rulings are the most obvious recent example.

We expect this trend to continue as EU Member States seek to implement the BEPS conclusions. So, although the Group has been successful in the past, tackling complex challenges to fair taxation and safeguarding tax transparency now requires more decisive action and more rigorous monitoring to ensure that Member States respect their commitments.

Based on suggestions made by the European Commission, the Group has agreed to a new work programme in November 2015.[16] The new work programme re-focuses the Group’s activities in the light of recent international developments in tax policy and builds on the Group’s past successes. However, in the post-BEPS environment, it is essential for the Group to continue to develop and remain effective. This is why the European Commission has recommended that the criteria and scope in the Code of Conduct should be modified so that the Group can give high priority to ensuring effective taxation.[17] This is currently being discussed in the Council[18] and will ideally result in the Group becoming the key body that

[14] European Parliament (2015b).

[15] The committee’s report was published in November 2015. *See* European Parliament (2015a).

[16] Document 14302/15 FISC 159.

[17] European Commission (2015c).

[18] Council of the European Union (2015).

Member States use to ensure co-ordinated solutions as well as to work out hard law solutions to the problems presented by harmful tax competition.

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Valère Moutarlier is Director of the Direct Taxation, Tax Coordination, Economic Analysis and Evaluation, DG Taxation and Customs Union at the European Commission.

Anti-avoidance Measures and State Aid in a Post-BEPS Context: An Attempt at Reconciliation

Edoardo Traversa and Pierre M. Sabbadini

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Abstract From an EU law perspective, anti-avoidance measures adopted by Member States have long been subject of scrutiny of the CJEU under EU fundamental freedoms (See also the judgment in Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue, Case C-524/04, ECLI:EU:C:2007:161, paragraph 25; judgment in Lankhost-Hohorst, C-324/00, ECLI:EU:C:2002:749; judgment in Lasertec, C-492/04, ECLI:EU:C:2007:273; judgment in NV Lammers & Van Cleeff, C-105/07, ECLI:EU:C:2008:24; judgment in Itelcar—Automóveis, C-282/12, ECLI:EU:C:2013:629). This article focuses on the treatment of anti-tax avoidance measures under EU State aid law in the light of current

E. Traversa (✉)
Catholic University of Louvain, Brussels, Belgium
e-mail: edoardo.traversa@uclouvain.be

P.M. Sabbadini
Liedekerke Law Firm, Brussels, Belgium
e-mail: p.sabbadini@liedekerke.com

© Springer-Verlag Berlin Heidelberg 2016

I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_6

international developments as regards fight against base erosion and profit shifting. Anti-tax avoidance measures indeed often contain rather open-ended notions and entail distinctions based on criteria relating to economic substance, which leads to a wide margin of appreciation by tax authorities. Therefore, they are likely to be caught by the prohibition of State aid. After a brief introduction on the principles guiding the application of State aid rules to fiscal measures, a typology of anti-avoidance measures adopted by the EU and its Member States according to their source, scope and their effects is provided. Then, the article discusses the most significant case-law on the topic, i.e. the Finnish P Oy and German Sanierungsklausel cases and their consequence on the current approach taken by EU institutions in the fight against purely tax driven arrangements. Finally, it proposes interpretative tools to reconcile state aid enforcement with substance-based anti-avoidance measures, in particular as regards the definition of the reference framework, the selection of the main objective of the tax measure at stake and the assessment of the genuine character of economic activities.

1 Introduction

Within the European Union, direct taxation remains within the scope of exclusive competence of Member States, leaving them the freedom to devise tax systems as they see fit based on their own preferences. However, Member States' tax sovereignty is subject to certain limitations, among others European State aid rules. Those rules are designed to provide a framework to streamline support granted by Member States to certain market players or sectors of their national economy notably to prevent a detrimental subsidy race among European Member States. This objective is not foreign to the idea of including anti-avoidance tax measures in national tax legislation which are designed to set limits to the possibility to structure their economic activity so as to maximize the enjoyment of tax advantages and therefore to a certain extent contribute to restrict (harmful) tax competition, whether on a domestic or more often on a cross-border basis.[1]

The concept of State aid defined in Article 107 of the Treaty on the functioning of the European Union ("TFEU") entails four cumulative features, consisting of (1) an advantage being granted by the State and through State resources, (2) favouring certain undertakings or the production of certain goods, (3) distorting or threatening to distort competition and (4) affecting trade between Member States. This concept does not carve out tax measures: the prohibition of State aid applies to aid in the form of direct subsidies, but also covers more indirect forms of

[1] Schön (2003), in particular p. 18 et seq.

aid, such as relief from fiscal and para-fiscal levies.[2] Such advantage is granted by the State to the beneficiaries under the form of reduction of the amount of, e.g. corporate income tax collected by the State, it thereby foregoes State resources by relieving the beneficiary of the corresponding amount.

Concerning the selectivity of a measure, the European Court of Justice ("CJEU") has developed a specific three-step analysis in cases involving fiscal state aid.[3] First, the normal/ordinary tax regime (the reference framework) in the Member States concerned has to be identified, in order to serve as a benchmark for establishing whether the measure under scrutiny is selective. Due to the complexity of national corporate tax systems, the identification of the reference framework often proves very difficult.[4] National taxes tend to be complex systems, where to a certain degree, coherence may nevertheless be found in the simultaneous application of apparently distinct tax provisions, which for this reason should not be treated in an isolated perspective. For example, it is not uncommon to find in the Member States corporate tax systems combining a (relatively) high nominal tax rate with a (relative) narrow taxable base. The latter is as a rule obtained through several deductions, exemptions and credits (each with different scope and effects), which lead to a considerably lower effective tax rate. Both from a policy and legal perspective, it would be simplistic, if not ill-advised, to consider that the high nominal tax rate is the normal regime and that the provisions narrowing the taxable base are derogations. And this is for a very simple reason: those elements of corporate tax systems are inextricably linked. In other cases, even when a general (normal) tax regime can apparently be identified, it can happen that it coexists with another general (normal) tax regime, making it very hard to establish which one of the two is the "common" one and which of them constitutes an exception.[5] In the light of the existing case-law, it is therefore not unreasonable to consider that in tax matters (at least), the prohibition of State aid amounts to a prohibition of

[2] See the founding Italian textile case, judgment in *Italy v Commission*, C-173/73, EU:C:1974:71. See also judgment in *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke*, C-143/99, EU:C:2001:598; judgment of 13 September 2006, *British Aggregates v Commission*, T-210/02, EU:T:2006:253; judgment in *British Aggregates v Commission*, C-487/06, EU:C:2008:757 and judgment of 7 March 2012, *British Aggregates v Commission*, T-210/02 RENV, EU:T:2012:110; judgment in *GIL Insurance and Others*, C-308/01, EU:C:2004:252; judgment in *Commission and Spain v Government of Gibraltar and UK*, C-106/09 P and C-107/09 P, EU:C:2011:732; judgment of 7 November 2014, *Autogrill Espana v Commission*, T-219/10, EU:T:2014:939; judgment of 7 November 2014, *Banco Santander, SA and Santusa Holding, SL v European Commission*, T-399/11, EU:T:2014:938. On State aid and taxation in general, see Quigley (2015), pp. 97–152; Rust and Micheau (2013); Micheau (2013); Hancher et al. (2012), pp. 321–362; Kube (2005), pp. 99–117; Panayi (2004), p. 283; Waelbroeck (2004), p. 1023; Luja (2003); Wouters and Van Hees (2001), p. 655; Schön (1999), pp. 927–928.

[3] Judgment in *Italy v Commission*, EU:C:1974:71, paragraph 15.

[4] Schön (1999), pp. 29 f.; Lang (2009), p. 25; Sutter (2005), p. 112.

[5] See on this issue, *Lang* (2012), p. 418.

discrimination between taxpayers in a comparable legal and factual situation[6] similar to the Treaty fundamental freedoms (which latter scope is however limited to the cross-border context).[7] It is therefore not surprising that the CJEU in assessing the existence of an aid in tax matters adopts a practical approach, acknowledging that the assessment of the reference framework requires both familiarity with the provisions under scrutiny and an analysis of their administrative and judicial application as well as of their scope *ratione personae*.[8]

Once the reference framework is identified, it is then necessary to assess whether the measure constitutes a *prima facie* derogation by differentiating between economic operators that are in a comparable factual and legal situation in light of the objective assigned to the tax system of the Member State concerned.[9] Assuming this is the case, the CJEU considers that it is still possible to escape the qualification of State aid by ascertaining whether this derogative measure is justified by the nature and general scheme of the reference framework. To that end, the CJEU verifies whether the "measure results directly from the basis or guiding principle of its tax system."[10] and "[ensures] that those [measures] are consistent with the principle of proportionality and do not go beyond what is necessary, in that the legitimate objective being pursued could not be attained by less far-reaching measures".[11] This reference to the nature or general scheme of the tax system, acknowledged in the Italian textile case *Italy v Commission* and later included in the 1998 Commission Notice on the application of the State aid rules to measures relating to direct business taxation (hereafter the "1998 Commission Notice")[12] proves to be quite challenging to apply because it is not always clear how those "inherent principles" may be identified in relation to a particular tax system or to a specific aid measure such as a fiscal measure.[13]

[6] See Lang (2012), p. 418; Rossi-Maccanico (2012), p. 98; Bousin and Piernas (2008), pp. 640–642; Kube (2004), p. 244.

[7] For a case of concurring application of State aid rules and Treaty Freedoms, see Case C-169/08 *Presidente del consiglio dei Ministri v Regione Sardegna*, [2009] ECR I-10821. For a critical comment, Traversa and Vintras (2013), p. 184. See also Engelen (2012) and Micheau (2012).

[8] Judgment in *P Oy*, C-6/12, EU:C:2013:525, paragraphs 19–20.

[9] Judgment in *Paint Graphos and others*, EU:C:2011:550, paragraph 49 and cited case-law.

[10] Judgment in *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke*, EU: C:2001:598, paragraph 42.

[11] Judgment in Paint Graphos and others, joined cases C-78/08 and 80/08, paragraphs 73–75.

[12] European Commission (1998), paragraph 12.

[13] The examples provided at the 1998 Commission Notice, such as the progressive nature of an income tax scale or profit tax scale, the calculation of asset depreciation and stock valuation methods or the arrangements for the collection of fiscal debt, instead of clarifying this concept appear to add further uncertainty. See European Commission (1998), paragraphs 23–27. See also recent guidance provided in the 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 (C/2016/2946, OJ C 262, 19.7.2016, p. 36 – 40) and in the DG Competition – Internal Working Paper – Background to the High Level Forum on State Aid of 3 June 2016 (available at http://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf, last accessed on 10 August 2016).

Therefore, according to article 107 TFEU, as interpreted by the case-law of the CJEU, no tax measure could a priori be excluded from the qualification of (prohibited) state aid. The selective character does not have to result directly from the wording of the domestic provision but could originate from the administrative implementing practice.[14] Many domestic tax provisions require an authorisation procedure designed to provide undertakings with legal certainty as to the future application of a tax provision to their situation or to secure an agreement from the tax authorities on a given interpretation of a tax provision (rulings).[15] The Court of Justice considers that, in principle, the existence of an authorisation procedure does not preclude in itself such justification.[16] This analysis is refined based the actual scope of the examination of tax authorities in the course of the authorisation procedure.

On the one hand, the CJEU considers that justification is possible if, under the authorisation procedure, the competent authorities enjoy a degree of latitude limited to verifying the conditions laid down in order to pursue an identifiable tax objective and the criteria to be applied by those authorities are inherent in the nature of the tax regime.[17] On the other hand, if the discretion left to the tax authorities enables them to directly determine the beneficiaries or the conditions of application of a tax measure, resulting in an advantage for certain taxpayers, the measure cannot be considered as general.[18]

2 Anti-avoidance Rules: Typology and Scope

2.1 Origin and State of Play

Based on the above-mentioned analytical framework, anti-avoidance provisions therefore potentially constitute state aid. According to the OECD, “avoidance refers to the arrangement of the affairs of a taxpayer set up in order to reduce tax liability and despite the fact that the arrangement could be legal from a strict point of view, it runs typically against the intent of the law it purports to follow”.[19] In order to combat those practices, most countries have enacted so-called anti-avoidance (or -anti-abuse) tax measures designed to counter schemes set up by taxpayers at both

[14] See European Commission (1998), paragraphs 10, 12, 21–22 and judgment in *Déménagements-Manutention Transport SA (DMT)*, C-256/97, EU:C:1999:332, paragraph 30; Judgment in *P Oy*, C-6/12, EU:C:2013:525, paragraph 27.

[15] See European Commission (2014d); European Commission (2014a); European Commission (2014b); European Commission (2014c); European Commission (2015c); European Commission (2015a); European Commission (2015b).

[16] Judgment in *P Oy*, EU:C:2013:525, paragraph 24.

[17] Judgment in *Déménagements-Manutention Transport SA (DMT)*, EU:C:1999:332, paragraph 27 and the case-law cited.

[18] Judgment in *Commission and Spain v Government of Gibraltar and UK*, EU:C:2011:732, paragraph 75.

[19] OECD (2016a).

domestic and international levels. International organizations such as the OECD and EU have played a major role in raising the awareness of the public opinion on those schemes and have pushed for the adoption of anti-avoidance measures by States, often proposing model provisions.

In 2013, the OECD, on request by the G20, adopted a 15-point Action Plan to tackle base erosion and profit shifting (BEPS). The BEPS project ultimately aim at realigning taxation with economic substance and value creation via a comprehensive package of measures designed to better coordinate domestic tax systems and promote transparency and exchange of information. It targets harmful international tax arrangements taking advantage of the differences between several states legislation (two or more). The outcome of the BEPS action plan, contained in final reports published in October 2015, consists in measures of soft law nature,[20] taking the form of "minimum standards," "best practices" or "recommendations".[21] The European Union has supported this initiative from the beginning and promotes the implementation of the BEPS recommendation into hard law rules, both at the domestic and European level. On 28 January 2016, the European Commission issued proposals and recommendations forming the EU Anti-Tax Evasion Package,[22] which aims at ensuring a uniform and EU law compliant[23] application of some of the BEPS recommendations by Member States.

Although listing exhaustively all the anti-avoidance measures adopted by EU member States in their domestic legislation would be an impossible task, it is nevertheless possible to classify them according to their source, their scope and their effects.

2.2 *International, European and Domestic Anti-avoidance Measures*

As for the source, anti-avoidance measures exist in the domestic legislation, in EU law or in international tax treaties. An example of anti-avoidance measure in

[20] The measures, by their nature, are not legally binding, but it is expected that they will be applied according to the consensus.

[21] OECD (2015f), p. 6.

[22] Among others, see European Commission (2016c); European Commission (2016a). See the recently adopted Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (OJ L 193, 19.7.2016, p. 1–14.)

[23] In respect of the obligation of MS to abide by EU law, the CJEU in several cases made it clear that "*it should be recalled that, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law*". See judgment in *Wielockx v Inspecteur der directe belastingen*, Case C-80/94, ECLI:EU:C:1995:271, paragraph 16; judgment in *Imperial Chemical Industries v Colmer*, C-264/96, ECLI:EU:C:1998:370, paragraph 19; judgment in *De Baeck*, C-268/03, ECLI:EU:C:2004:342, paragraph 19. See Kemmeren (2014), p. 190.

EU law is contained in the Merger Directive,[24] according to which "a Member State may refuse to apply or withdraw the benefit of [the Directive] where it appears that one of the operations referred to in Article 1 (. . .) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalisation of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives" (Article 15, a).

Typical anti-avoidance rules contained in tax treaties are the Limitation of Benefits rules ("LOB"). The LOB provisions have the purpose of countering the practice of structuring a business to benefit from more favorable tax treaty networks available in certain jurisdictions.[25] These provisions consist of a series of tests designed to limit treaty benefits to qualified persons based on legal form, ownership and activities. The OECD in its Final report on Action 6[26] recommends the adoption of such clauses, together with the inclusion of a "derivative benefits" provision that would enter into play when a payee would fail to qualify under the LOB provision.[27]

Other well-known measures contained in double taxation treaties, whose effect is to counter avoidance strategies by taxpayers are the transfer pricing rules.[28] Specific issues arise regarding tax avoidance in the framework of cross-border transactions entered into between entities belonging to the same multinational group. The difference between such transactions and those concluded between independent parties (at arm's length) is that the price set for the latter is in principle the result of the free play of supply and demand while the former is not subject to these market constraints. Therefore, for transactions between entities of the same group located in jurisdictions applying different levels of taxation, it is possible to set a "transfer price" which results in profits being shifted to the jurisdiction applying the lowest level of taxation.[29] Transfer pricing rules aim at enabling tax administrations to review the pricing of intragroup transactions within multinational groups, by applying specific methods of determination of the market (arm's length) value.[30]

[24] Council of the European Union (2009), pp. 34–46.

[25] These structuring practices are referred as to treaty shopping. For a definition of treaty shopping, see De Broe (2008), pp. 5–20.

[26] OECD (2015a), pp. 20 seq.

[27] OECD (2015a), pp. 42 seq.

[28] However, transfer pricing rules can also be considered as a system aiming at establishing a fair (er) allocation income between jurisdictions. This does not appear to be the original intent of the first transfer pricing legislations. See Schoueri (2015), p. 690.

[29] See OECD (2015b), at Article 9 and OECD (2016b); OECD (2015c).

[30] See Luja (2015), pp. 12–13.

Beside legislative or conventional rules, anti-abuse doctrines have been developed in European or domestic case-law, such as the principle of the prohibition of abuse of rights developed by the CJEU,[31] or the "substance over form", *fraus legis* or sham doctrines developed in several domestic jurisdictions.[32]

2.3 Scope of Anti-avoidance Measures

The scope of anti-avoidance measures can be either general (sometimes within one single tax) or specific. The European Commission has recommended since 2012 to Member States to adopt General Anti-Abuse Rules (GAARs) in EU Directives, domestic tax systems and, more recently in tax treaties.[33] For example, a "general" anti-avoidance rule is contained in the Parent-Subsidiary Directive,[34] according to which:

> (. . .) Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances.
>
> An arrangement may comprise more than one step or part.
>
> (. . .) For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. (. . .)

The GAAR proposed by the Commission in the Proposal for a Directive against tax avoidance practices of 28 January 2016 follows the same pattern in broader terms, with some differences: the "main" purpose is replaced by the "essential"

[31] Judgment in *Hans Markus Kofoed v Skatteministeriet*, C-321/05, ECLI:EU:C:2007:408, paragraph 38. The principle of non-application of EU law to abusive practices was applied for the first time in the area of VAT in the Halifax and University of Huddersfield cases (judgment in *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v HMRC*, C-*255/02*, ECLI:EU:C:2006:121, and judgment in *University of Huddersfield Higher Education Corporation v Commissioners of Customs & Excise*, C-223/03, ECLI:EU:C:2006:124. On the prohibition of abuse in EU direct tax law, see in particular the judgment in *Cadbury Schweppes and Cadbury Schweppes Overseas*, C-196/04, EU:C:2006:544; judgment in *Test Claimants in the Thin Cap Group Litigation*, C-524/04, EU:C:2007:161 and judgment in *Glaxo Wellcome*, C-182/08, EU:C:2009:559. On the principle of abuse of rights in EU tax law, see O'Shea (2011), p. 77; De la Feria (2008); De Broe (2008), pp. 755 et seq. For a critical comment, see Arnull (2009), pp. 18–23; and Sørensen (2006), p. 423.

[32] See Zimmer (2002); De Broe (2008), pp. 71–72.

[33] European Commission (2012b) and European Commission (2012a); European Commission (2016b).

[34] Council of the European Union (2015), pp. 1–3.

purpose, as the Commission had proposed in its 2012 Communication[35] and the "object and purpose" refers to the applicable domestic provisions.

An example of a specific anti-avoidance provision is the limitation of deductible interests. According to the OECD, excessive interest deduction leads to profit shifting and base erosion. This is why OECD BEPS Action 4[36] focuses on these uses of debt to obtain a favorable tax result such as to "*achieve excessive interest deductions* [to reduce taxable profits] *or to finance the production of exempt or deferred income* [so as to obtain a deduction for interest expense while the related income is taxed later]."[37] The advantage for taxpayers to use interest payments for profit shifting are a consequence of the difference in the level of taxation of corporate profits, but also by mismatches in the characterization of the payment in the state of the payer and in the state of the payee resulting in the absence of taxation (hybrids).[38]

There is therefore an incentive to finance subsidiaries in high tax jurisdiction through that instead of equity. If interest rates are determined outside market conditions, States may apply general transfer pricing rules to limit the extent of the deduction.[39] However, in most of the cases, specific anti-avoidance rules are needed and international tax practice shows many differences in the approaches taken by states, which mainly take the form of thin capitalization, earnings stripping and interest barrier rules.[40] The OECD in its Final report on Action 4 recommends to deny the deduction, when interest paid to a nonresident related party exceeds a certain threshold. Such threshold is based on a fixed ratio rule that may be adapted to specific country or group situations and which connects the amount of interest deductions and the level of taxable economic activity measured through the company's earnings before interest, taxes, depreciation and amortization ("EBITDA"). As a result, no deduction is granted to interest (and payments economically equivalent to interest) in excess of this defined threshold.[41] In its Proposal for a Directive against tax avoidance practices of 28 January 2016, the European commission endorses the OECD approach by proposing a ratio for deductibility of "borrowing costs" limited to the highest of the following: 30 % of

[35] "*An artificial arrangement or an artificial series of arrangements which has been put into place for the essential purpose of avoiding taxation and leads to a tax benefit shall be ignored.*" See European Commission (2012a). The distinction between main purpose and essential purpose or even sole purpose in also to be found in the VAT case of the CJEU on abuse of rights. See Case C-653/11, Newey, [2013], ECLI:EU:C:2013:409, paragraph 46 and the case-law quoted). For an analysis of the GAAR recommended by the Commission in 2012 and the relationship with BEPS, see Dourado (2015a), pp. 42–57.

[36] OECD (2015d).

[37] OECD (2015d), p. 17.

[38] OECD (2015e).

[39] See OECD (2010).

[40] For a description, see Traversa (2013), p. 611.

[41] OECD (2015d), pp. 13 and 17 et seq.

a taxpayers' EBITDA or EUR 1 million.[42] Similar rules are currently applied by several EU Member States, among which Germany, Italy and Spain.[43]

Anti-avoidance measures can also be categorized according to their effects, which greatly vary across jurisdictions. Some measures aim at excluding from the scope of tax provisions somehow favourable to the taxpayer, situations that are considered—at least potentially—as not falling within the purpose of the measure at stake. They can limit the benefit of tax incentives, such as tax credits for research and development or investment credits, or restrict the application of otherwise general rules, such as the deduction of business expenses or losses, the exemption of foreign income or the deferral of capital gains in case of corporate reorganisation. Some other anti-avoidance measures cause more radical effects, since they introduce fictions with significant tax consequences, such as recharacterization of transactions or reattribution of income. An example of such far-reaching provisions are the Controlled Foreign Corporations (CFC) rules. Those rules are anti-avoidance mechanisms aiming at preventing the loss of tax revenue via the shift of income to a low-tax jurisdiction where the CFC is established or their long-term deferral.[44] CFC rules aim at reincorporating in the tax base of a taxpayer of jurisdiction profits of a corporate entity controlled by the resident located in another country, which would otherwise not be taxable in the country of the controlling entity, in the absence of distribution. The BEPS report on Action 3 provides recommendations for the design of domestic CFC rules.[45] CFC rules are also contained in the European Commission's the Proposal for a Directive against tax avoidance practices.[46] The proposal provides for the inclusion of CFC income in the profits of an EU company if three conditions are met. First, the company must hold more than 50 % of voting rights, capital or entitlement to profits in the foreign controlled company. Second, the general tax regime of the country of the CFC has to be lower than 40 % of the effective tax rate of the residence country. Thirdly, more than 50 % of the total income of the CFC has to be composed of financial income or intragroup services (except for financial institutions). Moreover, to comply with the requirements imposed by the case-law of the CJEU, if the CFC is located in EU or EEA Member States, those rules shall apply only if the

[42] European Commission (2016a), Article 4.

[43] First Germany (2008), followed by Italy (2008), Spain (2012), Portugal (2013) and Finland (2014) and Greece.

[44] See Dourado (2015b), p. 353: "*CFC legislation can either be seen as restoring the original right of a jurisdiction to tax its residents on a worldwide tax principle or an exception to the international tax rule that recognises deferral of taxation of profits accrued by foreign entities*."

[45] It notably discusses the definition of a CFC and recommends the adoption of a broad definition applicable to corporate entities including transparent entities (partnerships and trusts) and permanent establishments. The recommendation also concerns the required type and level of control to qualify. It proposes to apply both a legal test and an economic test and to establish a threshold at minimum 50 % control, whether direct or indirect.

[46] European Commission (2016a), Articles 8 and 9.

establishment of the entity is considered wholly artificial or the entity engages, in the course of its activity, in non-genuine arrangements.

The above-mentioned examples show that the distinction between “genuine” and “abusive” transactions can be based on rigid criteria, such as turnover, shareholding or balance sheet data, but also often rely on more vague notions, such as “genuine economic activity”, “valid commercial reasons” or even “arm’s length value”. The application of such undetermined concepts requires a higher degree of scrutiny—and consequently a wider margin for discretion—by tax authorities. In certain cases, anti-avoidance measures combine both techniques, by establishing a safe harbour rules based on fixed criteria and leaving the taxpayer which does not comply with those rules free to demonstrate that the carried out transaction still satisfies a substance-based test.[47]

Those substance-based test are likely to be more and more used by tax administration of EU Member States. The idea to establish a clearer link between taxation and value creation is indeed one of the three pillars of the BEPS Action Plan and is one of the leading lines of actions of the EU. Besides the fact that those tests tend to leave more discretion to tax authorities, they also imply to weigh the importance of non-fiscal motives, rendering the application of more favourable tax rules dependent upon economic considerations.

In such a context, The analysis of the compatibility of anti-avoidance rules with State aid provisions[48] raises important legal issues concerning the application of the traditional three-step test, in particular the determination of the framework of reference and the justification by the nature or economy of the system. From a policy perspective, the Court’s case-law could significantly influence the design of substance requirements in future anti-avoidance measures.

3 The Application of State Aid Rules to Anti-avoidance Measures: The *P Oy* and *Sanierungsklausel* Cases

3.1 Facts and Legal Background

Three Court decisions, both concerning the limitation to the deduction of corporate losses, are of particular interest in this context: the *P Oy* case, concerning Finland, decided by the CJEU in 2013,[49] and the twin *Heitkamp* and *GFKL Financial*

[47] For a global overview, see Van Weeghel (2010), pp. 18 et seq.

[48] See OECD (2015d), p. 20 and Annex A, p. 85.

[49] Judgment in *P Oy*, C-6/12, EU:C:2013:525. See Traversa (2014).

Services AG cases, decided in early 2016,[50] where the General Court confirmed a negative decision of the Commission against Germany in 2011.[51]

Those cases deal with the issue of the commoditization of loss-making or empty-shell companies, although with noteworthy differences in the approaches taken by the Finnish and German legislators. While the Finnish measure was relatively general, the German provision at stake was specific to the restructuring of undertakings in difficulty, an area where the Commission had already established specific guidance on that matter under the form of a Temporary Framework.[52] An additional difference lies in the fact that *P Oy* also displays an supplementary leg of selectivity assessment due to the fact that the Finnish legislator had set up an authorization system. Therefore, this case offers some guidance as to the impact of the margin of discretion of the national authorities on the likelihood that a finding of selectivity would materialize. Those cases address however the fundamental issue of the determination of the reference framework of exceptions to anti-avoidance measures motivated by (apparently) non-fiscal considerations.

The facts are the following. In the *P Oy* case, under the Finnish income tax law, companies are allowed to carry forward losses incurred from business activity during the taxable period to later taxable periods. As a consequence, for the purposes of determining the tax base, it is possible to offset carried-forward losses against taxable income realized in the following 10 years. However, this right to deduct losses from present and future profits is denied in the event of the company's ownership changes. This measure aims to counteract the situations where profitable companies would aim to acquire loss-making companies with the only purpose of reducing their tax base.

Finnish domestic law provides for an escape clause allowing tax authorities to authorize the loss offset even in the situations where the company ownership has changed. This is can be done taken into consideration "special circumstances". Administrative guidelines available to the public (a guidance letter and a circular) clarified the conditions of exercise of such discretionary power of the Finnish tax authorities. The guidance letter list as special reasons, *inter alia* "transfers from one generation to another; the sale of an undertaking to its employees; the purchase of a new undertaking not yet active; changes of ownership within a group of companies; changes of ownership related to a rescue programme; particular impact on employment; and changes in ownership of listed companies".[53]

[50] Judgment of 4 February 2016 in *Heitkamp BauHolding GmbH v European Commission*, T-287/11, ECR, EU: T:2016:60, and judgment of 4 February 2016 in *GFKL Financial Services AG v European Commission*, T-620/11, ECR, EU:T:2016:59.

[51] European Commission (2011). This Commission decision was abundantly discussed in the German literature. See Schön (2011) p. 127; Arhold (2011), pp. 71 and at 75; Brodersen and Mückl (2014).

[52] European Commission (2009), p. 1.

[53] Judgment in *P Oy*, EU:C:2013:525, para. 8.

The *Heitkamp* and *GFKL Financial Services AG* cases concern the German *Sanierungsklausel*, a provision allowing companies in difficulty acquired for restructuring to benefit from loss carry-forward. This provision was devised as an exception to the limitation on tax loss carry-forwards in case of change in control. According to the German Income Tax Act, losses incurred in a tax year are allowed to be carried forward so that taxable income in future tax years may be reduced by setting off the losses up to a maximum of EUR 1 million each year. This possibility to carry forward losses is also available to entities subject to corporate income tax pursuant to §8(1) of the Corporate Income Tax Act (*Körperschaftsteuergesetz*, hereafter the "KStG").

Successive changes were brought to the restriction for those entities to deduct or carry-forward corporate losses, in order to avoid trade in companies which had ceased any economic activity but whose value consisted only in the amount of losses they could carry forward (empty-shell companies—*Mantelgesellschaften*). The German legislator introduced in 1997 the shell acquisition rule (*Mantelkaufregelung*)[54] to restrict the possibility of carrying forward losses for corporate entities that were legally and economically identical to the entity that incurred the losses. While the rule did not contain a definition of the 'economically identical' feature, it provided first that *a corporate entity is not economically identical if more than half of its shares are transferred and if the entity then continues its economic activity or starts it again with predominantly new assets*. The rule also mentioned two situations, also commonly referred to as the "*Sanierungsklausel*" (clause allowing for restructuring of companies in difficulty), under which a corporate entity was deemed economically identical. This was namely the case (1) *if the injection of new assets is solely for the purpose of restructuring the loss-making entity and if the activity which gave rise to the unrelieved loss carry-forward continues on a comparable scale for the following five years* and (2) if, *rather than injecting new assets, the acquiring entity covers the losses that have accrued at the loss-making entity*.

On 1 January 2008, the provision was repealed and loss carry-forward restricted in the case of changes in the shareholding of a corporate entity. While the aim was to simplify the legislation and better target abuses, it also meant in the case of a restructuring of an undertaking in difficulty which implied a change in ownership, that carry-forward of losses would no longer be possible. However, the tax authorities could waive tax debts in such a situation based on considerations of equity, even without specific legislative provision. In June 2009, the KStG was amended

[54] KStG §8(4).

again in order to allow loss carry-forward when a company in difficulty is acquired for the purpose of restructuring, under certain conditions.[55]

3.2 *The 2011 Commission Decision as Regards the* Sanierungsklausel *and the 2016 Judgments of the General Court*

In its 2011 decision, the European Commission drew a comparison between the new §8c(1a) KStG and the repealed §8(4) KStG concluding that under the former the general rule is the forfeiture of loss carry-forwards on significant changes in ownership, unless the exception available under the *Sanierungsklausel* applies. Under the latter, the general rule was to allow loss carry-forwards in the case of significant changes in ownership, provided that the company was economically identical in order to prevent abusive trading in shell companies.[56]

After a reminder of the three-step test applicable to fiscal measures, the Commission first established as the system of reference not the whole German corporate income tax system, but the rules on tax loss carry-forward for companies subject to change in their shareholding, which are laid down in §8c(1) KStG.[57]

Second, after refusing to consider the argument of the German Government based on the fact that a measure applicable to all undertakings in difficulty and which does not leave any discretion to the public authorities is not selective, the Commission concluded to the *prima facie* selectivity of the measure based on the fact that §8c(1a) KStG differentiated between loss-making companies that were otherwise healthy and those that were insolvent or over-indebted.

Third, the Commission assessed whether the measure could be justified by the nature or general scheme of the tax system of which it forms part, relying on the

[55] The conditions to benefit from the new *Sanierungsklausel* were the following:

a) the acquisition serves the purpose of restructuring the corporate entity

b) the company is, or is likely to be, insolvent or over-indebted at the time of the acquisition

c) the company's fundamental business structures are preserved, which requires:

– the corporate entity to honour an agreement between management and works council (*Betriebsvereinbarung*) on the preservation of jobs, or

– preservation of 80 % of the jobs (in terms of the average annual wage bill) for the first five years following the acquisition, or

– injections of significant business assets or write-off of debts which still have an economic value within 12 months; business assets are significant if they represent at least 25 % of the assets of the previous financial year; any transfer back to the acquiring entity within the first three years are deducted;

– the company does not change sector of activity during the five years following the acquisition;

– the company had not ceased operation at the time of the acquisition.

[56] European Commission (2011), paragraph 21–23.

[57] European Commission (2011), paragraph 66.

distinction made by the case law between the extrinsic objectives to a particular tax scheme and the mechanisms inherent in the tax system itself which are necessary to achieve such objectives and considering only the latter to qualify for a justification by the nature or the general scheme of the tax system of which it is part.[58]

On that basis, the Commission made a distinction between on the one hand the objective of §8c(1) KStG, acknowledged by Germany as constituted by the need to prevent abuse of the loss carry-forward allowed by the German tax system in the form of purchases of empty shell companies and, on the other hand, the much broader objective of tackling the global financial and economic crisis of §8c (1a) KStG by introducing support to ailing companies as evidenced by the explanatory memorandum to the new *Sanierungsklausel*. The Commission concluded that the latter is not an anti-abuse measure and pursues an extrinsic objective to the tax system which cannot be relied upon as a justification at this stage but may be analysed in the compatibility assessment.[59]

As to the compatibility assessment, the Commission indeed considered whether the measure could be declared compatible under Article 107(3)(b) TFEU, as interpreted by the Temporary Framework applicable at that time, but quickly came to the—obvious—conclusion that, as a tax break for companies in difficulty, it did neither fall under any of the measures set out in the Temporary Framework, nor partially under a previously approved German aid scheme.[60]

The negative decision ordering recovery was challenged by Heitkamp BauHolding Gmbh (hereafter "Heitkamp"), supported by Germany, before the General Court.[61] Heitkamp was an undertaking at risk of insolvency and needed restructuring. In February 2009, Heitkamp KG, its mother company had acquired all outstanding shares in order to merge the two companies. The transaction was eligible under the new *Sanierungsklausel* pursuant to §8c(1a) KStG as confirmed by the communication received in April 2010 from the German tax authorities confirming that losses carried forward had been taken into account. Upon the decision of the Commission to open the formal procedure, the German Finance minister ordered the tax administration not to apply the *Sanierungsklausel* anymore. On that basis, in December 2010, a new communication discarding the possibility to carry losses forward was addressed to Heitkamp and changed its situation so that it was then later prevented to use the *Sanierungsklausel*.

Heitkamp raised two pleas including first its arguments regarding the absence of selectivity of the measure based on (1) an error made by the Commission in the definition of the reference framework and (2) an error in the assessment of the legal and factual situation of the undertakings requiring restructuring and the

[58] European Commission (2011), paragraphs 80–83.

[59] European Commission (2011), paragraphs 83–89.

[60] European Commission (2011), paragraphs 109–113.

[61] Judgment of 4 February 2016 in *Heitkamp BauHolding GmbH v European* Commission, T-287/11, EU:T:2016:60.

qualification of the *Sanierungsklausel* as a general measure.[62] Second, Heitkamp argued that (3) the measure was justified by the nature or economics of the system.[63]

As to the definition of the reference framework, Heitcamp claimed that the system of reference is actually the indefinite carry-forward of losses to which the loss of carry-forwards provided for in §8c KStG constitutes an exception, whilst the *Sanierungsklausel* in §8c(1a) KStG, reinstates the general rule by constituting an exception to the exception. Heitkamp alleged that the *Sanierungsklausel*, which treats economically sound undertakings and those in need of restructuring unequally, is not a selective measure, but the concretisation of the principle that taxable persons should contribute to State financing in accordance with their ability-to-pay (the *Leistungsfähigkeitsprinzip*), which is a constitutional principle that has always been recognised by the German Basic Law (Grundgesetz).[64]

The Court considered that the Commission did not err by considering that the reference framework was constituted by the forfeiture of losses even if it had acknowledged the presence of more general rule allowing the carry forward of corporate losses.[65]

As for the assessment of the legal and factual situation of the undertakings requiring restructuring and the qualification of the *Sanierungsklausel* as a general measure, the General Court endorsed the view of the Commission on the fact that the German provision is intended to prevent undertakings which change ownership from carrying forward their losses. Therefore, all undertakings which change ownership are in a comparable legal and factual situation, irrespective of the question whether they are in difficulty within the meaning of the *Sanierungsklausel*. However, the measure under scrutiny does not apply to all undertakings which change ownership but it only applies to those which, according to the wording of the *Sanierungsklausel*, at the time of the transaction, are “facing insolvency, are indebted or likely to be”. That is why the Court considers that this category does not include all undertakings which are in a similar factual and legal situation in light of the objective of the tax regime at stake.[66]

Regarding the argument brought by Heitkamp concerning the fact that the measure is general because it is potentially available to all undertakings within the meaning of the *Autogrill Espagna/Commission* case, the Court discarded the

[62] Heitkamp had also invoked the protection of legitimate expectation in a plea which was deemed inadmissible, see judgment in *Heitkamp BauHolding GmbH v European* Commission, paragraphs 146–150.

[63] Judgment in *Heitkamp BauHolding GmbH v European* Commission, EU:T:2016:60, paragraphs 151–174.

[64] Judgment in *Heitkamp BauHolding GmbH v European* Commission, EU:T:2016:60, paragraph 99.

[65] Judgment in *Heitkamp BauHolding GmbH v European* Commission, EU:T:2016:60, paragraph 107.

[66] Judgment in *Heitkamp BauHolding GmbH v European* Commission, EU:T:2016:60, paragraphs 123–138.

argument and took the view that the measure under scrutiny actually included a definition of its scope of application *ratione personae,* i.e. undertakings in difficulty.[67] The Court also dismissed Heitkamps's argument that the measure was general in nature because it could benefit to any undertaking in difficulty.[68]

Finally, the General Court did not admit any justification of the measure on the basis of the nature and economy of the system. The Court noted that the Commission had made a distinction between on the one hand the objective of the rule of forfeiture of losses and on the other hand the objective of the *Sanierungsklausel*.[69] Regarding the former, German authorities had invoked the objective to exclude transactions aiming at abusing the possibility to carry forward losses but the Commission had considered, on the basis of the amendments to the previous rules that the objective was to finance a reduction of the corporate tax rate shifting from 25 % to 15 %. As to the objective of the latter, the Commission took the view that the objective was to tackle issues resulting from the economic and financial crisis and to help undertakings in difficulty in that context, which it deemed to be extrinsic to the tax system. The General Court endorsed that view based notably on the analysis on the wording of the rule.[70]

Therefore, the Court took the view that there was no need to go further and analyse whether the measure is proportionate to its objective. Similarly, according to the Court, the ability to pay principle, as a general principle underlying the possibility to carry losses forward, cannot serve as a justification notably because, under the measure under scrutiny, it would allow an undertaking in difficulty to carry losses forward while an healthy undertaking would be barred from doing it, although it would fulfil the other conditions of the *Sanierungsklausel*.[71]

3.3 The P Oy Case

The case pending before the Supreme Administrative Court of Finland in *P Oy* was brought by a company which was denied the authorization to deduct previous losses because of a change of ownership, because it could not demonstrate any special circumstances which would have enabled the tax administration to make use of the

[67] Judgment in *Heitkamp BauHolding GmbH v European* Commission, EU:T:2016:60, paragraph 141 and cited judgment of 7 November 2014 in Autogrill Espagna/Commission, T-219/10, EU: T:2014:939, paragraphs 44–45.

[68] Judgment in *Heitkamp BauHolding GmbH v European* Commission, EU:T:2016:60, paragraph 140.

[69] Judgment in *Heitkamp BauHolding GmbH v European* Commission, EU:T:2016:60, paragraph 161.

[70] Judgment of 4 February 2016 in *Heitkamp BauHolding GmbH v European Commission*, EU: T:2016:60, paragraphs 162–164.

[71] Judgment of 4 February 2016 in *Heitkamp BauHolding GmbH v European* Commission, EU: T:2016:60, paragraph 170.

power conferred by the domestic income tax legislation. In its request, the Supreme Administrative Court first expressed doubts as to the determination of the reference framework. It considered that this framework could be either the general rule according to which losses can be carried forward or in the alternative the specific exclusion of the carry-forward in the case of a change of ownership. Then, the referring court asked whether the contested measure could be justified as a mechanism inherent to the tax system aiming at the prevention of abuse or evasion. Finally, it asked to what extent relevance has to be given to the margin of discretion granted to administrative authorities by the domestic legislation.

Although the Advocate General refused to address the issue of the qualification of the contested measures as State aid on the ground that it would not be relevant for the solution of the case before the referring court,[72] the CJEU made several interesting observations in that regard. However, due to the lack of the information submitted, it did not go as far as ruling on the classification of the tax measure as a State aid.

The CJEU first reminded that favourable tax measures can be considered as an aid, provided that they are not generally applicable to all economic operators. Then, it recalled the analysis to be followed to classify a State measure as selective. The CJEU went on by saying that the measure conferring an advantage to its recipient could be justified by the nature or general scheme of the system of which it is part. In the area of taxation, this is the case when the measure "directly results from the basic or guiding principle of its tax system".[73]

As regards the administrative discretion in the granting of the authorization to offset losses, the CJEU did not consider it as an element which would necessarily preclude a justification on the ground of the nature or general scheme of the system. Further, the Court labelled a particular criterion mentioned in the administrative guidelines detailing the special circumstances under which deduction could be granted, in particular maintaining the employment as "unrelated to the tax system" and therefore as potentially selective. Nonetheless, after noting that those guidelines were not legally binding, the CJEU did not analyse whether selectivity could be justified or whether the other constituting criteria of the notion of State aid were met due to the lack of information.

In a broader context, the CJEU's judgment confirms the Commission practice—in particular the 2006 decision on the French depreciation rules applicable to Economic Interest Groupings—according to which anti-avoidance measures are

[72] See Opinion AG Sharpston, 7 February 2013, C-6/12, EU:C:2013:69, paragraph 34. According to the Advocate general, since the measures at stake were already into force in the moment of Finland's accession to the EU, even if they would constitute State aid, had to be considered as existing aid and for applied by the national judge as long as the Commission would not have intervened on the ground of Art. 108(2) TFUE.

[73] Judgment in *P Oy*, EU:C:2013:525, paragraph 22. See also judgment in *Paint Graphos and others*, EU:C:2011:550, paragraph 65.

selective if they contain exceptions based on criteria not entirely consistent with the objective of combating tax avoidance.[74]

In *P Oy*, the CJEU did not take an explicit stance on the selectivity of the Finnish measure, due to the lack of information it had received from the referring Court.[75] However, the Court appeared to narrow the scope of its review and to focus on the specific provision excluding the deduction of losses in the case of change of ownership, instead of analysing it in the broader framework of the general rule of the Finnish system which allows the deduction of losses.[76] As a comparison, in *Heitkamp*, the General Court chose more explicitly to consider a reference framework constituted by the forfeiture of losses even though it had acknowledged the presence of more general rule of the possibility to carrying forward losses.[77]

At first sight, such decision may seem questionable because the very essence of this latter provision can only be understood in the light of the more general regime concerning the tax treatment of losses. Apparently, as a general rule, the Finnish system allows the deduction of losses. Disallowing the deduction for businesses after a change of ownership can indeed be regarded as an "exceptional" measure aiming at avoiding tax-saving practices consisting of taking advantage of the rule generally allowing the deduction of losses. The consequence of this approach would be to treat the "exception to the exception", allowing the tax administration to allow deduction under special circumstances as a mere application of the general rule, therefore excluding the qualification of selective aid. One can assume that the discretionary powers conferred to tax administration aimed at verifying on a case-by-case basis whether the change of control was motivated by genuine economic considerations or is simply tax-driven. The CJEU, however, did not appear to follow this line of reasoning.

[74] European Commission (2006), recital 133 and seq. This decision illustrates the high standard to meet for a Member State to prove the existence of a justification based on the internal logic of the tax system. Although in that case the Commission had found at paragraphs 134–135 that "*by limiting the amount of deductible depreciation [the legal provision] does in fact seek to combat abusive recourse to tax-transparent structures with a view to achieving a tax saving as part of operations to finance assets leased out or otherwise made available. That objective is clearly necessary and rational for purposes of ensuring the effectiveness of the scheme of tax-deductible depreciation of assets leased out or otherwise made available and must therefore be considered to form an inherent part of the said scheme*". However, after acknowledging that a derogation was admissible, the Commission emphasized at paragraph 136 that "*although derogations [...] are admissible, they should be based only on criteria the fulfilment of which would be capable of preventing recourse, for tax optimisation purposes, to the financing [...] by means of tax-transparent structures such as EIGs*" and concluded to the absence of any valid justification.

[75] Judgment in *P Oy*, EU:C:2013:525, paragraph 21.

[76] Judgment in *P Oy*, EU:C:2013:525, paragraph 32. This is the case in most, if not all, EU Member States. It can be seen as a measure implementing the principle according to which each taxpayer asked to be taxed according to the ability to pay principle. See Michelsen (1998), pp. 21–69; Ault and Arnold (2010), pp. 393–397 and from the German prospective, Brodersen and Mückl (2014).

[77] Ibid, Judgment of 4 February 2016 in *Heitkamp BauHolding GmbH v European* Commission, EU:T:2016:60, paragraphs 107.

In defence of the CJEU's approach in the *P Oy* case, the objective of contrasting tax avoidance is taken into consideration later in the judgment to justify the difference in treatment. Moreover, the CJEU seems to show a—legitimate—concern about the fact that tax authorities could exercise their margin of discretion in a manner inconsistent with State aid rules. And, had it not adopted a narrow reference framework, the CJEU would have had more difficulties to rule on this aspect. A definitive analysis is nonetheless difficult to give, since as the CJEU rightly pointed out, it "presupposes not only familiarity with the content of the provisions of relevant law but also requires examination of their scope on the basis of administrative and judicial practice and of information relating to the ambit *ratione personae* of those provisions".[78]

The Court's approach is likely to lead to an increased likelihood to meet the selectivity condition of an aid. Exceptions to an anti-avoidance rule are indeed per definition limited to an even smaller category of undertakings than the one to which the anti-avoidance rule apply. In addition, while the exception to the exception may theoretically lead to reinstating the normal tax regime, the respective underlying objectives of the general system and of that exception to the exception may differ. This difference however should not necessarily lead to the conclusion that the objective of the latter rule should not qualify in order to justify the provision under State aid rules.

4 Fighting Against Purely Tax Driven Arrangements: An Objective Inherent to the Tax System?

The approach taken by EU institutions would gain in predictability if some fundamental characteristic of anti-avoidance rules in domestic tax systems were better taken into account.

The objective to fight against avoidance or abusive practices has to be regarded as consubstantial to the objective of "[collecting] revenue to finance State expenditure", recognized in the 1998 Commission Notice as the main purpose of the tax system.[79] The objective of counteracting abuses, i.e. legal and fiscal engineering designed solely for the purpose of enjoying a tax benefit without any other valid justification of commercial nature, should be considered to be inherent to the tax system, both at the level of comparability and justification.

Therefore, the recognition of the fight against tax avoidance and abuse as an objective inherent to the tax system implies that undertakings in abusive situations can never be compared to undertakings, which are in similar tax positions or enter into similar transactions, but for motives that are not purely tax driven. The non-application of anti-avoidance rules to undertakings conducting genuine

[78] Judgment in *P Oy*, EU:C:2013:525, paragraph 20.

[79] European Commission (1998), paragraph 26.

economic activities should therefore not be considered as a selective advantage. This should be the case even if the drafting technique chosen by the domestic tax legislature would take the form of an exclusion of these undertakings from the scope of an anti-avoidance measures.

However, it should also be taken into consideration that the same tax measure may actually display various objectives, which have to be weighed against each other and tested against the proportionality principle. From this perspective, the German *Sanierungsklausel* case offers a good illustration of a measure part of the scheme that pursued at the same time budgetary objectives, anti-avoidance purposes and motivations aimed at helping undertakings in financial difficulties. Successive modifications of the scheme did not help to render that legislation more coherent and there was legitimate doubt as to the fact that the exclusion of restructuring undertakings as such was proportionate to the objective of fighting against abusive transactions.

Nevertheless, European institutions, whether the Commission or the Courts, should be very careful in determining the objective of domestic tax measures. In the *P Oy* case, the CJEU pointed out the fact that the Finnish scheme at stake—under which tax authorities could allow the deduction of losses in case of change of control for special reasons, such as the maintain of employment—could pursue employment policy goals—extrinsic to the tax system—and was therefore likely to be selective. However even if admitting that employment policy objectives fall outside the goals normally assigned to taxation, it remains unclear to what extent the discretion of the Finnish tax authorities to authorize the deduction of losses in the case of special circumstances was exercised on the basis of "objective unrelated to the tax system". According to domestic administrative guidelines referred to in the CJEU's judgment, "the purpose of the Paragraph 122 of the TVL to prevent loss-making companies from being converted into a commodity. If an undertaking's change of ownership does not have the characteristics described, the authorisation for loss deduction may be granted". The same guidelines also state that "authorisation for loss deduction may be granted where deduction is necessary for a [company] to continue its activities. An absolute condition may be that the [company] continues its activities after the change in ownership. If, in practice, the [company] has ceased activities and its value is essentially based on the established losses, authorisation to derogate should not be granted".[80] This seems to indicate that the power granted to the tax administration is exclusively exercised in order to avoid trade of loss-making company. The reference to employment considerations in a non-exhaustive list of special reasons, also containing circumstances such as transfers from one generation to another or changes in the ownership of listed companies, appears in this context rather casual and should not, in the authors' view, be put on the same footing as what undoubtedly appears to be the primary objective of the legislation at stake. The non-exhaustive list of the Finnish tax administration appears to indicate a list of motives that are considered as non-tax

[80] Judgment in *P Oy*, EU:C:2013:525, paragraph 8.

driven and therefore able to justify the non-application of a measure whose objective is to counteract abusive schemes. From this perspective, it seems to be perfectly proportionate to the objective of the scheme as such.

5 State Aid Rules in a BEPS Context: Putting Substance-Based Anti-avoidance Measures at Risk?

State aid rules should not restrict the possibility for Member States to limit the application of general or specific tax measures to genuine, non-abusive economic activities. The Court of justice has indeed recognized that "preventing possible tax evasion, avoidance and abuse is an objective recognised [by European Law]", whether in harmonized[81] as well as in unharmonized[82] areas. Moreover, several amendments to existing EU directives in the area of direct taxation have been adopted recently to that end,[83] and, as reflected in the 2016 proposal for an Anti-tax avoidance Directive,[84] further anti-avoidance measures are likely to be incorporated in EU law in the future. Those legislative changes at the EU level are directly connected to the work of the OECD in the framework of the BEPS action plan.[85] Among other objectives, that plan aims at strengthening anti-avoidance rules in order to limit the room for manoeuvre of taxpayers to set up entities and transactions, which are deprived of economic substance.

It is therefore important to interpret the prohibition of state aid in the light of those developments. Of course, this should not go as far as excluding certain well-defined category of undertakings from the scope of anti-avoidance measures. This is for example the case of the interest barrier rule contained in 2016 Commission's proposal for an anti-tax avoidance directive, which provides for an exclusion in favour of financial undertakings.[86] However, considering that if

[81] Judgement in *Gemeente Leusden and Holin Groep BV vs Staatssecretaris van Financien*, joined Cases C-487/01, EU:C:2004:263 and judgment in *Holin Groep*, C-7/02, EU:C:2004:263, paragraph 76; judgment in *Halifax and Others*, C-255/02, EU:C:2006:121, paragraph 71; judgment in *Mahagében and Dávid*, Cases C-80/11 and C-142/11, EU:C:2012:373, paragraph 41; judgment in *Bonik*, C-285/11, EU:C:2012:774, paragraphs 35 and 36; judgment *LVK 56,* C-643/11, EU: C:2013:55, paragraph 58.

[82] Judgment in *Cadbury Schweppes*, EU:C:2006:544, and the case-law and literature quoted at footnote 34.

[83] Council of the European Union (2014), pp. 40–41; and Council of the European Union (2015), pp. 1–3.

[84] See European Commission (2016a).

[85] European Commission (2016a), Explanatory memorandum, at 3.

[86] See European Commission (2016a), Articles 4 and 6.

the directive were to be adopted and implemented by Member States, the exclusion would not be imputable to the Member States but to the EU, characterization as State aid should be excluded.[87] Moreover, the carve-out of financial institutions seem to be in the Commission intentions purely temporary. Indeed, according to the Proposal, "(. . .) *it is however necessary to clarify that despite the temporary exclusion of these financial undertakings, the intention is to ultimately conclude an interest limitation rule of broad scope which is not subject to exceptions"*.[88]

However, as regards the implementation of anti-avoidance measures using rather undetermined concepts such as valid commercial reasons or genuine economic activities, State aid control should be exercised with a certain degree of restraint. Indeed, the application of those measures depends on a case-by-case analysis of the facts and circumstances under which a transaction has taken place. By nature, economic objectives—which, according to a narrow view of the existing Commission's practice and courts case law, could be considered as extrinsic to the tax system and therefore irrelevant from a State aid perspective—play a decisive role. There is therefore a risk that each individual decision of a domestic tax administration that would put aside an otherwise applicable anti-avoidance measures on the ground that the transactions at stake pursues non tax objectives could be considered as selective State aid, on the grounds that those objectives are similar to economic, social or environmental policies, that would be considered extrinsic to the tax system of the Member States concerned. Such an interpretation would severely hinder the effectiveness of the efforts of tax authorities to sanction purely tax-driven operations, while at the same time either unduly favoring abusive transactions or unnecessarily targeting genuine activities.

In conclusion, in order to avoid such a clash between State aid and Tax policies, it appears necessary to define first the reference framework as broadly as possible. Isolating an anti-avoidance measures from the broader tax system whose integrity it aims to protect does not indeed favour a clear understanding of the effects of the system as a whole. Then, comparability should be established in the light the main objective of the tax measure of scheme at stake, after having identified the different objectives pursued by the same measure. Finally, it should be admitted that identification of the genuine activities that are not targeted by anti-avoidance measures might require from tax authorities to use criteria based on the economic rationale of the transactions at stake, even if those criteria could lead outside the specific context of the application of anti-avoidance measures to the qualification of selective aid.

[87] See judgment of 5 April 2006 in *Deutsche Bahn v Commission*, T-351/02, EU:T:2006:104.

[88] See European Commission (2016a), Explanatory memorandum, at 7.

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Edoardo Traversa is Professor of Tax Law, Catholic University of Louvain; Of Counsel, Liedekerke Law Firm, Brussels.

Pierre M. Sabbadini is an associate specialised in competition and state aid law with Liedekerke Law Firm, Brussels.

State Aid Benchmarking and Tax Rulings: Can We Keep It Simple?

Raymond Luja

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Abstract Tax rulings and advance pricing agreements may run the risk of providing an advantage to taxpayers upon ex-post analysis. This contribution will first focus on how group companies may differ from stand-alone companies for state aid purposes and address the Commission's potential use of secret comparables as part of a transfer pricing analysis. A flowchart to determine when a ruling may be deemed selective is provided. Then mismatches will be addressed in tax treaty situations, like the (de)recognition of permanent establishments. Lastly, the (ir)

All statements in this paper are personal and do not necessarily represent the views of Loyens & Loeff. As the author is frequently consulted in matters of state aid, the reader may assume that the author may have been consulted in past or ongoing disputes. This paper was updated until 29 February 2016.

R. Luja (✉)
Maastricht University, Maastricht, The Netherlands
e-mail: raymond.luja@maastrichtuniversity.nl

© Springer-Verlag Berlin Heidelberg 2016

I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax
Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_7

relevance of the new EU tax ruling database for state aid investigations will be discussed.

1 Introduction

> Tax rulings as such are not a problem under EU state aid rules if they simply confirm that tax arrangements between companies within the same group comply with the relevant tax legislation.[1]

The Oxford Dictionaries website's definition of 'simple' offers options such as: "(1) Easily understood or done; presenting no difficulty, (1.1) Used to emphasize the fundamental and straightforward nature of something, (2) Plain, basic, or uncomplicated in form, nature, or design [. . .], (2.1) Humble and unpretentious, (3) Composed of a single element; not compound, [. . .]".[2] Which definition of 'simple' the Commission had in mind in the quote above is open to interpretation. With the increasing complexity of tax systems and the resulting need for clarity for many large (and small!) corporations, neither of these definitions really seems to fit the tax ruling practice nowadays.

In this contribution the term 'tax rulings' will include advance pricing agreements (APAs) where feasible, in line with Commission practice. I will not make a full review of the *Starbucks* and *Fiat* cases from October 2015,[3] but instead I will look at some of the more fundamental issues that arise in these cases, in particular the use of the at arm's length principle—something that also plays a part in the *Belgian Excess Profit Ruling* case[4]—and the possible use of secret comparables in a transfer pricing analysis.[5] Some remarks will also be made about a recent decision to investigate *McDonald's* as it indicates that the Commission is now addressing mismatches at large when reviewing rulings.[6] There are at least 300 other rulings out there that are still the subject of a preliminary investigation and some of them may become the subject of a formal public enquiry in the months to come.[7]

In paragraph 2 we will discuss the standard of comparability, in particular addressing whether stand-alone companies are to be considered the proper benchmark for a selectivity analysis under state aid rules. In paragraph 3 we will focus on the Commission's authority to gather market information and the role this may play in reviewing transfer pricing decisions. A flow chart will be provided to clarify when an advantageous ruling actually may turn into either a selective-individual

[1] European Commission (2015c).

[2] Oxford Dictionaries.

[3] European Commission (2015a).

[4] European Commission (2016).

[5] *See* Starbucks, European Commission (2015a).

[6] *See* McDonalds, European Commission (2015c).

[7] Formal investigations into Apple and Amazon are also still pending as are the Luxleaks cases.

advantage for state aid purposes or a non-selective advantage from a tax system allowing for advance clarity. Paragraph 4 will address the Commission's apparent shift in focus from transfer pricing to a broader focus including mismatches. Special attention will be given to the (de)recognition of foreign permanent establishments (PEs). Paragraph 5 will briefly provide a review of the tax ruling database that will be introduced at EU level from a state aid point of view. Some concluding remarks will follow in paragraph 6.

At the time this publication was finalized, the full text of the Commission's decisions had not been made public yet. This contribution is based on the summaries provided for by the Commission in its press releases and it may therefore address certain questions or uncertainties that may have already been addressed in the final decisions. As for the press releases, they are what they are: releases to draw the attention from the press and the general public at large that attempt both to explain the nature of the Commission's decision and its political/ethical context. This means that they sometimes contain some statements written to address public and parliamentary concerns and to influence public opinion, even though such statements are unlikely to occur in the actual decisions as they have little legal relevance. None of the Commission's decisions is final yet, as even those decisions that have been issued may still be subject to scrutiny by the EU's courts.[8] A decision that illegal state aid has been granted may indeed be big news, but as all of these decisions are *de facto* test cases we should take due account of the fact that the Commission may well be right but equally be wrong in its approach. Especially with the final text of decisions still being unavailable, we need to be careful not to draw conclusions too easily about how these cases will play out.

2 Are Stand-Alone Companies a Benchmark?

2.1 Setting the Tone: A Fair Share or the Legally Required Share

All companies, big or small, multinational or not, should pay their fair share of tax.

This quote from Commissioner Vestager sets the tone in the *Starbucks*/*Fiat* press release ordering the recovery of about € 20–30 million in taxes from each of these firms by the Netherlands and Luxembourg respectively.[9] These numbers are just estimates; it is most likely that the final decisions will not mention an exact number

[8] Appeals have already been filed by Luxembourg (T-755/15, OJ C 59/48 of 15 February 2016) and Fiat Chrysler Finance Europe (T-759/15, OJ C 59/49 of 15 February 2016) in respect of Fiat Finance and Trade, by the Netherlands in respect of Starbucks (T-760/15, OJ C 59/50 of 15 February 2016), and by Belgium in respect of the Excess Profit Rulings (T-131/16, not yet published).

[9] *See* Starbucks, European Commission (2015a).

but order the Member States involved to make an exact calculation of the taxes due based on an amended tax burden. It will be interesting to see how this will develop; what will be of particular relevance is whether the Commission provides Member States with their own assessment of acceptable transfer prices or whether it only tells them to redo their homework.

The problem I have with the quote above is that it has little to do with state aid. From a legal perspective a correct quote should have be something like this:

> All companies, big or small, multinational or not, should pay their legally required share of tax.

If one compares these quotes, a rather common response would be that the latter would favor tax avoidance practices and fails to recognize the Commission's efforts to deal with setups to reduce applicable taxes and possible double non-taxation. Here we should keep in mind that state aid rules are not meant to keep companies from using the loopholes in domestic tax systems or from exploiting the differences between national tax systems as long as what they do does not violate the correct application of those general national laws. There is much room for improvement of national tax systems and for bilateral/multilateral coordination to reduce tax avoidance, but when we start using state aid as a legal tool to force countries into changing their tax systems we may end up in a situation that may backfire on the EU a few years from now. Foreign competitors and governments may be able to use the EU's state aid rules against it. That said, to the extent rulings clearly deviate from the normal tax system in a Member State to the benefit of individual companies the Commission is entitled to act when all conditions of Article 107(1) TFEU are met.

2.2 Group Companies and Stand-Alone Companies Are Not Comparable

Before we can discuss the Commission's approach towards transfer pricing and at arm's length treatment, we need to understand what its starting point is. From the tone of the press releases it seems that the Commission is approaching transfer pricing from the perspective that group companies and stand-alone companies are in a similar legal and factual situation and should be taxed similarly.

While, in theory, state aid law may warrant such an approach real life is different: group companies and stand-alone companies are *not* in a similar legal and factual situation exactly because the first are part of a group of related companies. If we were to treat group companies and stand-alone companies alike we would have to operate from a presumption that any dealings with other companies will be uninfluenced by any interpersonal relationships and hence take contracts etc. for granted. In many EU Member States tax authorities may not second-guess normal business decisions, even if they lead to more losses/less profit than a 'better' businessman would make. It is the presence of intra-group transactions that allows most tax authorities to actually question business decisions taken where normally they have to refrain from doing so.[10] It is because of this interrelation between group members that most national tax laws provide specific rules to counter tax avoidance, such as an interpretation of the at arm's length principle to be applied for intra-group transactions, limitations on intra-group interest deductions, CFC legislation and alike.

Thus, I wonder whether the Commission actually intends to overrule domestic anti-avoidance rules if their result would be that group companies would not be taxed the same as stand-alone companies. From my perspective state aid is still about applying national anti-avoidance legislation in a non-selective manner, even when that legislation is imperfect and does not create full equal treatment. It is a Member State's prerogative to create (non-selective) anti-avoidance measures and set limits to them. However, if, in the design of these rules, particular escapes have been built-in that would allow a particular group of companies to circumvent anti-avoidance rules in situations where they should apply in light of their rationale, state aid may step in.[11]

What to think of situations where we try to cap tax avoidance opportunities without getting rid of them completely? Consider what would happen if we introduce a thin cap rule allowing interest to be deducted up to 30 % of EBITDA. Suppose that in a particular sector of industry interest payments would normally average at about 20 % of EBITDA for stand-alone companies. There is a group company with interest payments going up to 40 % of EBITDA. Should tax authorities now use an at arm's length approach to get to 20 % or may they adopt a policy of being satisfied with the cut-off at 30 % for any company and leave it at that when prioritizing their work? Would the non-application of at arm's length transfer pricing rules now be selective or not, as this approach may favour companies in certain sectors? Or is this the result of the normal application of a tax system where objective and publicly verifiable criteria are used to set acceptable limits, no questions asked? This scenario is not relevant to any of the pending cases; it merely serves to point out the kind of follow-up questions we need to address if the Commission proceeds on its current course.

2.3 Second-Guessing Business Decisions

If one operates from the presumption that group companies and stand-alone companies would be in a legally and factually comparable situation, *quod non*, the main question would still be to what extent national tax law would allow tax authorities to second-guess business decisions made.

[10] For ease of reading. "intra-group transactions" may also include transactions between legal entities and related natural persons such as shareholders.

[11] *See*, for the most recent examples, General Court T-287/11 of 4 February 2016, *Heitkamp BauHolding v Commission*, ECLI:EU:T:2016:60, para 106 and T-620/11 of 4 February 2016, *GFKL Financial Services v Commission*, ECLI:EU:T:2016:59, para. 111–114 (both concerning the German Sanierungsklausel).

In the Commission's analysis of *Starbucks* the tax burden was reduced via (i) (too?) high prices paid for supplies of Swiss green beans and (ii) royalties being paid for the know-how of how to roast coffee. I will come back to the bean pricing in the next paragraph. Here, let us focus on the royalty payments.

The Commission argues that the payment "does not adequately reflect market value. In fact, only Starbucks Manufacturing is required to pay for using this know-how – no other Starbucks group company nor independent roasters to which roasting is outsourced are required to pay a royalty for using the same know-how in essentially the same situation."[12] This is of some relevance *if* we accept the premise that Starbucks Manufacturing's activities are indeed comparable and not go beyond normal roasting activities. The Commission may well be right in considering that the amount of royalties is overstated and should have been (near) nil, but the mere fact that royalties are charged in one case but not in others in itself cannot be decisive. It takes more before we can call a royalty payment purely artificial should actual, exploitable know-how be involved.

For example, a multinational might decide to charge royalties in relation to its European activities but not in relation to its activities in emerging markets where it is expanding its presence. This is a typical business decision which tax authorities should steer clear of as long as the level of royalties is acceptable.

Back to the actual case at hand, if royalties were overstated the question remains whether this as such leads to an advantage for state aid purposes. The answer would likely be affirmative if we review each item of a ruling at its own merits. If we look at the ruling as a whole, however, the answer might be different if there are other elements in there that ensure that taxable profit is still at arm's length overall.[13] As we will see next, the CJEU tends to look at the actual effect of measures.

3 Transfer Pricing and the Commission's Information Gathering Process

3.1 Free Competition as a Benchmark for Advantage

One of the most tricky issues in the Starbucks decision is the application of the at arm's length principle. According to the Commission's analysis the margin paid on green beans bought by Starbucks had more than tripled in recent years, resulting in

[12] *See* Starbucks, European Commission (2015a).

[13] In a public statement the Dutch Under Secretary of Finance took the position that by using the transactional net margin method (TNMM) the focus was on determining an overall profit level in line with business standards, instead of focussing on the appropriateness of the royalty directly. Overall profitability of Starbucks Manufacturing was comparable to that of independent roasters, according to the Under Secretary. See Dutch Ministry of Finance (2015). The use of the TNMM has been questioned by the Commission in this case.

"inflated" prices being paid to a Swiss group company. Now, due to lack of data, we cannot redo the Commission's calculations nor do we need to in the context of this contribution. What concerns us here is how the Commission gathered its data.

The Commission gathered market information from third parties on the basis of what is now Article 7 of the Procedural Regulation, in order to get sufficient comparables to do a transfer pricing analysis.[14] Article 7 is a relatively new tool the Commission copied from other areas of competition law where it might need to order market operators to provide it with the information it needs when investigating cartels or reviewing mergers. When applying this tool in the area of state aid, however, we must carefully consider how such information can be used.

What is under review is the ruling given to Starbucks confirming the use of a particular price for beans. The question that needs to be answered is whether that ruling provided an actual advantage to Starbucks. This is an objective concept and it does not matter whether the tax authorities actually wanted to give an advantage or not. However, as the Commission confirmed:

> Tax rulings as such are perfectly legal. They are comfort letters issued by tax authorities to give a company clarity on how its corporate tax will be calculated or on the use of special tax provisions.[15]

Now, if we do accept that giving clarity in advance is acceptable, what can we expect from parties? If a taxpayer and the tax authorities would agree to settle a transfer pricing issue prior to the taxpayer engaging in a certain investment or transaction, they should do a proper transfer pricing analysis in accordance with the domestic rules governing such analysis. They can be a copy-paste from OECD rules or a domestic variation thereof, but not necessarily so.

What we do know from the CJEU's *Forum 187* decision, is that EU Member States should apply the at arm's length principle as embedded in their national tax system to resemble prices that would have been charged "in conditions of free competition".[16] In *Forum 187* a cost-plus method was used where certain highly relevant costs were excluded from the cost-plus base. In addition a fixed profit margin was used that was not determined on a case-by case basis. The Belgian Government and/or Forum 187, representing numerous affected taxpayers, pointed out that the Belgian tax administration was bound by the OECD transfer pricing guidelines as a proper standard for reference in their defence in this case, so here the Commission had the opportunity to use the OECD guidelines and its at arm's length principle as it was deemed part of the national reference system.[17]

Although there are no EU guidelines on how to determine a transfer price, we do know that in order to determine whether an advantage is present we need to compare the outcome of a transfer pricing analysis "with the ordinary tax system,

[14] Council of the European Union (2015b).

[15] *See* Starbucks, European Commission (2015a).

[16] CJEU Joined Cases C-182/03 and C-217/03 of 22 June 2006, *Belgium and Forum 187 v Commission*, ECLI:EU:C:2005:266, para. 96.

[17] European Commission (2003), paras. 43 and 95.

based on the difference between profits and outgoings [in French: ‘produits et charges’, RL] of an undertaking carrying on its activities in conditions of free competition.”[18] Whether the analysis is rather straightforward or using more complex, refined methods to address the specifics of a case should not matter, as it is the outcome that is to be compared to this baseline that determines the presence of an advantage. As the CJEU put it:

> Article 107(1) TFEU does not distinguish between measures of State intervention by reference to their causes or their aims but defines such measures in relation to their effects, and thus independently of the techniques used [. . .].[19]

3.2 An Advantageous Ruling Is Not Selective Per Se

In *Forum 187* it was rather clear that normal OECD rules had not been complied with, so there one step of the state aid analysis has effectively been skipped. What would happen if a Member State has an elaborate transfer pricing system—let us assume it adopted the OECD guidelines—and the transfer price has been set *in line* with these guidelines? Then, after some time, it turns out, based on market data that became available in the meantime, that the price previously set led to a lower taxable profit, namely, an advantage. The taxpayer was subsequently protected by the advance ruling giving legal certainty.

Let us assume that the CJEU follows a strict reading of *Forum 187* and concludes that there is an advantage because of the lower taxable profit upon an ex-post comparison. Several scenarios are possible. I will address two of them:

i) The CJEU reasons that the ruling as such results in individual aid and hence state aid may be present (assuming that the involvement of the state and a potential distortion of trade and an effect on intra-union competition are not at issue).
ii) The CJEU reasons that the advantage results from the non-selective application of the national transfer pricing regime providing advance clarity and legal certainty, hence aid will be absent as the advantage was justified by the nature and general scheme of the tax system.

[18] CJEU C-182/03 and C-127/03 of 22 June 2006, *Belgium and Forum 187 v Commission*, ECLI: EU:C:2005:266, para. 95. “Free competition” is not a synonym to “acting as a stand-alone company”, as in a free internal market companies may work together for economic reasons to increase their benefit or reduces their costs (within the limits of Article 101 and 102 TFEU of course).

[19] CJEU C-5/14 of 4 June 2015, *Kernkraftwerke Lippe-Ems*, ECLI:EU:C:2015:354, para. 75. *See also* Joined Cases C-106/09P and C-107/09P of 15 November 2011, *Commission v Gibraltar*, ECLI:EU:C:2011:732, para. 87; 173/73 of 2 July 1974, *Italy v Commission*, ECLI:EU:C:1974:71, para. 13.

Scenario i) would be the scenario most likely envisaged by the Commission. An EU at arm's length principle effectively demands a profit level that is as close to 100 % of profits reported by stand-alone entities as possible. Here a ruling would be considered selective by itself, as an individual aid measure, without considering the bigger question of whether it is the result of a more generally applicable scheme.

Scenario ii) raises the question whether a system of issuing binding rulings can be considered part of the reference system. For me, the answer to this is an affirmative one. Like with some anti-avoidance legislation mentioned in paragraph 2.2 above, in the case of APAs the transfer pricing verification and adjustment process by its very nature applies to transactions with related parties only and such rules can be non-selective. In *P Oy* the CJEU held:

> [A] measure which, although conferring an advantage on its recipient, is justified by the nature or general scheme of the system of which it is part does not fulfil the condition of selectivity [. . .]. Thus, a measure which constitutes an exception to the application of the general tax system may be justified if the Member State concerned can show that that measure results directly from the basic or guiding principles of its tax system [. . .].[20]

Therefore, if an individual APA turns out to be advantageous, we must determine whether the APA as such is in line with the very basics of the tax system of which the ruling regime is part. The general objectives of national tax rules such as transfer pricing rules are not in themselves sufficient as to keep those rules outside of the scope of Article 107(1) TFEU, as they may still have the effect of giving an advantage to particular companies.[21] This is something the CJEU had to struggle with in *Gibraltar* where it stated that "a different tax burden resulting from the application of a 'general' tax regime is not sufficient on its own to establish the selectivity."[22] If the national ruling system is clearly flawed in a way that it favors group companies by definition, the entire transfer pricing system may turn out to be an integral part of an aid scheme that benefits a privileged category of taxpayers "by the virtue of the properties which are specific to them", i.e. being part of a group.[23] If the regime as such is flawed, the Commission does not need to do an assessment of each individual ruling.[24]

Both scenarios i) and ii) assume that the ruling as such remained within the limits of the domestic transfer pricing regime to start with. This will require the Commission to review the method selected to determine profits, the comparables used and any subsequent adjustments made.

[20] CJEU C-6/12 of 18 July 2013, *P Oy*, ECLI:EU:C:2013:525, para. 22. *See also,* amongst others, C-143/99 of 8 November 2001, *Adria Wien*, ECLI:EU:C:2001:598, paras. 41–42.

[21] CJEU 310/85 of 24 February 1987, *Deufil*, ECLI:EU:C:1987:96, para. 8.

[22] Joined Cases C-106/09P and C-107/09P of 15 November 2011, *Commission v Gibraltar*, ECLI:EU:C:2011:732, para. 103.

[23] Joined Cases C-106/09P and C-107/09P of 15 November 2011, *Commission v Gibraltar*, ECLI:EU:C:2011:732, para. 104.

[24] *See* CJEU 248/84 of 14 October 1987, *Germany v Commission*, ECLI:EU:C:1987:437, para. 18.

3.3 Accessibility of Comparables

In order to determine whether a ruling was *in line* with the domestic transfer pricing regime, the tax authorities and the taxpayer involved should preferably use the best comparables they can find. However, this also assumes that parties had actual access to a particular comparable in order to include it in a transfer pricing calculation.

When the Commission gathered market information from competitors, did it also receive and use confidential business information which was not accessible to the taxpayer and the domestic tax authorities at the time? While the Commission may normally use information received from competitors in other areas of competition law, here it needs to approach such information with caution. It may not be sufficient just to provide aggregated data or otherwise anonymized data when dealing with business secrets. These 'usual' methods of dealing with confidential information may make it impossible to verify the Commission's state aid analysis.

The actual text of the final *Starbucks* decision is unlikely to reveal the exact names and numbers provided by other market operators, but the decision should at least reveal whether the numbers used were indeed accessible by at least one party to the ruling at the time the ruling was issued (or at any later periodical review thereof). Not revealing this may raise procedural issues which might lead to the (partial) annulment of the Commission's decision even upon marginal review.[25] Either way, the procedural issue at hand may also translate to a material issue: if the national transfer pricing rules do not allow for the use of secret comparables—not accessible to both parties at the time the ruling was concluded—then the Commission is bound to that when performing its own state aid assessment of the validity of that ruling in retrospect.

The very nature of providing advance certainty based on transfer pricing methodologies may in the end result in a company being somewhat better off if, based on ex-post data, the methodology or the comparables used turn out not to have been the most reliable indicators. The question is whether at the time the ruling was given the framework for giving advanced certainty was neutral, in a way that getting a ruling was not restricted to particular companies but a general right in the Member State involved, and whether the methodology used for transfer pricing in itself was not set up to provide ex ante benefits.

The fact that there was an advantage ex post would normally be decisive for state aid purposes, as it does not matter whether the government intended to provide the advantage or not. Still, it would be the nature or general scheme of a tax system providing binding procedures providing legal certainty that would keep the advantage from coming within the scope of state aid. (See scenario ii,

[25] The Commission would still be allowed to take a new decision in case of an annulment; using only accessible data to do a recalculation might result in no aid being present at all or in a different amount of aid to be recovered.

supra). Keep in mind that a Member State is not normally in a position to provide legal certainty as to prevent recovery of unlawfully granted state aid, but here it is the process of providing advance legal certainty as such that is the subject of review.

3.4 Recap

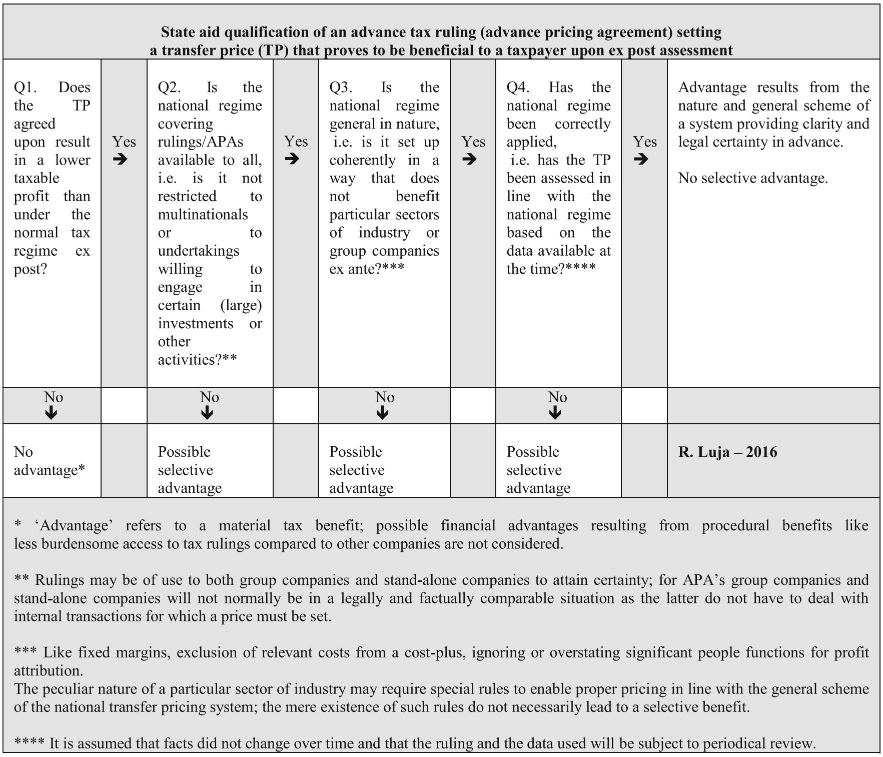
The mere fact that a ruling is given in a one-on-one situation might lead to a presumption of individual, hence selective, aid, but this can only apply to *ad hoc* rulings. If rulings are based on a ruling framework, like binding transfer pricing guidelines or a system embedded in interpretation of case law, then we must first test whether the access to the framework is limited as to exclude companies who are in a similar legal and factual situation.[26] If not, we must determine whether the framework itself is selective. A ruling complying with a broadly accessible framework that is non-selective in nature, may well lead to a non-selective advantage, justified by a tax regime that offers any taxpayer the possibility to get advance legal certainty in the face of uncertainties. Figure 1 summarizes the analysis above.

At present it is difficult to apply this flowchart to the recent *Starbucks* and *Fiat* decisions without having more detailed information. In the *Fiat* case, not discussed up to here, the Commission starts with addressing the appropriateness of using "an artificial and extremely complex methodology" to calculate the profit attributable to its financial services activities.[27] As mentioned before, the mere complexity has no role to play here. What is relevant is the result; it concluded that the company's capital base was understated in respect to the transfer pricing analysis and that the remuneration applied to this already small tax base was also too low. Both combined resulted in a taxable profit which, according to the Commission, should have been 20 times as high if normal market conditions were used (a normal capital base and normal remuneration).

If we follow the Commission's press release with respect to Fiat, the answer to Q1 would be a clear yes—an advantage. It does not raise the issue about access to APAs (Q2), so let us assume for the sake of argument that this is not an issue. This brings us to Q3, where we need to wonder whether the Luxembourg law as such contains rules that would allow for a major discrepancy between actual capital (or industry standards) and assumed capital, which by itself could result in a selective aid scheme. If this had been the case, the Commission would probably have taken action against the law as a whole as in the *Belgian Excess Profit* case.

[26] CJEU C-6/12 of 18 July 2013, P Oy, ECLI:EU:C:2013:525, para. 27.

[27] *See* Fiat, European Commission (2015a).



State aid qualification of an advance tax ruling (advance pricing agreement) setting a transfer price (TP) that proves to be beneficial to a taxpayer upon ex post assessment								
Q1. Does the TP agreed upon result in a lower taxable profit than under the normal tax regime ex post?	Yes ➔	Q2. Is the national regime covering rulings/APAs available to all, i.e. is it not restricted to multinationals or to undertakings willing to engage in certain (large) investments or other activities?**	Yes ➔	Q3. Is the national regime general in nature, i.e. is it set up coherently in a way that does not benefit particular sectors of industry or group companies ex ante?***	Yes ➔	Q4. Has the national regime been correctly applied, i.e. has the TP been assessed in line with the national regime based on the data available at the time?****	Yes ➔	Advantage results from the nature and general scheme of a system providing clarity and legal certainty in advance. No selective advantage.
No ↓		No ↓		No ↓		No ↓		
No advantage*		Possible selective advantage		Possible selective advantage		Possible selective advantage		**R. Luja – 2016**

* 'Advantage' refers to a material tax benefit; possible financial advantages resulting from procedural benefits like less burdensome access to tax rulings compared to other companies are not considered.

** Rulings may be of use to both group companies and stand-alone companies to attain certainty; for APA's group companies and stand-alone companies will not normally be in a legally and factually comparable situation as the latter do not have to deal with internal transactions for which a price must be set.

*** Like fixed margins, exclusion of relevant costs from a cost-plus, ignoring or overstating significant people functions for profit attribution.
The peculiar nature of a particular sector of industry may require special rules to enable proper pricing in line with the general scheme of the national transfer pricing system; the mere existence of such rules do not necessarily lead to a selective benefit.

**** It is assumed that facts did not change over time and that the ruling and the data used will be subject to periodical review.

Fig. 1 State aid qualification of advance pricing agreements (APAs)

Thus, Q4 remains in order to determine whether in this particular case unjustifiable adjustments were made to the capital base and whether remunerations used were clearly not at arm's length. Here we are dependent on data that has not been made available; the Commission's estimate of a taxable profit that was only 1/20th of what it should have been does indicate that Luxembourg has some explaining to do to save this case in court.

It should be mentioned that state aid investigations by their very nature tend to and need to focus on a single Member State. The end result of a case like *Fiat* may well be that an increase in Luxembourg taxes—by assuming a larger tax base and a higher remuneration—may result in a tax decrease abroad if the other State is held to take these changes into consideration retroactively. Due to differences in tax rates, the group as a whole may be better off in the end. The one-sided view on the concept of 'advantage' will not allow these effects to be considered in a state aid procedure, although these effects might have some influence on which cases will be selected for review in future given the Commission's limited resources.

3.5 Synergy Effects and Double Non-Taxation

The *Belgian Excess Profit* case raises a number of fundamental issues in relation to transfer pricing that have not yet been addressed.[28] Excess profits presumably result from being part of a group, such as economies of scale, closer contacts, etc. Belgium allowed certain multinationals, who received advanced authorization via a ruling, to deduct any excess profit from the Belgian tax base. The Commission, however, reasons that even if it would accept that excess profits exist, the Belgian government should not have allowed the entire excess profit to be allocated to a group entity abroad. In the Commission's reasoning at least a reasonable share of those profits should have been taxed domestically while Belgium seems to be taking the position that only stand-alone profits should have been taxed.

In its 2015 BEPS action plans, the OECD proposed to actually revise its 2010 Transfer Pricing Guidelines as to allow for synergy benefits to be taken into consideration in some situations:

> [W]hen synergistic benefits or burdens of group membership arise purely as a result of membership in an MNE group and without the deliberate concerted action of group members or the performance of any service or other function by group members, such synergistic benefits of group membership need not be separately compensated or specifically allocated among members of the MNE group. [. . .] If important group synergies exist and can be attributed to deliberate concerted group actions, the benefits of such synergies should generally be shared by members of the group in proportion to their contribution to the creation of the synergy.[29]

Thus, the question here is whether the Commission is ahead of schedule when applying the second rule to the past, if current OECD rules indicate differently (assuming Belgium follows suit)? Dividing the upside from synergy effects may seem common sense, but if the national tax policy at the time was to allocate them to a group's parent or head office as to exclude synergy related profits from taxable stand-alone profit then we should check whether this could have been a general measure.

That said, in order to be a general measure excess profits should also have been reallocated within domestic groups alike when determining the taxable profit of individual taxable entities that are part of such a group. This was not the case in Belgium, it seems. The coherence of the national system may be at stake as well, if Belgium would totally disregard excess profits which its resident group companies

[28] European Commission (2016).

[29] OECD (2015), excerpts from para 1.158 and 1.162. In paragraph 1.10 of its current 2010 Transfer Pricing Guidelines the OECD even acknowledges that there are "no widely accepted objective criteria for allocating the economies of scale or benefits of integration between associated enterprises." OECD (2010).

could be deemed to receive from abroad. This raises the question whether the regime as such is selective towards multinationals, in which case any ruling confirming its application could lead to selective aid as well (notwithstanding the possibility that the need for an advance ruling and its restricted availability might already lead to selectivity).[30]

A unilateral correction of profit like in the Belgian case may lead to double non-taxation if the profit allocated abroad is not picked up there, but this does not mean that such a correction should be dependent on a foreign pick-up from a domestic point of view. If the national tax system allows for a unilateral correction 'simply' to establish the correct at arm's length profit that should be taxed, then what happens abroad is not relevant as preventing double taxation is not the main objective of the measure. Nothing would have prevented the national legislator from building in a safeguard requiring a pick-up at the side of the receiving party as a condition for attributing profits to it for tax purposes (if applicable tax treaties would allow it). In the absence of such a national rule, the lack of a pick-up abroad and the resulting double non-taxation may well be the result of a *genuine* mismatch if two countries allocate profits differently because of divergences between their national transfer pricing rules or a different choice of (non-selective) calculation methods acceptable from a domestic point of view.

A *deliberate* mismatch would require excess profits from synergy effects to be attributed to other entities when such effects are either absent or overstated. Belgium should have established such profits by doing a case-by-case assessment, backed by proper transfer pricing analysis. This is what the Commission seems to be after in the Belgian case, and which will need a review of data to verify. In that context the Commission had to address the question of double non-taxation as Belgium explicitly raised the argument that "reductions were necessary to prevent double taxation" when attempting to justify an apparent selective advantage.[31]

To conclude, even though double non-taxation may be a trigger for opening a state aid investigation in the current political climate, its presence does not confirm that there is actual state aid. However, exclusive access via advance rulings as well as a possible overstatement of qualifying 'outgoing' excess profits may, as may the lack of coherence in the taxation of 'incoming' excess profits.

[30] Belgium would need to show that the restrictive access to the ruling was not based on non-tax requirements, such as engaging in major investments, as to include all groups small and large. Compare CJEU C-6/12 of 18 July 2013, P Oy, ECLI:EU:C:2013:525, para. 23–24: "The fact that an authorisation procedure exists does not in itself preclude such justification. [. . .] Justification is possible if, under the authorisation procedure, the degree of latitude of the competent authorities is limited to verifying the conditions laid down in order to pursue an identifiable tax objective and the criteria to be applied by those authorities are inherent in the nature of the tax regime." The latter may be the most difficult part here.

[31] European Commission (2016). 'Justification' is the last step in a selectivity analysis.

4 Shifting Focus to Non-TP Mismatches

The *McDonald's* case is somewhat different from the *Starbucks* and *Fiat* cases, as here it is a mismatch that draws the Commission's attention.[32] In a nutshell the case is as follows:

> McDonald's Europe Franchising in Luxembourg receives royalties from franchising activities all over Europe. However, those royalties were attributed to a US permanent establishment (to which they were transferred via Switzerland) and hence remained untaxed in Luxembourg. The latter treatment was confirmed by a ruling from the Luxembourg tax authorities. The US branch, however, was not a PE under US law as a result of which the royalties remained untaxed in the US.[33]

The Commission indicated that it will assess whether Luxembourg selectively derogated from (i) national tax law and (ii) the Luxembourg-US double tax convention. So it is now focusing on double non-taxation resulting from what could be a deliberate mismatch. Before submitting mismatches to a state aid investigation, a tax treaty being involved requires that the Commission first focusses on a number of constitutional issues from a Luxembourg point of view. Allow me some observations in this respect.

First, double non-taxation may occur because under a normal reading of Luxembourg law and jurisprudence a PE will be assumed more easily than under US law. As it is mostly up to the national courts of a contracting state to interpret a tax treaty it may well be that the Luxembourg courts in applying the PE-definition take a somewhat different view than their US counterparts. These kinds of differences in interpretation may happen as long as the treaty does not provide for an adequate bilateral procedure to deal with such discrepancies (and the exchange of information allowing for their detection). State aid is not meant to address these mismatches; treaty protocols and anti-avoidance provisions should play their part here. Making use of such mismatches as part of a tax avoidance scheme may raise political and public issues, but state aid should be of little to no influence here. Genuine differences between tax systems like this may occur.

Second, what would happen if the tax treaty provides a more stringent reading of what a PE is than under normal Luxembourg law? This may be a matter of Luxembourg constitutional law, as in most countries a tax treaty cannot normally lead to taxation where national law does not provide for a basis to tax already. Normally a treaty will restrict a contracting party from levying taxes it would normally impose. If there is a general rule of attributing profits to foreign branches under Luxembourg law, that rule will first need to be applied before we can check whether a tax treaty reduces any tax burden that remains. When there would be no profit to attribute to Luxembourg under domestic law, a tax treaty will not normally

[32] European Commission (2015c).

[33] We follow the terminology used in the Commission's press release. With 'not a PE under US law', the Commission meant to indicate that the entity did not engage in US trade or business.

overrule national law in this respect. Therefore, from a state aid point of view, the relevance of the bilateral tax treaty will be rather limited.

Third, if the Luxembourg ruling confirmed the presence of a US PE while no such PE would be deemed present under normal Luxembourg law, then it becomes relevant whether a tax treaty might overrule Luxembourg law as it is. This third option is however not relevant to the *McDonald's* case.

Fourth, if the full amount of royalties is attributed to a PE where Luxembourg law nor the treaty recognize a foreign PE, diverting from domestic Luxembourg law could indeed turn out to be a matter of state aid being involved. In that case, the diversion from normal application of the Luxembourg PE definition in an individual ruling may lead to a selective benefit.

Fifth, in the press release the Commission emphasized that in a first ruling Luxembourg authorities required proof of actual taxation of the royalties in the US (and Switzerland), while in a second ruling such proof was no longer required. This raises a procedural issue: if, for any exemption, such proof would have been required under Luxembourg domestic law then the second ruling may again lead to a selective benefit. If Luxembourg law would provide for unilateral avoidance without any such proof to start with, then the second ruling may be fine regardless of whether the tax treaty with the US would require some proof in order to be eligible for an exemption.

Sixth and last, even if a US PE is duly recognized under Luxembourg law, attributing the full amount of royalties to the US despite some relevant activities being carried out in Luxembourg may still raise a red flag. If no share of profit would remain for significant people functions carried out in Luxembourg—if any—the profit allocation may be subject to scrutiny under the at arm's length principle and any excess royalty should not have been exempt from Luxembourg tax to begin with.

Thus, what is relevant here is that the Commission first investigates how national law and tax treaties interrelate under Luxembourg constitutional law before drawing any conclusions on whether a ruling deviates from the Luxembourg-US tax treaty. In Member States where treaties may override domestic law when it comes to restricting national taxing powers the above would result in the overview shown in Table. 1.

5 The Tax Ruling Database: Useful or Useless for State Aid Review?

In December 2015 the ECOFIN Council added an automatic exchange of tax ruling information to the Administrative Cooperation Directive.[34] It effectively regulates the creation of an EU-wide database of those national tax rulings that have cross-

[34] *See* Council of the European Union (2011, 2015a).

Table 1 Interrelation between National Law and Tax Treaties

National PE definition met?	Treaty PE definition met?	Foreign PE definition met?	May a ruling confirming the presence of a PE to which profits can be attributed result in state aid, if any profit so allocated would meet the national at arm's length standard (where applicable)?
Yes	Yes	Yes	No
Yes	Yes	No	No, unless actual foreign taxation would be required under both the domestic law and the treaty
Yes	No	Yes	No
Yes	No	No	No, unless actual foreign taxation would be required under domestic law
No	Yes	Yes	No
No	Yes	No	No, unless actual foreign taxation would be required under the treaty[a]
No	No	Yes	Yes, unless a (general) unilateral double tax avoidance rule would apply as a consequence of actual foreign taxation[b]
No	No	No	Yes

[a] Even though it is unlikely that parties would have agreed on a PE definition neither of them applied at the time they concluded a treaty, it may well be that national laws have changed afterwards as a result of which an outdated but binding PE definition might still be contained in a treaty. In these situations parties may resort to a protocol or otherwise as to change such a definition

[b] This is a highly theoretical scenario which is unlikely to occur between developed countries; it has been included here for the sake of completeness

border effects as of 2017. The exchange of tax rulings has already been covered somewhere else, here the focus will be thus on its relevance to state aid investigations.

To start with, the ECOFIN Council added a specific restriction to the Directive which prohibits the Commission from using the information in the database for any purpose other than to determine whether and to what extent Member States comply with their ruling sharing obligations.[35] Effectively the Commission will be barred from using any information in the database for state aid purposes. This raises a number of interesting issues: does the Commission have an adequate Chinese Wall in place to prevent the Directorate-General for Taxation and Customs Union (DG TAXUD) from sharing information with the Directorate-General for Competition (DG COMP)? Most likely they will by 2017, but up to now most Chinese Walls were set up to protect the work of DG COMP to leak and not to prevent information from getting into DG COMP. But still, if the Commission—as one single administrative body—takes a formal state aid decision to what extent would information available to one DG be attributed to the Commission a whole?

From my perspective it is not very likely that future rulings will contain clear-cut cases of state aid once they are subject to inclusion in the database. That said, the

[35] Council of the European Union (2011), Article 23a, para. 1.

database will contain also some existing rulings which in light of the recent ruling cases might deserve some reconsideration. Even without the Commission having direct access for state aid purposes, Member States may inform the Commission of what they find if they consider it useful for domestic political purposes.

We should not forget that under the current focus on cross-border tax avoidance, there may still be cases where benefits are provided to domestic companies at the expense of national tax revenue without any foreign tax being avoided. The tax ruling database will not include such rulings, nor will it reveal any tax benefits resulting from informal communications that are not legally binding upfront. Tax authorities may live up to what they did, or they did not, promise to ensure a reliable tax climate, without any enforceable legal agreement showing up in the new database.

Thus, why should we care that the Commission is kept from accessing the database for state aid purposes? Yes, it may still require information from Member States and ask for a specific ruling, but in order to do so it needs to know that something is out there. Does this mean that it will still have to rely on revelations by the press and NGOs, on complaints by competitors, or on one of those rare national parliamentary enquiries on tax avoidance that get international news coverage?

Since 2013 the Commission is entitled to do an EU-wide review of certain (alleged) aid measures, like tax rulings. In order to engage in such a review it does not need to show a cause, it seems.[36] It first required Member States to provide lists of rulings issued from 2010 to 2013 and some general information on their national ruling practice. It then asked for some particular rulings for further investigation. By now most Member States have complied with this approach, some reluctantly.[37]

Given the proportionality required from the Commission when issuing request for information (and injunctions), picking 10–15 rulings out of a much larger list for further review may seem logical. It does, however, raise legal issues in regard to the selection process; up to now it is unclear why and how certain rulings were selected

[36] Council of the European Union (2015b), Article 25a. When this new investigative power was introduced it was stated: "In order to ensure that the Commission addresses similar issues in a consistent manner across the internal market, it is appropriate to complete the existing powers of the Commission by introducing a specific legal basis to launch investigations into sectors of the economy or into certain aid instruments across several Member States. For reasons of proportionality and in the light of the high administrative burden entailed by such investigations, sector inquiries should be carried out only when the information available substantiates a reasonable suspicion that State aid measures in a particular sector could materially restrict or distort competition within the internal market in several Member States [. . .]". Council of the European Union (2013), Preamble 17. It should be noted that a 'reasonable suspicion' was deemed to be required for sector-wide investigations but not for investigations into certain aid measures, like the ones at hand.

[37] *See* European Commission (2015b); 21 Member States provided both the lists and the individual rulings requested. No individual rulings were requested from 5 other Member States after submitting their lists. In June 2015 information injunctions were issued to Poland and Estonia who refused to hand over the lists up to that point in time, ordering these Member States to comply.

from these lists. Most likely, many of the rulings selected will never become public once they are cleared, but it would have been most helpful to have more information on the selection process. This is something the European Parliament could consider asking for on an anonymous basis without violating professional secrecy obligations, as part of its review of Commission activities. As the Commission faces pressure from the US claiming that it is targeting US companies primarily, it may have to release some further data on the nationality of companies it is currently investigating anyway and of their ultimate parent companies.[38] That said, as the Commission is understaffed it will have an interest in not disclosing the procedures it uses for detection and selection of rulings as part of its monitoring powers under competition law.

6 Concluding Remarks

State aid rules are not about treating stand-alone companies and group companies alike; this is a matter that may be addressed via other legal instruments. To the contrary, the fact that group companies and standalone companies are not on a par is one of the main reasons to fill our tax laws up with anti-avoidance legislation. State aid rules are about whether anti-abuse rules are non-selective by themselves and, if so, whether they have been properly applied when called for. Though not having effective anti-abuse rules might be considered by some as a benefit granted by the State, State aid rules should not serve as their replacement. Should all Member States have effective legislation? Yes. Is state aid the way of getting there when 60 years of bilateral and multilateral negotiations could not close all loopholes to date? No.

A ruling regime offering advance clarity can be an integral part of a tax system. Even when the national rules governing the determination of transfer prices are general in nature as not to benefit group companies from the start, a price that has been calculated in line with it may still turn out to deviate from actual market prices in retrospect. If this translates into less taxable profit than a stand-alone company paying market prices, what initially seems to be a selective advantage may be something that still fits within the nature and general scheme of a tax system allowing for advance legal certainty. If the transfer price was set in deviation of acceptable practice under the rules of a Member State, it may result in selective, individual aid. In the process of proving the latter, the Commission should restrict itself to the use of comparables that would have been available to the parties to a ruling at the time the ruling was concluded (or upon periodical review thereof); this may rule out some of the data the Commission may have gathered from market participants within the EU as part of its state aid investigations.

[38] *See* Financial Times (2016).

In situations where tax treaties play a part, the Commission should first focus on how these treaties interact with national law, prior to focusing on what such a treaty prescribes. In most countries treaties do not create taxing rights, but their function is to divide and limit them. This limits their relevance from a state aid perspective.

Most likely the Commission will be able to make its case for unlawfully granted aid in a number of ongoing and recently concluded investigations in the EU's Courts, depending on the data and details it is able to provide. However, when testing the waters, the Commission should give due account of the domestic tax principles that should be at the very basis of any fiscal state aid analysis and which may be different from the principles that would reign a BEPS-free world.

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Dr. Raymond Luja is professor of Comparative Tax Law at Maastricht University and fiscal state aid counsel to Loyens & Loeff N.V. in Amsterdam.

Double Taxation Relief, Transfer Pricing Adjustments and State Aid Law

Werner Haslehner

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Abstract This contribution explores the influence of state aid law on tax measures for the provision of relief from double taxation and the consequences of its application to transfer pricing adjustments. In particular, it analyses the compatibility of measures that prevent merely virtual double taxation and transfer pricing adjustments that might result in "white income". It also reviews the merits of the Commission's claim that Member States have to apply the arm's length standard to transfer pricing adjustments as a matter of State aid law.

W. Haslehner (✉)
University of Luxembourg, Luxembourg, Luxembourg
e-mail: Werner.HASLEHNER@uni.lu

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_8

1 Introduction

This contribution explores the influence of state aid law on tax measures for the provision of relief from double taxation and the consequences of its application to transfer pricing adjustments.

The connection between the two might not be immediately apparent, as double taxation relief has so far not been at the centre of scrutiny from the perspective of state aid law, whereas recent and currently pending cases concerning transfer pricing adjustments have generated a lot of interest both in academia and in tax practice. The reason for this, it seems, lies in the different perception of the two types of measures applied by Member States: relief for taxes levied in another jurisdiction is "good" as it prevents the "evil" of double taxation, whereas (the lack of) transfer pricing adjustments are seen as an inappropriate way to unilaterally give a benefit to multi-national enterprises. Why should this be so?

The key problem of "wrong" transfer pricing adjustments seems to be the creation of potential mismatches between jurisdictions with the result of "white income" (i.e. income that is taxed in no country). The same issue exists, however, for standard methods of double taxation relief: If a residence country decides to exempt foreign income that it considers to "belong to" the source country (be it as a consequence of a tax treaty or as a unilateral measure), and that source country does not tax said income (by unilateral choice or a as a consequence of its different interpretation of the tax treaty in question), "white income" also results therefrom. Are the two cases conceptually different? Or are they conceptually similar, but there is something specific in the method of state aid control that leads to different view on these different types of measures? Or are we really only waiting for the next wave of cases where the Commission starts to investigate the granting of exemption (or indeed credit, under certain circumstances) in cases where no "other" country has imposed a tax?

One possible answer to this is that the reason for the interest in transfer pricing adjustments from a state aid perspective lies not in the substance of the legal matter, but rather in the method of decision-making, i.e. the prevalence of "tax rulings" or "Advance Pricing Agreements" (APAs) in that area, which is contrasted by the much more legally deterministic provisions concerning juridical double taxation relief. The nature of tax rulings, the special conditions for them to constitute selective aid and possible remedies through structural changes in how such rulings are prepared and rendered have been discussed already at length by other authors in this volume and will thus not be addressed again here. It is taken for granted that individual administrative decisions that provide a benefit to only a selected group of taxpayers are likely to fulfil the conditions to constitute illegal state aid. However, whether or not a selective advantage is provided to a taxpayer by means of a ruling or an APA is, in and of itself, irrelevant. Considering this, the aim of this chapter is to explore if and when conditions for state aid might be fulfilled not as a consequence of individual decisions that are at odds with generally applicable rules of domestic law, but as a consequence precisely of such generally applicable rules and principles. In particular, it will assess the validity of the Commission's apparent claim that the application of the arm's length standard is a legal requirement for Member States under state aid provisions.

The broader questions this contribution will touch upon without the hope of being able to provide a definitive answer concern the determination and allocation of income in the eyes of EU law. Can the ECJ decide what "income" is for a multinational enterprise? If so, can the ECJ decide how much of it must be taxed and in which Member State? Considering that the TFEU leaves tax law squarely within the competence of the EU Member States, it would appear challenging to answer "yes" to either question. It may nevertheless be possible to derive certain principles from EU law, such as a principle to avoid double taxation or double non-taxation under specific circumstances, but it remains questionable to what extent these can determine domestic taxation.

The following analysis consists of two parts: In the first part, it explores the relationship between double taxation relief and EU law generally and state aid law specifically, focusing on the question whether granting relief for double taxation can in itself constitute state aid. In the second part, it analyses the relationship of transfer pricing adjustments and state aid law. This second part proceeds in three separate steps. In the first step, it considers similarities and differences between measures to avoid juridical double taxation and transfer pricing adjustments from a state aid perspective. It then proceeds, in a second step, to analyse the value of the arm's length standard and the OECD Transfer Pricing Guidelines under the two approaches used in state aid cases to establish the existence of selective advantages. In a final third step, it discusses the potential importance of "white income" from a state aid perspective.

2 Double Taxation Relief and EU State Aid Law

2.1 Introduction

In EU tax law, double taxation and its avoidance have been discussed primarily through the lens of the fundamental freedoms.[1] This seems natural to international tax lawyers, as double taxation has obviously harmful consequences for the cross-border exchange of goods, services and capital[2] and thus creates a serious obstacle[3]

[1] See, e.g. Rust (2011).

[2] See Introduction to the Commentary on the OECD Model Tax Convention, paragraph 1: "Its harmful effects on the exchange of goods and services and movements of capital, technology, and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries."

[3] In the famous words of AG Colomer, "the most serious obstacle there can be to people and their capital crossing internal borders". See Opinion in C-376/03 *D*, ECLI:EU:C:2005:663, para 85.

to the achievement of the internal market the fundamental freedoms are aiming to establish and protect. It is clear that from an international tax law perspective, relief from double taxation should be the norm. Although there are several different ways to provide for such relief, these are generally considered to be equivalent with respect to their main object, the ability to avoid double taxation. Leaving aside the broader debate concerning different welfare standards and neutrality concepts supported by different methods of double taxation relief,[4] it therefore matters rather little to taxpayers which technique is employed so long as the increased burden resulting from parallel exercise of tax jurisdiction by two states is effectively avoided.

From a state aid lawyer's perspective, both the inclination to treat double taxation as a phenomenon that should primarily be analysed through the prism of the fundamental freedoms and the tendency to view relief from double taxation as the norm regardless of the method employed may not be entirely self-evident.

On the first point, it is not at all clear that state aid law could not also play a role in the assessment of double taxation relief provisions. It is well understood that state aid rules are very similar in their basic functionality and approach to the fundamental freedoms as applied to tax measures, as both address Member States rules that apply different treatment of comparable situations.[5] Differences in their scope, such as the fact that Article 107 TFEU covers only different treatment between economic operators, contains a variety of specific exceptions and that it is not limited to different treatment of cross-border situations as compared to purely domestic ones, do not affect this fundamental similarity. This raises the question how the results from existing jurisprudence on double taxation and its relief in the area of the fundamental freedoms could be relevant for the potential application of state aid rules to similar issues. This question appears difficult to answer, as the Court of Justice's case law on double taxation appears somewhat patchy, excluding instances of juridical double taxation from its scrutiny, while frequently holding Member States to account for a failure to relieve economic double taxation, and also requiring Member States to be consistent in their endeavour to provide relief. Viewed differently, however, the Court has consistently held only that "the disadvantages which arise from the parallel exercise of tax competences by different Member States do not constitute restrictions on the freedom of movement to the extent that such an exercise is not discriminatory".[6] This clearly does not amount to a complete exclusion of (juridical) double taxation from the scope of the fundamental freedoms. Indeed, the Court of Justice held that Member States, even though they are not obliged in principle to provide double taxation relief, are required to

[4] See, e.g. Desai and Hines (2003); Kane (2006); Hines (2009); Weisbach (2016); Shaviro (2014).

[5] See, e.g. Lang (2012), p. 85 at 97 et seq.

[6] For this most recent formulation, see Opinion of AG Bobek in NN (L) International (C-48/15, EU:C:2016:45, para 59, referring in particular to Kerckhaert and Morres (C-513/04, EU:C:2006:713, paragraph 20) and Damseaux (C-128/08, EU:C:2009:471, paragraph 27).

provide any such relief in a non-discriminatory manner[7] and to extend it to taxpayers in comparable circumstances to those covered by their relief provisions.[8] Double taxation is thus not out of the scope of the analysis of the fundamental freedoms, but only to the extent that it results from entirely non-discriminatory rules. The same should then be true from the perspective of state aid law. Since Article 107 TFEU lacks the equivalent to the fundamental freedoms' non-discriminatory restriction dimension, it would thus appear to be unaffected by that case law, so that it could apply unconstrained by it to discriminatory provision of double taxation relief. This means that one cannot argue that the Court's reluctance to mandate relief from juridical double taxation under the fundamental freedoms would automatically exclude double non-taxation as its flipside from scrutiny under state aid rules. Similarly, the fact that the Court accepts both exemption and credit as equivalent methods to avoid (economic) double taxation does not in itself exclude an argument that the exceptional granting of exemption rather than credit could under certain circumstances provide a selective advantage, since that equivalence is itself subject to conditions with respect to the concrete design of the mechanisms.[9]

The second point is related to the fact that state aid law is *a priori* neutral as to the desirability of certain features of tax design; it merely requires whatever tax rules normally apply under the existing regime to apply consistently to all comparable undertakings. From that perspective, it is not at all evident that provisions ensuring double taxation relief should be "immune" from closer inspection, as they could in principle apply only exceptionally and only to certain undertakings. The fact that relief from double taxation might be considered the "norm" as a matter of principle from a tax law perspective is thus not per se enough to insulate the various types of relief that can be given from any further consideration. It is necessary to analyse under what circumstances such provisions could violate state aid law and whether there are any particular obstacles to such a finding.

2.2 State Resources Affected by Double Taxation Relief

A first doubt might be related to the requirement that state aid be granted by **state resources**. If relief is provided as a consequence of the bilateral rules agreed upon in a tax treaty, it could be argued that it is not clear which country's resources are affected by the reduction in collected tax, because the rules of a tax treaty will

[7] See, e.g. De Groot (C-385/00, EU:C:2002:750).

[8] See, e.g. Manninen (C-319/02, EU:C:2004:484) for economic double taxation, and Orange European Smallcap Fund (C-194/06, EU:C:2008:289) for juridical double taxation.

[9] In particular, the Court requires the granting of a credit on the basis of the nominal corporate tax rate charged in the dividend distributing subsidiary's residence state. See FII Group Litigation (C-35/11, EU:C:2012:707, paragraph 65).

typically result in reducing the tax due in both contracting states. Similarly, countries conclude tax treaties under the assumption that it will lead to increased economic activity, which would ultimately increase the state's resources. Both arguments appear too far removed from the immediate effect of providing double taxation relief, however. Even if the reduction in tax came from both contracting states, taking an overall view of all cross-border economic activity, it would still be true that each state's resources are negatively affected by the limitation of its tax jurisdiction imposed by the treaty. The counterfactual that in the absence of a treaty, lower investment would have resulted in even lower tax revenue, cannot be proven in the abstract. At most, it might be used as an argument to limit recovery of any tax relief granted in a selective manner, if a concrete enterprise succeeds in showing that it would not have engaged in the relevant gainful activity in the absence of the availability of said relief. The standard of proof would necessarily be quite high, however.

2.3 Selective Advantage: The Reference System and the Right Comparison for Double Taxation Relief

If there can therefore be little doubt about the use of state resources in providing double taxation relief, it is less clear whether such relief can indeed amount to a **selective advantage** and under what circumstances this might be the case. It has been argued that double taxation relief can never be considered a relevant advantage for state aid purposes as it is fully in line with the general nature and scheme of an income tax system that is based on the ability-to-pay principle.[10] Although this solution has the advantage of simplicity and is naturally appealing to tax scholars, it fails to account for the diverse effects of different methods for double taxation relief apart from their avoiding of double taxation. Countries are not simply choosing between double taxation or single taxation, but face several further choices once they decide to implement a system that avoids double taxation (as arguably required by the ability-to-pay principle), such as the choice of a particular credit limitation method, matching or sparing credits, exemption with or without progression and with or without subject-to-tax condition as well as different rules on the treatment of foreign losses. This multitude of possible relief methods calls for a more elaborate analysis, as they have quite different effects for the taxpayers apart from the mere prevention of double taxation, where some methods are clearly more advantageous than others. The analysis thus should start not with the question whether double taxation relief as such provides a relevant advantage, but rather

[10] See Schön (2012a), p. 321 at 350; However, W. Schön also acknowledges that the choice between different types of double taxation relief constitutes a "borderline scenario". See also Schön (1999), p. 911 at 935.

with the **question whether there is an inconsistent manner of providing double taxation relief that applies to comparable taxpayers**, which leaves certain of them in an economically better position than others. This view is also in line with the approach taken by the Commission. It had initially indicated that provisions to prevent double taxation would normally be considered as general measures of a mere technical nature and would thus not constitute state aid as long as they applied without distinction to all firms.[11] Nevertheless, it later found the exceptional application of the exemption method for certain undertakings to constitute prohibited state aid, where the general rule for double taxation relief provided for a credit.[12]

If measures for double taxation relief do therefore fall squarely within the ambit of state aid review, how is one to assess their compatibility with Article 107 TFEU? The element of comparability has to be determined in light of the objective of the relevant tax system. When tied to the tax system as defined by one specific Member State, this **'comparability approach'** is fundamentally equivalent to the standard **'derogation approach'** to determine the selectivity of a tax measure. Under both approaches, the key element to a finding of selectivity is the **definition of the reference framework**. Under the first approach, this requires the definition of the relevant system in light of whose objectives differently treated taxpayers might be comparable[13]; under the second approach, it requires the definition of the relevant system from which a measure derogates. Applying these principles, one has to decide whether the right reference framework to analyse double taxation relief measures consists of (1) domestic law applying to domestic income (no relief from double taxation), (2) domestic law rules on foreign income (unilateral relief provisions), (3) the tax treaty network of a Member State as a whole, (4) each individual tax treaty in its entirety or (5) the provisions applied to particular foreign income under an individual tax treaty. The related question under the comparability approach is whether a resident taxpayer with foreign income that is exempt under the provisions of a tax treaty is comparable to (1) a resident taxpayer with domestic income, (2) a resident taxpayer without tax treaty protection, who is taxed on foreign income but receives a credit under unilateral relief provisions in domestic law, (3) a resident taxpayer with foreign income who is subject to tax with credit on the basis of another tax treaty, (4) a resident taxpayer who is subject to tax with credit under the same treaty earning income falling under a different distributive rule or (5) a resident taxpayer who is subject to tax with credit under the same treaty earning income falling under the same distributive rule. It is not immediately

[11] Commission notice on the application of State aid rules to measures relating to direct business taxation of 11 November 1998, OJ C 384/3 (10 December 1998), para 13.

[12] Commission decision 2003/601/EC of 17 February 2003, OJ L 204/51 (13 October 2003).

[13] For a different view, see Lang (2011), p. 593 at 598, who argues that comparability should be established based on the existence and degree of competition between the categories of taxpayers. See also Lang (2012), p. 85 at 99.

apparent how to draw the right comparison under these circumstances. Let’s look at them in turn:

(1) If the reference framework to be used were domestic law as it applies to domestic income, any relief that reduces the residence state’s tax claim would constitute a prima facie selective advantage. This will not be convincing if double taxation relief measures are generally available in situations where double taxation occurs. Under these conditions, it is equally clear that taxpayers with purely domestic income and those with foreign income are not comparable in light of the objectives of a tax system that is based on the ability-to-pay principle.

(2) The second option is more difficult to dismiss. It would compare the general rules applicable to foreign income under domestic law to those that apply exceptionally in cases covered by a tax treaty. *Luja* argues that differences in the conditions for double taxation relief and the type of relief granted in both situations are part of the nature and general scheme of a tax system, taking into account Member States’ freedom to negotiate and conclude bilateral agreements, which necessarily involves a compromise.[14] Such freedom would become meaningless if Member States were unable to derogate from their domestic law, as such derogation is the only reason to conclude such treaties. That argument corresponds to the Court of Justice’s acceptance of different rules applied to taxpayers falling under different tax treaties in the *D* case, where it held that the bilateral nature of a tax treaty rendered the situation of a person protected by a tax treaty and another person who was not so protected incomparable.[15] However, the Court’s position in that case only concerned the comparability of non-resident taxpayers, which the Court had already held would—under the circumstances of the case—not be comparable to a resident. The same reasoning cannot be as easily applied to the question at hand, which concerns the different treatment of resident taxpayers. Notably, the Court of Justice has also dismissed a claim of discrimination resulting from the application of different relief methods following the German switch-over clause in its *Columbus Container Services* judgment.[16] Yet the Court’s holding was not based on the incomparability of situations, but rather on the one-sided nature of the fundamental freedoms: since the application of the credit method was not less favourable than national treatment, no relevant discrimination could be found. By contrast, state aid rules are not limited in their scope to the comparison between domestic and cross-border situations. More beneficial treatment of cross-border situations—whether agreed in a tax treaty or granted unilaterally—falls within the scope of the state aid provisions. The bilateral nature and attendant give-and-take of a tax treaty are also not very strong arguments when

[14] Luja (2004), p. 234 at 235.

[15] D (C-376/03, EU:C:2005:424, paragraph 61).

[16] Columbus Container Services (C-298/05, EU:C:2007:754).

reviewing exceptional benefits granted by a Member State to its own residents, as the concrete method of relief for source taxation appears more often to be chosen in accordance with the preferences of each residence state rather than granted as a concession to the source state.

(3) The same arguments could also be brought forward against the comparison between taxpayers falling under different treaties, but this approach would additionally be complicated by the difficulty to determine which method of relief should constitute the relevant benchmark. Although normal tax system and exception are not generally identified on the basis of the number of taxpayers to which each applies,[17] it would not be unreasonable to take the view that the more commonly used method in tax treaties should constitute the reference framework for the taxation of a treaty protected resident's foreign income if one had to define a benchmark for the entire tax treaty network of a given Member State.

(4) Alternatively, each individual tax treaty could constitute its own reference system. Even in this instance, state aid could still arise from the application of different methods of double taxation relief to different categories of income, unless the objectives of the treaty provide an inherent justification for such distinction.

(5) Finally, one cannot escape the conclusion that taxpayers in the same circumstances with respect to all the factors that are relevant to determine tax jurisdiction under a tax treaty, that is to say the taxpayers' residence and the source and category of income earned, are comparable for purposes of state aid law. It follows that more beneficial double taxation relief granted to some of those taxpayers, for instance, based on their use of that income, would constitute state aid.[18]

2.4 Equivalence of Relief Methods?

According to this analysis, any of the proposed comparisons in (2)–(5) are potentially relevant. Whichever view one follows, it does not in itself take away a Member State's power to apply different relief methods, however. First, it is certainly possible to find specific system-inherent justifications for distinctions made in different tax treaties in many cases. Second, the analysis so far is based on the assumption that certain types of relief can be considered more beneficial than

[17] See Lang (2011), p. 593 at 596; Haslehner (2012), p. 301 at 317. For a different view, see Flett and Walkerova (2008), p. 223 at 228.

[18] Such was essentially the finding of the Commission in its decision 2003/601/EC of 17 February 2003, OJ L 204/51 (13 October 2003) concerning the exceptional application of the exemption method to foreign dividends that are reinvested in Ireland.

others from a state aid perspective. It has been using the distinction between the credit and the exemption method as an example. But it still has to address the argument that both methods might indeed be considered to be equivalent, arguably mirroring the position taken both by the Court of Justice[19] and secondary EU law[20] in the context of relief from economic double taxation. Both credit and exemption lead to the same result for both taxpayer and Member State if source and residence state impose equivalent tax rates on the taxpayer's income. As a finding of state aid should not depend on the vagaries of tax rate changes by other countries, it is reasonable to make the existence of equivalent tax rates a necessary simplifying assumption for purposes of assessing the validity of the relief provisions. Any advantage accruing to the taxpayer as a consequence of a tax rate mismatch would then not be attributed to the residence state and could be ignored. Such approach would notably coincide with the Court of Justice's view on tax system disparities in the context of the fundamental freedoms.[21] However, the Court of Justice could make the acceptance of different methods of juridical double taxation relief contingent on certain design features, in the same way as it predicates the equivalence of credit and exemption in the context of inter-company dividend taxation on the condition that credit is provided on the basis of the source country's nominal rate.[22] **Systematic overcompensation in particular should trigger warning lights**. This will certainly be the case where a Member State exceptionally grants tax-sparing credits, which are designed to keep tax incentives granted by the source country intact. If the benchmark for comparison is the application of the ordinary credit method, this could provide an unjustified advantage to taxpayers who exceptionally benefit from it.[23] More controversially, the exemption method might be considered to be prone to systematic overcompensation as measured against its own primary objective (to avoid double taxation), if it applied without distinction to cases of virtual and actual double taxation.[24] Such result would be based on a breach of the tax system's internal logic: if exemption itself were a deviation from normal taxation that is justified by the ability-to-pay principle, the provision of relief in cases where no double taxation exists would constitute an inconsistency in light of the tax system's general principles. **A strict application of this view might require Member States to include subject-to-tax clauses in all of its treaties.** Such a view is certain to run into strong objections from Member States with a tradition of exempting foreign income. One counterargument to such

[19] *Supra* Section 2.1.

[20] Cf. Art. 4 Parent Subsidiary Directive.

[21] See Gilly (C-336/96, EU:C:1998:221, paragraph 34).

[22] See FII Group Litigation (C-35/11, EU:C:2012:707, paragraph 65).

[23] Luja considers both tax sparing and matching credits, finding the former more problematic as their objective is indeed to maintain incentives for investment without any real justification based on the need to avoid double taxation, whereas the latter provide relief at a standard rate that may over- but can also undercompensate. See Luja (2004), p. 234 at 236.

[24] Luja (2004), p. 234 at 236.

objections is that this analysis requires nothing more than consistent treatment of foreign income, and merely objects to the exceptional exemption of certain foreign income where such cannot be justified on the basis of the ability-to-pay principle. However, in light of their competence to negotiate bilateral tax treaties, the standard of consistency required from Member States' tax systems should not be set too high.

2.5 A Higher Standard of Selectivity to the Member States' Rescue?

In addition to this last objection to mandatory subject-to-tax clauses, a further argument to the rescue of Member States' freedom to apply different methods of relief comes from the **criterion of specificity**. Following the General Court's judgments in Autogrill[25] and Banco Santander[26] and AG Kokott's analysis in Finanzamt Linz,[27] increasing weight appears to be put on a requirement for beneficial rules not only to constitute derogations from the general system, but also for them to identify their beneficiaries as a privileged group of enterprises on the basis of characteristics that are specific to them. In light of this, it is questionable whether the application of a more beneficial mechanism for double taxation relief granted to all taxpayers protected by a particular tax treaty as compared to taxpayers whose income falls under another (or no) tax treaty is sufficient to identify those taxpayers as a distinct group of beneficiaries, if any undertaking could avail itself of the same benefit by engaging in gainful activity protected by that treaty.[28] The standard is not yet settled, however. Notably, AG Wathelet has rejected the General Court's approach in his recent Opinion on the appeals in both cases, holding that no specific category of undertakings needs to be identifiable from a legal regime for it to grant a selective advantage.[29]

[25] Autogrill España (T-219/10, EU:T:2014:939, paragraph 52 et seq).

[26] Banco Santander and Santusa (T-399/11, EU:T:2014:938, paragraph 56 and seq).

[27] See Opinion of AG Kokott in Finanzamt Linz (C-66/14, EU:C:2015:242, paragraph 108 et seq) referring to Gibraltar (C-106/09 P and C-107/09 P, EU:C:2011:732, paragraph 104): "[T]he criteria forming the basis of assessment which are adopted by a tax system must also, in order to be capable of being recognised as conferring selective advantages, be such as to characterise the recipient undertakings, by virtue of the properties which are specific to them, as a privileged category".

[28] Luja answers this question in the affirmative, considering investors in a specific country to be a sufficiently selective group for purposes of Article 107(1) TFEU. See Luja (2004), p. 234 at 236.

[29] Cases C-20/15 P and C-21/15 P, EU:C:2016:624, paragraph 84 et seq.

3 Transfer Pricing Adjustments and State Aid Law

3.1 Introduction: Transfer Pricing Adjustments as Coordination Measures to Avoid Double Taxation

Transfer pricing adjustment rules share some similarity with the relief provisions discussed so far. Their primary purpose is to ensure the proper allocation of profits to tax jurisdictions in line with the criteria agreed upon in a tax treaty. Additionally, they also aim to avoid double taxation by aligning otherwise unilateral transfer pricing adjustments with a common standard for both contracting states.[30] A notable difference to the previously analysed relief methods is that this concerns instances of economic double taxation rather than juridical double taxation. It is debatable whether this difference matters for the analysis of the rules from a state aid perspective. On the one hand, both the Commission and the EU Courts consistently hold that state aid analysis has to be carried out based on the economic effects of a measure regardless of their legal form. It is clear that the distinction between juridical and economic double taxation is a mere technicality based on the difference between opaque and transparent entity structures. The distinction thus should not be of relevance. On the other hand, since the distinction between opaque and transparent entities is fundamental to direct taxation systems, it would seem fanciful to suggest that the granting of relief from economic double taxation in a cross-border situation (as required by the Court of Justice's case law[31]) constituted a selective benefit in the absence of relief from juridical double taxation for a company's foreign permanent establishment profits. Considering the fundamental differences between both types of legal structures under domestic laws, it seems more appropriate to extend the Court's approach in its fundamental freedoms case law to consider them incomparable from the home state's perspective[32] to the area of state aid law. Relief provisions for the different types of double taxation thus do not have to be necessarily aligned. Nevertheless, the analysis for both remains substantially the same.

From a state aid perspective, a specific question arising for the discussion of economic double taxation relief is whether there is only "one correct way" of adjusting transfer prices for multinational enterprises. The Commission appears to take that view and effectively require Member States to follow the arm's length standard for the determination of their taxable profits. It is debatable, however,

[30] See Art. 9(2) OECD Model Tax Convention concerning mandatory corresponding adjustments.

[31] See, e.g. Manninen (C-319/02, EU:C:2004:484), FII Group Litigation I (C-446/04, EU:C:2006:774), Meilicke (C-292/04, EU:C:2007:132), Haribo and Salinen (C-436/08 and C-437/08, EU:C:2011:61), Meilicke II (C-262/09, EU:C:2011:438), FII Group Litigation II (C-35/11, EU:C:2012:707).

[32] See, e.g. Bosal (C-168/01, EU:C:2003:479, paragraph 32), Columbus Container Services (C-298/05, EU:C:2007:754, paragraph 51 et seq), X Holding (C-337/08, EU:C:2010:89, paragraph 40).

whether state aid law requires the application of the arm's length standard to multinationals. First, the standard is itself increasingly controversial in the international tax law debate, not only because of technical difficulties of determining its content in practice, but also because of its significant theoretical shortcomings.[33] Second, even if it were a sound principle to allocate tax burdens in a bilateral setting, the standard approaches to determine state aid under Article 107(1) TFEU does not rely on a comparison of a Member State's tax system with an international standard. The consistent implementation of another method to determine the taxation of multinational enterprises by any Member State must be accepted by the Commission, unless such other method can be shown to be inherently biased to the benefit of certain undertakings.

Further questions arise from such initial doubts: if two Member States agree on a common approach to allocate profits of an enterprise that operates in both jurisdictions, it would seem odd to consider the resultant delineation of tax bases subject to scrutiny by state aid rules. Under the assumption of equivalent taxation in both Member States, no benefit would accrue to that enterprise as a whole regardless of any tax base shifts between them. In principle, this result is the same as under the application of the credit method with respect to juridical double taxation. One Member Sate might be required to tax on a lower base compared to that which its domestic law would set as a consequence of a corresponding adjustment in line with Article 9(2) OECD Model Tax Convention. To the extent that one might consider such reduced taxation in that Member State an advantage to the enterprise, it would then also be justified by nature and general scheme of the tax system based on the ability-to-pay principle and its attendant predisposition against double taxation. It is not clear whether the coordination with the other country changes the situation, however. The same justification would be applicable if a corresponding measure were taken unilaterally to avoid double taxation of an enterprise.

As with unconditional relief for virtual double taxation discussed above, the situation may be different where a Member State grants downward adjustments to its tax base that are not matched by upward adjustments in another country. Subsequent partial non-taxation or "white income" might thus be indicative of state aid.[34] However, not every instance where income remains partially untaxed in a cross-border setting can be tackled by state aid rules. Where white income results from genuine mismatches of—in themselves coherent—different tax systems in two Member States, no aid arises, since it cannot be shown that either State suffered a reduction in tax revenue.[35]

By contrast, the Commission appears to defend the position that the arm's length standard is the only correct way of allocating profits to companies that form part of a multinational enterprise. For that to be true in all circumstances, a lower tax burden applying to a single company of an international group would be sufficient

[33] See, e.g. Brauner (2013), p. 387; Schön (2012b), p. 47 at 53 et seq.; Wilkie (2012), p. 137.

[34] See Rossi-Maccanico (2015), pp. 63–77. See also further *infra* 3.4.

[35] Cf. Lyal (2015), p. 1017 at 1043.

to find state aid, even if no advantage accrued to the group as a whole.[36] The rest of this contribution will review this position in light of the principles of state aid law and the Court of Justice's approach. It analyses the potential relevance of the arm's length standard under two alternative views: first, it could be binding on Member States as the benchmark set by its own domestic law. Taxation of companies in line with the arm's length standard would, under this view, be the correct reference system to determine a selective advantage. Under the second view, the arm's length standard is mandatory regardless of the internal law of a Member State because a corporation tax only treats legally and factually comparable taxpayers in a consistent manner if it is based on that principle. These two views broadly coincide with the two approaches discussed for the application of state aid rules to tax law, and will be discussed in turn below.

3.2 The Arm's Length Standard as Part of Domestic Law (Reference System Approach/Derogation Test)

Under the standard approach taken for state aid review in tax cases, Member States are bound to apply their tax rules consistently in light of the general tax system in question. The first step on the road to find illegal state aid has thus traditionally been for the Commission to define the "reference system", against which a concrete measure could be tested. If such measure represents a deviation from that reference system and, in addition, resulted in a lower tax burden for the taxpayer than if that measure had not existed, the Commission would find a selective advantage, leaving only the question as to whether such advantage might be justified by the system's internal logic. The search for the right reference system can be a very difficult task, the outcome of which largely determines the outcome of the state aid investigation. The question is whether the general system of taxation, applicable to all undertakings that are subject to that tax, requires a determination of profits in line with the arm's length standard. One has to be careful not to simply assume such to be the case, however. In particular, the standard inclusion of an equivalent to Article 9 OECD MC in a Member State's tax treaties does not by itself warrant the conclusion that the arm's length standard is a necessary general element of that state's tax system. Not only is that provision not self-executing and thus does not, by itself, result in any transfer pricing adjustments, it is indeed not meant as a legal basis for such adjustments, but, in fact, acts as a barrier to prevent adjustments

[36] It is worth noting that this effectively mirrors the Court of Justice's approach to transfer pricing under the fundamental freedoms, which leaves the Member States free to allocate taxing rights among themselves, but limits their unilateral allocation of (excess) profits to companies. While, on the one hand, double taxation is not in itself a problem, discriminatory transfer pricing adjustments for one company are not justified by the absence of resulting double taxation because of a corresponding adjustment for another company. See Schön (2015), p. 417 at 422; also Schön (2013), p. 73 at 83 et seq.

beyond the arm's length standard.[37] It may thus well be that a Member State's general tax system is indeed based on a more onerous approach towards associated enterprises and only deviates therefrom in special cases where a tax treaty so requires.[38] In this case, an immediate conclusion would appear to be that the Member State's refraining from such higher adjustments only in cases where a tax treaty so provides might constitute state aid, especially if the same rule were not applied in all tax treaties. Under such circumstances, then, taxation in line with the arm's length standard could violate EU rules on the prohibition of state aid, unless this departure from the reference system could be found justified by the nature or general scheme of the tax system. Such justification might be argued to arise from the need to prevent double taxation and the subsequent need to adjust to internationally accepted standards concerning the allocation of profits to multinationals. However, the same reasoning could also be used to justify a departure from the arm's length standard in situations where another State (regardless of whether it is a Member State or a third State) exercised its tax jurisdiction beyond what would be considered to be in line with the arm's length standard.[39]

However, even if the arm's length standard is not explicitly part of the domestic legal framework, it might be so implicitly, as a consequence of the common interpretation of the existing rules. If, therefore, the arm's length standard is considered to be a general principle applied by the tax administration when interpreting the statutory rules, it might equally be part of the reference system. This possibility is what the Commission clearly has in mind when it defines a selective advantage in its recent decisions concerning Advance Pricing Agreements:

> While tax rulings that merely contain an **interpretation of the relevant tax provisions without deviating from administrative practice** do not give rise to a presumption of a selective advantage, rulings that deviate from that practice have the effect of lowering the tax burden of the undertakings concerned as compared to undertakings in a similar legal and factual situation. To the extent the Luxembourgish authorities have deviated from the arm's length principle as regards the contested tax ruling, the measure should also be considered selective.[40]

This assessment is clearly based on the assumption that the domestic law of Luxembourg itself is based on the arm's length standard, or, at the very least, that the arm's length standard is the guiding principle of interpretation of that law in practice. This may be true in principle; but, as the arm's length standard is not very precisely defined, but leaves a rather wide range of possible ways to implement it, a

[37] See Kofler (2015).

[38] Consider e.g. the case of adjustments made in Germany on the basis of formal criteria: this, although originally based on case law of the BFH on transactions between (domestic) closely connected persons and maintained as a basis for adjustment for cross-border intra-group relationships, has been found by the BFH to violate the arm's length principle. The BFH thus limits its application to situations that are not covered by a tax treaty.

[39] See the arguments concerning corresponding adjustments contrary to the arm's length standard, *infra* 3.4.

[40] Preliminary Decision SA 38944 (Amazon), paragraph 78 (emphasis added).

Member State may apply that principle in various different ways in practice. The arm's length standard does not provide a single correct answer to the question how profits of an MNE should be allocated. Two countries may come to different results despite both relying on the arm's length standard. While this highlights the difficulty of applying the arm's length standard as a useful benchmark to establish a "selective advantage", it does not suffice to discount the theoretical possibility of relying on such an approach. But it argues for a cautious approach to finding administrative decisions of competent national authorities to be incompatible with their own practice. Where both such practice and a derogation therefrom can be clearly shown (and the burden of proof should normally fall on the Commission in this respect[41]), the conclusion that the state has granted a special advantage cannot be easily escaped. Just exactly how that can be *clearly* demonstrated, remains a problem.

As a first approximation, the Commission aims to solve this by using the OECD Transfer Pricing Guidelines to close in on a precise meaning of the arm's length standard, although it acknowledges that the "*OECD Guidelines can result in a wide range of outcomes as regards the amount of the taxable basis*"[42] and even suggests that compliance with these guidelines might not in itself (always) guarantee an acceptable outcome from a state aid perspective.[43] It is partly a separate question whether the OECD Transfer Pricing Guidelines can act as an appropriate basis to assess the existence of a selective advantage granted to certain undertakings. It is separate to the extent that they may be part of the domestic legal system of a Member State, if they have been incorporated or acknowledged in a way that shapes the general tax system.[44] In that case, regardless of whether the arm's length

[41] It should be noted that, in its recent (preliminary) decisions concerning the cases of Amazon, Fiat and Starbucks, the Commission has not substantiated what the correct application of the law would have been; it merely raised doubts as to whether the Member State has done enough to ensure that its laws (as interpreted consistently in its own practice) have been applied correctly by the taxpayers calculation of transfer prices. This effective reversal of the burden of proof seems prima facie problematic; upon closer inspection, it may not be so: if, as in the Amazon case, the very existence of a transfer pricing study is in doubt, although such would normally be required under domestic law for such cases, this may well justify such reversal. By contrast, the mere fact that an existing study had been approved within a certain (short) period of time can hardly be considered to be a "smoking gun" equivalent to that case and thus exonerate the Commission from the need to substantiate its objections to the content of that study.

[42] Preliminary Decision SA 38944 (Amazon), paragraph 55; see also Preliminary Decision SA 38375 (FFT), paragraph 62.

[43] Preliminary Decision SA 38944 (Amazon), paragraph 55: "*Moreover, depending on the facts and circumstances of the taxpayer, not all methods approximate a market outcome in a correct way. When accepting a calculation method of the taxable basis proposed by the taxpayer, the tax authorities should compare that method to the* ***prudent behaviour of a hypothetical market operator****, which would require a market conform remuneration of a subsidiary or a branch, which reflect normal conditions of competition*". (emphasis added)

[44] Note Simmons & Simmons Report (study on behalf of the European Commission on Administrative Practices in Taxation, 1999): "We found that **few countries have explicitly adopted the OECD guidelines** (the UK has incorporated the guidelines into domestic law), **but a majority of**

standard as such is itself a part of the reference system, the OECD Transfer Pricing Guidelines would themselves form a benchmark as part of that reference system. This includes situations where they form the basis of transfer pricing adjustments as a practical matter in "normal" cases, for instance, as a consequence of a reference to them in administrative regulations or directives. The OECD Transfer Pricing Guidelines are also used in practice to fill the arm's length standard with life through national guidelines that closely resemble them. To the extent that they actually overlap, such approach will clearly make them part of the "reference system", as the Commission argued in its Amazon decision:

> [. . .] an approval of a transfer pricing arrangement which does not reflect a market outcome and which favours a particular undertaking must be considered as prima facie selective, the selective treatment deriving from a deviation or misapplication of the **arm's length principle, as set out in** the OECD Model Tax Convention and **the OECD Guidelines and incorporated in national law pursuant to Article 164 LIR**.[45]

If that is indeed the case for a particular Member State, it seems difficult to object to the Commission's reference to the OECD Transfer Pricing Guidelines as a useful benchmark to examine the existence of a selective advantage. Their use would be much less easily justified, however, if no such direct reference to them existed in domestic law or administrative practice. Accepting the OECD Transfer Pricing Guidelines as a benchmark simply because they form an "internationally agreed standard"[46] would be unconvincing, as it would be tantamount to requiring Member States to shape their tax systems upon a standard that is not only of questionable origin concerning its legitimacy,[47] but also constantly changing—in blatant disregard of the principle that they remain free to set their own tax laws.

It were more easily acceptable to see the OECD Transfer Pricing Guidelines as but one embodiment of the arm's length standard, which may thus at most act as a starting point to assess a national measure as to its consistency with that principle.

Member States either follow the guidelines, or adopt an approach consistent with them. Greece, Ireland and Luxembourg do not appear to do so, and the approach taken in Finland and France amounts to only a partial adoption of the guidelines. Sweden applies OECD principles, but in many cases in an inappropriate manner. Many countries follow OECD principles but will not accept secondary methods of profit determination (Belgium and the Netherlands being examples of this)." (emphasis added)

[45] Preliminary Decision SA 38944 (Amazon), paragraph 60 (emphasis added).

[46] The Commission seems to go into that direction in the beginning of its (preliminary) decisions: see e.g. Preliminary Decision SA 38944 (Amazon), paragraph 11: "The internationally agreed standard for setting such commercial conditions between companies of the same corporate group or a branch thereof and its parent company and thereby for the allocation of profit is the 'arm's length principle' as set in Article 9 of the OECD Model Tax Convention."

[47] The OECD TPG are, as the work of the OECD generally, the result of work done by experts with different background, but ultimately agreed upon by the official representatives of the OECD Member States in the Fiscal Committee. These are government representatives who exercise their function in this international forum entirely unconstrained by any influence of their national legislatures as the competent authority to decide on direct tax matters.

This view can also find support in the Commission's decisions on the matter, although it does not seem to consistently adhere to it:

> The OECD Guidelines are a reference document recommending methods for approximating an arm's length pricing outcome and have been retained as appropriate guidance for this purpose in previous Commission decisions.[48]

As an interim conclusion, if the Commission were to confine itself to the "standard approach" of the national reference system to find a selective advantage, it would be unable to find any derogation from the arm's length standard to constitute state aid in cases where that standard cannot be said to have been implemented in any way or form as part of domestic law.

3.3 The Arm's Length Standard as an Independent Benchmark (Hypothetical Reference System/ Comparability Approach)

The Commission does not seem to see a need to confine itself to this aforementioned approach, however, although some of its decisions appear somewhat equivocal about whether it could do so in the cases it had to decide. It is well known that the Court of Justice has, in its *Gibraltar* judgment, found a way out of the restrictive requirements of using a national reference system to identify a selective advantage. Rather, the ECJ accepted the finding of different treatment of a certain category of companies (in casu: "offshore companies") as compared to others, where both categories of companies were in comparable circumstances in light of the objective of a general tax system for all companies, to be sufficient to accept the existence of a state aid granted to the exempt category of companies. This approach can be used in a much broader manner as it allows the Commission to effectively assume a certain "normal" tax system, which it derives from elusively defined "objectives of the tax system", giving it vast power to reinterpret and tamper with domestic tax policy decisions.[49] Indeed, in *Gibraltar*, the Court superposed the objective to "introduce a general system of taxation for all companies established in Gibraltar"[50] on the

[48] Preliminary Decision SA 38944 (Amazon), paragraph 55; see also Preliminary Decision SA 38375 (FFT), paragraph 62; see also [Commission Decision 2003/755/EC of 17 February 2003 on State aid C 15/02, Belgian Coordination centres, OJ L 282, 30.10.2003, p. 55, recitals 89 to 95 and Commission Decision 2003/512/EC of 5 September 2002 on State Aid C 47/01, German Coordination Centres, OJ L 177, 16.07.2003, p. 17, recitals 27 and 28.

[49] Cf. Lyal (2015), p. 1017 at 1039: "More general application of the Court's approach in *Gibraltar* would be problematic: it would require careful determination of the basis of comparison and an assessment of the legitimacy of differentiation. In other words, it would require potentially far-reaching intrusion in the tax policy of Member States."

[50] Commission and Spain v. Government of Gibraltar and United Kingdom (C-106/09 P, EU: C:2011:732, paragraph 101).

actually created system in order to find that all companies so established would be in a comparable situation in light of that objective, even though it has nowhere been stated (nor was it obvious from the way the various taxes were designed) that this would indeed be the objective. In fact, a more appropriate description of the system's objective would have been to "create a tax system for all companies *with physical presence* in Gibraltar". In light of that objective, offshore companies would clearly *not* be comparable to companies with physical presence there.[51]

In its earlier decisions, the Commission appeared to be hesitant about its approach. It typically started with the claim that the determination of an advantage required comparing the method of profit calculation applied to a MNE *"to the ordinary tax system, based on the difference between profits and losses*[52] *of an undertaking carrying out its activities under normal market conditions"*.[53] This could be understood as an attempt to ascertain the actual "ordinary tax system" of the Member State under scrutiny as a point of reference, with an ensuing search for a derogation in the tax base calculation used under the specific circumstances concerning a certain taxpayer.[54] But in fact, that is not what the Commission was looking for: instead, it examined whether the tax system[55] of a Member State took measures to respond to the different situation groups of companies find themselves

[51] The ECJ thus seemed to employ a similar strategy to the one uses in its case law on economic double taxation, where it ignores certain elements of a Member State's goals with a certain tax measure: in *Manninen*, the ECJ held the relevant objective of the tax credit system was merely to "avoid economic double taxation" and thus easily found comparability between income derived from domestic companies as compared to income derived from foreign companies, as both could be subject to economic double taxation. The ECJ thus ignored the real objective of the system, which was to avoid economic double taxation occurring as a consequence of Finland's own taxation. This approach may be sound in substance if it can be shown that the "real" objectives of a Member State are themselves contrary to the internal market, but the ECJ did not undertake that analysis and simply re-interpreted the national tax systems underlying principles.

[52] Note: "the difference between profits and losses" does not make much sense, and should be explained as a mere mistranslation from the original French "la différence entre les produits et les charges" which rather means "the difference between receipts and costs", i.e. a simple calculation of commercial profits.

[53] E.g. Preliminary Decision SA 38944 (Amazon), paragraph 53; see also Preliminary Decision SA 38375 (FFT), paragraph 60.

[54] One should note that finding such derogation, e.g. with respect to the profit allocation of companies that form part of an international group, would not necessarily result in a finding of prohibited aid, as such derogation could be consistent with the nature or general scheme of the tax system. A tax system may legitimately distinguish between domestic and cross-border situations because of the need for coordination with the tax jurisdiction of other countries; see the discussion above concerning the potential different treatment under different relief mechanisms to the extent that they lead to double taxation relief. I shall revisit this issue again below when discussing the search for the right comparator.

[55] As explained above, the fact that the concrete cases before the Commission relate to individual tax rulings appears to be of little import: there is no reason to believe that the Commission would take a different view if the treatment of the multinational enterprises under scrutiny were fully compatible with the tax rules laid down in domestic law.

in as compared to independently operating entities, because the former, but not the latter, are in a position to manipulate prices and thus their accounting profits. As the Commission stated in its *Amazon* decision:

> When accepting a calculation method of the taxable basis proposed by the taxpayer, the tax authorities should compare that method to the **prudent behaviour of a hypothetical market operator**, which would require a market conform remuneration of a subsidiary or a branch, which reflect normal conditions of competition.[56]

The Commission's reliance on an "EU arm's length principle" independent from the OECD rules and domestic regulations on transfer pricing has now become most clear from is formulation in its decision on the Belgian Excess Profit Regime, where it noted:

> The arm's length principle therefore necessarily forms part of the Commission's assessment under Article 107(1) of the Treaty of tax measures granted to group companies, independently of whether a Member State has incorporated this principle into its national legal system and in what form.
>
> … the arm's length principle that the Commission applies in its State aid assessment is not that derived from Article 9 of the OECD Model Tax Convention and the OECD TP Guidelines, which are non- binding instruments, but a general principle of equal treatment in taxation falling within the application of Article 107(1) of the Treaty, which binds the Member States and from whose scope the national tax rules are not excluded.[57]

Underlying this approach is thus really a comparison (and assumption of comparability) of independently acting undertakings and such entities that also (or exclusively) transact with associated enterprises. As the former (necessarily) transact at market prices, a tax system that calculates taxable profits to consist of the result of receipts minus costs as achieved in a free market (i.e. based on such market prices), must in turn apply measures to ensure that a comparable measure of profit is applied to companies that do not (necessarily) transact at market prices. The Commission supports this (implicit) comparison with the Court of Justice's endorsement of this approach in its decision concerning Belgian Coordination Centres.[58] This certainly appears to be sound, if the pair of comparison is and has to be that described, taking, as the Court suggests, the objective of the tax system as a whole as the relevant starting point. It also seems to match perfectly with the idea of the arm's length standard, which is why the Commission can complete the circle to this with stating:

[56] E.g. Preliminary Decision SA 38944 (Amazon), paragraph 55; see also Preliminary Decision SA 38375 (FFT), paragraph 62 (*emphasis added*).

[57] Decision SA 37667, published 4 May 2016, paragraph 150.

[58] ECJ C-182/03 and C-217/03, Belgium and Forum 187 v. Commission, ECLI:EU:C:2003:385, paragraph 95: "Pour examiner si la détermination des revenus imposables, telle que prévue dans le régime des centres de coordination, procure un avantage à ces derniers, il y a lieu, comme le suggère la Commission au point 95 de la décision attaquée, de comparer ledit régime à celui de droit commun fondé sur la différence entre produits et charges pour une entreprise exerçant ses activités dans des conditions de libre concurrence".

> In this context, market conditions can be arrived at through transfer pricing established at arm's length.[59]

Yet it is debatable whether this comparison is indeed appropriate. Prior to this, however, two problems with the Commission's reasoning merit separate scrutiny.

First, the Commission is not entirely clear (at least in its preliminary decisions) as to what comparison it suggests, and states that the advantage from a tax base calculation that is not at arm's length *"provides the taxpayer with a more favourable treatment as* ***compared to other companies which are in a similar factual and legal situation****. Those companies are* ***either domestic****, i.e.* ***non-multinational companies*** *whose taxable profit is calculated on the basis of the difference between a company's income and charges* ***or****, if they are* ***multinational companies****, their taxable profit is derived at on the basis of a correct application of the arm's length principle."*[60] Thus, the Commission leaves it open whether the taxpayer in question should be compared to a domestic group company or to another multinational. Yet both comparisons are flawed in the context of the "comparability approach". The first comparison because a company that is a member of a domestic group of companies obviously faces the same opportunities to manipulate its prices in transactions with other group companies; it might not face the same incentives to do so, although effective tax rates can also differ for companies of a domestic group, but it is clear that the profits as calculated by a simple subtraction of costs from receipts where both are from transactions with associated enterprises will not reflect "normal market conditions". What is more, Member State may generally reserve the application of strict transfer pricing rules to cross-border situations and are not obliged to impose similar adjustments on purely domestic groups. If domestic groups and cross-border groups were comparable 'in light of the objective of the tax system', that different treatment would result in prima facie advantage provided to companies that deal solely with domestic associated enterprises. It is unlikely that this would result in a finding of actual state aid, however: as the Court accepts the application of (strictly proportionate!) transfer pricing rules to be confined to cross-border situations within the scope of the fundamental freedoms,[61] it would probably also find such differential treatment to be justified by the nature and general scheme of the tax system. In the absence of a need to allocate profits properly to taxpayers in line with an agreed allocation of taxing rights vis-à-vis other countries, there is no reason to require transfer pricing adjustments in the case of purely domestic transactions, which is entirely logical and consistent.[62] This only

[59] E.g. Preliminary Decision SA 38944 (Amazon), paragraph 54; see also Preliminary Decision SA 38375 (FFT), paragraph 61.

[60] E.g. Preliminary Decision SA 38944 (Amazon), paragraph 60.

[61] See e.g. SGI (C-311/08, EU:C:2010:26).

[62] One might also be tempted to argue that there can be no "aid" in that case because the State does not renounce any resources: any tax forgone from one member of the group would be collected from another member of the same group. For this to be true, however, it is necessary to look not at the individual company, but rather the group as a whole. If not the group, but the individual company is the taxpayer under the corporate tax system, such an approach does not seem

serves to show, however, that a comparison between an international group and a purely domestic group makes little sense in the first place.[63] The second comparison, between two multinational enterprises, seems more straightforward. However, it only makes sense if the Member State in question actually applies the arm's length standard to certain companies; it fails where the arm's length standard is simply not part of domestic law. But if it is, then there is no need for the use of the "comparability approach" at all, as it would be easy to identify the application of the arm's length standard as the domestic reference system and the lack of its application in certain circumstances as derogation therefrom.

Second, the Commission treads on treacherous terrain with its reference to a "prudent hypothetical market operator", who *"would not accept that its revenues are based on a method which achieves the lowest possible outcome if the facts and circumstances of the case could justify the use of other, more appropriate methods"*.[64] This could be stating the obvious, namely that an arm's length profit needs to be determined by the use of appropriate methods and comparables, in which case there was no particular reason to refer to the concept of a prudent *hypothetical* market operator; it might also signify, however, something different: potentially a deviation from the OECD Transfer Pricing Guidelines, which rely on "actual comparables" and shy away from mere "hypotheticals".[65] It has been suggested that the concept bears resemblance to the "market economy investor principle", which is used to assess the Member State's behaviour allegedly as private investors.[66] However, there is no clear link between the two other than a certain similarity in the criteria applied to the assessment of "market-like" (i.e. exclusively self-interested) behaviour. The more interesting question is whether the concept indicates a deviation from the way the OECD interprets the arm's length standard. It would not be convincing to argue that the arm's length

warranted: Theoretically, any resources the State uses to provide "aid" to a certain entity have to be collected elsewhere—in the absence of any productive market activity of the State, necessarily from another taxpayer. If we were to look beyond the concrete taxpayer to define the "renunciation of revenue", we would thus never find any aid. Practically, the distinction between taxpayers matters: the tax not collected from one entity may not be collectible from the other entity, e.g. because it is insolvent; also, transfer pricing manipulation may be used domestically to offset losses and thus defer taxation, which would again result in a reduction of tax revenue.

[63] In fact, the "justification" with the "nature and general scheme of the tax system" makes similarly little sense as it merely repeats the exercise already undertaken in the comparability analysis. This is notably different from the situation under the fundamental freedoms: there, the ECJ (also) accepts justifications which lie "outside" the internal logic of the system in question, whereas it only looks for "internal" justifications applying state aid rules (cf. Commission State Aid Draft Notice at paragraph 138; see also Paint Graphos (C-78/08, EU:C:2011:550, paragraph 69).

[64] E.g. Preliminary Decision SA 38944 (Amazon), paragraph 55; see also Preliminary Decision SA 38375 (FFT), paragraph 62.

[65] See Bullen (2011), p. 335.

[66] See Gunn and Luts (2015), p. 119 at 123.

standard is a relevant benchmark for state aid analysis simply *because* it is a widely accepted international standard. Rather, the arm's length standard as understood in international tax law is only incidentally the "correct" standard from a state aid perspective, despite the fact that the objectives of the OECD on the one hand and the EU rules on state aid on the other hand are quite different: the former aims to achieve a generally acceptable measure to allocate profits between sovereign countries torn between interests of competition and coordination; the latter aims to protect (or rather: create) an internal market in which Member States do not subsidize certain enterprises and thus distort free market outcomes. It is thus perfectly possible (although it appears unlikely in practice) that the EU law concept of the arm's length standard for purposes of state aid review deviates from the arm's length standard as proposed by the OECD Transfer Pricing Guidelines.[67] Indeed, the reference to a *hypothetical* private market operator seems to echo not so much the OECD Transfer Pricing Guidelines as the concept of the "hypothetical arm's length comparison" (*hypothetischer Fremdvergleich*) carried out under Germany's § 1 III AStG, which entails the determination of transfer prices on the basis of what two hypothetical prudent and diligent directors (*"ordentliche und gewissenshafte Geschäftsleiter"*) would have accepted in a fully-transparent negotiations. This approach, which appears sound in principle, is easily criticized on the basis that it does exactly not reflect true market behaviour, not least because true markets are not characterized by complete information symmetry.[68]

Returning to a more general reservation about the Commission's approach, is the comparison between companies that engage in cross-border transactions with other members of one multinational enterprise and companies that engage in cross-border transactions with independent contracting partners the correct one? When measured against the alternatives, this ought to be answered in the affirmative. Since the arm's length standard is designed specifically for a problem that occurs in cross-border situations, it makes little sense to involve a purely domestic taxpayer in the comparison. Similarly, while trying to determine the independent normative value of the arm's length system under state aid law, it is not useful to compare two multinationals where one is exceptionally not subjected to its more rigorous rules. It follows naturally therefrom that the correct comparison should hold everything else equal apart from the source of the potential distortion of competition, which is the possibility to reduce the tax burden through the application of non-market price transactions that follows from membership in an international group.

However, the choice of this pair of comparison does not mean that the arm's length standard provides the only right measure of profits for a company that is part of an international group. It is not certain that independent companies are truly in

[67] This notwithstanding the fact that recent developments surrounding the BEPS debate raise questions as to the sustainability of the arm's length standard, as various suggestions for changes to the Transfer Pricing Guidelines seem to signify effective derogations from its content.

[68] See e.g. Eigelshoven (2015).

similar legal and factual circumstances with companies that are members of a group of companies. This needs to be assessed separately. Two views appear prima facie relevant to such assessment: an "economic" or a "doctrinal" perspective. The economic approach, in short, posits that the arm's length standard is not the correct standard to assess the profits of a member of a group, as it necessarily ignores any benefits that result from the integration in the group even though such benefits explain its very existence.[69] The doctrinal approach, by contrast, seeks to assess comparability in light of state aid law's concern for free competition between independent undertakings. That latter approach would thus create a benchmark that deliberately ignores economic differences between integrated and independent businesses, in order to prevent the former from gaining an advantage as a consequence of their integration. This appears to resonate with the argument advanced by *Lang* that the proper comparison should be made on the basis of the competitive relationship between entities.[70] In principle, there is no reason to assume that group companies and independent companies are not in direct competition with each other—this holds true even if a group company only provides services within its group and thus does not appear to participate in the "free" market—competition still exists as the group has to decide whether to outsource activities to an independent enterprise or keep it within the group. If state aid law is concerned with potential distortions of that decision, it might thus be justified that tax considerations should not influence that decision. Under that approach, the imposition of the arm's length standard as an independent standard flowing directly from the EU competition rules could be justified. There should be no illusions about the meaning of such approach, however. If comparability of independent companies with companies that are members of a group were confirmed, it would not result in an alignment of tax rules with economic reality. It would rather appear to transform tax rules into an anti-trust tool that negates efficiency advantages from the integration of separate enterprises. Paradoxically, however, if that approach were applied consistently in all countries—i.e. to mandate downward adjustments as well as upward adjustments in order to arrive at a taxable profit that corresponds to the market return achieved by non-integrated enterprises, it would lead to the dislocation of any excess profit generated by group synergies and thus inadvertently even promote integration. If, as appears more likely, the approach will only be employed to instigate upward adjustments, it might, by contrast, result in double or multiple taxation of such excess profits.

[69] Brauner (2013), p. 387; Schön (2012b), p. 47 at 53 et seq.; Wilkie (2012), p. 137; Vann (2010), p. 291.

[70] See Lang (2012), pp. 85–115 at 99. See also Lang (2011), p. 593 at 598.

3.4 Adjustment Mismatches and the (Ir)relevance of "White Income"/Double Non-taxation

So far, the analysis has concerned the application of the arm's length principle in one Member State under the implicit assumption of corresponding rules applied in other countries of business for a multinational enterprise. The case of adjustment mismatches, which can result in tax-specific advantages that are not related to efficiency gains from integration and are thus not defendable on the basis that they reflect economic reality, are quite another matter. It appears that at least certain of the recent investigations of the Commission into transfer pricing arrangements were driven by concerns about such practices.[71]

As briefly outlined above, a result of double non-taxation is a priori neither necessary nor sufficient for a finding of state aid. However, where a Member State seeks to justify a derogation from the normal tax system on the basis of that system's nature and general scheme and, in particular, the principle of ability to pay, double non-taxation as a consequence of such derogation is highly suspicious. If a tax reduction in one country is offset by a tax burden in another jurisdiction, the ability-to-pay principle suggests that no relevant advantage exists. The same will not be true if the actual tax burden is lower compared to the purely domestic situation or even results in "white income". Although that outcome could be dismissed as a consequence of the other country's unilateral decision concerning its domestic scope and level of taxation in combination with the effect of a bilateral agreement with that other state, it remains the case that the first state has reduced its tax claim without attendant justification as provided by the ability-to-pay principle. The arguments for this position are even stronger in the context of mismatching transfer pricing adjustments for related companies in comparison to the case discussed previously,[72] where white income resulted from the application of the exemption method in a situation of merely virtual double taxation. This is so because the case of mismatching transfer pricing adjustments concerns separate taxpayers and the ability-to-pay principle as a taxpayer-oriented (rather than an enterprise- or state-oriented) principle makes the tax burden of each separate entity the relevant benchmark of a normative corporate income tax system. A unilateral downward adjustment that cannot be expected to be matched by a corresponding upward adjustment by another jurisdiction is thus likely to fall foul of state aid rules.[73]

A difficulty remains, however, to determine the ability to pay of a company that is entirely embedded in a multinational group on a stand-alone basis: in the absence

[71] See e.g. European Commission (2015). Similar arguments have been raised with respect to the Starbucks case, where payments deducted by the Dutch company to its British sister entity was allegedly not taxable in the UK as a consequence of that entities hybrid nature.

[72] *Supra* Section 2.

[73] This is clearly the Commission's view in the case of the Belgian unilateral adjustments under its Excess Profits tax scheme. See European Commission (2016).

of its relationship to the other member of the group, its profit may well be zero. Even though a certain downward transfer pricing adjustment may thus appear to constitute an advantage, the correct remedy is not obvious: such adjustment might indeed have been required by the arm's length principle. One is thus thrown back to the question as to whether the arm's length standard can act as the proper benchmark to determine the "correct" profit. Two examples of transfer pricing adjustments are briefly discussed here. Both examples are based on the view rejected above, that the arm's length standard is a mandatory feature of Member States' tax system: The first leads to "white income", but should still be accepted from a state aid perspective (even) if the arm's length standard is used as a normative standard. This example reinforces the point made earlier, namely that mismatches are not per se relevant for state aid review. The second aims to show that transfer pricing adjustments that are contrary to the arm's length standard should still not be considered state aid (even) if the arm's length principle were accepted as an independent benchmark, when they are based on the need to avoid economic double taxation, which renders concerns regarding distortionary effects of the adjustment measure unfounded.

As concerns the first situation, if a Member State makes a downward adjustment to a resident company's profits in line with the arm's length standard, it does not grant a selective advantage to the taxpayer even if there is no equivalent upward adjustment in another jurisdiction. This is so despite the fact that "white income" arises as a consequence to the extent that a part of the overall economic profit of the associated entities remains untaxed as a consequence. If the arm's length standard is mandatory as a matter of state aid law, it must also be sufficient to comply with its rules. The fault in this case lies thus squarely with the other country. If the other jurisdiction were a Member State, the Commission would certainly try to require an upward adjustment from that state in order to avoid the mismatch, but it obviously has no such power where that jurisdiction is a third country. Such limitation cannot, however, affect the legitimacy of the Member State's conduct.

With regard to the second situation, if a Member State makes a corresponding (downward) adjustment to avoid economic double taxation in a situation where the corresponding first (upward) transfer pricing adjustment was not in line with the arm's length principle, the question arises whether such relief would constitute illegal state aid. The company in question will certainly receive a benefit from state resources (if the comparison is a domestic independent company making a higher "normal" market profit) and the tax treaty cannot provide a justification, as it does not require an adjustment in cases where the other country does not follow the arm's length standard. Similarly, the ability-to-pay principle will not easily justify that treatment as it is focused on the situation of the single taxpayer. However, state aid law is not confined to so narrow a perspective. Instead, it applies to the undertaking as a whole, which is the multinational enterprise.[74] In the case at hand, however, the granting of relief, if fully matched by an upward adjustment in the other country,

[74] See Rossi-Maccanico(2015), p. 63 at 67.

does not result in any advantage to the undertaking as a whole, as any reduction in tax base in one country is matched by a matching increase in the other state. If the relevant subject for state aid purposes is the multinational enterprise as a whole, no aid can thus arise despite the application of rules that are not in line with the arm's length standard. This result might be disputable if tax rates differ between the states involved, as profit shifting could then achieve a lower overall tax burden for the multinational even without any mismatch. Such finding would however also require a more elaborate analysis than simply relying on the arm's length standard in the way proposed by the Commission.

4 Conclusion

The analysis above allows for a few conclusions concerning the interaction of EU state aid law with measures to determine a multinational enterprise's profit and avoid double taxation. Firstly, Member States remain free in principle to choose between different methods to provide relief from double taxation. This follows the fact that double taxation is itself anathema to the principle of ability to pay upon which national tax systems are built. This freedom to choose is, however, limited by the non-discrimination rules that form the basis of the internal market principle. It appears impossible to define the exact balance between the two in the abstract and no attempt to do so has been undertaken in this contribution, but it has explored the different considerations that need to be taken into account to do so in a concrete case. The final outcome necessarily depends on the assessment of comparability between different taxpayers and the definition of a sufficiently circumscribed group of beneficiaries of an exceptionally favourable relief method. Although it has been suggested that the granting of exemption without a subject-to-tax condition might be prima facie problematic when compared to a benchmark of granting a tax credit, the Member States' power to negotiate bilateral tax treaties as well as the rather general nature of such measure if it is available to all taxpayers protected by a particular treaty tend to sway the conclusion the other way. Similar considerations apply to more unusual methods of relief, such as a sparing tax credit.

Secondly, the analysis above has shown that measures to avoid juridical double taxation and transfer pricing adjustments share substantive similarities as far as their interaction with EU law is concerned, in particular with respect to state aid law. Nevertheless, a relevant difference results from the fact that the former relates to singular taxpayers whereas the latter concern (double) taxation of separate taxpayers. This distinction cannot be easily dismissed as a mere technicality, because it is fundamental to Member States' tax systems. It has the effect that double non-taxation as a consequence of uncoordinated transfer pricing adjustments cannot as easily be justified in situations where the same could be defended were it to occur as a consequence of the application of the exemption method in the absence of a subject-to-tax clause.

Thirdly, the contribution dismisses a claim that the arm's length standard could act as an independent benchmark with which Member States have to comply irrespective of its actual implementation as a general rule in their domestic tax systems. Such claim, which the Commission seems to base on a comparison between independent companies and companies that are part of a multinational group, is flawed, as it does not properly take into account the legal and factual differences between both categories of taxpayers.

Fourthly and finally, if the arm's length standard were held to constitute a mandatory element of Member States' tax systems despite the above objections, this contribution has argued that neither gaps in taxation from uncoordinated transfer pricing adjustments nor matching transfer pricing adjustments that are not in line with the arm's length standard predicate a finding of state aid. In the first case, this follows from the fact that—under this assumption—the application of the arm's length standard would have to be considered in line with the "normal" system of taxation regardless of the outcome, thus allocating any blame for lower taxation to the other country. In second case of coordinated adjustments not in line with the arm's length standard, the compatibility with state aid requirements follows from the fact that the correct subject for purposes of state aid review is the multinational enterprise as a whole, which does not reap any benefits (in the absence of tax rate differences) from matching transfer pricing adjustments, whatever the standard.

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Prof. Dr. Werner Haslehner is Professor of Law and ATOZ Chair for European and International Taxation, Faculty of Law, Economics and Finance at the University of Luxembourg.

Double Taxation Relief, Transfer Pricing Adjustments and State Aid Law: Comments

Rita Szudoczky

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Abstract This contribution examines whether double taxation relief measures and downward transfer pricing adjustments which are granted irrespective of whether or not the income for which such relief is granted has been taxed in another State can constitute State aid under EU law. The question is analysed through three examples where the application of such measures may lead to double non-taxation. The conclusion is drawn that the complete unilateral application of such measures contradicts their purpose and thus is likely to be disproportionate, which may lead to their qualification as State aid.

R. Szudoczky (✉)
Vienna University of Economics and Business, Vienna, Austria
e-mail: rita.szudoczky@wu.ac.at

© Springer-Verlag Berlin Heidelberg 2016

I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax
Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_9

1 Introduction

The unprecedented efforts of recent years to combat aggressive tax planning and base erosion and profit shifting (BEPS) have put the State aid rules in the spot light in EU tax law and policy. The search for more effective means to fight these phenomena within the EU has led the Commission to intensify the State aid review of tax measures which are commonly exploited in tax planning structures.[1] This generated a storm in EU State aid law, the waves of which have reached new territories that thus far seemed to be firmly lying outside the boundaries of State aid, such as mismatches and disparities between different tax systems, loopholes in domestic laws or the lack of effective anti-avoidance rules or the use of double tax treaties to the effect of achieving double non-taxation. The continuous testing of the limits of the State aid rules by the Commission, which in certain cases led to an endorsement by the Court of Justice,[2] brought about a debate as regards the appropriateness of the State aid rules for combatting tax planning and BEPS within the EU.[3] Beyond the academic debate, the Commission's activist approach also raised sensitive questions of tax policy, in particular, rows between the EU and its largest trading partner due to allegations that the new State aid investigations specifically target US multinationals[4] as well as disputes within the EU on how beneficial it is to the competitiveness of the EU as a whole to increasingly use the State aid rules for the purpose of limiting the Member States' ability to offer competitive tax systems.[5]

This comment focuses solely on the legal aspects of the debate and in that it aims at contributing to the search for the boundaries of the concept of State aid. In particular, it inquires whether the granting of double taxation relief and transfer pricing adjustments could lead to selective advantages being granted to certain undertakings, and thus to State aid within the meaning of Article 107(1) TFEU.[6] Under the latter provision a Member State measure constitutes State aid if: (i) the measure confers an advantage on the recipient, which is (ii) granted by the State or through State resources and (iii) it favours certain undertakings or the production of certain goods, i.e. selective whilst (iv) distorts competition and affects intra-Union trade.[7] Having regard to these conditions, the claim that the granting of double taxation relief or a transfer pricing adjustment could constitute State aid seems, for the first glance, rather far-fetched. Relieving double taxation does not afford an

[1] See European Commission (2014a); European Commission (2014b); European Commission (2015a); European Commission (2015b); European Commission (2016).

[2] CJEU, Joined Cases C-106/09P and C-107/09P *Commission v Gibraltar*, ECLI:EU:C:2011:732.

[3] Rossi-Maccanico (2014); Luja (2014); De Broe (2015).

[4] United States Senate-Committee on Finance (2016); United States Department of the Treasury (2016). See also Grinberg (2016).

[5] Luja (2014), p. 356; Luja (2015).

[6] Consolidated version of the TFEU (2012).

[7] Micheau (2014), p. 157; Micheau (2012), p. 211; Lang (2012), p. 411; Lyal (2015), p. 1028.

advantage; it merely eliminates the effect of being taxed twice on the same item of income, restoring the standard and desirable situation of single taxation. According to the Commission's Notice on the application of the State aid rules to measures relating to direct business taxation ("Commission's 1998 Notice"), tax measures of a purely technical nature, such as provisions to prevent double taxation, are general measures provided that they apply without distinction to all firms.[8] In addition, the Commission's 1998 Notice states that "each firm is supposed to pay tax once only. It is therefore inherent in the logic of the tax system that taxes paid in the State in which the firm is resident for tax purposes should be taken into account".[9] Most likely, this refers to measures aimed at eliminating economic double taxation on distributed profits, which are accordingly justified by the nature and general scheme of the system. Similarly, the Commission's Draft Notice on the Notion of State Aid points out that the need to avoid double taxation could justify *prima facie* selective measures.[10] As far as transfer pricing adjustments are concerned, they are also not immediately suspect of conferring advantages on taxpayers, as most of such adjustments are aimed at increasing the profits of a resident company which were understated due to applying non-arm's length prices in intra-group transactions between the company and its associated enterprises. This is what Article 9(1) of the OECD Model Convention ("OECD Model")[11] authorizes to do. At the same time, Article 9(2) OECD Model provides for a corresponding adjustment, that is, the lowering of the profits of a resident company in cases where a primary adjustment has been made in the other State to the profits of an associated company in order to avoid double taxation of the profits which were subject to the adjustment. While according to their purpose double taxation relief rules should not go beyond eliminating double taxation, their unilateral application, which disregards whether or not taxation has occurred in the other State, can result in double non-taxation. Likewise, the granting of a corresponding transfer pricing adjustment without regard whether a primary adjustment has been made anywhere else can lead to double non-taxation. The same would be the effect of a primary downward adjustment which is supposed to proactively prevent any "virtual" double taxation which may potentially occur if any other State would want to tax the same profits. Double non-taxation may well qualify as an advantage under the State aid rules and if such advantage can be attributed to one Member State only and if it is achievable only for a certain group of undertakings, the far-fetched allegation that these mechanisms can constitute State aid becomes a real and serious probability.

As the theoretical and doctrinal aspects of the topic are comprehensively analysed in the previous contribution of Prof. Haslehner, I will take a practical approach by testing three scenarios under the State aid rules where the application

[8] European Commission (1998), pp. 3–9 para. 13.

[9] European Commission (1998), pp. 3–9 para. 26.

[10] European Commission (2014c), at para. 139.

[11] 2014 OECD Model Tax Convention on Income and on Capital.

of double taxation relief or an adjustment to transfer prices can lead or is likely to lead to double non-taxation. In the first scenario dividends received by a parent company from its subsidiary are exempt in hands of the parent company irrespective of whether the profits out of which the dividends were distributed have been taxed in the State of the subsidiary. This happens commonly under participation exemption or similar regimes of the Member States which are aimed at eliminating economic double taxation of intercompany dividends. In the second scenario, an item of income of a resident derived from another State is exempt in the residence State under a double taxation convention ("tax treaty") with the source State irrespective of whether the income has been taxed in the source State. This scenario would also commonly occur by applying the double taxation relief provision of a tax treaty that follows Article 23A of the OECD Model Convention. Finally, in the third scenario, a Member State under its domestic law provides that a resident company which is a member of a multinational group can deduct from its taxable income an amount which corresponds to the profits which have been made due to the fact that the company is a member of a group. In order to calculate the deductible amount a comparison has to be made to the profits which an independent stand-alone company would have made under similar circumstances. In essence, such a provision grants a unilateral downward adjustment to the profits of a resident member of a multinational group without regard whether the exempted profits has been taxed or are likely to be taxed in the hands of another member of the group in another country.

2 Example 1: Participation Exemption Regime Without a Subject-to-Tax Clause

A participation exemption regime, which does not make the exemption of dividends in the hands of the recipient company dependent on the underlying profits having been taxed in the hands of the distributing subsidiary in its State of residence, may well lead to double non-taxation. Many Member States extend their participation exemption regime not only to dividends paid from other Member States but also to third-country dividends. This increases the chance that dividends the underlying profits of which have not been taxed or have only been taxed minimally would also get exempted under the participation exemption regime. Even in the EU, the application of participation exemption can lead to double non-taxation or negligible overall taxation where the distributing subsidiary is entitled to a preferential tax regime in its Member State of residence. Cases where double non-taxation would occur within the EU because of a hybrid mismatch have been taken care of by the insertion of the anti-hybrid rule to the Parent-Subsidiary Directive.[12]

[12] European Commission (2014d), pp. 40–41.

Double non-taxation is evidently an advantage for the purposes of Article 107 (1) TFEU. It is much more questionable, however, whether the condition of selectivity is fulfilled by a general participation exemption regime. As the CJEU laid down in its case law "*in order to classify a domestic tax measure as 'selective', it is necessary to begin by identifying and examining the common or 'normal' regime applicable in the Member State concerned. It is in relation to this common or 'normal' tax regime that it is necessary, secondly, to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it 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*."[13] If we take the general corporate tax system as the reference system, although the exemption of dividends derogates from the normal rule according to which profits are liable to tax, it is likely that the exemption does not differentiate between comparable taxpayers, as those who are exposed to double taxation on their income are most likely not comparable to those who are not exposed to such double taxation in the light of the objective of the corporate tax system of taxing profits in line with the ability-to-pay principle. Even if comparability exists and thus the different tax treatment results in *prima facie* selectivity, this would be justified by the nature and general scheme of the tax system, as the Commission 1998 Notice referred above also confirms.

The conclusion that a measure which gives an advantage to companies who own shares in other companies and receive dividends with respect to those shares cannot be considered selective, as it does not favour any specific group of undertakings is reaffirmed by the General Court's decisions in *Banco Santander* and *Autogrill España*.[14] In these decisions the General Court firmly maintained that "*for the condition of selectivity to be satisfied, a category of undertakings which are exclusively favoured by the measure at issue must be identified in all cases and that, [. . .], the mere finding that a derogation from the common or 'normal' tax regime has been provided for cannot give rise to selectivity*."[15] With regard to the measure at issue in these cases, which provided for financial goodwill amortization only in the case of acquisition of foreign shareholdings and not domestic ones, the General Court held that "*[it] applies to all shareholdings of at least 5% in foreign companies which are held for an uninterrupted period of at least one year. It is therefore aimed not at any particular category of undertakings or production, but at*

[13] CJEU, Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*, ECLI:EU:C:2011:550, para. 49; CJEU, Case C-6/12, *P Oy*, ECLI:EU:C:2013:525, para. 19.

[14] General Court, Case T-399/11, *Banco Santander SA v Commission*, ECLI:EU:T:2014:938, para. 37; General Court, Case T-219/10, *Autogrill España, SA v European Commission*, ECLI:EU:T:2014:939.

[15] General Court, Case T-399/11, *Banco Santander SA v Commission*, ECLI:EU:T:2014:938, para. 49.

a category of economic transactions."[16] Overall, according to the General Court, measures where "*the beneficiary undertakings would not share any specific characteristic distinguishing them from other undertakings*"[17] cannot be deemed selective. Admittedly, the view expressed by the General Court in these cases is far from being undisputed. It is questionable to what extent the CJEU's previous case law supports such an interpretation of "selectivity". As the cases have been appealed, the final word on this issue will be for the CJEU. Nevertheless, even if the CJEU rejects the General Court's view and holds that apart from a derogation from the normal system no further condition exists under Article 107(1) TFEU which would require a "certain category of undertakings being favoured", this would not affect our conclusion as regards the non-selectivity of a general participation exemption regime. Such regime, as shown above, is likely not to constitute a derogation from the normal system. As it exempts both domestic and foreign-source dividends, it is certainly a more general measure than the one examined by the General Court in *Santander* and *Autogrill* which exclusively favoured the acquisition of holdings in *foreign* subsidiaries.

The only ground on the basis of which a general participation exemption regime without a subject-to-tax clause could be challenged is that of proportionality. If such regime turns out to be *prima facie* selective and needs to be justified by the nature and general scheme of the system, it cannot avoid a scrutiny of its proportionality.[18] As it will be analysed more in detail in the next section, a measure which provides double taxation relief without regard to the fact whether double taxation, in fact, occurs can hardly be regarded as necessary to achieve its objective and as consistent with its own objective.

It is worth mentioning that the recent proposal of the Commission for an Anti-Tax Avoidance Directive[19] offers a solution to this case in the form of a specific anti-avoidance rule the implementation of which would make the recourse to the State aid rules to tackle the resulting double non-taxation largely unnecessary. In particular, the proposal includes a switch-over clause for untaxed or low-taxed third-country income.[20] Notably, this rule would not apply in an intra-Union context although very low taxation may well occur also in the EU where the distributing subsidiary makes use of a preferential regime in one of the Member States.

[16] General Court, Case T-399/11, *Banco Santander SA v Commission*, ECLI:EU:T:2014:938, para. 57.

[17] General Court, Case T-399/11, *Banco Santander SA v Commission*, ECLI:EU:T:2014:938, para. 72.

[18] CJEU, Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*, ECLI:EU:C:2011:550, para. 75.

[19] COM(2016) 26 final, 28.1.2016.

[20] COM(2016) 26 final, Article 6.

3 Example 2: Application of Double Taxation Relief Under a Tax Treaty Resulting in Double Non-taxation

3.1 Double Non-taxation Under the OECD Model and Its Commentary

The application of tax treaties can lead to double non-taxation when a tax treaty provides for the exemption method to relieve double taxation following the pattern of Article 23 A of the OECD Model. In this case double non-taxation can occur due to various reasons. The OECD Model and its Commentary try to deal with those cases where double non-taxation is specifically the result of the application of the treaty itself. Such is the case, first of all, in conflict of qualification situations[21] where the two Contracting States, due to differences in their domestic laws, apply different provisions of the treaty to the effect that the source State considers itself prevented from taxing the income at issue whilst the residence State, under another distributive article, considers that the source State has the right to tax the income and therefore exempts the income under Article 23 A paragraph 1.[22] As this case mirrors conflicts of qualification leading to double taxation,[23] the OECD Commentary suggests the same solution as for cases of double taxation, i.e. the residence State should follow the source State's qualification and thus consider that the source State may not tax the income "in accordance with the provisions of this Convention." Therefore, the residence State is not obliged to exempt the income pursuant to Article 23 A paragraph 1. The Commentary adds to this that such a result is "*consistent with the basic function of Article 23 which is to eliminate double taxation*."[24] Secondly, double non-taxation can also be the consequence of the two Contracting States applying the treaty differently to the facts of the case or interpreting the treaty rules differently.[25] Article 23 A paragraph 4 of the OECD Model includes an express provision for such a case which states that in this situation paragraph 1 of the same Article does not apply meaning that the residence State is under no obligation to exempt the income.

Hence, the Commentary caters for situations of double non-taxation caused by conflicts of qualification and differences in the interpretation of the facts or the

[21] Commentary on Articles 23 A and 23 B concerning the methods for elimination of double taxation, paras. 32.1–32.7.

[22] Commentary on Articles 23 A and 23 B concerning the methods for elimination of double taxation, para. 32.6.

[23] Lang (2009), p. 204.

[24] Commentary on Articles 23 A and 23 B concerning the methods for elimination of double taxation, para. 32.6.

[25] Commentary on Articles 23 A and 23 B concerning the methods for elimination of double taxation, para. 56.1.

provisions of the treaty. On the other hand, it specifically emphasizes that the solutions envisaged for these situations do not apply to cases where the source State considers that it may tax the income under the treaty but levies no tax on the income under its domestic law.[26] Under Article 23 paragraph 1, the obligation on the residence State to exempt income which *may be* taxed by the other State is irrespective of whether or not the right to tax is in effect exercised by that other State.[27] Thus, double non-taxation caused by the domestic laws of the Contracting States is left untouched by the OECD Model and its Commentary. Such approach may well be criticised from a tax policy point of view, especially in the light of the Commentary's statement referred to above according to which the basic function of Article 23 is to eliminate double taxation. However, this position can also be supported. If the underlying philosophy of the exemption method is capital import neutrality, this implies that the residence State wants to ensure that its taxpayers can compete under equal conditions with the enterprises of the other State in the market of that other State, which presupposes that the exemption at home is granted regardless of the existence of taxation or the level of taxation in the foreign market.[28] The question which can be raised, in turn, whether capital import neutrality which aims at giving incentives to a certain group of resident enterprises to make foreign investments is a legitimate aim in the light of the EU State aid rules.[29] According to the OECD, it is up to the Contracting States to negotiate the double tax relief provision of their treaties differently from Article 23 A and insert a subject-to-tax clause[30] or apply (or switch to) the credit method if they are bothered by the potential of double non-taxation. On the other hand, in the light of the growing concern about double non-taxation which is one of the "evils" targeted by the BEPS project, it may well be questioned whether tax treaties should continue to be interpreted in a way that in the absence of a subject-to-tax clause they require the State of residence to blindly exempt the income which may be taxed by the other State even in cases where it is clear that the income is actually not subject to tax in that other State.[31]

[26] Commentary on Articles 23 A and 23 B concerning the methods for elimination of double taxation, para. 56.2.

[27] Commentary on Articles 23 A and 23 B concerning the methods for elimination of double taxation, para. 34.

[28] Van de Vijver (2015), p. 250.

[29] Van de Vijver (2015), p. 250.

[30] On the various forms of subject-to-tax clauses, see Burgstaller and Schilcher (2004).

[31] One of the proposed measures under BEPS Action 6 is to include a Preamble in the OECD Model which would clearly state that the Contracting States do not intend to create, by the conclusion of the treaty, opportunities for non-taxation or reduced taxation. However, the phrase "through tax evasion or avoidance" is added to this which limits the scope and effect of this statement. See OECD (2015).

3.2 An Illustration: The McDonald's Case

The question of whether the application of a double tax relief mechanism under a tax treaty causing double non-taxation can constitute State aid is not a hypothetical one any longer. The Commission has recently announced the start of a formal State aid investigation against two rulings granted by Luxembourg to McDonald's which confirmed that the income of McDonald's Europe Franchising, a Luxembourg subsidiary of the McDonald's group, would be exempt in Luxembourg from tax due to the application of the Luxembourg–US tax treaty although the income was not subject to tax in the US.[32] McDonald's Europe Franchising receives all the royalties from franchise holders in Europe and Russia. The royalties are transferred internally to a US branch of the company which has no real activities. Luxembourg sees the US branch as a permanent establishment and attributes the royalties to it while the US considers that the royalties are not effectively connected to a US trade or business and therefore does not tax the royalties. The first ruling granted by the Luxembourg authorities confirmed that the royalties were exempt in Luxembourg on the condition that proof is provided that they were taxed in the US. As such proof could not be provided in the absence of taxation in the US, McDonald's Europe Franchise requested and obtained a second ruling which confirmed that exemption in Luxembourg would be granted irrespective whether or not the income was subject to tax in the US.

The case touches upon several aspects, which are right at the core of many tax planning structures. First, the double non-taxation seems to be caused by a difference between Luxembourg and US tax law. What constitutes for Luxembourg tax purposes income attributable to a US permanent establishment, for US tax purposes does not constitute income taxable there. This difference between the domestic laws results in double non-taxation in the context of the Luxembourg–US tax treaty. However, such difference between the domestic laws does not lead to a real conflict of qualification within the meaning of the Commentary on Article 23 of the OECD Model. This is because the difference does not cause the Contracting States to apply different distributive provisions of the treaty which would mutually prevent them from taxing. The double non-taxation is also not caused by different interpretation of the facts or the provisions of the treaty. Thus, having regard to what was discussed in the previous section, neither the interpretation of paragraph 1 nor paragraph 4 of Article 23 A offers a solution here for avoiding double non-taxation. The double non-taxation is, in fact, caused by the fact that the US does not exercise taxing rights over the income which it has the right to tax under the Luxembourg–US tax treaty. In such a case the tax treaty—specifically, Article 23 A paragraph 1 as interpreted according to the Commentary[33]—requires Luxembourg to exempt the income which *may be* taxed by the US in accordance with

[32] European Commission (2015c).

[33] The corresponding provision is Article 25(2) of the United States-Luxembourg DTC (1996).

Article 5 and 7 of the treaty even if the US does not effectively tax the income under its domestic law.

Nonetheless, the fact that an applicable tax treaty obliges Luxembourg to exempt the income of McDonald's Europe Franchise does not exclude the possibility that such exemption could constitute State aid. The prohibition set out under Article 107–108 TFEU applies to any selective advantage granted by a Member State irrespective of the fact whether it is domestic law or an international obligation which makes the Member State grant the advantage.[34] The international obligation does not excuse Luxembourg from its obligation under EU law to refrain from granting State aid. Therefore, it has to be examined whether the granting of double tax relief in a case such as that of McDonald's can be considered State aid within the meaning of Article 107(1) TFEU.

First of all, the question arises whether the fact that the Luxembourg authorities confirmed the result of double non-taxation by way of a ruling has relevance under the State aid rules. On the one hand, some commentators argue that deliberately enabling tax arbitrage may produce an unjustified derogation from normal taxation contrary to the fundamental principle of preventing abuse of law.[35] Apart from the fact that this statement assumes that the prevention of abuse is a fundamental principle which is part of an international tax regime which is followed by all national tax systems, it is relevant to the case of McDonald's if the issuance of a ruling is considered as a deliberate enabling of tax arbitrage. Contrarily, however, it seems in this case it is not the ruling which enables the tax arbitrage but the tax treaty itself which requires Luxembourg to exempt income regardless whether or not it was subject to tax in the US. The ruling merely confirmed this result and as such it is in line with the underlying law, i.e. the Luxembourg–US tax treaty. As clarified in the Commission's Draft Notice, rulings that merely contain an interpretation of the relevant tax provisions without deviating from them (or from existing case law and administrative practice) do not come within the scope of the State aid rules.[36] It has been pointed out in the literature that an advance ruling should not pose greater risks from the point of view of State aid than *ex post* assessments.[37] If they are constrained to the interpretation and application of the law to a concrete case, neither advance rulings nor *ex post* assessments grant a selective advantage. On the other hand, when they derogate from the generally applicable law, they both can qualify as State aid. Nevertheless, in practice, rulings are frequently used in tax planning structures because the advance certainty that they grant is perceived by taxpayers as a *per se* advantage.

[34] The only exception to this is the situation where a selective advantage is granted by a Member State through the compulsory implementation of EU legislation where the Member State has no discretion in the implementation; in this case the aid cannot be attributed to the Member State. See General Court, Case T-351/02 *Deutsche Bahn v Commission*, ECLI:EU:T:2006:104; CJEU, C-460/07 *Puffer*, ECLI:EU:C:2009:254.

[35] Rossi-Maccanico (2014), p. 867.

[36] European Commission (2014c), at para. 175.

[37] Luja (2014), p. 354.

If the ruling in which the Luxembourg authorities confirmed the result of double non-taxation does not have relevance from the point of the State aid review, it is the system of granting double tax relief under the tax treaty which needs to be scrutinized under the State aid rules. This means, however, that all the treaties which apply the exemption method without a subject-to-tax clause, i.e. the majority of tax treaties in force, are exposed to the suspicion of State aid.[38] In the State aid scrutiny of such treaty relief mechanism two questions deserve particular attention. Namely, whether the resulting advantage of double non-taxation is selective and whether it can be attributed to a single Member State.

3.3 Selectivity

Although it has been claimed that tax measures aimed at relieving international double taxation should in principle be characterized as favouring multinational enterprises (MNE) inasmuch as they provide no limits to manipulation by MNEs,[39] this does not seem to be sufficient to underpin the selectivity of such measures. A double taxation relief provision under a tax treaty is available to all taxpayers who are residents in one of the Contracting States and derive income from the other Contracting State which may be taxed by that other State. If the provision leaves room for double non-taxation it can be exploited by all those taxpayers not only by MNEs. Hence, in order to test the selectivity of such a measure, it has to be verified whether it derogates from the general system insofar as it treats undertakings which are in a legally and factually comparable situation differently. Thus, first the reference system has to be identified which, at the same time, determines with which category of undertakings the beneficiaries of the measure have to be compared. Under recent case law it is the corporate tax system which is normally taken as the reference system.[40] Within the corporate income tax system we have to look at the provisions on unilateral double taxation relief, as they are the general rules compared to which the double taxation relief mechanism under a tax treaty may constitute a derogation.[41] In this respect, we need to distinguish two scenarios. Under the first scenario, the unilateral relief rules are different from the tax treaty relief, that is, they either provide for the credit method or for exemption but with a subject-to-tax requirement. Under the second scenario, the unilateral relief

[38] Contrarily, see Gunn (2016).

[39] Rossi-Maccanico (2014), p. 861.

[40] CJEU, Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*, ECLI:EU:C:2011:550. See Lyal (2015), p. 1032.

[41] Another question in connection with double tax relief mechanisms is whether the fact that different treaties provide for different methods could be considered as a differential treatment of comparable situations which grants selective advantage to certain enterprises. See on this Luja (2004), p. 235.

provision under domestic law is the same as the one under the tax treaty, i.e. exemption without a subject-to-tax clause.

3.3.1 Domestic Law Relief: Credit or Exemption with Subject-to-Tax Clause

In this case, the tax treaty relief clearly deviates from the general system. It also has to be verified, however, whether the deviation leads to an unequal treatment of comparable situations. In this regard, the question is whether those taxpayers who derive foreign income which is exposed to double taxation but who do not fall under the scope of the treaty at issue (or another treaty with similar double tax relief rules) are in comparable situations to those who fall under scope of the tax treaty concerned and can thus potentially benefit from double non-taxation. It could be argued by analogy to the fundamental freedom case law that a potential double non-taxation under a tax treaty cannot be regarded as a benefit separable from the remainder of the treaty, but is an integral part thereof and contributes to its overall balance.[42] As persons who fall under the scope of a tax treaty are entitled to all the reciprocal rights and obligations under the treaty which constitute an integral whole, their situation is distinct from all the other taxpayers not falling under the scope of the treaty. Therefore, the two categories cannot be considered comparable from the point of view of one single provision of the treaty. Although this could be a plausible argument in favour of non-comparability, it has to be recalled that according to the CJEU's case law the comparison for the purpose of establishing selectivity has to be made in the light of the objective of the system.[43] In the light of the objective of the corporate income tax system, i.e. taxing company profits in line with the ability-to-pay principle, the two categories of taxpayers which are both exposed to double taxation on foreign-source income are comparable and the fact that one of them is entitled to the benefits of a tax treaty does not affect their comparability.

Given that the tax treaty relief constitutes a derogation from the general rules and results in a different treatment of comparable taxpayers, it should be considered *prima facie* selective. Such *prima facie* selectivity is likely to be justified by the nature and general scheme of the tax system. As mentioned above, the need to avoid double taxation qualifies under such justification and the conclusion of a tax treaty is an appropriate means to avoid double taxation. The fact that different treaties provide for different methods of relieving double taxation could be explained by the fact that treaties are the result of a negotiation process which is conducted in the

[42] CJEU, Case C-376/03 *D*, ECLI:EU:C:2005:424, para. 62.

[43] CJEU, C-172/03 *Heiser*, ECLI:EU:C:2005:130, para. 40; CJEU, Joined cases C-106/09 P and C-107/09 P *Commission v Gibraltar*, ECLI:EU:C:2011:732, paras. 75, 101; CJEU, Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*, para. 49; General Court, T-210/02 RENV *British Aggregates v Commission*, para. 49. See on this Szudoczky (2014), pp. 553–560.

specific economic and legal context of a bilateral relationship and which involves a give-and-take process of mutual benefits and concessions. The result of such process may differ from treaty to treaty.[44] Even the fact that a tax treaty sets out an allegedly more favourable method than the one applied unilaterally under domestic law can be perceived as an inherent consequence of tax treaties which are aimed at boosting the economic relations between the two States by providing for a beneficial tax environment. However, the more favourable method under the treaty cannot be disproportionately favourable. As has been mentioned above, for a *prima facie* selective measure to be justified by the nature and general scheme of the system, it is also necessary to ensure that the measure is "*consistent with the principle of proportionality and do not go beyond what is necessary, in that the legitimate objective being pursued could not be attained by less far-reaching measures*."[45] In the case of a double tax relief measure which provides for the exemption of an item of income irrespective of whether or not it was subject to tax in the other State, it is hard to maintain that it does not go beyond what is necessary. Certainly, double taxation can be relieved by a less far-reaching measure which makes sure that the exemption is only granted for income actually taxed. Applying a double tax relief rule to an item of income which has not been taxed and thus enabling it to remain untaxed appears to be inconsistent with the rule's own objective.[46]

In addition, the Court expressly held in *Paint Graphos* that it is for the Member State concerned to introduce and apply appropriate control and monitoring procedures in order to ensure that specific tax measures introduced for the benefit of certain taxpayers are consistent with the logic and general scheme of the tax system and to prevent economic operators from abusing those measures.[47] In the context of the exemption method as a double taxation relief mechanism the obligation to prevent abuse could be understood as a requirement to make the exemption dependent on effective taxation in the other State, i.e. applying a subject-to-tax clause in combination with the exemption method. On the other hand, the question can be raised whether double non-taxation arising from the application of a treaty relief provision is, in fact, abuse. The Contracting States may have intended such double non-taxation when they agreed on the exemption method without a subject-to-tax clause perhaps in pursuance of the goal of capital import neutrality. In this case it would be difficult to argue that the resulting double non-taxation defeats the object and purpose of the rule and thus constitutes abuse.

[44] Similarly, Luja (2004), p. 235.

[45] CJEU, Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*, ECLI:EU:C:2011:550, para. 75.

[46] Contrarily, Luja (2004), p. 236.

[47] CJEU, Joined Cases C-78/08 to C-80/08, *Paint Graphos and others*, ECLI:EU:C:2011:550, para. 74.

3.3.2 Domestic Law Relief: Exemption Without Subject-to-Tax Clause

If domestic law provides for the exemption method without a subject-to-tax clause as unilateral double taxation relief mechanism, the tax treaty relief will not derogate from the general rule. Can such a system still be considered selective? Again the argument that only MNEs can make use of tax arbitrage and disparities between tax systems leading to double non-taxation and therefore tax planning techniques which exploit disparities are by nature selective[48] is not understandable in the light of the selectivity analysis required by the CJEU's case law and the Commission's practice. To establish selectivity we need a derogation from the general system which causes unequal treatment. Where the general system of double taxation relief does not differ from the treaty relief, the only way in which a derogation can be identified is presupposing that a principle of higher standing exists which requires single taxation.[49] If it were to be accepted that the single tax principle is customary international law and therefore binds all national tax policy makers and tax legislators, it can be deemed to be the reference system. In this case both the domestic law relief and the treaty relief which enable double non-taxation to occur can be considered as derogations from such reference system. To determine whether the derogation results in unequal treatment of comparable situations, the situations of undertakings deriving only domestic-source income should be compared to that of undertakings deriving foreign-source income. In the light of the objective of taxing income once and not more or less, the situation of these two groups are comparable and the more favourable treatment of the latter causes the measures to be *prima facie* selective. At this point, the analysis will continue as above. Even if a reason intrinsic to the tax system, such as relieving double taxation, can justify the relief measures under domestic law and the tax treaty it is further necessary for these measures to comply with the principle of proportionality. In this respect the same considerations apply as above.

The most controversial point of this reasoning is certainly the claim that a "single tax" principle exists above and beyond national tax laws which would not allow national tax legislators to derogate from such principle. If we reject this assumption, can it still be argued that leaving certain companies untaxed in the context of a general tax system which is intended to cover all resident companies amounts to a selective advantage under Article 107(1) TFEU? The CJEU's *Gibraltar* decision[50] could give ground to such an argument.[51] However, contrary to the measure at issue in *Gibraltar*, the exemption method without a subject-to-tax clause as a double taxation relief measure does not seem to favour certain companies by

[48] Rossi-Maccanico (2014), p. 857.

[49] Avi-Yonah (2007) and based on this Rossi-Maccanico (2014).

[50] CJEU, Joined cases C-106/09 P and C-107/09 P *Commission v Gibraltar*, ECLI:EU:C:2011:732.

[51] Luja (2014), p. 355.

"*characterising the recipient undertakings, by virtue of the properties which are specific to them, as a privileged category*".[52] The beneficiaries of the treaty exemption, i.e. companies which derive foreign-source income which is not subject to tax in the source State, are undoubtedly a less defined group than offshore companies which were the beneficiaries in *Gibraltar*. Thus, the *Gibraltar* case law cannot be relied on to establish the selectivity of the lack of taxation in this scenario.

3.4 Attributable to a Member State

If a tax treaty provision granting an exemption regardless of actual taxation in the other State is considered selective according to one of the scenarios discussed above, it is in addition necessary that the double non-taxation, which may follow from such provision, is attributable to one Member State. In the Commission's practice it is not unknown that the qualification of a measure as State aid has been rejected on the ground that the advantage at issue was not imputable to one Member State. Specifically, in the Dutch Group Interest Box decision the Commission held that a reduced tax rate for intragroup interest which domestically functioned in a consistent way while cross-border produced an apparent arbitrage was not State aid, as the advantage for cross-border groups was a result of disparities between different tax systems.[53]

As regards the question which state grants the advantage, it can be argued, on the one hand, that a measure the purpose of which is eliminating double taxation should only be applied if not applying it would lead to double taxation. Thus, the residence State should not apply the exemption where the income has not been taxed in the other State otherwise it risks of granting a selective advantage. On the other hand, where a tax treaty allocates taxing rights over a certain item of income to the source State, can the non-exercise of that taxing right not be considered as State aid? Or is the resulting double non-taxation the consequence of a disparity?

It is worth recalling that a similar "who is to blame" question has been left unanswered by the CJEU under the fundamental freedoms. In particular, the CJEU refused to solve double taxation cases under the fundamental freedoms on the ground that EU law does not contain criteria as to the allocation of taxing rights between States and in the absence of such criteria the CJEU cannot decide which Member State is entitled to tax the income and which has to refrain from taxing.[54] Hence the obstacle to the internal market which arises from the parallel exercise of

[52] CJEU, Joined cases C-106/09 P and C-107/09 P *Commission v Gibraltar*, ECLI:EU:C:2011:732, para. 104.

[53] Commission Decision of 8 July 2009 on the groepsrentebox scheme which the Netherlands is planning to implement (C 4/07 (ex N 465/06)), OJ L 288, 4.11.2009, pp. 26–39, paras. 114–117.

[54] CJEU, Case C-513/04 *Kerckhaert and Morres*, ECLI:EU:C:2006:713, para. 22; CJEU, Case C-128/08 *Damseaux*, ECLI:EU:C:2009:471, paras. 32–33; CJEU, Case C-67/08 *Block*, ECLI:EU:C:2009:92, para. 30.

taxing jurisdiction by two Member States cannot be removed by recourse to the fundamental freedoms. In the reverse situation, i.e. double non-taxation, there is also an obstacle to the internal market, as the fact that certain income of certain taxpayers is not taxed is capable of distorting competition. The question is whether one of the States can be blamed for this under the State aid rules. When answering this question, we need to take into account how taxing rights are allocated over different types of income under tax treaties. First, exclusive taxing right can be granted either to the residence[55] or the source State.[56] Second, taxing rights can be shared in a way that a limited taxing right is granted to the source State while the residence State has to give relief for the tax levied by the source State by application of the credit method under Article 23 A paragraph 2 or 23 B OECD Model.[57] Finally, over other types of income a primary taxing right is granted to the source State and the residence State has to give relief either by exemption or credit under Article 23 A or B OECD Model. In the case of shared taxing rights or primary taxing right granted to the source State the residence State, although it has to give relief, has a residual taxing right over the income. This principle does not seem to be changed even where exemption is chosen as a relief for double taxation. If the residence State has residual taxing right it should exercise it in cases where the source State does not make use of the right primarily allocated to it. If this is, indeed, a principle, the exercise of residual taxing right should not depend on whether or not it is expressly reserved in the form of a subject-to-tax clause.

Therefore, the principle of residual taxation and the argument that a double tax relief measure and, in fact, a tax treaty itself should be applied consistently with its purpose support the conclusion that in the case at issue the double non-taxation can be attributed to the State which exempts the income even in the absence of taxation by the other State.

To avoid the risk of granting State aid, EU Member States could include in their tax treaties Article 23 A OECD Model with a wording which requires for the exemption to be granted not that the income "may be" taxed but rather "is taxed" in the other State (or another form of subject-to-tax clause). The proposal for the Anti-Tax Avoidance Directive extends the scope of the switch-over clause also to third country permanent establishment income, which—contrary to a subject-to-tax clause—would address not only non-taxation but also low taxation cases. However, it is rather questionable whether such a rule, which is to be implemented to the domestic laws of the Member States, would also apply under their tax treaties to the effect of switching the treaty exemption to credit. Another solution could be to require EU Member States to apply purposive interpretation to their treaties and thus grant double tax relief only in cases where there is an actual risk of double taxation. This may not have the desired effect, however, if treaties which apply the exemption method are considered to pursue the aim of capital import neutrality.

[55] For example, Article 12 OECD Model.

[56] For example, Article 19(1)(a) and (2)(a) OECD Model.

[57] Article 10 and 11 OECD Model.

Finally, a further remedy could be in Member States where treaty override is acceptable, the introduction of a domestic law rule which would prevent double non-taxation in cases where the application of the treaty would lead to such result.[58]

4 Example 3: Unilateral Downward Transfer Pricing Adjustment

The scenario where the unilateral application of a transfer pricing adjustment leads to double non-taxation is a real life example, in particular, the Belgian excess profit ruling regime, which the Commission has investigated and already declared illegal State aid.[59] According to this regime Belgian entities of multinational groups, instead of being taxed on the accounting profits recorded in Belgium, are allowed to calculate a so called arm's length profit on the basis of a comparison with the profits that a standalone company would make and substitute that for the actually realized profits as a tax base. Belgium defended the measure during the investigation as a mere application of the arm's length principle to the effect of allowing a proactive corresponding adjustment in order to avoid double taxation in relation to profits which are included in the accounting results of the Belgian entity but, in fact, do not belong to the latter.[60] Such profits arise from the fact that the Belgian entity is a member of a large group where it benefits from synergies, cost efficiencies, economies of scale, know-how, intangibles etc. As an independent company would not be able to achieve such extra profits, a member of a group of associated companies should not either be taxed on them according to the arm's length principle. As regards the question who should then tax those profits, the Belgian authorities maintained that it is not their task to determine which foreign group member should include the excess profits in its tax base.[61]

One of the questions which can be raised in connection with the measure is the real meaning of the arm's length principle. Does it authorize a broad profitability comparison between independent companies and companies being part of a group with the aim of equalizing their results or it rather requires that group companies apply in their intra-group transactions prices and conditions which would be set between independent companies under market conditions? The Commission in its opening decision made several observations along this line. This question has

[58] An example for such rule is the German treaty override provision which has recently been declared constitutional, see Treaty between Germany and Turkey – German Federal Constitutional Court finds domestic treaty override provision constitutional, IBFD TNS Report, 12 February 2016. Notably, this provision only prevents unintended double non-taxation.

[59] European Commission (2016). At the time of writing the public version of the decision is not yet available.

[60] C(2015) 563 (final), para. 41. The Commission's reasoning is described here on the basis of this opening decision, as the final decision is not available at the time of writing.

[61] C(2015) 563 (final), para. 25.

relevance in establishing the selectivity of the measure. The Commission argued that the deduction of excess profit from the tax base is a derogation from the general rules in the context of the reference system, which is the Belgian corporate income tax system. Within that system the starting point for the calculation of the tax base is the accounting profit to which various additions and deductions are applied when determining the tax base. As long as the deductions are of general application, they are not susceptible to State aid. However, if a deduction favours a certain group of undertakings, it should be regarded as a derogation for the purpose of the State aid rules. The excess profit deduction favours companies being member of a multinational group. However, this could still be justified if the deduction was in line with the arm's length principle. In view of the Commission, a transfer pricing adjustment which is consistent with the arm's length principle is justified, as it is necessary to prevent the abuse of the general rules. However, such a derogation from the general rule must be exceptional and strictly limited to situations where the application of the general rule would allow the taxpayer to abuse the system. Derogations which are not justified by an anti-abuse purpose allow certain taxpayers to reduce their tax base and thereby confer a selective advantage on them.[62] In the Commission's view, the excess profit deduction is not limited to situations where the application of the general rule, i.e. taxation of the full accounting profits, would give rise to abuse and where there would be a need to have recourse to the arm's length principle.

Second, even if there was a need to apply the arm's length principle, according to the Commission, Belgium does not apply that principle properly.[63]

Having regard to the above, the excess profit deduction favours the Belgian entities of multinational groups vis-à-vis Belgian standalone companies and members of purely domestic groups. The Commission rejected the Belgium's argument that multinational groups are not comparable to standalone companies and purely domestic groups (and therefore can be treated differently). In fact, when the Commission chose a broad reference system, i.e. the corporate income tax system under which the general rule is that all companies should be taxed on the entirety of their profits, it determined the comparators with whom the beneficiaries of the excess profit deduction should be compared. The comparators are all those companies who are subject to the general rule of the corporate income tax system as regards the taxable base. Belgium, on the contrary, argued that the tax base after all the deductions, including the excess profit deduction, should be taken as a reference point when looking for a derogation.[64] If this path was followed multinationals which are the only taxpayers being taxed on such tax base would constitute their own system of reference and therefore could not be compared to standalone companies and domestic groups. No other groups of taxpayers would be comparable to them, and therefore, the comparison would be rendered meaningless.

[62] C(2015) 563 (final), paras. 58–62.

[63] C(2015) 563 (final), para. 72 et seqq.

[64] C(2015) 563 (final), para. 64.

After establishing the selectivity of the excess profit deduction, the Commission concluded that the advantage granted to multinational groups is imputable to Belgium. Thus, the argument that the advantage follows from the absence of taxation in other countries of the exempted profits was not accepted. The Commission held that it is Belgium that unilaterally reduces the tax base independently of what the other State does; therefore, the advantage is attributable to Belgium.[65]

In the case of the Belgian excess profit deduction it is easier to establish the selectivity of the measure than in the case of double non-taxation caused by the application of a treaty relief provision. The excess profit deduction clearly favours a distinct category, multinational groups, which are comparable from the point of view of the definition of the tax base to other taxpayers, notably, standalone companies and purely Belgian groups. As regards the analysis of *prima facie* selectivity, the Commission's argument seems to be based on an anti-abuse ground. Transfer pricing adjustments are derogations from the general rule but when they are limited to the prevention of abuse of the general rule and are in line with the arm's length principle, they are justified. This implies that according to the Commission transfer pricing rules are of an anti-abuse nature. It is interesting that the Commission in the analysis of *prima facie* selectivity focuses on the anti-abuse purpose of transfer pricing rules while in the justification analysis it treats the avoidance of double taxation as the purpose of the measure at issue. Hence, depending on the stage of the analysis the objective of transfer pricing rules seems to be changing. Admittedly, the purpose of transfer pricing rules is not unequivocal. They can be anti-abuse rules[66] or rules preventing double taxation but they are also often perceived as rules allocating income between various jurisdictions. The purpose of these rules is not at all insignificant, as the question whether or not transfer pricing rules can be applied unilaterally largely depends on the purpose of the rules. If the purpose is the avoidance of double taxation, it is difficult to argue that they can be applied unilaterally with complete disregard what is happening in other States. As the Commission pointed out, the downward adjustment under the Belgian excess profit regime does not appear to be either necessary or proportionate to the objective of avoiding double taxation. The Belgian authorities do not require proof that that the exempted profits have been included in the profits of an associated company in another country or that there is any sort of risk as such. They do not even inform other countries of the downward adjustment; it is thus virtually impossible to know in other countries that according to Belgium the profits belong to them. However, if the purpose of transfer pricing rules is income allocation amongst various jurisdictions, their unilateral application is more defendable. As Belgium pointed out most of the transfer pricing methods are unilateral methods, which provide an arm's length profit for only one participant

[65] C(2015) 563 (final), para. 98.

[66] Koomen (2015), p. 152.

in the transaction.[67] As all countries apply the methods only for the entity which is resident in their territory, the results are not necessarily congruent.

Although there can be different objectives behind transfer pricing rules, in the case of a corresponding adjustment based on Article 9(2) OECD Model, it is hardly questionable that the purpose of it is the avoidance of double taxation of profits which have been subject to primary adjustment in another country. As the Belgian excess profit rule is basically a corresponding adjustment, its application should be consistent with the purpose of eliminating actual and not virtual double taxation. The fact that its application is totally independent of double taxation indicates that its real intent and effect is to confer a selective advantage in the form of double non-taxation on multinational company groups.

5 Conclusions

In light of the analysis above, it can be maintained that rules which are aimed at relieving double taxation cannot be applied completely unilaterally against their own rationale irrespective of whether or not there is a need to eliminate double taxation without being at risk of constituting State aid. A few qualifications can be made to this statement with regard to the examples analysed above. In the case of a participation exemption regime without a subject-to-tax clause, the technicalities of the analysis may influence the result thereof. If the exemption of income falling under the participation exemption regime is not considered *prima facie* selective and therefore requires no justification, the analysis will lack the examination of proportionality which the measure would fail. On the other hand, if such a regime is considered *prima facie* selective but justifiable by the nature and general scheme of the system, it will not be able to avoid the test of its proportionality. At that stage, it may well be argued that an exemption regardless of prior taxation of the income goes beyond what is necessary to achieve the purpose of relieving double taxation and therefore confers a selective advantage on all those taxpayers that can make use of the resulting double non-taxation.

As regards the application of a tax treaty exemption without a subject-to-tax clause, such measure could qualify as State aid if domestic law provides for a less favourable unilateral double tax relief method. In such a case the measure can be regarded as a derogation from the general rules which is likely not to be justified by the need to avoid double taxation due to its disproportional nature. Admittedly, this is quite a drastic conclusion, as most of the tax treaties in force today which set forth the exemption method do so without a subject-to-tax requirement. In addition, the OECD endorses the potential double non-taxation which may result from such system. However, that does not exclude its qualification as State aid under EU law.

[67] C(2015) 563 (final), para. 39.

As regards unilateral downward transfer pricing adjustments which are carried out as proactive corresponding adjustments preventing virtual double taxation, such measure is clearly disproportionate to its alleged aim of avoiding double taxation and is rather a disguised selective advantage to multinational enterprises which has been rightly qualified as State aid by the Commission.

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Dr. Rita Szudoczky is assistant professor at Vienna University of Economics and Business.

The Cat and the Pigeons: Some General Comments on (TP) Tax Rulings and State Aid After the Starbucks and Fiat Decisions

Peter J. Wattel

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Abstract The Commission State aid decisions on individual tax rulings have created legal uncertainty, which may have been one of their goals. This article comments on their political and policy merits and effects, it wonders whether EU law requires member States to have—and apply in a certain manner—specific transfer pricing rules, it discusses the creditability of the tax to be recovered from US groups in their home State, it comments on the possible implications of the Commission decision on the Belgian excess profits scheme (is smart tax competition State aid? Is not curbing BEPS State aid?), it wonders whether the CCTB may have become politically feasible, and it wonders why the Commission does not seem to investigate tax breaks extended by large member States.

P.J. Wattel (✉)
University of Amsterdam, Amsterdam, The Netherlands
e-mail: P.J.Wattel@uva.nl

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_10

1 Throwing the Cat Among the Pigeons: The (Political and Policy) Merits of the Commission Decisions

The Commission State aid decisions as regards Starbucks and Fiat might make one think that one of the main goals was to create legal uncertainty. Especially the Starbucks decision would seem rather debatable. First, there does not seem to exist any EU arm's length pricing principle. EU law does not require member States to have any (arm's length or other) transfer pricing legislation, let alone any specific method of transfer pricing adjustment. Therefore, such arm's length principle can hardly be part of a State aid assessment. The only references to an OECD soft law arm's length principle in documents connected to the EU are in the Code of Conduct for Business taxation,[1] which is a legally non-binding gentlemen's agreement not defining nor prioritizing any arm's length pricing methods, and in Article 4 of the multilateral Arbitration Convention[2] between the member States, which is not an EU law instrument and which does not describe, prescribe or prioritize any transfer pricing method either. Moreover, transfer pricing is not an exact science. Not just one possible outcome is correct. Transfer pricing adjustments may be in order when conditions have been agreed upon within a group which would not have been agreed upon between independent parties; they are not relevant already because a hypothetical third party might possibly have been able to negotiate a better deal. The fact that the Commission does not trust the outcome of the transactional net margin method (TNMM) does not mean that it is the wrong method, and even if it were, or even if the application by the tax authorities were erroneous, then that is not State aid, but a mistake.

Second, the market economic operator (MEO) criterion that the Commission apparently applies, does not seem to make much sense, as there is no market on which a commodity 'taxation' is being traded. Taxation is an exclusive sovereign prerogative. The Commission 2014 draft notice on the notion of State Aid states that: "the MEO test cannot be ruled out simply because the means employed by the State are fiscal".[3] Maybe not, but neither can it be ruled in simply because the Commission wants to use it. This comparator was developed by the EU Courts for comparing State *investorship* to private investorship, State *creditorship* to private creditorship and State *vendorship* to private vendorship, not for something quite different, i.e. State *taxation*. It is difficult to see its helpfulness in establishing fiscal State aid in transfer pricing: should one compare State taxation to *private* or *market* taxation??

Third, the Commission does not seem to have demonstrated that a similar group in similar circumstances would not have been considered a toll manufacturer as

[1] ECOFIN Council (1998), p. 1.

[2] Convention 90/463/EEC (1990), p. 10.

[3] European Commission (2014), p. 23.

well by the Netherlands tax administration, and would not have been eligible for the same ruling.

As was to be expected, therefore, the Netherlands government appealed the Commission decision,[4] if only to get some clarity on the existence of the power the Commission claims to require member States not only to have specific transfer pricing adjustment legislation in place conforming to the Commission's idea of an EU law principle of arm's length conditions (where does it say so in binding EU law?), but also to apply *a certain method* in a certain manner in a certain case, even though the OECD transfer pricing guidelines are merely soft law and do not prescribe an order of priority between the five methods they describe. Apparently, the Commission considered the TNM method applied to Starbucks' coffee roasting facility to be inappropriate, even where no reliable comparable uncontrolled price or cost plus would seem to have been available, or at least it considered that method to have been applied incorrectly.

Both Fiat and Luxembourg appealed the Fiat Decision,[5] Luxembourg advancing, a.o., that no selectivity or trade restriction has been demonstrated by the Commission, and that the principle of legal certainty and the rights of the defence were violated. Fiat adds that no arm's length principle derives from EU law, that the Commission fails to even explain what that principle is, and that the Commission introduces complete uncertainty and confusion as to when an advance pricing agreement, and indeed any transfer pricing analysis might breach EU state aid rules, a.o. because the Commission inexplicably departs from OECD transfer pricing guidelines.

By creating retroactive uncertainty and therefore future risk, the Commission encourages addressees of tax rulings issued by national tax authorities to get a *second* ruling, this time from the Commission, clearing the national ruling. Indeed, targeting individual rulings and thereby individual tax assessments which were already final under national law, undermines the very aim of tax rulings, which is to provide legal certainty for investors planning to put into place costly operations which will simply not be put into place without advance legal certainty. If multinationals must turn also to the Commission to get the required certainty, then this provides the Commission with an automatic notification of tax rulings, if not by the member State involved (because it does not consider any State aid to be present), then by the investor involved, who cannot afford 10 years of legal uncertainty. Legal uncertainty about tax rulings and the prospect of possibly having to impose huge additional assessments on investors who were relying on tax rulings, may also enhance member States' preparedness to consider adopting some sort of common corporate tax base (CCTB). For the Commission, the knife thus cuts both ways. And maybe even three ways: the State aid investigations into tax rulings also urge

[4] Appeal pending with the General Court of the EU under Case nr T-760/15, *Netherlands v. Commission.*

[5] Appeals pending under Case No. T-759/15, *Fiat Chrysler Finance Europe v. Commission*, and T-755/15, *Luxembourg v. Commission.*

member States to make serious progress within their peer pressure group, the Code of Conduct Group for Business Taxation. The Commission's State aid investigations into tax rulings may well have been triggered by the Lux Leaks affair, which demonstrated, amongst other things, that the agreement reached within the Code of Conduct Group to exchange information on tax rulings was not implemented by the member States wholeheartedly, to say the least.

2 The Belgian Excess Profit Scheme and the Questions It Raises: Is Causing Mismatches or Not Having (or Not Applying) Anti-Abuse Legislation State Aid? Smart Tax Competition? *Amurta* in Reverse?

A rather fundamental question as regards fiscal State aid is the following: if a group's profit is taxed once at a statutory rate somewhere in the EU, then what is the internal market problem? If Belgium takes the tenable position that certain advantages of an international group result from being an integrated business and should not be allocated to Belgium but to (some of) the other jurisdictions in which that group operates, *and* these other jurisdictions include these advantages in their tax bases (so no double non-taxation ensues), then it is difficult to see the State aid. Such approach would perfectly fit the internal market principle of mutual recognition. In such circumstances, one *may* be looking at 'smart' tax competition[6] (by Belgium), which *may* be harmful to the internal market, but if that would be the case, the problem should be tackled either under the market distortion provisions (Articles 116 and 117 TFEU) or within the Code of Conduct Group. I understand the Commission nevertheless considers the Belgian Excess Profits regime to produce State aid,[7] mainly because (i) purely domestic groups and stand-alone companies are unable to benefit from such international profit allocation (but are they comparable?) and (ii) the other jurisdictions to which the profits should be allocated according to the Belgian rules, do *not* (always) tax these profits, as they apply different profit determination or allocation rules, which may result in double non-taxation (but is that Belgium's responsibility?). Differences in profit determination and especially in profit allocation often lead to double taxation, which clearly hinders the functioning of the internal market. Nevertheless, such disparities or 'parallel exercise of taxing power' cannot be remedied by negative integration.[8] If such differences, conversely, lead to double non-taxation or to double dips,[9] then in principle there is no EU law remedy either, unless the Belgian

[6] *See* Pistone (2012).

[7] Case No. SA.37667, press release IP/16/42.

[8] *See*, e.g. ECJ Cases C-403/03 *Egon Schemmp*, C-67/08 *Margarete Block* and C-513/04 *Kerckhaert and Morres*.

[9] Compare Case C-18/11, *Philips Electronics UK*.

measure can be demonstrated to be either selective or discriminatory. If the other jurisdiction does tax the profit allocated to it by Belgium at its normal statutory rate, then one might even argue that even if the Belgian measure may be considered selectively advantageous, that selective advantage is neutralized by the inclusion in the normal tax base in the other jurisdiction. Similar reasoning has already been followed by the ECJ in the *De Groot*[10] and *Amurta*[11] cases as regards discriminatory taxation under the free movement of persons and of capital: the violation by a member State of EU internal market law may be pardoned if that violation is 'neutralized' in the other EU jurisdiction(s). A discriminatory source taxation or refusal of personal deductions may be neutralized by a tax credit or a deduction in the other jurisdiction involved. Similarly, an international profit allocation advantage which may be selective from an internal perspective, may be neutralized by taxation of that profit in the other jurisdiction(s) involved. Supposedly, the main problem the Commission has with the Belgian scheme is that often, the other State does not tax those profits, as it is not made aware of that allocation by the Belgian tax authorities, or as it is even quite unclear to what other jurisdiction(s) one should turn, as the Belgian scheme suffices with establishing that the profit is *not* allocated to the Belgian taxing jurisdiction.

At any rate, the Belgian excess profits tax case raises the question of whether State aid my be present because of the fact that a member State has not enacted, or does not apply properly, according to the Commission:

- a limitation on benefits clause in its tax treaties;
- CFC rules in its national legislation (overriding its tax treaties?);
- a switch-over clause in its national law and its tax treaties (or overriding its tax treaties?), trading exemption for credit where the foreign income was taxed below a certain level in the source State.

All of the improper tax advantages such measures aim to curb, only exist in cross-border situations, not in purely domestic situations. Does that imply that their mere absence is already a selective advantage for multinationals? Are cross-border groups (exposed to two or more taxing jurisdictions) comparable to domestic groups or domestic stand-alone companies (exposed to only one jurisdiction)? With respect to the application of the free movement rights, the ECJ's established case law is that nonresidents earning domestic source income and residents are not as a rule comparable.[12]

Another question the Belgian excess profits scheme case raises, especially if one also considers the ECJ's *Gibraltar* Case,[13] is whether a territoriality system of taxation may produce State aid. Indeed, the corporation tax system condemned by

[10] Case C-385/00, *F.W.L. De Groot v Staatssecretaris.*

[11] Case C-379/05, *Amurta SGPS.*

[12] *See*, e.g. cases C-279/93 *Roland Schumacker*, C-374/04 *Test Claimants in Class IV of the ACT Group litigation*, and C-9/14 *D.G. Kieback.*

[13] Case C-106/09 P, *Commission and Spain v Government of Gibraltar and the UK.*

the Court in the *Gibraltar* Case was not very different in its effects from a territoriality system (which Gibraltar therefore subsequently introduced). Obviously, a territoriality system invites improper (offshore) contraptions.

3 Creditability of the Tax To Be Recovered; Transatlantic Budget Shift? US Taxpayer Footing the Bill? Retroactive or Discriminatory Taxation?

A small search on the internet shows that Starbucks' pre-tax income in 2014 was $ 3.16 billion and that for 2015 it expects to make a profit of $ 3.9 billion.[14] It also shows that Starbucks' effective tax rate in the years 2010–2014 was between 31 and 34.5 % (the US statutory corporation tax rate is 35 %).[15] In light of that, 20–30 million euros to be recovered, as the Commission estimates, does not seem very significant for Starbucks' European operation and does not seem to reveal significant tax avoidance.

But more interesting is the fact that Starbucks, being a US (Seattle) based group, will probably credit these 20–30 million euros against its US corporate tax exposure if it turns out it will still have to pay that amount to the Netherlands government. Indeed, the US is a credit jurisdiction and its statutory corporate income tax rate is significantly higher (35 %) than the Netherlands' rate (25 %). Whatever Starbucks pays less in the EU, it will eventually still pay in the US, and whatever it will have to pay additionally in the EU (like the tax it started paying in the UK), it will eventually credit against US tax. Overall, the main effect of the Commission's Starbucks decision may be a public budget shift between the EU and the US.

This has not escaped the attention of the US Senate Finance Committee, which is concerned that the Commission's State aid investigations as regards US groups (Starbucks, Amazon, Apple, McDonald's) may result in 'a direct threat to US interests.' The Senators are especially concerned that US taxpayers may end up 'footing the bill' of the Commission's State aid decisions. The chairman and three members of the Committee wrote a letter[16] to the US Minister for Finance, urging the Treasury 'to intensify its efforts to caution the EU Commission not to reach retroactive results that are inconsistent with internationally accepted standards,' and expressing four objections:

(i) forcing member States to still charge tax possibly as far back as 10 years, is unacceptable retro-active taxation, as the Commission's reasoning in its final decisions (Starbucks and Fiat) and in its opening decisions (Apple, Amazon,

[14] http://www.marketwatch.com/investing/stock/sbux/financials. Accessed 3 March 2016.

[15] https://www.stock-analysis-on.net/NASDAQ/Company/Starbucks-Corp/Analysis/Income-Taxes. Accessed 3 March 2016.

[16] United States Senate-Committee of Finance (2016).

McDonald's) reflects 'a novel interpretation' of EU law of which neither the taxpayers, nor the member States could have taken account at the time the rulings were issued. The senators quote the Netherlands minister of finance Dijsselbloem announcing his appeal against the Starbucks decision: "the Commission applies its own new criterion for profit calculation, which is incompatible with domestic regulations and the OECD framework."

(ii) the Commission would seem to disproportionally target US multinationals and therefore to fiscally discriminate against US multinationals; the senators ask Treasury to investigate whether section 891 of the US Internal Revenue Code may be applied. That provision authorizes the President of the USA to double the US tax rate for persons and businesses from countries which engage, according to the US, in 'discriminatory or extraterritorial taxation';

(iii) the Commission's decisions undermine the bilateral tax treaties between the US and the member States involved. If the EU Commission is capable of telling member States how they should have applied their tax laws over a 10 year period in the past, then US companies and the US government are not able to rely on the bilateral tax treaties in force in that period. Neither the US companies involved nor the US government is a party to these State aid cases, while the EU is not a party to the tax treaties whose effectiveness it is undermining. An institution which is not a party to these tax treaties (the EU), should not be capable of frustrating them by a separate procedure pre-empting the US government's possibilities to represent the interest of US taxpayers not to be exposed to double taxation;

(iv) (the moment of truth) the Commission State aid investigations could give rise to US companies paying member States billions of dollars in tax assessments that may be creditable foreign taxes, resulting in US taxpayers "footing the bill";

Does the Senate Finance Committee have a point?

Ad (ii): Until now, there are only two final decisions on rulings, of which one targeting a US company and one targeting an EU company. That hardly substantiates a suspicion of discrimination. It is true, however, that the Commission makes itself vulnerable to criticism of selectivity or arbitrary choices by targeting individual rulings (i.e. individual assessments) instead of legislative or policy schemes such as the Belgian Excess Profits Scheme. Its recent decision on that scheme affects approximately 35 multinationals, most of which are European—taking away a suspicion of anti-US bias—and which will have to pay—according to the Commission—additional tax of in total approximately 700 million euro.

Ad (iv) As regards the possible "footing the bill" by the US taxpayers: one might just as well say that the US have all those 10 years been overtaxing non-US (EU) profits. A credit system *never* disadvantages the treasury of the home State; on the contrary: as compared to an exemption system, a credit system is biased against foreign investment and is inherently inconsistent and protective: it adheres to capital export neutrality (CEN) only as long as that benefits the home State treasury, but shifts to capital import neutrality the minute CEN becomes disadvantageous because of a higher effective tax burden in the source State. It taxes away foreign tax efficiency; that is its very goal. It never loses out. If the source State (the EU) chooses to levy more tax, but still below the level of tax the US chooses to levy on those *non*-US profits, then the US should simply credit that legitimate sovereign foreign tax on that foreign source income.

Ad (iii) as regards good faith in applying tax treaties: it is not immediately clear what the treaty issue might be. There will not be any double taxation if the US honours its treaty obligation to credit the additional tax, which is fundamentally not different from any other additional assessment following a (national) tax audit. That additional tax is simply a sovereign EU/source State matter and does not in any way represent a treaty override, for which, for that matter, the US are (in)famous.

Ad (i) Remains the allegation of retroactive taxation, or at least an unforeseeable 'novel interpretation'. The EU Regulation requiring recovery of illegal State aid[17] and its primacy over national law has been the law of the European land for many decades, and the ECJ's case law has been consistent over these many decades that as regards State aid, economic operators can never rely on comfort or expectations raised by member State authorities or legislation, but only on expectations raised by the only competent authority, the Commission. The Finance Committee may have a point, however, as regards the Commission's 'novel interpretation' of EU law no-one could reckon with, but that is exactly why Fiat, Luxembourg and the Netherlands are litigating, and that is what Courts are for. If the EU Courts agree that the Commission's position is unacceptable in the light of either EU State aid law or the rights protected by the EU Charter of Fundamental Rights, which guarantees, a.o., the protection of legitimate expectations, the right of property, including protection against retroactive taxation without legitimate aim, the right to equal treatment, and the rights of the defence (some of which have expressly been relied on by Fiat in its appeal), then there is no additional tax and no issue. If, by contrast, the EU Courts accept the Commission's interpretation of the EU State aid rules and does not consider it unforeseeable, then it may to a certain extent be novel, but not retroactive or otherwise unlawful, and there is no issue either. It should be observed that apparently Starbucks did not appeal its Commission decision. The EU can hardly be criticized for the fact that a US multinational chooses not to use its right to appeal an EU Commission decision. Possibly, Starbucks did not appeal, precisely because of the credit effect described above, which renders a recovery order eventually neither here nor there for a taxpayer resident in a credit country.

[17] Lately: Article 14(1) of Council Regulation (EC) No. 659/1999 of 22 March 1999 laying down detailed rules for the implementation of Article 93 of the EC Treaty.

4 Final Observations

It is fortunate that the Commission decisions in the Starbucks and Fiat cases are being appealed, as we dearly need case law on the reach of the Commission's possibility to criticize member States for not having certain transfer pricing rules in place or for—in the eyes of the Commission—incorrectly applying their transfer pricing rules.

In the light of the principle of mutual recognition and of the ECJ case law on free movement, a profit shift within the EU is in principle not problematic as long as the shift is not wholly artificial and the shifted profit is effectively taxed at the statutory rate of the receiving jurisdiction.

Sandwiched between State aid rules and free movement rules (and between each other in the Code of Conduct Group), the member States seem to have so little room left to actually be sovereign in (cross-border) corporate income tax policy that the introduction of a CCCTB or at least a CCTB may become a politically realistic perspective. A first step has almost been taken: harmonization of many anti-abuse rules by way of the proposed ATA-Directive.[18] This Directive is in fact substantive corporate tax harmonization, whether the member States like it or not. Economic necessity thus supersedes articles of faith such as fiscal sovereignty, which in reality does not exist anyway vis à vis globalized multinationals whose quoted value sometimes exceeds many a (small) country's gross domestic product. For the time being, however, the member States still go for patchwork half-solutions: exchange of information (also on rulings), country-by-country reporting, peer pressure (open method of coordination (OMC)) in the Code of Conduct Group, and harmonizing only minimum anti-avoidance measures.

Ceterum censeo that the Commission should show, not only that it does not disproportionally target US groups, but also that it does not disproportionally target smaller member States. Why did it not investigate, e.g. the country which reported itself, in an EU commissioned administrative practices report,[19] a.o., that a 'well known amusement park' benefited from 'very favourable rulings' so exceptional that 'the decision was taken by the Minister of Finance himself', and many more reported practices that called for thorough investigation? Everyone knows that size matters and that large member States have large home markets, necessitating small jurisdictions, which do not have such automatic competitive advantage, to be more tax efficient.

[18] European Commission (2016).

[19] Simmons & Simmons (1999).

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Peter J. Wattel is professor of EU Tax Law at the ACTL of the University of Amsterdam and Advocate-General in the Netherlands Supreme Court.

Part III
Sector-Specific Aspects of Preferential Taxation

Energy Taxation and State Aid Law

Marta Villar Ezcurra

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Abstract Despite the progress achieved in harmonizing indirect taxes at the European Union level, harmonization has not generally succeeded in energy taxation. As a result, EU State aid rules come into play for regulating the intervention of Member States regarding tax sovereignty in the energy sector. This chapter analyses the current legal framework dealing with energy taxation. It also addresses CJEU case-law, where a constant balance is sought between different goals and values, such as environmental protection, competition, trade and competitiveness of national and European industries.

M. Villar Ezcurra (✉)
San Pablo CEU University, Madrid, Spain
e-mail: vilezc@ceu.es

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_11

1 Introduction

This chapter will focuses on the relations between energy taxation and State aid law in the EU context. In all Member States of the EU, tax incentives in energy taxes are a common phenomenon that should be checked against State aid law, basically in order to distinguish general fiscal measures from selective ones.[1]

The EU framework for energy taxation has a quite long history and it currently pivots around the Energy Taxation Directive (ETD) and the requirement of a minimum level of taxation in all Member States.[2] Rules on State aid are of considerable importance to the energy sector given the traditional high level of involvement of governments in energy production and supply. They continue to play a significant role in ensuring a controlled transition from closed to open markets under competition. Indeed, in the field of taxation and other levies (fees and charges), State aid rules play a major role in the regulatory intervention practices by EU Member States.

In the EU, national governments are free to decide how to exploit their energy resources, what mix of energy sources they prefer to rely on (with the exception of renewable energy for which national targets are settled at EU level),[3] and how they tax or subsidise energy. Taxes being a central aspect of national sovereignty, most of the Member States have introduced taxes on energy products. Fiscal purposes are often combined with environmental objectives, such as stimulating the reduction of energy consumption and greenhouse gases emissions into the atmosphere. These so-called "eco-taxes" or "environmental taxes" are frequently levied on certain types of emissions, such as CO2, or on the consumption of energy.[4]

However, different approaches to energy taxation may create obstacles to trade and a good proportion of the national tax schemes may come into conflict with EU law and international trade law.[5]

[1] While the fundamental freedoms do not distinguish between general and specific tax measures which have discriminating or restrictive effect, this distinction is vital in a State aid context.

[2] European Commission (2003). The Proposal for a Council Directive amending Directive 2003/96/EC (COM (2011) 169/3) was given up. *See* European Union (2015).

[3] As David Buchan explains from a policy-making point of view: "EU energy policy has developed unevenly because it is part of economic policy, part of environmental policy, and part security policy. Market-making came first, but it took several decades before environmental policy took off, and the EU is still stumbling over security policy". *See* Buchan (2015), p. 365.

[4] *See* European Commission (2015).

[5] The WTO is the most important international trade regime for the vast majority of all sovereign States. Looking into WTO and EU law, it seems possible to provide a basis for a coordinate approach to environmental taxation, and as a consequence, to establish a common framework for developing harmonized taxation on a global level. On environmental taxation and WTO and the interaction between trade and environmental taxation, *see* Olsen (2012), p. 210. For a general reflection on the interaction of the tree different levels that tax incentives are regulated, *see* Micheau (2014).

The establishment of an EU internal market comes very close to the core of the national tax sovereignty. This is why most of indirect energy taxes are harmonized, whereas little progress has been made so far regarding environmental related matters or direct taxation, primarily due to Treaty requirement of for unanimity. As a result, in the absence of legal harmonization, EU competition law and, in particular, EU State aid regime represent at this stage the main constrains to tax sovereignty.[6]

This chapter analyses the relations between energy taxation and State aid law in the EU context in five main sections. Section 2 presents general features of the State aid topic, energy tax peculiarities, ETD and guidelines' criteria. Section 3, analyses the connection between "energy taxes" and "environmental taxes" in order to emphasize practical and conceptual concerns. Section 4 refers to some considerations to landmark and recent cases. And finally, Section 5 offers a set of concluding remarks.

2 The Definition and Notification Requirement of State Aids in the Field of Energy Taxation

Basically, the structure of EU State aid law consists of two main levels. At the first level, the general prohibition of State aid can be found in Article 107(1) of the Treaty of the Functioning of European Union (TFEU) and it is developed in the definition of State aid. Article 107(1) states as follows:

> Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

The second level is based on Article 107(2) and (3) TFEU. These two provisions provide for exemptions to the general prohibition on the granting State aids. Automatic justifications mentioned in paragraph 2 are declared to be compatible with the internal market and no discretion is possible.[7]

[6] The EU does not have direct authority over national tax systems, but the Commission can investigate whether certain tax regimes would constitute unlawful State aid to companies by granting selective tax advantages. Under the State aid framework, the Commission is, at present, raising doubts about the compatibility of some tax practices adopted by large multinational companies in the context of aggressive tax planning. Now, in the eye of the storm are cases such Apple in Ireland, Starbucks in the Netherlands and Fiat Finance & Trade or Amazon in Luxembourg. As provided by Michael Honoré: "[T]he Opening Decisions illustrate one fundamental problem in the area of fiscal aid: the lack of legal certainty". *See* Honoré (2015). *See also* Lang (2012).

[7] Moreover, the exhaustive list regarding, in summary, "social aids", "disaster aids" and "German aids" "*must be construed narrowly*". *See* Case C-156/98, *Germany v. Commission*, Judgment of 19 September 2000 (EC:C:2000:467), para. 49.

Conversely, regarding the list included in paragraph 3 concerning the discretionary justifications,[8] as it settled law, the Commission "*enjoys a wide discretion, the exercise of which involves assessments of an economic and social nature which must be made within a Community -Union- context*". The Court would here "*restrict itself to determining whether the Commission has exceeded the scope of its discretion by a distortion or manifest error of assessment of the facts or by misuse of powers or abuse of process*".[9] Among the activities referred to in paragraph 3, c, the Commission has included aids related to environmental protection and energy. The Commission may, of course, decide to structure its discretion through the adoption of formal or informal regulatory acts.

Acting on the basis of Article 109 TFUE, the Council has granted the Commission the power to adopt block exemptions in a number of areas[10] and the Commission has used this power to adopt the General Block Exemption Regulation (GBER).[11] As we will further on in this chapter, the current GBER is greatly relevant for several energy taxes and environmental tax reliefs. In addition to formal secondary law, the Commission has also introduced a range of soft law measures, which are generally labeled as "guidelines" or "communications". These "guidelines" and "communications" informally structure the Commission's discretion.

Therefore, any kind of tax measure that can benefit certain undertakings—also in the context of energy taxation, should be checked against the four well-known requirements of article 107 (1) TFEU. The measure has to be granted by the State or through Sate resources (first element); it has to favour an undertaking or the production of certain goods (second element); it has to be selective (the third and more complex criterion to prove); and it has to affect trade between Member States in such way that it leads to a distortion of competition (fourth element).

What constitutes an "aid" in with respect to tax[12] and parafiscal levies in the energy sector depends on the CJEU interpretation based on a case-by-case approach. Such clarification is particularly important in view of the procedural requirements that stem from designation as aid and of the consequences where

[8] The most important categories of exemptions are enumerated in paragraph 3 (a), (b), and (c) as follows: "(*a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation; (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest*".

[9] Case C-225/91, *Matra SA v. Commission*, Judgment of 15 June 1993 (EU:CE1993:239), paras. 24 and 25.

[10] One of these areas is "environmental protection". *See* Council of the European Union (2015), Article 1 (1)(a)(iii).

[11] European Commission (2014b).

[12] On this topic in general, *see* Schön (2012).

Member States fail to comply with such requirements. Each of the four mentioned elements are analysed below.

2.1 Granted by the State and State Resources: Alternative or Cumulative Conditions?

The wording of Article 107 "*granted by a Member State or through State resources*" suggests that the prohibition outlaws two forms of State interference. In a number of cases, the CJEU has come to clarify that the two conditions are cumulative.[13] In other words, the distinction should not be made between "*aid granted by a Member State*" and "*aid granted through State resources*", but rather—in a broad interpretation of the terms—between two separate and cumulative conditions: "the State imputability" and "the use of State resources".

This case-law was confirmed, among others, in *PreussenElektra* under the following terms: *"The distinction made in that provision between aid granted by a Member State and aid granted through State resources does not signify that all advantages granted by a State, whether financed through State resources or not, constitute aid but is intended merely to bring within that definition both advantages which are granted directly by the State and those granted by a public or private body designated or established by the State".*[14] In the case at stake, German environmental legislation obliged electricity supply undertakings to purchase renewable energy from green producers at a price above the market value. The legislative system was designed to support energy producers and the Court denied the existence of an aid because "*the allocation of the financial burden arising from that obligation for those private electricity supply undertakings as between them and other private undertakings cannot constitute a direct or indirect transfer of State resources".*[15] In *PreussenElektra,* the Court relied, in essence, on the fact that the German legislation did not present elements from which it could be inferred that there had been a direct or indirect transfer of State resources.[16]

Concerning the State imputability of the aid, the measure is regarded as not being imputable to the State to the extent that the implementation of the text was in compliance with a legal measure adopted at EU level with a clear and precise content. In *Ireland and others v. Commission* case, which involved the application

[13] Then, the term "or" should be interpreted as "and". For a clear example, *see* Case C-189/91, *Petra Kirsammer-Hack v. Nurhan Sidal*, Judgment of 30 November 1993 (EU:C:1993:907), paras. 16–19.

[14] Case C-379/98, *PreussenElektra v. Schleswag*, Judgment of 13 March 2001 (EU:C:2001:160), para. 58.

[15] Case C-379/98*, PreussenElektra v. Schleswag,* Judgment of 13 March 2001 (EU:C:2001:160), para. 60.

[16] Case T-251/11, *Republic of Austria v. European Commission, Judgment of 11 December 2014* (EU:T:2014:1060), para. 59.

of different rates of excise duty on mineral oil used as fuel for alumina production, the Court stated that the "*non-payment (…) can be attributed to the Council's decisions authorising the Italian Republic, Ireland and the French Republic to continue apply, until that day, full exemptions from excise duty*".[17]

Regarding the condition of the "use of the State resources", the issue is to determine whether the aid is directly or indirectly financed by the Member State. CJEU case-law clarifies that "State" should be interpreted in a broad sense, including not only State bodies but also regional and local authorities.

The aid can also be granted through public funds administrated by non-State bodies if they play a role of intermediary for the State authorities or if the aid is granted through a fund under State aid control. Measures financed by compulsory contributions can raise more difficulties. On this issue, one of the most interesting questions is related to the transfer of State resources.

Again, the *PreussenElektra* case brings some light on the question. Indeed, the Court considered that no direct or indirect transfer exists despite the fact that the purchase obligations is imposed by statute and confers an undeniable advantage to certain undertakings: "*A statutory provision of a Member State which, first requires private electricity supply undertakings to purchase electricity produced in their area of supply from renewable energy sources at minimum prices higher than the real economic value of that type of electricity and second, distributes the financial burden resulting from that obligation between those electricity supply undertakings and upstream private electricity network operators, does not constitute State aid*".[18]

2.2 The Criterion of Advantage

Advantage is a substantial element and a broad notion that covers a very large range of situations. The advantage can be temporary, either direct or indirect ("*in any form whatsoever*"). Therefore, the fact that an advantage is labelled as a tax, a parafiscal levy, a charge or a duty, does not prevent the Commission (nor at times the CJEU) from carrying out a deep research into the economic consequences of a specific government regulation in order to establish whether certain elements of the regulation constitute unlawful State aid or not.

As it was clarified by the CJEU, a link between the notions of "advantage" and "State originated resources" should also be considered. In the case *Compagnie Commercial de l'Ouest*, a French parafiscal charge levied on certain petroleum products under the same conditions for both domestic and imported products was put into question, because the incomes generated were used only for the benefit of

[17] Case C-272/12P, *European Commission v. Ireland and others*, Judgment of 10 December 2013, (EU:C:2013:812), para. 93.

[18] Case C-379/98, *PreussenElektra v. Schleswag*, Judgment of 13 March 2001 (EU:C:2001:160), para. 66 related to para. 61.

domestic products.[19] In other words, tax advantage may also derive from the use of tax resources. Despite the difficulties in identifying the tax advantage, the Commission distinguished, in its 1998 Notice, three main categories of tax advantages that may be provided through a reduction in the firm's tax burden: a reduction in the tax base (such as special deductions, special or accelerated depreciation arrangements or the entering of reserves on the balance sheet); a total or partial reduction in the amount of tax (such as exemption or a tax credit); and the deferment, cancellation or even special rescheduling of tax debt.[20] Moreover, the Commission defined the advantage by reference to a measure, which confers "*on recipients an advantage which relieves them of charges that are normally borne from their budget*".[21] In the analysis made by the Commission and the CJEU in the EU practice, the notion of "advantage" is not always separated from the concept of "selectivity" when the assessment concerns tax measures. Indeed, both notions require a departure from the standard application of the general system.[22]

We agree with some authors who have criticised the absence of distinct and separate approaches to the concept of an "advantage" on the one hand and "tax selectivity" on the other. In this sense, it has been argued that this simplistic approach to check selectivity and advantage *de facto* negates Member States a full assessment of all elements of the State aid prohibition. The root of the problem lies on the CJEU's approach to the "system immanence test". Certainly, from the time of the judgment in *Adria-Wien Pipeline*, in 2001, the CJEU has treated system immanence as part of the selectivity element.[23]

2.3 Selectivity of the Aid

Only the measures granting an advantage in a selective way to certain undertakings or categories of undertakings or to certain economic sectors fall under the notion of aid. Thus, general measures, which are effectively open to all undertakings operating within a Member State on an equal basis, are not selective. Nevertheless, for a measure to be genuinely general in character, it shall not be *de facto* reduced in scope by factors that restrict its practical effect.

Nicolaides, in assessing the applicability of article 107 (1) TFEU to tax measures, argues as follows:

[19] *See* Joint cases C-78/90, C-79/90, C-80/90, C-81/90, C-82/90 and C-83/90, *Compagnie Commerciale de l'Ouest and others v. Receveur Principal des Douanes de La Pallice Port,* Judgment of 11 March 1992 (EU:C:1992:118), paras. 31–35.

[20] Commission Notice (1998), para. 9.

[21] Commission Notice (1998), para. 9.

[22] The two criteria have been analysed under the same aspect of "selective advantage". *See* Commission Notice (1998), para. 9.

[23] *See* Jaeger (2015), pp. 550–551.

> there is normally no doubt that they involve transfers of public funds[24] (because, for example, tax reductions result in loss of tax revenue), that they confer an advantage (because they reduce liabilities that are normally covered by the revenue of the beneficiary undertakings) and that they affect trade and distort competition (because the concept of trade is very wide and once trade is affected it is very easy to show that some firms in other Member States are harmed by the extra competition from lower taxes). Therefore, the core issue in most cases is whether a tax measure is selective or not; i.e. whether it relieves from taxes only certain undertakings instead of all undertakings that are normally liable to that tax. Since, however, tax systems are not uniform (i.e. they apply different rates of taxation to different sources of income) and since they apply to so many diverse activities, it is not easy to determine whether a tax measure is selective.[25]

2.4 Affectation of Trade, Distortion of Competition and Adverse Effects

The Court case-law does not require an actual analysis of these criteria and has developed an extensive interpretation of the conditions of affectation of trade and competition. In fact, if there were such a presumption it would not be irrefutable.

For practical purposes, a distortion of competition within the meaning of Article 107 TFEU is thus assumed as soon as the State grants a financial advantage to an undertaking in a liberalised sector where there is, or could be, competition.[26] The Commission has developed a set of rules applicable to the so-called "de Minimis' aid". According to the new 2013 *de Minimis* regulation,[27] aids no more than EUR

[24] Parafiscal levies and analogous subsidy schemes are analysed by the European Court on a case by case basis. In *Austria v. Commission,* case T-251/11, the Court finds that the partial exemption of energy intensive consumers included within the Austrian Green Electricity Act 2008 is a State aid, using State resources. Case T-251/11, *Republic of Austria v. European Commission, Judgment of 11 december 2014* (EU:T:2014:1060). In the *PreussenElektra* case (a landmark decision), the Court considered that the obligation to buy renewable electricity imposed to electricity suppliers by German legislation, does not involve any transfer of State resources to undertakings, which produce green electricity and ruled: "Statutory provisions of a Member State which, first, require private electricity supply undertakings to purchase electricity produced in their area of supply from renewable energy sources at minimum prices higher than the real economic value of that type of electricity, and second, distribute the financial burden resulting from that obligation between those electricity supply undertakings and upstream private electricity network operators do not constitute State aid within the meaning of Article 92(1) of the EC Treaty". Case C-379/98, *PreussenElektra v. Schleswag*, Judgment of 13 March 2001 (EU:C:2001:160). In case C-262/12, *Association Vent De Colère! et al v. Ministre de l'Ecologie, du Développement durable, des Transports et du Logement and Ministre de l'Economie, del Finances et de l'Industrie* (EU: C:2013:851), the Court concluded that the obligation to purchase wind-generated electricity at a price higher than the market price that is financed by all final consumers of electricity in the national territory, constitutes an intervention through State resources.

[25] Nicolaides (2004).

[26] European Commission (2014b), para. 188.

[27] European Commission (2013).

200,000 granted over a period of the 3 years fall outside the scope of the State aid law.

2.5 General Trends or Energy-Tax-Specific Considerations?

A broad and specific legal framework characterises energy taxation when EU Sate aid regulation is concerned. The general regulatory framework of Article 107 (1) TFEU needs to be completed in the area of energy taxation by the regulatory provisions of the ETD and by the GBER. Besides, the 2014 European Commission's guidelines on State aid for environmental protection and energy (2014–2020) complement this *hard law* framework.[28]

It is important to notice that there are no particular guidelines on the application of the State aid rules to all types of energy taxes. Indeed, all "energy taxes" do not perfectly fit into the categories of direct and indirect taxes[29] or into the notion of "environmental taxes", at least, not as this notion is defined in the GBER and in the 2014 guidelines.[30] Indeed, some of the energy taxes and all of the parafiscal levies on the energy sector are not harmonised. They may nevertheless also be considered as an aid.

In contrast, in other fields like business taxation, as part of the commitment in the Code of conduct on business taxation,[31] the European Commission published specific guidelines on the application of the State Aid rules to measures relating to direct business taxation.[32] In addition, in the Energy Taxation Directive, although some of the most important State aid issues are expressively addressed to, there is a lack of clarity and the differences foreseen depend on the uses of the product and other factors.

As a consequence, Article 107 (1) TFEU remains the most important legal basis, as the notion of "aid" should be analysed as an objective concept in relation to which the Commission cannot use any discretional power. The Commission is then bound by this objective notion, subject only to specific situations involving economic assessments.[33]

[28] European Commission (2014a).

[29] For example, taxes on process and production methods and taxes on inputs not incorporated in the final product cannot completely be regarded as indirect taxes imposed on products.

[30] Following Article 2 (119) of the GBER and European Commission (2014a), Article 1.3 (15): "A tax with a specific tax base that has a clear negative effect on the environment or which seeks to tax certain activities, goods or services so that the environmental costs may be included in their price and/or so that producers and consumers are oriented towards activities which better respect the environment".

[31] Council of the European Union (1998).

[32] The guidelines were adopted by the Commission on 11 November 1998. *See* Commission Notice (1998).

[33] For further development of this assessment, *see* European Commission (2016), para. 4.

Among the four criteria, the selectivity criteria may be particularly complex to asses when energy taxes are concerned. This is, because the four elements of the notion of "aid" may, in fact, not be easy to assess. However, the evolution of the notion of selectivity in the CJEU case-law seems to follow the general trends: the concept of aid is an expansive concept that allows for a larger intervention of the European Commission (the effect-based approach or the possibility of *de facto* selectivity). From an internal market rationale, the CJEU case-law seems to support a more competition-like approach (where the legal and factual situation is compared in the light of the objective pursued by the measure in question).[34]

2.6 The EU Directive on Taxation of Energy Products: State Aids References and Notification Standards

Taxation of energy products has been greatly debated in the EU for more than a decade. In 1992, a proposal for a common CO2/energy tax was introduced, but the negotiations never resulted in a substantial agreement.[35] Prior to the 2003 Energy Taxation Directive, the only legislation setting minimum levels for the taxation of energy products was the Mineral Oils Directive[36] (which, as it names indicate, only concerned mineral oils). However, the overall lack of harmonization of EU taxation on energy and the conflicts caused by several national systems of taxation implemented during the 1990s and the regulations for the internal market, often resulted in risks of loss of national industrial competitiveness. These conflicts lead to the 1997 proposal for a Directive restructuring the Community framework for the taxation of energy products.[37]

On 20 March 2003, after more than 6 years of negotiations, political agreement was finally reached on the Energy Taxation Directive. The aim of the ETD is to guarantee the proper functioning of the internal market[38] and to support other

[34] *See* Maillo (2016), p. 233.

[35] For a full overview of driving forces governing the negotiations, *see* Klok (2002).

[36] Based on an initial proposing dating from August 1973, EU Directive 92/81/EEC on harmonized rules on mineral oil taxation was implemented in 1992 as part of seven directives which from the EU exices duty framework.

[37] European Commission (1997).

[38] Tax harmonization was considered necessary to reinforce the "unity of the single market and the liberalisation of the energy markets, in particular in the fields of natural gas and electricity". In its Proposal, the Commission considered that "the non-harmonization of national rates for the taxation of energy products (. . .) leads to distortions due to excessive tax competition" and also refers to the need to preserve the "competitiveness of European firms vis-à-vis third countries". *See* European Commission (1997), 3 and Article 17, para. 1(s) ETD, concerning tax reductions in favour of "energy intensive business". On that regard, *see* Antón Antón and Villar Ezcurra (2014). Regarding the implications of competitiveness of environmental taxes focusing on energy, Ekins and Speck conclude that "concern with the competitiveness effects of energy taxes may have been

Community policies[39] by requiring minimum levels of taxation to be laid down at Community level for most energy products, including electricity, natural gas and coal.[40]

The Directive entered into force on 1 January 2004. The Directive is characterised by the following features: new minimum rates were to be set at the latest by 1 January 2012 for a new period from 2013; the minimum rates are very low; tailor-made implementation agreements exist for some Member States, sometimes with long transitional periods; there are exemptions for some energy-intensive industries and generally lower rates for business and industry; possibilities exist to return the tax revenue to companies/industries which have entered into energy efficiency agreements. Discussions on whether some exemptions from the Directive would qualify as illegal State aid were settled by the removal of these industrial sectors from the Directive.

It is worth to note that the ETD does not consistently help pursuing environmental (and, in particular, climate change) objectives. Minimum tax rates and exemption clauses addressed to Member States do not always follow an environmental logic. For instance, minimum rates are not defined by taking into account the emissions intensity of energy products. Consequently, higher taxes may be imposed—counter intuitively—on renewable energy sources than on fossil fuels.[41]

The Proposal of revised Directive aimed to reinforce the environmental character of the Directive.[42] Particularly, the Commission proposed to introduce an “additional uniform CO_2-related tax” on energy products falling under the ETD.[43] The proposal of revision has unfortunately been withdrawn in 2015.[44] The ‘light’ environmental character of the ETD may, nevertheless, slightly be reinforced by Directive 2012/27/EU on energy efficiency.[45] This Directive imposes the obligation on Member States to set up energy efficiency obligation schemes. Under these schemes, “energy savings from taxation measures” should only be

misplaced, and that the tax exemptions and special provisions put in place to mitigate it are excessively complex in relation to the actual issue at stake”. Ekins and Speck (2008), p. 105.

[39] The ETD can be considered as one of the three EU’s portfolios of energy related environmental policy instruments. The EU has opted for a three-pronged approach towards selecting a viable portfolio policy instruments for energy and climate related environmental protection: EU emissions trading, Renewable Energy Directive and Energy taxation. For further information, *see* Hasselknippe and Christiansen (2004), p. 27.

[40] *See* Recital 3 ETD. The requirement of minimum levels of taxation for energy products, such as is the case of natural gas and coal and electricity is introduced, which to date had not been taxed harmonized.

[41] European Commission (2011), p. 3.

[42] European Commission (2011), pp. 2 and 3.

[43] European Commission (2011), p. 5.

[44] European Union (2015).

[45] European Parliament and Council of the European Union (2012).

considered for energy savings "exceeding the minimum levels of taxation applicable to fuels as required in Council Directive 2003/96/EC".[46] Unfortunately, most of the solutions addressed by the Proposal of 2011 for amending the ETD, as the coordination of energy taxes and ETS via tax exemptions[47] or as the improvement of the environmental concerns,[48] will remain unresolved.

It is important to relate the scope of the ETD with the minimum tax rates obligations and the possibilities of granting an aid. In Article 2 ETD, there is a definition of the term "energy products" for the purposes of this Directive (in paragraph 1) and a list of cases to which the Directive shall not apply (in paragraph 4). CJEU case-law dealing with the ETD mainly focuses on the delimitation of the scope of the Directive. On one hand, the CJEU interprets the "use criterion" along with some exemption and non-taxation situations, such as, for example, the concept of 'dual use' or 'private pleasure air navigation'. On the other hand, based on some domestic taxes, the Court studies various scenarios where concrete energy products must be included or excluded from the scope of the Directive, and explains their potential legal consequences. Nuclear energy, for example, is excluded from the scope of the Directive. As the CJEU has clarified, this means that nuclear fuel is not covered by the exemption laid down in Article 14 (1) (a) of that Directive. Consequently, this opens doors to Member States in order to tax the use of nuclear fuel to produce commercial electricity.[49]

One key aspect of the discussions of the ETD in the Council had been precisely, the connections between tax incentives and EU State aid rules. In particular, Member States and the industry wanted to be certain that the reductions and exemptions they were negotiating would not be prohibited by the Commission when transposed in national legislations.[50] On this issue, the ETD compulsory or facultative nature of certain tax reductions and/or exemptions must be

[46] European Parliament and Council of the European Union (2012), Annex V, point 3 (a).

[47] *See* Soares (2007), and for the non-fiscal nature of the emission trading allowance see the statements made on the case *Air Transport Association of America and Others v. Secretary of State of Energy and Climate Change*, Judgment 21 December 2011, para. 143.

[48] Since the time the ETD was adopted, the underlying framework changed radically. As the Commission recognised, the current Directive is not consistent with climate change and energy market policies. For instance, the ETD promotes the use of coal (with a lower tax rate), which is the product with the highest CO2 content and the current minimum rates are based on the volume of energy products consumed. Then, they do not reflect the energy content or CO2 emissions of the energy products leading to inefficient energy uses and distortions of the internal market. A clear summary of the EU policy framework for energy taxation as an environmental instrument and an analysis of practical implementation rules are provided by Ingo Schlegel. *See* Schlegel (2014), p. 115.

[49] Case C-5/14, *Kernkrafwerke Lippe-Ems GmbH v Hauptzollamt Osnabrück*, Judgment of 4 June 2015 (EU:C:2015:354), para. 43. As Recital 33 ETD states "*the scope of Directive 92/12/EEC should, where appropriate, be extended to the products and indirect taxes covered by this Directive*".

[50] *See* Boesherz (2004).

differentiated. If the tax exemption derives from a Community measure such as a Directive, without leaving any scope for discretionary application at national level, the measure is not "imputable" to the State and cannot therefore be considered as a State aid. Hence, the first condition that the aid must be imputable to the State (which is to be distinguished from the need to be granted through State resources) is not met.

The circumstances under which Member States can grant tax reductions and/or exemptions are detailed in the ETD and developed in the Commission guidelines. A wide range of differentiations and tax exemptions is established which reduce, and even eliminate in some cases, the effective taxation of certain products. In fact, three situations may be distinguished: (i) EU standard measures; (ii) measures that should be notified; and (iii) measures automatically approved.

Under the scope of the ETD, the energy national tax concessions that reflect a standard measure of the harmonized energy tax regime are, for example, the exemptions for energy products supplied for use as fuel for the purpose of air navigation or navigation within Community waters.[51] Therefore, these are not subject to the State aid control under Articles 107 and 108 TFEU. Nevertheless, in most cases, measures are not "EU standard measures" but are granted at the discretion of the Member States, based on the authorisation and conditions of Articles 5 and 15–17 ETD.[52] As Article 26 (2) ETD[53] clarifies, such preferential measures might constitute State aid.[54] If this is the case, the measure normally has to be notified to the Commission. However, no need for notification exists to the extent that the measure is covered by the GBER. On the other hand, under the provisions set out in Article 19 (1) and (3) ETD, the Council may also authorise any Member to introduce further exemptions or reductions for specific policy considerations—environmental protection, energy and transport policies are specifically relevant.[55]

[51] *See* Article 14 (1) (b) and (c) ETD. Mandatory exemptions are also provided when energy products and electricity are, on the one hand, used to produce electricity or, secondly, to maintain the ability to produce electricity. However, the ETD allows Member States to tax by environmental reasons policy. In this case, compliance with the minimum levels of taxation of the Directive is not required.

[52] Under Articles 15 to 17 ETD, Member States may apply tax exemptions, including the implementation of a level of taxation down to zero and reductions.

[53] Article 26 (2) ETD states as follows: "Measures such as tax exemptions, tax reductions, tax differentiation and tax refunds within the meaning of this Directive might constitute State aid and in those cases have to be notified to the Commission pursuant to Article 108 (3) of the Treaty".

[54] On the issue of imputability in the context of indirect taxation, *see* Englisch (2013).

[55] Article 19 ETD provides that "*the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce further exemptions or reductions for specific policy considerations*".

Currently, only certain categories of energy tax incentives—covered by the ETD—qualify for an automatic approval under Article 44 GBER.[56] In addition to certain general formalities set out in Article 9 GBER, there exist essentially two requirements that an energy tax relief must fulfill: (i) The beneficiaries of the tax reduction shall pay at least the Community minimum tax level set by the ETD[57] and (ii) its beneficiaries must not be selected on the basis of opaque or arbitrary criteria.[58]

As regards the legitimacy of the objects pursued by the different categories of energy tax reliefs, we agree with Prof. English when he asserts that "it is highly questionable to frame all of those tax benefits as serving environmental protection objectives, as the GBER implicitly does in its Article 44".[59]

2.7 The Guidelines' Criteria on State Aid for Environmental Protection and Energy 2014–2020

Since 1 July 2014, the European Commission applies new guidelines on State aid for environmental protection or energy objectives.[60] State aids, in the form of reductions or exemptions of "environmental taxes" are directly addressed in these Guidelines. To be compatible with EU State aid law, it must be shown that: (i) the tax exemptions or reductions are necessary for all the suggested categories of beneficiaries, and (ii) that they are proportional in size. This is assumed to be the case when beneficiaries pay at least the Community minimum tax level set by the

[56] Article 44 GBER refers to "Aid in the form of reductions in environmental taxes under Directive 2003/96/EC" and states the following: "*1. Aid schemes in the form of reductions in environmental taxes fulfilling the conditions of Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity shall be compatible with the internal market within the meaning of Article 107(3) of the Treaty, and shall be exempted from the notification requirement of Article 108(3) of the Treaty, provided that the conditions laid down in this Article and in Chapter I are fulfilled. 2. The beneficiaries of the tax reduction shall be selected on the basis of transparent and objective criteria and shall pay at least the respective minimum level of taxation set by Directive 2003/96/EC. 3. Aid schemes in the form of tax reductions shall be based on a reduction of the applicable environmental tax rate or on the payment of a fixed compensation amount or on a combination of these mechanisms. 4. Aid shall not be granted for biofuels which are subject to a supply or blending obligation*". See also Recital 64 GBER.

[57] Such aid is presumed to have an "incentive effect" considering that these reduced rates contribute at least indirectly to an improvement of environmental protection by allowing the adoption or the continuation of the overall tax scheme concerned, thereby incentivizing the undertakings subject to the environmental tax to reduce their level of pollution.

[58] *See* Englisch (2015).

[59] *See* Englisch (2015).

[60] *See* European Commission (2014a), para. 13.

applicable Directive, if any. Otherwise, the necessity will depend on the impact of the national tax on production costs as well as on the possibility to pass on the tax to consumers and reduce profit margins. The aid should be proportionate. Proportionality will be assessed in light on whether (and to what extent) the beneficiaries can further reduce their consumption or emission, pay a part of the national tax or enter into environmental agreements to reduce pollution.[61]

The key criteria presented along the text of the Guidelines to ensure compatibility, is that the aid contributes, at least indirectly, to an improvement of the level of environmental protection and that the tax reductions and exemptions do not undermine the general objective pursued. The positive effects of the aid should outweigh its negative effects in terms of distortions of competition, taking account the polluter pays principle established by article 191(3) TFEU.[62] The Commission authorises aid schemes for maximum periods of 10 years, after which a Member State can re-notify the measure if the Member State re-evaluates the appropriateness of the aid measure concerned.

Both previous (2008) and current (2014) environmental Guidelines distinguish between harmonized and non-harmonized taxes and refer specifically to the ETD. In the first case, the Commission can apply a simplified approach to assess the necessity and proportionality of the aid. Once the beneficiaries have paid at least the Community minimum tax level set by the applicable Directive; the choice of beneficiaries is based on objective and transparent criteria; and the aid is granted in principle in the same way for all competitors in the same sector, if they are in a similar factual situation, the Commission will consider the aid necessary and proportionate. Otherwise,—if the beneficiaries pay less than the Union minimum tax level set by relevant applicable Directive and for all other non-harmonized environmental taxes—, the necessity, proportionality and their respective effects at the level of the economic sectors concerned will be subject to an in-depth assessment under the guidelines' objective criteria specified on paragraphs 176–180 of the 2014 Guidelines.

Some scholars point out that the Guidelines' provisions with respect to reductions of environmental taxes and green levies are inadequate in several respects. In particular, they are considered to be weak regarding the necessity and proportionality criteria and rather vague, allowing much leeway to Member States.[63]

Besides, we can add that the concept of "environmental tax" defined in the Guidelines—and also in the GBER—checked against the notion of "energy tax", demonstrates that a specific configuration is used in the field of State aid. The latter stems from the reference to both the taxable base and the beneficial effects—from an environmental point of view—obtained from the tax concerned. In our opinion,

[61] *See* European Commission (2014a), para. 167–179.

[62] *See* among others, European Commission (2014a), para. 48 and 168.

[63] *See* Nicolaides and Kleis (2014). See also Nicolaides (2014), p. 164. The author states "it is (. . .) puzzling how exemption from environmental taxes can protect the environment. Moreover, the justification for this exemption is often based on weak reasoning".

this way of articulating the concept of "environmental tax" causes legal uncertainty, and excludes certain energy taxes and their incentives, which fall outside environmental policies.[64]

3 Energy Taxes *Versus* Environmental Taxes

Following Article 2 (119) of the GBER and Article 1.3 (15) of the 2014 Guidelines,[65] environmental tax means:

> A tax with a specific tax base that has a clear negative effect on the environment or which seeks to tax certain activities, goods or services so that the environmental costs may be included in their price and/or so that producers and consumers are oriented towards activities which better respect the environment.

Although most of the energy taxes can also be considered to be environmental taxes, the concepts of 'environmental taxes' and 'energy taxes' cannot be considered two overlapping concepts. Besides, the concept of environmental taxes is not clear-cut, different terms are used (i.a. environmental taxes, green taxes, eco-taxes, environmental related taxes) and there are at least three different definitions of environmental taxes both in the international and European context.[66]

This absence of clear-cut definition of environmental taxes leads to a large number of practical and conceptual problems, in particular because of the legal references to "environmental taxes" in the area of energy taxation.[67] For example, because if an "energy tax" is deemed to be "environmental" (to be understood as defined in the legal context of State aid for environmental protection), it can be considered compatible with the internal market on the basis of Article 107 (1) TFEU, the GBER[68] and the European Commission's Guidelines on State aid for environmental protection and energy (2014–2020).[69] Then, the exclusion of

[64] *See* Villar Ezcurra and Wegener (2015).

[65] There is also a common definition of "environmental protection" in both texts, in particular in Article 2, para. 101 GBER and European Commission (2014b), para. 19. Although the definitions are not exactly the same, their slight differences do not affect substance. In both cases, there is a broad definition including measures addressed, among others, the fight against climate change, sustainable and efficient use of energy and promotion of renewable energy sources. *See* European Commission (2014a), para. 2 and 3.

[66] *See* Pitrone (2014).

[67] Some authors categorise these problems in two categories: "The first set of issues may in part be attributed to the continuing difficulties in defining with any degree of real certainty the actual scope of the concept of an "aid". The second issue is to be attributed to the lack of transparency which has traditionally characterised the relationship between state interventions in publicly owned or controlled firms". *See* Hancher et al. (2006), p. 458.

[68] European Commission (2014b).

[69] European Commission (2014a), *See* earlier contributions on this topic in Villar Ezcurra (2013, 2014).

certain energy taxes and their incentives, which fall outside the scope of the "environmental policies" or the "harmonized taxes" from the particular regulatory framework, is at least, theoretically possible.

In our view, there is a need to assess whether the EU legal references to "environmental taxes" suits the purpose and effectiveness of the special treatment of energy taxation in the field of State aid. It may also be necessary to consider which formula could offer better compatibility and greater efficiency in light of State regulatory objectives, taking into account that this area is characterised by significant litigation.[70]

We consider it desirable to dissociate the exclusive environmental purpose of energy taxes from their treatment with regard to State aid. The objective would be to evolve into a conceptual model where taxes on energy are specifically treated as such (in line with the climate change and energy policies goals), and where tax incentives are subject, in turn, to the same treatment as environmental protection measures or other measures justified on grounds of protection of industrial sectors, technology development, combating relocation or other relevant measures.

4 Some References to Landmark and Recent Cases in the Energy Tax Field

In the history of EU State aid evolution, the case-law of the CJEU has played a crucial role in setting up rulings to ensure compliance with EU law.

Member States' taxes must be approached basically from the requirements of the State aids Treaty rules as being interpreted by the CJEU. Unstable *soft law* affects the exercise of tax sovereignty and State aid rules cannot be intended as a full substitute for the positive approximation of the energy tax system of the Member States.[71] Besides, under the so-called 'balancing test', it is held that economic analysis should be of a different order and purpose when it is concerned with the actions of Member States as opposed to firms.[72]

[70] In other words, energy taxes and energy incentives are not always able to achieve or improve environmental protection. However, some of them may be aimed at achieving other legitimate public policy objectives such as ensuring a competitive, sustainable and secure energy system in a well-functioning Union energy market.

[71] *See* Traversa and Flamini (2015), p. 330.

[72] Under the balancing test, in assessing tax incentives and exemptions the Commission will consider the positive impact of the aid (achieving the environmental protection objective, appropriate instruments, necessity and proportionality of the aid) in reaching an objective of common interest against its potentially negative effects (such as distortion of trade and competition between Member States). *See* European Commission (2005).

It is remarkable that several landmark cases in the area of taxation, like *PreussenElektra,*[73] *Adria Wien-Pipeline,*[74] *British Aggregates,*[75] *Transportes Jordi Besora*[76] and *Kernkraftwerke Lippe-Ems GmbH,*[77] or more recent cases like *Republic of Austria v. European Commission,*[78] deal with energy taxes or levies. These cases represent a significant step towards the clarification of the notion of State aid and its compatibility with the internal market. However, at the same time, these judgments show how puzzling the topic of energy taxation is.[79] Moreover, new trends in the case-law, for example the effects-based approach, according to which only the effect of the measure on the undertaking is relevant, and not the cause or the objective of the State intervention, may lead to new legal issues.[80]

According to settled case-law, in the absence of harmonization of particular tax provisions, Member States are not prohibited from granting tax advantages in the form of exemptions or reduced rates, in favour of certain products or undertakings. Indeed, tax advantages of this kind may serve legitimate economic, environmental and social purposes[81] and differential treatment of economic activities may be justified by reference to their respective statutory and regulatory conditions.[82]

However, under EU State aid law, the objectives of the measure are not taken into account. It is indeed common ground that the tax measure is examined only in

[73] Case C-379/98, *PreussenElektra v. Schleswag*, Judgment of 13 March 2001 (EU:C:2001:160), para. 58.

[74] Case C-143/99, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirection für Kärnten,* Judgment of 8 November 2001 (EU:C:2001:598), paras. 52–55.

[75] Case C-487/06 P, *British Aggregates Association v Commission of The European Communities and United Kingdom,* Judgment of 22 December 2008 (EU:C:2008:757), paras. 85 and 89.

[76] Case C-82/12, *Transportes Jordi Besora SL v Generalitat de Catalunya,* Judgment of 27 February 2014 (EU:C:2014:108), paras. 32–36.

[77] Case C-5/14, *Kernkraftwerke Lippe-Ems GmbH v. Hauptzollamt Osnabrück*, Judgment of 4 June 2015 (EU:C:2015:354), paras. 48–54 and 79.

[78] Case T-251/11, *Republic of Austria v. European Commission* (EU:T:2014:1060), Judgment of 11 December 2014 paras. 160–171.

[79] As Michael Honoré pointed out "regrettably, the Court of Justice does not offer such clarification very often. Instead, case-law is in this field (taxation) is mostly characterized by a case-by-case approach, with many questions left unanswered. Moreover, The General Court and the Court of Justice often disagree on the exact scope of State aid in the area of fiscal aid, which does not make life easier for companies and authorities trying to navigate in the State aid universe". *See* Honoré (2015), p. 308.

[80] *See* Case C-173/73*, Italy v Commission*, Judgment of 22 December 2008 (EU:C:1974:71), para. 13, and C-487/06 P, *British Aggregates v Commission* (EU:C:2008:419), paras 85 and 89. The effects-based approach contribute towards the policy goal of "less and better targeted aid" and is helpful in terms of increasing the effectiveness and predictability of State aid control. *See* Friederiszick et al. (2008), pp. 2 and 54.

[81] Case C-148/77, *Hansen jun. & O.C. Balle GmbH & Co. v Hauptzollamt Flensburg,* Judgment of 10 October 1978 (EU:C:1978:173), para. 16.

[82] Case C-353/95P, *Tiercé Ladbroke SA v Commission,* Judgment of 9 December 1997 (EU: C:1997:596), para. 35.

the light of its effects (which prevail over its objectives). The CJEU has constantly maintained that Article 107 (1) TFEU defines aids in relation to their effects and neither economic, nor fiscal nor environmental objectives can be taken into account for the appraisal of State aid. The question arises as to whether the objective pursued by the tax measure could be taken into account.

In that regard, it should be noted that the commonly known as the ‘three-step analysis’ cannot be applied in certain cases to analyse material selectivity, taking into account only the practical effects of the measures concerned. This means that in some exceptional circumstances, in order to apply State aids rules, it is also necessary to evaluate whether the boundaries of the system of reference have been designed in a consistent manner (is the levy itself the right reference system as it was stated in *Adria-Wien Pipeline*?[83]) or, on the contrary, in a clearly arbitrary or biased way, so as to favour certain undertakings which are in a comparable situation with regard to the underlying logic of the system in question.[84]

CJEU case-law therefore seems to indicate that only the effect of the measure on the undertaking is relevant and not the cause or the objective of the State intervention.[85] Yet, in *Adria-Wien Pipeline*, the ecological considerations underlying the national legislations at issue were relevant and “*do not justify treating the consumption of natural gas or electricity by undertakings supplying services differently than the consumption of such energy by undertakings manufacturing goods*” because “*energy consumption by each of those sectors would be equally damaging to the environment*”.[86] Similarly, in the *British Aggregates* case, the Court rules that “*it is appropriate to examine whether within the context of a particular legal system that measure constitutes an advantage for certain undertakings in comparison with others which are in a comparable legal and factual situation*”.[87] In some cases the Court refers to the objectives pursued by the “system” in question whereas in others

[83] The advantageous terms granted in this case to undertakings manufacturing goods were intended to preserve the competitiveness of the manufacturing sector within the EU. Then, providing an energy taxes rebate for an entire sector of the economy, such as the manufacturing sector, would be regarded as entailing a State aid. *See* Case *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirection für Kärnten, Judgment of 8 November 2001 (EU:C:2001:598),* paras. 52–55.

[84] *See* European Commission (2016), para. 129 and case-law references.

[85] *See* Case C-173/73*, Italian Republic v Commission of the European Communities*, Judgment of 2 July 1974, (EU:C:1974:71) para. 13, and C-487/06 P, *British Aggregates Association v Commission of the European Communities*, Judgment of 22 December 2008 (EU:C:2008:757) paras. 85 and 89.

[86] *See* para. 52. The advantageous terms granted in this case to undertakings manufacturing goods were intended to preserve the competitiveness of the manufacturing sector within the EU. Conversely, in *Stadtwerke Schwäbisch Hall GmbH v Commission*, the CJEU held that the treatment of tax reserves for the decommissioning of nuclear power stations and the safe disposal of nuclear waste in Germany did not constitute State aid since it was based on generally applicable provisions allowing for the creation of reserves by all undertakings satisfying the relevant criteria, see Case T-92/02, Judgment of 26 January 2006 (EU:T:2006:26) para. 93.

[87] *See* Case C-487/06 P, *British Aggregates Association v Commission of The European Communities and United Kingdom*, Judgment of 22 December 2008 (EU:C:2008:757), para. 82.

cases the Court mentions the objectives pursued by the "measure" in question. As it has been observed, this can bring about different outcomes.[88]

Regarding the features of an "energy tax" (although based on the harmonizing Directive of hydrocarbon taxes), the CJEU held that the concept must be related to its legal set-up for its admission as "environmental tax", especially in the case *Transportes Jordi Besora*. Since every tax necessarily pursues a budgetary purpose, the mere fact that a tax is intended to achieve a budgetary objective cannot, in itself, suffices to preclude that tax from being regarded as having a 'specific purpose' within the meaning of article 3(2) of Directive 92/12. According to the CJEU "*a tax such as the IVMDH could be regarded as being itself directed at protecting the environment (…) only if it were designed, so far as concerns its structure, and particularly the taxable item or the rate of tax, in such a way as to dissuade taxpayers from using mineral oils or to encourage the use of other products that are less harmful to the environment*".[89]

In *Kernkraftwerk Lippe-Ems* case, regarding the German nuclear fuel tax,[90] the CJEU clarified that article 14(1)(a) ETD is to be interpreted "*as not precluding national legislation which levies a duty on the use of nuclear fuel for the commercial production of electricity*". The Court points out two main reasons: firstly, the nuclear fuel that is the subject of the German Law (*KernbrStG*) does not constitute an energy product' for the purposes of the ETD and it is not, therefore, covered by the exemption laid down in this article of the Directive. Secondly, it cannot be applied by analogy to the nuclear fuel that is the subject of *KernbrStG*.[91] Besides, this case is also interesting due to the selectivity criteria analysis held by the Court. The Court stated as follows:

> methods of producing electricity, other than based on nuclear fuel, are not affected by the rules introduced by KernbrStG and that in any event, they are not, in the light of the objective pursued by those rules, in a factual and legal situation that is comparable to that of the production method based in nuclear fuel, as only that method generates radioactive waste arising from the use of such fuel.[92]

The arguments raised on *Eurallumnia SpA* case may solve the question concerning the respective powers of the Council and the Commission in the area of the harmonisation of legislation, on the one hand, and in the area of State aid, on the other.[93] The CJEU held that in the State aid area, the Council powers must be

[88] *See* Micheau (2014), p. 287.

[89] *See* Case C-82/12, *Transportes Jordi Besora SL v Generalitat de Catalunya*, Judgment of 27 February 2014 (EU:C:2014:108), para. 32.

[90] *See* Case C-5/14, *Kernkrafwerke Lippe-Ems GmbH v Hauptzollamt Osnabrück*, Judgment of 4 June 2015 (EU:C:2015:354).

[91] See Case C-5/14, *Kernkrafwerke Lippe-Ems GmbH v Hauptzollamt Osnabrück*, Judgment of 4 June 2015 (EU:C:2015:354), paras. 47–48 and 53.

[92] See Case C-5/14, *Kernkrafwerke Lippe-Ems GmbH v Hauptzollamt Osnabrück,* Judgment of 4 June 2015 (EU:C:2015:354), para. 79.

[93] *See* in the *Euralluminia SpA*. Case C-272/1P, Judgment of 10 December 2013 (EU:C:2013:812) and T-90/06 *RENV*, Judgment of the General Court of 21 March 2012 (EU:T:2012:134).

interpreted and applied strictly and should not deprive the Commission of the right to exercise its powers. [94]

Finally, interesting issues on State aids and energy taxation are extensively considered in the case T-251/11, concerning parafiscal levies in the Austrian Green Electricity Act.[95] The CJEU held that, while extra cost or additional cost are comparable to a special tax levied on electricity, the rules governing reductions of energy taxes under EU law cannot be applied to para-fiscal charges by analogy.[96]

It is important to highlight that the Court stated, in this case, that the whole Austrian scheme is a State aid incompatible with the internal market, against the Community guidelines on State aid for environmental protection. The Court stressed that the exemption does not reflect harmonization at EU level regarding taxation in the area of renewable energy.

5 Concluding Remarks

On the way to fiscal integration in Europe, harmonization of tax law did not succeed in the field of energy taxation, except for the minimum level of taxation regarding taxes included on the scope of the ETD. Conversely, *de facto* indirect tax harmonization in an effective manner has taken place through the action of the European Commission against Member States, which—according to the Commission—infringe the basic State aids set of rules constituting the internal market by using tax incentives.[97]

Currently, the legal framework on energy taxation and State aids distinguishes between harmonized and non-harmonized taxes. Besides, automatic aid energy schemes in the form of tax advantages should continue, under the GBER and the 2014 Guidelines, to be subject to a specific condition concerning the proof of the incentive effect, due to the fact that this kind of aid is granted under different procedures than other categories of aid.[98] It is also remarkable that there is not common understanding of what constitutes or does not constitute an "environmental tax" in the 28 EU countries. Even more, we do not have a categorization of "energy taxes" or "energy tax incentives or reliefs".

The analysis of legal context and CJEU case-law also shows that the EU State aid control rules of environmental and energy taxes involves a constant balance between different goals and values. Among those goals, the most important ones

[94] *See* Case C-272/12P, *European Commission v. Ireland and others*, Judgment of 10 December 2013, (EU:C:2013:812), para. 50.

[95] *See* Villar Ezcurra (2015).

[96] *See* Case T-251/11, *Republic of Austria v. European Commission*, Judgment of 11 December 2014 (EU:T:2014:1060), para. 68 and 169 and case-law referred on these paragraphs.

[97] *See* Fantozzi (2003).

[98] *See* Recital 20 of the GBER.

may be environmental protection, competition and trade, and, in an indirect way, competitiveness of national and European industries.

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Marta Villar Ezcurra is Professor of Tax Law at the San Pablo CEU University, Madrid, PI Project (2004-58191-P) and Coordinator of a Jean Monnet Project (ETSA-CE Ref. 553321-EPP-1-2014-1-ES-EPPJMO-PROJECT), RID: 0-7484-2015.

Intellectual Property, Taxation and State Aid Law

Cécile Brokelind

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Abstract This contribution on Intellectual Property, Taxation and State Aid Law investigates whether some tax incentives for Research and Development—and Innovation (R&D or R&D&I) adopted by EU Member States are in line with the legal framework of State Aid rules in the context of the EU policy objectives and of article 179 TFEU. The main issue is to know whether output tax incentives such as Patent Box regimes could be considered as selective State aid by the ECJ. The chapter considers this issue both prior to any amendments suggested by the OECD BEPS Action 5, and after potential implementation of the modified nexus approach. The result of this investigation shows that some features of the patent box regimes could trigger the application of article 107 (1) TFEU. Additionally, a notification under the State aid modernization rules would not lead to a positive decision as several doubts remain on how output tax incentives such as Patent box regimes remedy the market failures for which a State aid is granted, i.e. increasing R&D&I in the EU (and not in one Member State only).

C. Brokelind (✉)
Lund University, Lund, Sweden
e-mail: cecile.brokelind@har.lu.se

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax
Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_12

1 Purpose Statement and Research Questions

The purpose of this chapter is to assess some issues on the compatibility of tax incentives for Research and Development—and Innovation (R&D or R&D&I) adopted by EU Member States with the legal framework[1] of State Aid rules in the context of the EU policy objectives.[2] Promoting R&D hopefully results in creating intellectual property rights (IPR) for the investor and hence provides the owner with a competitive advantage.

In addition thereof, a generous tax treatment of income arising from these IPR may increase this competitive advantage but at the same time infringe the State Aid prohibition (art. 107.1 TFEU). However, encouraging innovation and R&D is a priority for the EU, and is considered a cornerstone of economic growth and prosperity from an economic viewpoint.[3] Nonetheless, can innovation and R&D be promoted at any price?

As a matter of definition, it can be useful to distinguish R&D from innovation. According to the OECD "Research and experimental development (R&D) comprise creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of man, culture and society, and the use of this stock of knowledge to devise new applications."[4] Innovation covers "all those scientific, technical, commercial and financial steps, other than R&D, necessary for the implementation of new or improved products or services and the commercial use of new or improved processes."[5] However, the EU refers to "R&D&I" as one single concept.[6] For the sake of this study, the concepts will be assimilated unless a special interest to distinguish them arises.

The first question is to know whether the EU's policy on R&D supports a number of tax incentives leading to IPR, which is a current practice of EU Member States. As exposed extensively in academic debates, EU Member States have introduced several attractive tax regimes in order to foster and attract more R&D investments worldwide.[7] Additionally, some EU Member States promote IPR owners, granting a favourable tax regime to the income arising from the IPR (such as "patent box rules or IP boxes"). Most of these schemes reserve the tax advantage to IPR owners instead of granting a competitive advantage to actual users of the intangible rights. Whereas these tax regimes fall under a harsh critic for

[1] Article 107(1) TFEU; European Commission (2014a, e).

[2] Article 4(3) TFEU and articles 179–190 TFEU.

[3] OECD (2013); European Commission (2014b), p. 17.

[4] OECD (2002), para. 63.

[5] OECD (2002), para. 87.

[6] European Commission (2010b).

[7] Arginelli gives account of this research. See Arginelli (2015). See also Matteotti and Roth (2015a, b). Danon (2015), Luja (2015).

causing harmful tax competition between EU Member States themselves,[8] the critical assessment of the tax incentives in question for EU law purposes is less straightforward. While Member States of the EU remain sovereign for tax purposes, they may act only in respect of the legal EU framework on the creation of an internal market. Consequently, Member States may not freely decide to subsidize purely national R&D operations or operators, and cannot either exclude from the benefit of their incentives other EU Member States' economic actors. This would undermine the level playing field in the EU. The next question is therefore, to know whether Member State of the EU can legitimately financially encourage R&D at all, and if so, in which form.

A large interest for this question has already generated a substantial academic literature in the tax policy sphere, and in the EU tax law sphere.[9] The goal of this article is to bring the debate on tax incentives' legitimacy at an EU law level. The question could be redrafted as follows: At which level of competence shall R&D be fostered? And how? When the level of legislative competence is determined then only it becomes possible to find out whether the present Member States tax incentives are in breach of EU law or not.

The plurality of legal sources on which the answer to these questions has to be found makes the investigation challenging to structure. A reflection on the nature of IPR in the light of competition law (2) will serve as an introduction to the conundrum of reconciling EU R&D objectives (3) with that of State Aid law (4).

2 Intellectual Property Rights in the Context of EU Competition Law

Intellectual property rights (IPR) are the rights given to persons over the creations of their minds. They usually give the creator an exclusive right over the use of his/her creation for a certain period of time.[10] The term Intellectual property rights refer to two categories of intangible rights: Copyrights and industrial rights. It is fairly convenient to subdivide the industrial property rights category into two: The first subcategory of rights features those rights, which protect distinctive signs or characteristics of a given product. They stimulate and ensure fair competition and protect consumers, enabling them to decide which product to buy. The second subcategory includes rights meant to stimulate innovation, design and creation of technology, such as patents, industrial designs and trade secrets. These rights are meant to provide protection of the results of an investment in the development of a

[8] European Commission (2015), para. 2.3 on patent boxes and nexus approach; European Commission (2009) on harmful tax competition and the code of conduct.

[9] Danon (2015). European Commission (2014b), OECD (2015), Traversa (2014), Hansson and Brokelind (2014), and Luts (2014).

[10] World Trade Organization (2015).

new technology, and herewith, an incentive and means to finance R&D activities. They clearly provide for a monopoly to the owner of the right in question, which from a competition law viewpoint (art. 102 TFEU) is disputable, and therefore, the exclusivity may be subject to a number of limitations and exception for achieving a balance between the legitimate interests of the owner and that of users.[11]

In a nutshell, the legal monopoly arising from the IPR may impact positively[12] and negatively (few producers on a market) the decision to invest in R&D. Since the investment decision in R&D depends upon the ultimate benefits the invention may trigger, IPR are a necessary incentive, but do limit the entrance of competitors into a given market. Together with tax incentives for R&D, IPR prove contentious from an economic viewpoint, since the monopoly tends to limit the spill over effect of technology transfers.[13] Scholars have already demonstrated that IPR resulting from State aided R&D can affect trade between Member States and distort competition in the internal market.[14] However, and generally speaking in EU competition law, an IPR holder may not exclude competitors for the use of its rights when a licence thereof is essential to competition, and may not either monopolise a secondary market or introduction to a new product market though exercise of its IPR.[15] In the context of taxation, patent rights are supposed to generate taxable income arising thanks to this monopoly. The adoption of favourable tax rules on the top of the legal monopoly proves contentious for economic research purposes.[16] The outspoken goals in domestic tax policies for such favourable tax measures are certainly to promote R&D input activities, but also to stimulate the direct use of newly created and valuable intangibles in the production of goods and services, to attract highly mobile capital (intangibles) and to avoid exit of highly mobile capital and business activities.

However, the diffusion of innovation seems the most important target in EU law, irrespective of which tax rules apply on income generated by IPR, or of the prohibition of State Aid rules. At which legislative level (national or European?) shall incentives for R&D&I be adopted in order to best fulfil the targets of the EU R&D Policy? This is a matter of legislative competence.

[11] See for instance Anderman and Schmidt (2011), pp. 33 ff.

[12] The economic literature reports a link between large investments in R&D spending and an IPR granting monopoly. See for instance Mathieu and van Pottelsberghe de la Potterie (2010).

[13] Bloom et al. (2007). Cisnero (2014b).

[14] For an overview of relevant literature, see Cisnero (2014a).

[15] See for instance ECJ, *IMS Health GmbH &co*, C-418/01, 29 April 2004, EU:C:2004:257 on the application of art. 102 TFEU (abuse of dominant position). For a comment, see Schovsbo (2012), p. 40.

[16] Bloom et al. (2002), Griffith et al. (2011, 2014).

3 R&D&I Policy: Whose Competence?

From a policy viewpoint, the Lisbon Treaty acknowledges the importance of promoting scientific and technical advance that became in 2009 an objective of primary EU law (art. 3.3 Treaty on European Union). Far-reaching legal bases for the creation of the European Research Area (ERA) were therefore introduced in the TFEU on "Research, Technological Development and Space" (art. 179–190 TFEU). Promoting research and development and innovation ('R&D&I') is an important Union objective laid down in Article 179 of the Treaty, which states that "[t]he Union shall have the objective of strengthening the scientific and technological bases by achieving a European research area in which researchers, scientific knowledge and technology circulate freely, and encouraging it to become more competitive, including in its industry, while promoting all the research activities deemed necessary (. . .)". Articles 180 to 190 TFEU determine the activities to be carried out in that respect and the scope and implementation of the multiannual framework programme. Among others, article 182.5 TFEU provides for the adoption of measures necessary to implement the ERA through ordinary legislative procedure. The European Commission is in charge of coordinating mutual consistency between the EU and Member States' R&D policies.

However article 4(3) of the TFEU provides that the EU has competence to carry out activities, in particular to define and implement programmes in R&D, as long as it does not prevent Member States from exercising their own competence. It is therefore an area of shared competence. But this competence must be considered in the light of other EU competences. On the one hand, Member States are therefore free to choose the forms of national support to R&D, may it be through selective aid to undertakings, but on the other hand, the establishment of state aid rules necessary for the functioning of internal market remains an exclusive EU competence (art. 3 (1) (b) TFEU). Interestingly, the formulation of this shared competence is different from that in other fields. In other cases of shared competence, Member States act only in so far as the Union has not exercised or has stopped exercising its competences (art. 4.2 TFEU). From a legal perspective, when measures are adopted on EU level and Member States are obliged to implement them without any or very little discretion, they do not fall under State aid rules, as they are not imputable to the Member States. Hence, when the Commission implements and administer R&D programs, these actions are not imputable to the Member States as well. However, when Member States act on their own, i.e. introduce tax incentives, they may forego their resources and in such cases selectivity must be analysed as State Aid rules apply.

The EU Commission's State Aid policy has a direct link with the R&D policy expressed in 2010 within the so-called Europe 2020 strategy.[17] At the same time and in parallel, the European Commission initiated a modernization of the State Aid instruments and issued smoother rules for State Aid procedures in the R&D&I area.

[17] European Commission (2010a, b).

Whereas it is generally accepted that competitive markets tend to bring about efficient results in terms of prices, output and use of resources, in the presence of market failures, state intervention may improve functioning of the markets. In the context of R&D&I, market actors engage in a level of activities, which is too low from the viewpoint of society and needs to be encouraged. State aid for R&D&I can be compatible with the internal market insofar as it alleviates market failure to promote projects of European interest, "where the ensuing of distortion of competition and trade is not contrary to common interest". [18]

In its project on modernization of State aid rules,[19] the European Commission also expressed a number of policy goals in line with the R&D&I policy expressed above. The ECOFIN also supports the objectives of redirecting State Aid towards initiatives that can efficiently and effectively support European 2020 growth objectives. However, the Council expressed the need to prioritise scrutiny of those types of aid, which are potentially the most harmful to the internal market, and focus on effective evaluation and control of compliance of State aid rules (understated fiscal aids).[20]

All these policy statements pave the way to a stricter control of tax incentives for R&D&I under State Aid rules, when they distort competition. The European Commission exercises thereby its exclusive competence of monitoring competition law and hence, Member States' policy initiatives cannot undermine this competence. That is how the law as it stands is formulated and explained hereafter.

4 EU State Aid Law and Tax Incentives for IPR

The control of State aid is twofold: Either it prohibits State aids (Art. 107.1 TFEU) or it allows States under certain conditions, among others through the notification requirement (art. 107.3 TFEU). The Council issues its regulations based on Art. 109 TFEU.[21] Under Art. 108.4 the Commission is given competence to issue regulations based on Council Regulations.[22] The cumulative conditions for prohibiting State aid, which are the existence of a form of advantage, granted through state resources, being selective, and distorting competition and affecting trade between Member States, also apply to tax incentives.[23]

In the lack of ECJ case law dealing specifically with IPR tax incentives such as IP boxes, it remains an open discussion to determine whether existing IP box regimes would be declared compatible with article 107.1 TFEU. There are,

[18] European Commission (2014a), para. 4.

[19] European Commission (2012).

[20] ECOFIN Council (2013), p. 19.

[21] Council of the European Union (2015), pp. 1 ff.

[22] European Commission (2013b), pp. 1 ff.; European Commission (2014e), pp. 1 ff.

[23] European Commission (1998). See also European Commission (2014c).

however, arguments to fetch from a number of other cases dealing with either input R&D incentive, or other kinds of tax incentives.[24]

The main issue at stake is to know whether such tax rules apply *selectively* to certain undertakings, in which case the prohibition of article 107.1 applies. This is the key issue in respect of taxpayers enjoying a favourable tax regime for the income arising from IPR.

4.1 Selectivity of Tax Incentives for IPR Income

The selectivity requirement excludes at the outset all general measures (not especially directed towards a sector of economy) and those inherent to a tax system (such as deductions and favourable rules expressing the ability to pay for instance).[25] Tax incentives for IPR featuring favourable tax rates for income arising from patents or trademarks are at first sight, designed for the benefit of all who obtain these rights, and should escape the State aid prohibition.[26] However, a closer analysis of the comparable situation of undertakings benefitting from the IP box regime and other undertakings should be carried out to confirm this statement.

In order to determine whether an IPR owner enjoying a favourable tax treatment is in a different situation than other taxpayers in a comparable situation, it is necessary to apply a three-step analysis, as applied by the Commission after evolution of the ECJ case law on the selectivity requirement: (1) determine the general tax system applicable (full taxation of business profits); (2) identify the deviation (reduced tax on IPR income for *certain* undertakings) and (3) assess whether the deviation can be justified by the nature or general scheme of the tax system (foster R&D). In respect of income arising from IPR, all depends on the extent of the tax incentive, and of its scope. The terms of comparison are not established in the law, and doctrinal debates have highlighted the difficulty of the exercise.[27] As stated by the ECJ, the question is to know whether the state measure favours “certain” undertakings in comparison with other undertakings, which are in comparable legal and factual situation in the light of the objective pursued by the measure in question. How would this comparison be carried out for IP box regimes, is the next question.

Within the EU, Belgium, Cyprus, France, Hungary, Luxembourg (until 2016), Malta, the Netherlands, Portugal, Spain and the UK have adopted an IP box regime.

[24] For a detailed analysis of the Patent Box regimes, see Micheau and De la Brousse (2013), pp. 155–163.

[25] Schön (1999) was one of the first authors to explain the selectivity requirement.

[26] This is the view of for instance Luja (2015), p. 6, referring to the Commission’s practice: European Commission (2008), p. 3; European Commission (2005), p. 2 and EFTA Surveillance Authority (2011).

[27] See for instance Szudoczky (2014), chapter 9.

These tax rules either provide for a lower effective tax rate of output of the IPR in form of licensing or sale of these rights, or ad hoc allowances and tax credits for the acquisition of such IRP, and even selective lower taxation of the profits stemming from the sale of goods and the provision of services arising from these IPR. The intangible assets qualifying for the tax relief vary to a great extent; some regimes reserve the benefit of the tax relief to IP developed in-house, whereas others allow a relief even to acquired intangibles from third parties. Another variable element is the inclusion or not of marketing related IP rights such as trademarks, and the patent rights acquired from related parties. Finally, some regimes allow the incentive to apply on a net basis only (i.e. the input R&D expenses leading to the patent rights are excluded from the computation of the tax advantage), but some apply on a gross basis.[28] In other words, the variety of qualifying intangible assets, and qualifying income arising from IPR makes it difficult to come to a general conclusion on which undertaking compares to which other one.

The selectivity requirement is met when the domestic law in question applies the derogation to the general system *prima facie* or *de facto*. When the tax relief is meant to support R&D in general, but is available to income from IPR only, it is possible to talk about *prima facie* selectivity. Indeed, not all undertakings carrying out R&D obtain patents or IPR for each project. Such *prima facie* selectivity arises when the tax incentive is drafted in such was as to benefit only certain undertakings or the production of certain goods in comparison with 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."[29] A good example of this kind of *prima facia* selectivity arises from the administrative or tax rulings (advance pricing agreements—APA—for instance) that taxpayer may enjoy providing for a lower tax rate.[30] In the same spirit, the report of losses allowed for ailing companies, which changed more than 25 % of their shareholders, is a prima facie selective rule.[31] When the distinction is so clear, then the regime is selective *per se*, and has to be justified in the light of the objective of the measure itself. When the measure's objective is to *promote R&D*, the IP box can be justified only to the extent that there is no other way to promote R&D, which is unlikely, as other measures are possible (states financing new premises, researchers salary, direct grants etc.. . .). However, when the objective of the IP Box is to *promote innovation*, the IP Box can be justified only to the extent that all undertakings carrying out an activity leading to

[28] See for instance Evers et al. (2015); Arginelli (2015), pp. 32–33. The IFA congress for 2015 studies in a comparative approach R&D incentives of many jurisdictions where some sources can be fetched.

[29] ECJ, *Portugal v. Commission*, C-88/03, 6 September 2006, EU:C:2006:511, para 54; ECJ, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirektion für Kärnten*. C-143/99, EU:C:2001:598 para 41.

[30] SA.38375 State aid which Luxembourg granted to Fiat, negative decision of 21 October 2015 not published yet; SA.38374 State aid implemented by the Netherlands to Starbucks, negative decision of 21 October 2015, not published yet**.**

[31] GC, Heitkamp Bauholdig GmbH, T-287/11, 4 February 2016, EU:T:2016:60, para 141.

innovation are included in the regime, as well as all kinds of expenses for projects leading to IPR.

Consequently, these patent box regimes covering only patents, designs and models, plans or secret formula and excluding trademarks or commercial rights for copyrights or literary and artistic works appears be selective: There is no justification for reserving the tax advantage to patent rights only in the light of the objective of the measure itself. The promotion of innovation requires all kinds of IP rights to be covered, and not only those covering fundamental, experimental research products for instance.

In brief, this means that the purpose of fostering R&D&I (as promoted under article 179 TFEU) requires EU Member States to include in their IP box regimes all undertakings carrying out R&D and obtaining innovation products, which may be broader than what some of the existing schemes provide for (UK for instance, reserving the favourable tax rate to income from patent).

The EU Commission has already scrutinized a number of these schemes under State aid law and has come to different conclusions, which shows neither clarity nor general conclusion. This lack of decisive approach is expressed in a Commission's press release of 24 March 2014 (IP/14/309), admitting that there are indications that such regimes, although drafted generally by the law, actually mainly benefit highly mobile businesses and *do not trigger significant additional R&D activity*. Additionally, in the Gibraltar Grand Chamber case[32] the ECJ has expressed a stricter approach of the tax exemption for passive income attracting FDI, and all these rules render the field non-transparent.[33] Under this case law, business activity such as the licensing of IPR should be taxed at the same rate as other business activity.

At the time of writing, there are pending cases on the way in respect of a Spanish goodwill amortization that may cast new light on these issues though.[34] The selectivity condition is fulfilled when the law identifies a specific category of undertakings, which can be distinguished on account of their specific characteristics. This condition is not fulfilled according to the General Court when a domestic measure treats undertakings which are taxable in one Member State more favourably than undertakings which are taxable in the other Member States, in

[32] ECJ, *European Commission* (C-106/09 P) *and Kingdom of Spain* (C-107/09 P) *v Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland*. 15 November 2011, EU: C:2011:732.

[33] See for instance Zammit (2015).

[34] Commission decision of 1 April 2008 (European Commission (2011)) confirmed in the General Court's cases: *Spain v. Commission*, T-515/13 and T-719/13, 17 December 2015; *Autogrill España, SA v European Commission*, T-219/10, 7 November 2014, EU:T:2014:939 and *Banco Santander, SA and Santusa Holding, SL v European Commission,* T-399/11, 7 November 2014, EU:T:2014:938 . Both are under appeal to the ECJ under the numbers C-20/15 P and C-21/15 P.

particular because the measure facilitates acquisitions by undertakings established in a Member State of shareholdings in the capital of undertakings established abroad does not affect the analysis of the selectivity criterion.[35] The question is whether the other way round also follows this reasoning, when patent box regimes are reserved to domestic projects in R&D&I.[36]

Some doctrinal opinions suggest that patent box regimes are not *prima facie* selective as they are broadly open to all undertakers, irrespective of their size, legal structure or business sector in which they operate, but that still, some points of attention should be scrutinized, especially if the use of patent box is strongly concentrated among a limited number of undertakings.[37] On the one hand, it is clear that lower tax rates on royalty income arising from IPR deviate from the general CIT system. It can be argued, however, that they may be justified by the logic of the system when they correspond to general economic policy objectives through a reduction of the tax burden related to certain production costs (R&D, environment, training, employment).[38] However, the reduction of R&D costs is more efficient with input tax incentives rather than with output incentives such as IP box regimes. On the other hand, an incentive open to all economic actors which stimulates new R&D projects, in such way that no new investment would have been carried out without the tax incentive, and which contributes to the common goal of creating more R&D efficiently could be justified by the logic of the system, even though it proves selective *de facto*.[39]

4.2 Justification on the Ground of Economic Policy Grounds

In the situation where an IP box regime is selective *prima facie*, the measure can still be justified by the nature or general scheme of the system. The Commission's draft notice of 2014 states "This is the case where a measure derives directly from the intrinsic basic or guiding principles of the reference system or where it is the result of inherent mechanisms necessary for the functioning and effectiveness of the system. On the contrary, external policy objectives which are not inherent to the system cannot be relied upon for that purpose."[40]

[35] ECJ, *Banco Santander, SA and Santusa Holding, SL v European Commission,* T-399/11, 7 November 2014, EU:T:2014:938 at para 76.

[36] AG Kokott suggested in her opinion in C-66/14 of 14 April 2015 that this distinction between "national and non-national" beneficiaries would not be relevant. ECJ, *Finanzamt Linz v Bundesfinanzgericht, Außenstelle Linz,* C-66/14 5 October 2015, EU:C:2015:661.

[37] See Luja (2015).

[38] At least that was the Commission's view in its 1998s notice.

[39] For arguments in support of IP box stimulating new R&D and favouring a spill over effect of technology transfers, see Arginelli (2015), p. 41.

[40] Draft Commission Notice on the notion of State aid pursuant to article 107(1) TFEU, 14 January 2014, para 138.

The question is therefore to know whether an external policy objective such as the promotion of R&D&I, which is both of national and of EU competence, would be considered as a valid justification ground for the IP box regime on the ground of economic efficiency. The decisive issue is, therefore, whether IP box regimes are efficient to promote R&D&I. Academic research finds that economic evaluations of existing R&D incentives provide us with no strong support for R&D incentives being effective despite them being theoretically motivated.[41] Indeed, it could be difficult to show that the tax forgone is compensated by an increase of taxable bases and spill-over effects from the R&D activities (creation of new research centres, increase of the amount of sales of products attributable to the IPR owner etc.).[42] IP box regimes should generate more taxable bases than the tax foregone in order to be justified for the need to ensure the efficiency of the tax system, which is controversial. In any circumstances, this measure, even if justified, should be made proportionate to the goal it fulfils, i.e. promote more R&D&I.[43] The question then turns to know whether promoting R&D&I could occur through a less straightforward tax exemption than that of an IP Box, which is certainly possible. It could be argued that the monopoly arising from the patent right is a sufficient incentive in itself.

Against this background, the conclusion to draw from the application of article 107(1) TFEU is that IP box regimes may qualify as selective state aids, in the situation where the incentive is conceived in a way to promote and generate more R&D&I in the EU, but does not reach this goal or does not benefit all undertakings engaged in R&D&I while not only obtaining patents under equivalent conditions. An IP box regime reserved to patent rights and excluding for instance trademarks or other marketing rights from the favourable tax system would be difficult to justify from the objective of the measure itself, as the deviation from the benchmark is not are inherent to the tax system.

As expressed in doctrinal debates, there are as many arguments in favour of the application of article 107(1) TFEU as well as against.[44] In any circumstances, some questions remain to be answered in respect of the existing IP box regimes existing in the EU. Among others, the question is to know whether the nexus requirement under the recommendations under BEPS action 5 would change the analysis under both article 107(1) TFEU and article 49 TFEU (freedom of establishment).

[41] Hansson and Brokelind (2014), p. 189.

[42] Arginelli (2015), pp. 40 ff.

[43] ECJ, *Paint Graphos and others*, Joined Cases C-78/08 to C-80/08, 8 September 2011, EU: C:2011:550, paragraph 75.

[44] Luts (2014), p. 266.

4.3 IP Boxes, Harmful Tax Competition and Territoriality

Whilst the goal of fostering more R&D&I in the EU may be a valid policy argument in favour of IPB regimes, the resulting tax exemption of IPR income attracts FDI and has triggered critics at the international tax policy level. The outcome of these discussions results in the OECD release of 5 October 2015, of recommendations under Action 5 to revamp the work on harmful tax practices.

In a nutshell, the OECD recommends its members[45] to introduce a substantial activity requirement for IPR tax regimes already in force. Under this recommendation, only such income that arises from qualifying assets by qualifying taxpayers may benefit from the favourable tax rate provided for under IP box regimes. The goal of this recommendation is to ensure that Member States do not engage in harmful competition, while attracting foreign investors who do not contribute to the domestic economy. Among others, the transfer of IPR within affiliated companies in MNEs is seen as the worse case scenario. The OECD therefore recommends that States offering a patent box incentive should not allow a lower tax rate for intragroup transactions lacking corresponding substantial R&D activity in the same State.

This policy approach was not adopted in a view to generate more R&D, but to address the tax base erosion problem caused by harmful tax competition involving IP box regimes. Consequently, the recommended method ("nexus ratio") limits the income from IPR receiving tax benefits in proportion to the share of "own" R&D expenses, excluding from that incentive the income on IPR rights shifted intragroup. It also goes further, as allowing the patent box regime to apply to income from IPR arising from outsourced IPR to related parties up to 30 % of the amount of R&D acquired in the limit of the taxpayer's overall expenditures. However, outsourcing to unrelated parties is not controversial and does not trigger any limits for the tax relief.

Additionally, the OECD recommends its members to allow patent box regimes under restrictive conditions in respect of qualifying expenditures (a) and qualifying taxpayers (b). Both limitations may raise a number of problems in respect of the State aid rules, as well as of the freedom of establishment rules.

4.3.1 Qualifying Expenditures

Firstly, the BEPS action 5 requires States with IP box regimes to limit the amount of the tax incentive provided for in proportion of the *qualifying expenditures* on R&D incurred to develop the IP asset. These expenditures are therefore restricted to "actual R&D" (para 39 ff). The recommendation allows "salary, wages, direct costs and overhead costs directly associated with R&D facilities, and cost of supplies so

[45] Most EU Member States are also OECD members except for Cyprus, Latvia, Lithuania, Malta (enjoying a patent box regime), Romania, Bulgaria and Croatia.

long as all of these costs arise out of activities undertaken to advance the understanding of scientific relations or technologies, address know-how scientific or technological obstacles, or otherwise increase knowledge or develop new applications" as qualifying expenditures. However, it excludes interest payments, building costs, acquisition costs or any costs not specifically linked to a specific IP asset from the list of qualifying expenditures.

None of the existing regimes actually applies this clear distinction in their tax rules, but they tend to apply another form of substantial control.[46] Some regimes apply on a notional tax base, including the whole profits derived from the sale of goods and services imbedding an eligible intangible as qualifying IP income and then reducing such profits in order to carve out the part thereof attributable to routine business functions and non-eligible assets, and exclude financial expenses.[47]

Some other regimes apply the favourable tax rate to the income arising from the use of IP rights only, and not on the products they generate, irrespective of the amount of R&D costs incurred previously.[48] This OECD requirement, although already present in several tax regimes adopted by EU Member States, reserves the tax break to taxpayers not outsourcing nor acquiring R&D from related parties, or if they do, they have to prove the business reason for it (rebutting a presumption). Therefore, this may amount to a selectivity *prima facie* in the meaning of the ECJ's case law on article 107.1 TFEU since only those undertakings sufficiently equipped with own R&D facilities would qualify. However, it could be argued that since R&D facilities are not reserved to a category of taxpayers by the legal framework itself, a state aid measure such as the non-application of nexus to taxpayers with R&D facilities would not be selective *prima facie*. However, the nexus approach would have an effect to reserve a patent box regime to a selected number of undertakings, those investing in R&D facilities in the same Member State as that where the tax incentive is granted.

Could this be justified in light of the objective of the system? One of the reasons for justifying a deviation to the benchmark can be the application of measures preventing tax evasion, or effectiveness of fiscal supervision as belonging to the logic of the tax system.[49] One could argue that the fight against abusive practices (such as carried out applying a nexus approach) and anti-avoidance rules may be considered fulfilling this goal.[50]

[46] Arginelli (2015), p. 29.

[47] For instance the UK patent box regime, see Obuoforibo (2013), section 3.4.

[48] France for instance, applies to royalties and the outright sales of patent rights a reduced rate for long term capital gains (art. 39.12° CGI). Some specific provisions on the control of the substance of the transactions allow the tax authorities to challenge the right to deduction of the licensee especially when both companies are related (art. 39.13° CGI).

[49] European Commission (2014c), para. 39 ff., and para § 184, quoting GIL insurance C-308/01.

[50] ECJ, *GIL Insurances,* C-308/01, 29 April 2004, EU:C:2004:252, para 74; Commission Notice of 1998, para 12.

Moreover, the ECJ case law on the freedom of establishment (article 49 TFEU) indicates that a requirement of proof on the actual existence of an economic activity when tax reasons predominantly motivate the set up would not meet the proportionality requirement for such a justification.[51] Hence, the law implementing such a requirement could be held selective under article 107(1) TFEU, as the *prima facie* selectivity would not be cured by an objective reason linked to the general scheme of the measure, as it does not seem to pass the proportionality test, as applied by the ECJ in the case law on the freedom of establishment.[52] For the same reason, the BEPS recommendation requires a substantial documentation of tracking the expenses for R&D especially when IP regimes are product-based rather than IP asset based. This would make the nexus approach difficult to justify on the basis of the logic of the tax system, as less stringent measures to combat abusive practices could apply. For instance, the actual spending of R&D expenditures does not need to occur in the same territory than where the patent box regime is granted in order to obtain patents, and may be the proof of R&D expenditures *somewhere* is sufficient to show the link between the expenses and the R&D product. Besides, the loss of tax revenue, which the BEPS recommendation remedies, is not inherent to the logic of the tax incentive's goal to generate more R&D, and would probably not constitute a valid ground of justification.

Additionally, the BEPS recommends States to limit the tax incentives to "patents and other IP assets that are functionally equivalent to patents…".[53] The equivalents are meant to cover software copyrighted (as they share the fundamental characteristics of patents being "novel, non-obvious and useful") and utility models, plants and genetic material IPR, orphan drug designations and extensions of patent protections. However, any other IP asset featuring a certification process are allowed only when the qualifying taxpayer has an annual global group-wide turnover of 50 million € and do not earn themselves more than 7.5 million € in gross revenues from all IP assets on a 5-year average.[54] All intangibles on commercialization of IP rights such as trademarks should also be excluded from the scope of the patent box regime. At the outset, limiting the number of IPR rights related to a successful R&D activity may reduce the scheme's efficiency. Additionally, the threshold for including "derivative" IPR rights in the qualifying assets targets SMEs, and this is a *prima facie* selection,[55] the justification of which under the objective of the system remains unclear.

[51] ECJ, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue,* C-196/04, 12 September 2006, EU:C:2006:544, para 76.

[52] Szudocky explains the link and the similarity between these two fields of law in her PhD Thesis. See Szudoczky (2014).

[53] OECD (2015), para. 34.

[54] OECD (2015), para. 36.

[55] By analogy see European Union (2006) and the de facto selectivity of supporting SMEs access to capital risk.

4.3.2 Qualifying Taxpayers

The BEPS action 5 also limits the number of qualifying undertakings that can benefit from the tax incentive. For instance, it defines qualifying taxpayers as resident companies, or domestic PEs of foreign companies, and foreign PEs that are subject to tax *in the jurisdiction providing the benefits*.[56] Requiring the taxpayer to be subject to tax on a territorial basis proves controversial in the field of R&D. It should be noted that in the first drafts, the OECD had introduced a clear territorial nexus requirement, and commented that "Jurisdictions that are not Member States of the European Union could modify this limitation to include all qualifying expenditures for activities undertaken by both unrelated parties and resident related parties in the definition of qualifying expenditures."[57] Even though the final document was amended does not require in clear text a *territorial* nexus, it introduces indirectly a link between the amount of R&D financed by a taxpayer, and the income it personally generates *within one single tax jurisdiction*. The question is whether this requirement would pass the test of EU law on the freedom of establishment.

EU Member States providing for IP box regimes for resident taxpayers cannot exclude non-residents in a comparable situation (i.e. for the purpose of promoting R&D). Requiring that only "non-residents subject to tax" can access the benefit of the patent box regime may restrict the freedom of establishment and the freedom of provision of services. When IPR owners have to be subject to tax in the state where they carry out R&D, their choice of localisation of R&D is restricted. According to the ECJ case law on the input tax incentives, it is not possible, for a State, to argue that only domestic R&D can be financed by domestic tax foregone. The OECD means to align output incentives on input incentives, which are drafted in a way to reserve incentives for domestic operators or domestic R&D. However, this is not EU law compatible.

As explained in *Argenta Sparbanken*, the head office of a foreign branch is in a comparable situation as a head office of a domestic branch in respect of the need to finance their activities.[58] Therefore the tax incentive for risk capital should apply equally irrespective of where an undertaking has a permanent establishment in form of a PE, when both are taxed the same way.[59] A similar reasoning could apply for the limitation of patent box regimes to PEs subject to tax in the State where the incentive is offered. Indeed, this does not mean that there has been no R&D activity at all in the head office's state. The head office may be involved in operations linked to the R&D (management, organisation and so on) that would not have been possible for the foreign PE to carry out.

[56] OECD (2015), para. 33.

[57] OECD (2014), footnote 8 of Chapter 4.

[58] ECJ, *Argenta Spaarbank NV v. Belgische Staat*, 4 July 2013, EU:C:2013:447.

[59] ECJ, C-388/14, *Timac Agro,*17 December 2015, EU:C:2015:829, para 21/22.

Additionally, and even more importantly, article 179 TFEU clearly provides that R&D incentives cannot occur on a territorial basis. This has been confirmed repeatedly in the ECJ case law.[60] Indeed, the Court has constantly said that even if the promotion of R&D may be justified for public policy reason, it nevertheless considered that national legislation reserving the benefit of a tax credit (input incentive) solely to research carried out in the Member State concerned is directly contrary to the objective of EU policy in the field of research and technical development.[61]

The nexus requirement excludes from the tax incentive all R&D operators, which have set up their research centres in the form of branches in other States than where the IPR is granted and where the income arising from IPR is taxed. Even if this is an efficient way to avoid double non-taxation or rather, the use of double incentives (deduction of R&D in the foreign PE state and low taxation of incoming IPR income such as royalties), this limits the choice of localization of R&D activities in one State, which frustrates the freedom of establishment of article 49 TFEU. The tax treatment of a head office with a domestic branch or a foreign branch carrying out a comparable activity of R&D would not be similar. Even though the selectivity requirement under article 107(1) TFEU may not be fulfilled just because the benefit of the tax incentive excludes foreign PEs, it remains that the Commission would not be able to authorise a State aid violating the freedom of establishment.[62] Moreover, the requirement of selectivity can for instance be fulfilled when a tax measure is constructed in such way as to promote *domestic* R&D, whereas companies performing R&D in another Member State have to bear the full tax burden.[63] The question is to know whether the justification ground of preserving a balanced allocation of taxing powers often put forward successfully would supersede this objective of a common EU R&D policy.

[60] ECJ *Société Baxter, B. Braun Médical SA, Société Fresenius France and Laboratoires Bristol-Myers-Squibb SA v Premier Ministre, Ministère du Travail et des Affaires sociales, Ministère de l'Economie et des Finances and Ministère de l'Agriculture, de la Pêche et de l'Alimentation* C-254/97, 8 July 1999, EU:C:1999:368; *Laboratoires Fournier SA v Direction des vérifications nationales et internationales,* C-39/04, 10 March 2005, EU:C:2005:161; *Commission v. Spain* C-248/06 13 March 2008 C-10/10 EU:C:2008:161; *Commission v. Austria,* C-10/10*,* 16 June 2011, EU:C:2011:399; EU Commission, Motivated opinion against Ireland (43/59 TFEU, IP/07/408-23 March 2007).

[61] Traversa shows that the ECJ case law in other policy fields (culture, environment etc.) does not hold the same line of reasoning, and that a mild territorial justification may be accepted. See Traversa (2014), p. 337.

[62] ECJ *Sovraprezzo*, 73/79 EU:1980:129 para 11; *Glaxo Wellcome GmbH & Co. KG v Finanzamt München* II,C-182/08, 17 September 2009, EU:C:2009:559, para. 34; Draft notice on Business Taxation (2014), p. 41, note 214. It was also suggested by AG Kokott on the case C-66/14 *Finanzamt Linz,* (infra n. 57) in her opinion of 16 April 2015 para. 28.

[63] This reasoning arises from AG Saggio in the C-254/97 Baxter Case, as identified by Matteotti and Roth (2015a, b), p. 774.

In the *Finanzamt Linz*,[64] the ECJ clearly stated that when a tax incentive is designed to promote the creation of group of companies, it cannot be limited to the acquisition of shares of companies exclusively taxable in Austria, since the parent company is allowed to use the incentive (depreciation of goodwill) irrespective of whether the company in which a holding is acquired makes a profit or incurs a loss. The incentives designed without a direct link to a taxable basis cannot be justified for the need of preserving the coherence of the tax system, as there is no direct link between the advantage for the taxpayer (deduct amortisation of goodwill) and the taxation of the profits arising from the acquired companies. This reasoning is probably valid also for patent box regimes, which are meant to trigger more R&D irrespective of the tax result of the entity carrying out R&D. The introduction of a substance requirement at the level of the entity benefitting from the IPR regime is not a guarantee that such a direct link would suffice to establish a coherence-based justification ground.

4.4 Interim Conclusions

The existing patent box regimes present some features that would make them fall under the prohibition of article 107(1). Among others, the adoption of a closer nexus between R&D and the tax incentive as recommended by the BEPS would generate risks that the scheme becomes *prima facie* selective and concerns only a few sectors of the economy (patent intensive activities such as pharmaceuticals) or excludes a number of IPR which actually promote innovations. The nexus requirement is, moreover, more lenient for transactions within small groups of companies, and if adopted by EU Member States, leads to a selective scheme in favour of SMEs.[65] Even worse, such scheme may infringe the freedom of establishment. We know from previous ECJ case law dealing with input incentives that restricting tax incentives to taxpayers within one single EU Member State breaches the freedom of establishment and cannot be justified, because of the requirement to extend R&D incentives to all Member States of the EU (article 179 TFEU). The Commission would not be entitled to authorize a tax rule breaching the fundamental freedoms, even if it is in line with State aid provisions. Even if the Commission may adopt a lenient and pragmatic view on the patent box regimes available in the EU,[66] there are good legal reasons to doubt of the compatibility of those with EU law.

[64] ECJ, *Finanzamt Linz v Bundesfinanzgericht, Außenstelle Linz,* C-66/14 5 October 2015, EU: C:2015:661.

[65] OECD (2015), para. 39: IPR favorable regimes can be extended to other IP asset featuring a certification process only when the qualifying taxpayer has an annual global group-wide turnover of 50 million € and do not earn themselves more than 7.5 million € in gross revenues from all IP assets on a 5-year average.

[66] Luja (2015).

This does not mean that EU Member States cannot implement output R&D&I incentives, but they have to align on a number of prerequisites. These can be found in the 2014 documents on State aid modernization as explained hereafter.

5 How to Design an IPR Tax Incentive in Line with State Aid Rules?

This section deals with the hypothesis where a Member State intends to adopt a tax incentive of the "patent box" kind, and investigates the possibility to clear the scheme before hand. Generally speaking, incentives for R&D&I can be declared compatible with the common market where it can be expected that they alleviate a market failure in promoting the execution of an important project of common European interest. When EU Member States introduce attractive tax regimes for their IPR owners, in the name of promoting R&D, they have to do it for these two reasons. In other words, State aid law can prevent tax schemes without any positive effect on market failure. Schemes granting a tax relief for R&D that would have been carried out anyway even without R&D, or schemes without any positive cross-border effect promoting domestic R&D programmes only would not be allowed. Additionally, these schemes have to be carried out for the EU common interest of promoting R&D.

The rules for control of state aid to R&D are twofold, they apply either *ex ante* to schemes that obviously distort competition and need clearance[67] or *ex post* to those schemes that were not meant to provide a selective state aid and remain under the ultimate control of the ECJ's case law.[68] The *De minimis* aids (€200.000 per economic entity per 3 fiscal years) are however granted automatic clearance and do not need to be notified, but still need to be reported.[69] This supposes that the disputed tax incentive has a cash equivalent effect, and that its beneficiaries are easily identifiable. When a scheme is drafted generally and open to all sectors or economy and any form of undertakings, this may prove difficult. However in the case of IP boxes, the need to notify the scheme would be limited to the restrictive regimes identified previously.

This could be the case for IP box regimes granted to SMEs without any restriction for marketing intangibles as a result of the BEPS action 5 recommendations, or for IP box regimes excluding IPR owners outsourcing their R&D to foreign affiliates or tax exempt foreign PEs. The question is whether tax incentives for IPR

[67] Art. 107 (3) TFEU; European Commission (2014a, e); Art.108(3) TFEU and Council of the European Union (1999).

[68] Art. 107 (1) TFEU, and European Commission (1998); European Commission (2014c).

[69] The correct source of law for this statement is not clear, as they are divergences in primary (ECJ case law) and secondary EU law. European Commission (2013a). See Luja (2015), 8 f. 22. On the reporting requirement, see European Commission (2014e), art. 9.

(worth more than €200.000 per project)[70] can be notified in the first place. In the several sources of law arising from the State Aid modernization, such as the General Block Exemption Regulation (GBER) of 17 June 2014 (group exemption for R&D or SMEs for instance)[71] and the Framework of 27 June 2014 (guidelines for drafting the notification for individual schemes), there is a clear indication that only input and *not output incentives* could be considered compatible, and up to a certain limit. Whereas the former allows schemes falling under its scope not to be notified, the latter provides for guidelines for schemes to be notified as they are not compatible with art. 107.1 at the outset.

The GBER provides that state aids for fundamental research, industrial research, experimental research and feasibility studies enjoy a safe harbour dependant upon the aid intensity (i.e. percentage of the state's stake in financing) and upon aid amount, the maximum being € 40 M for fundamental research per project.[72] In other words, it must be possible to read from the law how much the incentive will cost upfront, and that the incentive has been capped to a maximum amount. This means that IPR tax incentives (patent boxes, IPR boxes. . .) can never enjoy this safe harbour. The relief of CIT on inbound royalties for patent rights can never be estimated upfront as royalties are usually based on a percentage of turnover, after a period of use of IPR. Additionally, the GBER requires an incentive effect of the scheme, and as explained earlier, it is disputed that patent box regimes or the like actually increase the spending of IPR owners in R&D.[73] However there is a controversy upon the social beneficial effect of output rather than input incentives. On the one hand, patent rights already confer a competitive advantage to the owner and are not generating more R&D spending *per se,* therefore output incentives such as tax exempt IPR income are not proportionate to the aim of investing in new projects, and are "exaggerated" as they subsidize an activity that is already granted a monopoly. On the other hand, output incentives tend to reward only successful R&D projects, spilling over technology acquired from other States, and hence are efficiency targeted, which EU competition law seems to require. Therefore the benefit effect of tax relief for income arising from IPR is not uncontroversial and it remains difficult to prove that income tax exemptions for IPR income generate more R&D&I.

As for the individual notification of a scheme, the Framework is even clearer. The notification of individual schemes by Member States on the basis of article 107 (3) TFEU leads the Commission to assess the beneficial effects of the aid and its

[70] In 2012, for instance Sweden introduced a scheme for risk capital limiting the face value of the tax relief for investors to reach the then applicable *de minimis* cap. See Brokelind (2011).

[71] European Commission (2014a, e).

[72] European Commission (2014e), art. 4 (1) i.

[73] Hansson and Brokelind (2014), pp. 175–176; Palazzi (2011), p. 48; Arginelli (2015), p. 20.

downsides in term of competition. In order to be approved therefore, the Member State must prove that the undertaking benefitting from the aid is likely to change its behaviour (i.e. invest in more R&D).[74] So the first question is to know whether a patent box owner would invest more in R&D&I if it obtained a CIT exemption in inbound royalties, irrespective of whether it is linked to R&D&I carried out previously.

To ensure predictability and a level playing field, the Commission usually applies a maximum aid intensity for each project of R&D&I aid, and not by taxpayer. However, for "fiscal measures" where it is not always possible to separate, the aid intensity can be allocated on a general basis to the undertaking carrying on the R&D&I. For fundamental research, the scheme may finance 100 % of the project irrespective of the size of the undertaking.[75] It seems obvious that patent box regimes (CIT exemption on royalty) do not fall in this category as patents usually cover inventions based on all kinds of research and not necessarily only fundamental research. When a scheme covers other kinds of research (industrial research, experimental development, aid for feasibility studies, aid for construction and upgrade of research infrastructures, innovation aids for SMEs, aids for process and organisational innovation, aid for innovation cluster), the rate of intensity falls to 50 % of even less for large enterprises.[76] In other words, should Member State notify a tax scheme exempting from CIT undertakings involved in "organisational innovation" for instance, they should be aware that they cannot finance more than 15 % of the project.[77] As explained by R. Luja, these thresholds express the need to limit the incentive to its lowest level to reach efficiency and it is unlikely that any scheme distorting product markets and location effects would be allowed.[78]

In any circumstances, the support must be provided for projects of EU common interest. This rules out tax incentives granted to IPR owners that would localise their R&D outside EU, unless they show the positive impact (increase of R&D in the EU) of such a practice. Additionally, it is also possible that regimes requiring the spending of R&D expenses *in one single tax territory* contradict the requirement

[74] European Commission (2014a), para. 46 ff. To demonstrate that individual aid contributes to an increased level of R&D&I activities, the scheme must lead to increase in project size or number of people assigned to the project; there must be an increase in the scope of research, in its speed, of in the total amount of spending without a corresponding decrease in the budget allocated to other projects.

[75] Fundamental Research is defined as experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any direct commercial application or use in view. See European Commission (2014a), preamble, (m).

[76] The Framework's last page shows an interesting table with all these categories and the different percentages allowed for aid intensity. See European Commission (2014a).

[77] The Framework's definition (y) of *organisational innovation* excludes those costs for reorganization that do not lead to total change of undertaking's practices. Mergers and acquisitions for instance are not covered. See European Commission (2014a).

[78] Luja (2015), 3.1.3.

of EU common interest, which requires a non-discriminatory treatment of IPR owners.

In other words, it is doubtful that Member States introducing new patent box regimes in line with the OECD recommendations on the nexus requirement and notifying the scheme under the 2014 State aid rules could obtain a positive decision from the Commission. When notifying, Member States need to show that the incentive will have a positive effect on the beneficiary's behaviour such as the actual increase in R&D&I. How a patent box regime leads to such increase remains controversial, especially when the Member State where the patent box regime is introduced already offers input incentives on R&D expenditures.[79]

6 Conclusions

This contribution tried to answer the question to know whether EU Member States are competent to adopt tax incentives for R&D&I policies and if so, whether tax incentives are appropriate and compatible with EU law. As indicated above, as EU Member States share this competence with the EU, this field of law is under specific delimitations, especially since fostering more R&D&I in the EU as a common goal supersedes their own tax competence. Expressed differently, States are free to adopt any tax measure in line with EU law, for the common interest of fostering more R&D&I in the EU. Among others, Member States may adopt either input or output incentives in line with the EU primary law and State aid law rules.

The OECD recommendation in the BEPS action 5 to revamp the fight against harmful tax competition, featuring a substantial activity requirement in the EU Member States providing for output tax incentive of the “patent box type” proves disputable for EU primary law and for State aid law rules, for two reasons. First, the territorial limitation resulting from the nexus requirement contradicts the common EU interest to locate R&D&I anywhere in the EU. Second, the State aid rules may be triggered due to the distinctions between SMEs and MNEs, between residents and non-residents, and between tax incentives for patent owners mainly. Additionally, a notification under the 2014 rules of the State Aid Modernization would not easily lead to a positive Commission decision.

The fight against harmful competition within the EU should therefore remain at a political level, and introducing a legal requirement of a “nexus”, in line with the OECD recommendations may lead to severe legal difficulties due to the ECJ's case law which does not go hand in hand with the Commission's pragmatic approach to carve out tax competition in the EU.[80]

[79] See for instance the Irish R&D tax credit, Section 766 and 766(A) Taxes Consolidation Act 1997, introduced in 2004 and the contemplated Knowledge Development Box rules. See also European Commission (2014d).

[80] Expressed for in instance in European Commission (2015), 10 at 2.3.

Finally, and against this background, one could bring a larger reflexion on the taxation of IPR income. There are indeed three possible ways to tax income from IP rights. First, the investor in IP rights sets up production possible thanks to these IP rights through a foreign affiliate in a foreign jurisdiction and obtains dividends. Second, the investors sets up production in the same tax jurisdiction than where IPR is obtained and sells goods across borders, and remains taxed on its worldwide business income. Third, the investor licenses out its technology to an IP user deriving income of production and obtains royalty income.

As we know this is not a neutral choice for tax purposes. This lack of neutrality means that taxpayers can choose where to locate their tax bases, avoid source taxation on gross income and recover expenditures in R&D.[81] Additionally, royalties reflect some fundamental values such as the amortization of the investor's investment in R&D, the reward of the value for use of manufacturing products based on the new technology, a notional interest on capital used for IPR as any asset. All rewards do not necessarily need to be obtained by the same taxpayer in one single tax jurisdiction.

So coming to an agreement on what and where is generating added value is not an easy task and coming to a political agreement such as the BEPS project is a good start, but far from sufficient from a legal viewpoint. The reward of the risk taken by the undertaking investing in R&D is therefore not necessarily linked to one single tax jurisdiction; hence, the benefit for the IPR owner is global and should not end up in one single tax jurisdiction. The discussion on aggressive tax planning under the impetus of which the nexus requirement for R&D&I incentives tends to lose from sight these fundaments. For the better and the worse. A simpler solution would suffice and for instance acknowledge that patent rights owners already enjoy a competitive advantage that needs no additional favourable tax treatment, since it does not even increase the number of R&D&I spendings in a secured way. There would be no need to undermine the international tax law principles applicable in the double tax treaties and jeopardize the notion of income, for the sake of chasing double non-taxation. It remains to be seen whether all concerned EU Member States will capitalize on the BEPS recommendation and place themselves in such a grey-zone legal area.

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[81] For discussions on the neutrality principle, see for instance Schön (2015), 271 ff. Avi-Yonah (2015), pp. 90–98.

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Prof. Dr. Cécile Brokelind is professor at the Department of Business law, School of Economics and Management at the Lund University in Sweden.

The Recovery Obligation and the Protection of Legitimate Expectations: The Spanish Experience

Juan Salvador Pastoriza

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J.S. Pastoriza (✉)
Garrigues, Madrid, Spain

Garrigues, Brussels, Belgium
e-mail: juan.pastoriza@garrigues.com

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I. Richelle et al. (eds.), *State Aid Law and Business Taxation*, MPI Studies in Tax
Law and Public Finance 6, DOI 10.1007/978-3-662-53055-9_13

Abstract The obligation to recover illegal and incompatible State aid, even though it is a basic principle of the system for controlling State aid, is not absolute. For example, this obligation would be overridden in cases involving protection of the general principles of EU law, legitimate expectations or legal certainty. This chapter, after examining the EU's practice in applying these principles, will look at two recent examples of State aid cases in Spain in relation to this issue, one of which concerned financial goodwill and the other, the Spanish tax lease. Finally, some observations will be made about the recent legislative developments in Spain with respect to the recovery of fiscal State aid.

1 Introduction

The Treaty on the Functioning of the European Union (hereinafter, the TFEU) harmonises a series of matters which do not include direct taxation (tax on the income of individuals and legal entities). In this field, Member States retain their exclusive competence, as can be seen from Articles 110 *et seq* TFEU. However, Member States traditional sovereignty as regards direct taxation is being progressively limited by two different ways that clearly originate from EU law. The first of these is the defence of the fundamental freedoms of establishment and movement within the EU, which cannot be unjustifiably obstructed by national fiscal rules. The second is State aid control, for which the European Commission is responsible pursuant to Articles 107–109 TFEU (previously Articles 87–89 of the EC Treaty). With respect to State aid control, national judges also have certain competences.[1]

In this context, in recent years we have witnessed significant change as regards fiscal State aid within European tax law. At the same time, the European Commission has taken a tougher line on State aid controls, particularly those of a fiscal nature.

Although the general theory of State aid will be looked at in more detail in other parts of this book, we will now give a brief introduction to the most important concepts, before focusing on questions concerning the recovery of aid. We can start by saying that Article 107(1) TFEU contains the general prohibition on State aid (general principle of incompatibility of aid) on the basis that such aid distorts competition in the market. In this regard, it should be recalled that State aid goes beyond merely subsidising a private activity via state funds, since it does not only include positive benefits, but also public intervention which would, by other means (e.g. through a tax reduction) alleviate the financial burdens that a company would normally face. In addition, when examining a measure to determine whether it amounts to State aid, it is not the cause or purpose of the measure that is of interest but rather its effects.

[1] European Commission (2009), p. 1.

In relation to the concept of aid, it should be briefly recalled that Article 107 TFEU defines the concept of State aid and lays down the rules on compatibility. According to the Commission's decision-making practice and the case law of the European Courts, for aid to exist, the following requirements must be met: (i) Existence of an advantage, (ii) Selective nature of the measure, by favouring certain undertakings or the production of certain goods (iii) The measure can be attributed to the State and has an effect on public resources, (iv) Effect on competition and intra-Community trade. These criteria are cumulative: if one of them is not complied with, this is enough for aid to be declared not to exist. As regards fiscal State aid, it is also necessary to take into account the possible justification of the measure due to it fitting into the logic and nature of the tax system, which would mean that we would not be dealing with State aid.

With fiscal State aid, the scope and content of the concept of aid has also been interpreted by the Commission Notice on the application of the State aid rules to measures related to direct business taxation, published in the OJ C 384, of 10 December 1998, p. 3 (hereinafter, "the Notice").[2] It should be pointed out, however, that the Commission's interpretation is not binding and can be modified by the European Courts.

The general rule that State aid is prohibited is subject to certain exceptions, since certain types of aid are compatible with the objectives of the Treaty. In principle, such compatibility can only be established by the European Commission.

As we will see, the effect of an internal fiscal measure being deemed to be State aid (incompatible) may be very significant for taxpayers. Thus, if an undertaking has received State aid that is later declared to be illegal by the Commission, the "aid" received in years which are not statute barred (10 years according to the general rules on State aid which, in this case, takes precedence over the specific fiscal limitation periods of each Member State) should be reimbursed, plus late interest.

One of the few possible defences in such a situation would be, as we will see, to rely on the possible legitimate expectations of the undertaking affected in which the measures in question were either not aid or they were compatible with EU law. In addition, the existence of a lack of legal certainty created by the EU Institutions could be pleaded as a defence.

This chapter will mainly analyse the obligation of recovery as regards illegal and incompatible State aid, as well as the situations in which this obligation would be overridden by the need to protect EU law. To this end, we will start by analysing the concept of the compatibility of State aid, as well as the obligation to recover incompatible aid. We will look at those situations in which this obligation, which is not absolute, would not be prevailed over by other EU principles. To illustrate the practical application of these principles we will use two Spanish examples of State aid cases, namely the financial goodwill and tax lease cases which were recently

[2] Mention should also be made of point 5.4 (Specific fiscal aid issues). European Commission (2014a).

decided by the General Court of the European Union (hereinafter, the "GC"), and which have been appealed to the Court of Justice of the European Union (hereinafter, the "CJEU"). Finally, we will look at the most recent legislative developments regarding the recovery of State aid in Spain.

2 The Rules on Compatibility and the Obligation to Recover Aid Declared to be Incompatible

Article 108(2) TFEU lays down an obligation to notify any aid regime to the Commission prior to its implementation in the following terms:

> [. . .] If, after giving notice to the parties concerned to submit their comments, the Commission finds that the aid granted by a State or through State resources is not compatible with the internal market having regard to Article 107, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission. [. . .]

This Treaty provision has been implemented through Regulation (EU) 2015/1589, laying down detailed rules for the application of Article 108 of the Treaty on the functioning of the European Union (codified version of Regulation 659/1999, of 22 March and successive amendments). This Regulation, also known as the Procedural Regulation, establishes the procedures for notifying aid to the Commission for its permanent examination pursuant to the latter's competence under Article 108 TFEU.

In this regard, it is important to distinguish between the concepts of legality and illegality and compatibility and incompatibility of State aid, as well as its different effects.

If aid exists, because the four requirements contained in Article 107(1) TFEU have been fulfilled, Article 108(3) TFEU requires its prior notification to the Commission, so that the latter examines and approves, where applicable, its entry into force.

The legality or illegality of State aid is determined exclusively according to the established procedure: aid is deemed to be legal if it has previously been notified to the European Commission pursuant to Article 108(3) TFEU, while the lack of notification makes the aid illegal.

If the aid is not notified or is implemented before it has been approved by the Commission, there is a theoretical risk that a national judge, in application of Article 108(3) of the Treaty, may suspend the operation and order the provisional recovery of the aid (although such interim measures are infrequent in practice).

A common way of avoiding the illegality of potential aid is to include a condition precedent which makes the intervention of public operators conditional upon approval being obtained from the European Commission, as, for example, Spain did when it approved its tax reduction rules on revenue derived from the transfer of certain intangible assets (also known as the patent box regime) which was finally declared not to be aid by the Commission (State aid no. 480/2007—Spain—Reduction of tax from intangible assets, OJEU C/80/2008).[3]

For its part, the compatibility or incompatibility of State aid is a substantive issue in relation to which only the European Commission (and not a national judge) is competent to declare.

Both where the aid is duly notified to the Commission and where it is made known to the latter as illegal aid, the Commission will carry out an examination to verify whether: (i) it is effectively aid, in that the requirements of Article 107 (2) TFEU are complied with; and (ii) such aid can be declared compatible pursuant to any of the situations described in paragraphs 2 and 3 of Article 107 TFEU and its implementing regulations, which mainly means the General Regulation on block exemptions (hereinafter the Block Exemption Regulation)[4] or the notices in which the Commission specifies the criteria that it will apply in certain sectors or in relation to certain types of measures.

The analysis which the Commission must carry out is substantive and does not depend on the notification. That is, the fact that there has been no notification will not be taken into account by the Commission when reaching a decision on the substance.

From the procedural point of view, the Commission may directly adopt a decision declaring that the measure is not State aid or that it is compatible aid if it considers that it can reach such conclusions without any major difficulty.[5]

By contrast, from the moment that the Commission has doubts about any issue, it will, in principle, be obliged to open a formal investigation procedure under Article 108(2) TFEU and publish its preliminary analysis in the Official Journal of the European Union (hereinafter the OJEU) in order to collect comments from any of the interested parties.

Although the opening of the procedure does not prejudge, either positively or negatively, the ultimate final decision (or should not do so according to certain EU case law), it appears clear that it could give rise to considerable alarm and uncertainty in relation to the risk of returning the aid that would weigh on the beneficiary companies. We will return to this point below when we analyse the Commission's recent practice in relation to the *dies ad quem* which defines the safe harbour of protection with respect to the legitimate expectations of the beneficiaries of aid.

[3] Regulated in article 23 of the Spanish Corporate Tax Act (*Ley del impuesto sobre sociedades*). At the same time that this provision was made part of Spanish law, an Additional Provision Nine was included in the same statute, entitled "Prior declaration of compatibility with the Treaty Constituting the European Community", which stated as follows: "The effective application of the provisions of article 23 of the Recast Text of the Spanish Corporate Tax Act, approved by Legislative Royal Decree 4/2004, of 5 March, according to the wording given by this Act, will be subject to their compatibility with Community law".

[4] European Commission (2014b).

[5] European Commission (2012). This decision approved the new Spanish tax lease regime notified to the Commission.

With respect to the measures considered by the Commission to be aid that is illegal and incompatible with the internal market, this declaration of incompatibility in principle means the obligation to proceed to recover the total amount of the aid, plus the corresponding interest.[6] This recovery requirement can only be avoided (i) if an interrupted period of 10 years has elapsed from when the aid was granted to the beneficiary (as per Article 17 of the Procedural Regulation), (ii) in very exceptional cases due to the beneficiaries' legitimate expectations regarding the conduct of the EU institutions or situations in which legal certainty has been created (Article 16(1) of the Procedural Regulation), or (iii) in situations of absolute impossibility, although it is very difficult for this latter ground to occur in practice and be accepted by the EU institutions.[7] These three possibilities will now be analysed in more detail.

3 Exceptions to the Recovery Obligation: Special Reference to the Principle of Legitimate Expectations

As noted above, there are different situations in which the obligation to recover illegal aid would be prevailed over. These situations are as follows: (i) the expiry of the limitation period; (ii) absolute impossibility, or (iii) where recovery breaches a general principle of EU law.

As already pointed out, the first of these situations in which the recovery of aid would not be ordered would be in those cases in which the 10-year limitation period contained in article 17 of the Procedural Regulation had expired. This period will start to run from the date on which the illegal aid was granted to the beneficiary both in cases of individual aid and with respect to aid schemes. In those cases in which the limitation period is interrupted, whether due to the action of the Commission or a Member State at the request of the former, the period will start to run afresh, as per the aforementioned Article 17.

The second category concerns cases where there is an absolute impossibility of recovery.[8] The CJEU's case law has clarified that impossibility cannot consist in

[6] European Commission (2004).

[7] Cf. CJEU judgments of 4 April 1995, Case C-348/93, *Commission of the European Communities v. Italian Republic*; 29 January 1998, Case C-280/95, *Commission v Italian Republic*; 22 March 2001, Case C-261/99, *Commission v. French Republic*; 3 July 2001, Case C-378/98, *Commission of the European Communities v Kingdom of Belgium*; and 11 September 2014, Case C-527/12, *European Commission v. Federal Republic of Germany*.

[8] Decision of 19 December 2012 on State aid SA.20829 (C26/2010, ex NN 43/2010 (ex CP 71/2006)) Scheme concerning the municipal real estate tax exemption granted to real estate used by non-commercial entities for specific purposes implemented by Italy (CJEU L 166, of 18.6.2013, p. 24), paragraphs 191–200.

mere difficulties in recovering the aid.[9] Nor can it consist in allegations of financial difficulties that the company in question may have, or possible State liability. Furthermore, no impossibility would exist when the State limits itself to alleging the existence of practical, legal or political difficulties without implementing any measure aimed at the recovery of the aid or proposing alternative methods to the Commission.

The third and final category covers those situations in which a general principle of EU law may be breached, such as the principles of legal certainty or legitimate expectations.

The principle of legal certainty is a general principle of EU law which the EU Courts have recognised can be relied on to avoid a recovery order. This principle is based on the need for certainty in the law, which means the certainty that one knows or can know what is or will be foreseen, prohibited, ordered or permitted by the State. The CJEU has defined it as the principle "*which requires that legal rules be clear and precise, and aims to ensure that situations and legal relations governed by Community law remain foreseeable*."[10] The principle of legal certainty can be seen as being wider than the principle of legitimate expectations in that it does not necessarily have to be the result of prior declarations of the EU institutions; even factual situations (such as the long periods for managing a case) may give rise to it. For its application, all that is required is for there to be uncertainty and lack of clarity regarding the application of the State aid rules to the specific case.

This general principle of law cannot be confused with other general principles and has its own rules of application, as was just noted. As the GCEU correctly recalled in *Salzgitter*,[11] this principle must not be confused with that of legitimate expectations, since the former "*does not depend solely on the conditions required for the creation of a legitimate expectation on the part of the recipient of the aid*."[12] In short, it is a different principle with different conditions of application, as has just been made clear.

In turn, the principle of legitimate expectations, although linked to the principle of legal certainty and the protection of acquired rights, has a different nature. It originates from German constitutional case law and "*in the field of public law it limits the activity of State power to prevent this from destroying without sufficient*

[9] CJEU judgments of 11 September 2014, Case C-527/12, *Commission v Germany*, paras 48 *et seq*; 18 October 2007, Case C-441/06, *Commission v France*, para 27; and 2 February 1989, Case 94/87, *Commission v Germany*, para 8, *inter alia*.

[10] CJEU judgment of 15 February 1996 Case C-63/93, *Duff and others*, ECR. p. I-569, para 20. See also the GCEU judgment of 12 September 2007 Case T-348/03, *Friesland Foods v. Commission*, Rec. p. II-101, para 125.

[11] Judgment of the GCEU of 1 July 2004 in Case T-308/00, *Salzgitter v. Commission*, ECR. p. II-1933, para 166.

[12] Note that the decision recalls that this judgment has been upheld on appeal by the CJEU in Case C-408/04P. It is true that the CJEU has finally upheld in the case analysed therein that the lack of legal certainty alleged by the claimants at first instance did not exist yet it obviously does not question the principles and definition which the GCEU gives of this general principle of law.

reason the expectations that its action may have created among citizens as regards the stability of a given legal situation."[13]

Furthermore, as we have just pointed out, in accordance with the case law of the European Courts, citizens are protected by the principle of legitimate expectations when they may reasonably trust in the maintenance or stability of a given legal situation[14] created through an administrative or legislative act of the EU institutions,[15] a reiterated legal practice or interpretation,[16] or even certain oral or written declarations.[17] However, as we have already mentioned, these are not the prerequisites for application of the principle of legal certainty, which only requires that the rules are clear and precise in relation to a given legal situation.

As regards State aid, this fundamental principle of EU law has been codified in the Procedural Regulation. Thus, Article 16(1) *in fine* provides as follows: "*The Commission shall not require the recovery of the aid if this would be contrary to a general principle of Union law*."

According to settled case law, the EU institutions must find legitimate expectations to exist when the EU administration acts in a way that generates a situation of expectations with respect to the litigant[18] through the recognition of specific guarantees. Thus, in *Koninklijke Friesland Foods v. Commission*[19] the GCEU held that the right to rely on the principle of protection of legitimate expectations extends to any litigant that is in a situation from which it is clear that an EU institution made the latter have legitimate expectations on the basis of specific guarantees, since in any event the legitimate nature of these expectations is based on prudent and diligent economic operators being able to reasonably expect the maintenance of a situation resulting from an act or behaviour of an EU institution. These "guarantees" which give rise to expectations may take different forms, such as:

- Through a legislative/administrative act, for example a Commission Decision.
- Through a continuous administrative practice, for example the interpretation of a given concept—selectivity or advantage—by the Commission.

[13] Barciela Pérez (2010), p. 1.

[14] See, among many others, the Judgments of the CJEU of 11 March 1987, in Case C-265/85, *Van der Bergh en Jurgens BV v. Commission* para 45 and of 15 April 1997, Case C-22/94, *Irish farmers Association and others v. Minister for Agriculture, Food and Forestry, Ireland y Attorney General*, ECR. p. I-1809, para 17.

[15] See, *inter alia*, the CJEU judgment of 26 June 1990, Case 152/88, *Sofrimport v. Commission*, ECR. p. 2477, para 26.

[16] See, *inter alia*, the CJEU judgment of 12 November 1987, Case 344/85, *Ferriere San Carlo SpA v. Commission*, ECR. p. 4435, para 13.

[17] See, *inter alia*, the CJEU judgment of 14 September 1995, Case T-571/93, *Lefebvre and others v. Commission*, ECR. p. II-2379, paras 73–74.

[18] CJEU judgment of 19 May 1983, Case C-289/81, *Vassilis Mavridis v European Parliament*.

[19] GCEU judgment of 12 September 1983, Case T-348/03, *Koninklijke Friesland Foods v Commission* (para 127).

– Through oral or written declarations, for example a reply to a parliamentary question by the Commission. In this regard, both the CJEU[20] and the Commission[21] have admitted that the response given by a Commissioner to a parliamentary question may give rise to legitimate expectations in which the regime analysed does not amount to an infringement of the Treaty rules on State aid.

In short, the legitimate expectations of litigants will be deemed to be violated when, from the perspective of a "diligent economic operator", they cannot foresee the change of approach of the EU administration or legislature. Legitimate expectations are therefore deemed to exist when one can "reasonably expect" the maintenance or stability of a given situation.[22]

Finally, it should be noted that, at times, the principle of legitimate expectations and the principle of equality may both be breached at the same time. We will return to these questions later when we look at the case studies.

4 EU Decision-Making Practice and Case Law in Relation to the Recognition of the Principle of Legitimate Expectations in the Field of State Aid

From an analysis of the State aid regimes implemented which have been declared incompatible with the internal market, it is clear that, in numerous precedents, the Commission has recognised that the *dies ad quem* for the recognition or protection of the principle of legitimate expectations is the date of the final decision adopted in the formal investigation procedure. This question is highly important because, in practice, it will have an enormous impact on the orders to recover aid due to a series of questions, such as the duration of the Commission's investigation. In this regard, we will first look at the decision-making practice of the Commission and the case law of the European courts and, secondly, we will assess Spanish examples in the financial goodwill and tax lease cases to verify in practice the impact on economic operators that this issue of the cut-off day has in relation to the protection of the principle of legitimate expectations of citizens in a given legal situation. As will be seen, greater consistency in the application of this matter by the Commission would be desirable.

In line with the above, reference can be made, *inter alia*, to the following matters where the *dies ad quem* is taken to be the date of the final Decision passed in the investigation procedure:

[20] CJEU judgment of 22 June 2006, Case C-217/03, *Forum 187 v Commission*, paras. 155 and 158.

[21] Decision 2003/755 of 17.02.2003, concerning the coordination centres established in Belgium, para. 122.

[22] Judgments of the CJEU of 11.03.1987, Case C-285/85, *Van den Bergh*, para 45 and of 15.04.1997, Case C-22/94, *Irish Farmers* (para 17).

- Decision of 30.3.2004—C52/2001—UK (*Gibraltar Qualifying Companies*), in which legitimate expectations were recognised due to the similarities of the *Gibraltar Qualifying Companies* with the *Exempt Companies Legislation* declared by the CJEU to be existing aid. The decision stated that recovery would be contrary to the general principle of legitimate expectations and did not order it. That is, it did not link legitimate expectations with the decision to open proceedings.
- Decision of 9.3.2004—C 33/2003—Austria (Energy Tax Rebate 2002–2003), which relies on the Adria-Wien judgment to justify the beneficiaries being able to rely on the absence of selectivity with this type of measures. The final decision also declared the inadmissibility of the recovery without any analysis of the date until when legitimate expectations may exist and, therefore, this was deemed to be until the final decision was adopted.
- Decision of 9.7.2003—C 12/1995—Italy (National law in natural disasters).
- Decision of 13.5.2003—C45/2001—France (Headquarters and logistics centres). Based on the decision of the Belgian coordination centres in which it was also found that legitimate expectations existed until the final decision was adopted.
- Decision of 17.2.2003—C 51/2001—The Netherlands (International financing activities). Also based on the Belgian coordination centres decision, in which legitimate expectations were found to exist until the final decision was adopted.
- Decision of 17.2.2003—C 54/2001—Ireland (Foreign Income). Similar to the previous decision.
- Decision of 11.12.2002—C46/2001—France (*Central corporate treasuries*). Once again relied on the Belgian coordination centres decision.
- Decision of 16.10.2002—C 49/2001—Luxembourg (Coordination Centres). Once again legitimate expectations were recognised as existing until adoption of the final decision, given the similarities with the Belgian case.
- Decision of 5.9.2002—C47/2001—Germany (Control and coordination centres). Similar to the previous decisions.
- Decision of 22.8.2002—C48/2001—Spain—(Basque coordination centres), also based on the similarities with the Belgian coordination centres decision.
- Decision of 31.10.2000—Spain—Deduction for export activities (DAEX).

On the contrary, in another more recent series of decisions—such as those concerning Spanish goodwill, the *dies ad quem* was taken as the date of publication of the decision to commence the formal investigation:

- Decision of 28.10.2009—SA.22309, ex NN51/2007, ex C45/2007—Spain—Financial goodwill.
- Decision of 12.01.2011—SA.22309, ex NN51/2007, ex C45/2007—Spain—Financial goodwill. In this second decision concerning financial goodwill, in addition to the operations prior to the publication of the decision to commence the formal investigation, some exceptional cases until the publication of the final decision were also recognised, as will be seen below.

Finally, in the Decision on the Spanish tax lease (Commission Decision of 17 July 2013, concerning State aid SA.21233 C/11 (ex NN/11, ex CP 137/06)), a different approach was taken. Thus, neither the date of commencement of the formal investigation or the final decision was used; instead the date of the final decision adopted in the investigation of a different case was taken. This case will be examined in more detail below.

From all the above we can conclude that in general the Commission tends to recognise legitimate expectations until the time of the final decision, without examining the effects of the decision to open the formal investigation procedure. Nevertheless, in more recent cases the Commission's practice has been more to consider the date of publication of the commencement of the investigation as the *dies ad quem* for recognition of protection of the principle of legitimate expectations. In this regard, it should be pointed out that, based on the principles of consistency of EU law and legal certainty, the final decision (rather than that adopted in order to open the formal investigation procedure) should also be the date to be taken into account in the rest of the decisions adopted by the Commission subsequently although, as we will see, this consistency has not been maintained in all cases, such as, for example, in the financial goodwill and STL[23] cases, as just mentioned. In conclusion, it would be desirable for the Commission to use standard criteria when applying the *dies ad quem* in relation to the principle of legitimate expectations.

4.1 Case Law of the European Courts

The case law on the interruption or ending of legitimate expectations for the purposes of recovery of aid revolves around the judgments adopted by the GCEU (judgment of 12.9.2007) and the CJEU (judgment of 17 September 2009) in *Koninklijke Frisland Foods* (Cases T-348/03 and C-519/07 P, respectively), together with the Opinion of the Advocate General (AG) in this same case. The background to these cases can be found in the CJEU judgment of 22 June 2006, *Forum 187 ASBL*, (Case C-217/03) and in the Opinion of the AG in that case; as well as the CJEU judgment of 11 July 1996, *SFEI*, (Case C-39/94) and the corresponding Opinion of the AG. More recently, the judgment of the CJEU of 24.10.2013 in Case C-77/12 P, *Deutsche Post v. Commission*, declared on a similar issue, as we will see below.[24]

[23] Albeit in the tax lease case, in relation to the principle of legal certainty.

[24] On this point, see also the CJEU judgment of 21.3.2013, Case C-129/12, *Magdeburger Mühlenwerke GmbH*, although this judgment is somewhat confusing in relation to the effects of the decision to open the formal investigation procedure in relation to the recovery of the aid and the legitimate expectations.

Starting with the judgment of 12.9.2007 issued in *Koninklijke Frisland Foods*, the GCEU recalled that the decision to open the formal investigation procedure did not in any way prejudge the Commission's final decision and, therefore, did not mean that a diligent operator could not raise the plea of legitimate expectations from that moment.[25] On this basis it annulled the Commission's decision, which had defined the cut-off date for recognising legitimate expectations as the date of the decision to open the formal investigation procedure.

Although the judgment of the CJEU annulled the GCEU's ruling, it did not follow the arguments of the AG[26] nor did it examine the effects of the decision to open the formal procedure on the recognition of legitimate expectations. The CJEU annulled the GCEU's ruling not because it had established the cut-off date for accepting the existence of legitimate expectations as the date of the final decision (rather than the decision to open the procedure) but rather because the defendant company was not the beneficiary under the regime (it had submitted a request to be covered by the regime but this had not been replied to or accepted since the processing thereof had been suspended as a result of the decision to open the procedure). The Court therefore considered that its legal situation was different from that of the current—not potential—beneficiaries of the regime.

Our reading of the CJEU's judgment is, therefore, that the GCEU's ruling is not annulled with respect to the central element in question and that, as a result, a decision to open the procedure does not bring an end to the legitimate expectations of economic operators, beneficiaries of the regime, given that it does not prejudge the wording of the final decision.

This conclusion would also be supported by the fact that the GCEU judgment simply reiterates the prior case law of the CJEU. Thus, in Case C-217/03, *Forum 187 ASBL*, (judgment of 22 June 2006), which dealt with the same legal question as the one we are dealing with here, the AG—Mr. Léger—stated in his Opinion that the decision to open the formal proceeding did not offer a sufficient degree of certainty as to what would be the content of the final decision. In fact the opposite was true, since the procedure may conclude with a decision declaring the absence of aid, for which reason he did not consider that this circumstance was sufficient to

[25] GCEU judgment of 12.9.2007, Case T-348/03, *Koninklijke Friesland Foods*, para 135.

[26] Opinion of the Advocate General Mr. Yves Bot of 23 April 2009, Case C-519/07 P, *Koninklijke Friesland Foods*. The AG stated that, in view of the fact that the Dutch regime had not been notified to the Commission, there were no elements that created in the beneficiaries of the regime the expectation of legality from the moment that the alleged similarities of the regime in question with that of the Belgian coordination centres. The AG stated that precisely because of the absence of any type of notification to the Commission, the decision to open the procedure and, therefore, the existence of serious doubts about the compatibility of the regime would be sufficient to deny the legitimate expectations of the appellant company.

finish the legitimate expectations of prudent economic operators (paragraphs 413–415 of the Opinion).[27]

The AG recalled that whether or not a measure is defined as State aid is an assessment based on the use of discretion (paragraph 401). Therefore, prudent operators can rely on the stability of the conclusions reached by the Commission in prior decisions (or in declarations of European Commissioners) that have denied the existence of aid. Finally, the AG recalled that the principle of legitimate expectations is "*a superior rule of law*" and "*one of the fundamental principles of the Community*" which obliges the Commission to protect the legitimate expectations of prudent operators.

The clear conclusions reached by the AG in his Opinion were followed in *Forum 187 ASBL* by the CJEU, which stated in its judgment that the adoption of a decision to open the formal investigation procedure was not sufficient for all of the operators to accept the possibility that the regime will come to an end (paragraph 162).

More recently, in the abovementioned judgment of 24.10.2013, *Deutsche Post v Commission* the CJEU stated that the decision to commence the formal investigation procedure had legal effects on new aid regimes. It continued by stating that the opening of the investigation sowed doubts about the legality of the measure and obliged the Member State to suspend its payment. The CJEU's arguments were also followed by the GCEU in its judgment of 16.07.2014 in Case T-309/12, *Zweckverband Tierkörperbeseitigung v Commission* (paragraphs 239 and 240). Nevertheless, the judgment in Deutsche Post did not strictly analyse the question of the interruption of legitimate expectations for the purposes of recovery but rather the effects of decisions to initiate formal procedures in general.

In view of the case law mentioned, it may be concluded that, as with the Commission's decision-making practice, the case law is not settled. It appears that the most recent case law of the CJEU suggests that decisions to open the formal investigation procedure may have legal effects in relation to legitimate expectations, although they do not clearly involve cases in which the operators had legitimate expectations as a result of prior declarations by the EU Institutions that rejected the definition of a measure as State aid (unlike what occurred, for example, in the Spanish financial goodwill case). It would, therefore be necessary to wait for further judgments to confirm whether we are dealing with a change of trend in the case law or if only the latest judgments referred to above would delimit the nature of the legal effects of decisions to open the procedure in general.

[27] Specifically, the Advocate General states: "In other words, the fact that the Commission is reviewing the national measure in question and the possibility that it may, once the formal investigation procedure has been completed, adopt a negative decision, is not of itself sufficient to prevent the traders concerned relying on a legitimate expectation that the existing situation will prevail." Para 406.

5 Some Examples (I): The Spanish Financial Goodwill Case

In relation to this case which the European Commission opened against Spain, an initial point that is worth making is that Spanish tax legislation allows (or, rather, allowed, as will be seen) companies that acquired shareholdings in non-resident companies (which complied with certain requirements) to deduct from their taxable income the amortisation of financial goodwill generated in the purchase over a minimum of 20 years (annual amortisation of 1/20th). The financial goodwill would be the difference between the purchase price of the shareholding and its theoretical accounting value on the date of purchase which has not been attributed to the non-resident entity's property and rights, pursuant to the criteria laid down in article 46 of the Commercial Code and implementing regulations. Article 12.5 of the Recast Text of the Spanish Corporate Tax Act (*Texto Refundido de la Ley del Impuesto sobre Sociedades*, hereinafter "TRLIS")[28] came about as a result of Act 24/2001, of 27 December, on Fiscal, Administrative and Social Order Measures, which amended Corporate Tax for the tax periods from 1 January 2002, by inserting a new paragraph 5 to article 12 of the Spanish Corporate Tax Act 43/1995, of 27 December, which was in force at that time.

The European Commission received a complaint in 2005 from an European multinational alleging that article 12.5 of the TRLIS amounted to illegal State aid. The opening of the procedure occurred as a result of a Commission Decision addressed to the Kingdom of Spain in October 2007.

The Commission considered that article 12.5 of the TRLIS could amount to State aid. In this case, in the Commission's opinion, it would be unlawful since it had not complied with the procedural obligation of prior notification to the Commission before being implemented pursuant to Article 108(2) TFEU and without approval from Brussels. In such situations, in theory the Commission is obliged to require recovery, as already noted, except where this involves infringement of a general principle of EU law.

5.1 *The Formal Investigation Procedure*

The opening of the procedure occurred through a Decision adopted by the Commission addressed to the Kingdom of Spain, which was published in the Official Journal on 21 December 2007 (date which, as will be seen, will be taken as the limit for the recognition of the beneficiaries' legitimate expectations, i.e. as the *dies ad quem*).[29]

[28] Recast Text of the Spanish Corporate Tax Act (*Refundido de la Ley del Impuesto sobre Sociedades*), approved by Legislative Royal Decree 4/2004, of 5 March 2004.

[29] European Commission (2007a).

Numerous Spanish and European companies and associations submitted observations in this procedure, the vast majority of which were in favour of article 12.5 TRLIS being retained and against it being defined as aid.

5.2 The Commission's First Final Decision (Acquisitions of Shareholdings Within the EU)

The Decision which brought an end to the administrative procedure, adopted on 28 October 2009 (published in the OJEU of 11 January 2011), solely concerned the application of article 12.5 TRLIS to shareholding acquisitions in EU countries. As will be seen, the question of the application of the measures in third countries was postponed to a later decision.

In relation to operations in EU countries, the Commission took the view that article 12.5 of the TRLIS constituted a selective advantage, due to the fact that it applied solely to the acquisition of shares abroad and not to similar acquisitions in Spain. The Commission did not accept the argument that this difference did not give rise to selectivity, because any company (Spanish or foreign) set up in Spain may, *de jure* and *de facto*, carry out an acquisition abroad and apply the aforementioned fiscal advantage. This was despite the fact that the statistics provided by Spain in the administrative procedure showed that there was not a specific type of company that benefited from this provision; rather, there were companies from all different types of sectors and of all sizes. However, the Commission limited itself to rejecting this evidence, declaring that the data provided by Spain were "too vague".

Nor did the Commission accept that it was *de facto* impossible to merge with undertakings set up in other EU Member States. It therefore rejected the functional equivalence of article 12.5 of the TRLIS with the possibility of depreciating goodwill in internal mergers (which would mean that article 12.5 of the TRLIS would fit into the logic of the Spanish fiscal system and, as a result, it would not be selective in the context in which the Commission appeared to detect said selectivity).

In any event, the Commission found that the deduction foreseen in article 12.5 of the TRLIS, in relation to acquisitions within the EU, constituted State aid. Likewise, the Commission rejected its compatibility with the Treaty.

The Commission's position should automatically have implied the obligation to recover the aid in question. However, it took the view that, based on the date on which their acquisition transactions were concluded, certain operators could have the legitimate expectation that article 12.5 of the TRLIS was not aid, relying in this regard on various answers to parliamentary questions in the European Parliament given by the Commission.[30] This legitimate expectation led the Commission not to require the recovery of deductions applied in relation to transactions closed prior to the publication in the OJEU of the decision to open the formal investigation procedure on 21 December 2007. By contrast, intra-EU transactions closed after that date were subject to such recovery.

The declaration regarding the application of article 12.5 of the TRLIS to third countries was postponed to a subsequent decision that was adopted on 12 January 2011 (OJEU of 21 May 2011), which will be analysed later in this chapter.

5.3 Consequences of the First Decision and Appeals to the General Court

As we have seen, the fact that the Commission found legitimate expectations to exist led it not to require the recovery of aid in relation to operations within the EU closed before the publication of the decision to open the formal investigation procedure on 21 December 2007. In addition, acquisitions which at that time had been closed and were only waiting for regulatory or antitrust approval (e.g. corporate merger transactions) were also covered by the legitimate expectations. The decision also established that the financial goodwill corresponding to transactions that were not subject to recovery could continue to be written off over the 20 years laid down in the rule.

The absence of recovery of the amounts corresponding to operations prior to 21 December 2007 dispelled the possible economic risks for the operators affected. The decision defined the application of article 12.5 of the TRLIS to these operations as incompatible State aid. However, as will be seen below, there was at least one

[30] 1) With respect to the parliamentary question of the MEP Mr. Erik Meijer (GUE/NGL) regarding the possible nature of State aid of article 12.5 of the TRLIS (Question E-4431/05 of 30 November), the Commissioner Mr. McCreevy replied on behalf of the Commission on 9 January 2006 in the following terms: "The Commission cannot confirm whether the high bids by Spanish companies are due to Spain's tax legislation enabling undertakings to write off goodwill more quickly than their French or Italian counterparts. They can confirm however that such national legislations do not fall within the scope of application of State aid rules, because they rather constitute general depreciation rules applicable to all undertakings in Spain".

2) With respect to the parliamentary question of the MEP Mrs. Sharon Bowles (ALDE) regarding the possible nature of State aid of article 12.5 of the TRLIS (Question E-4772/05 of 19/12/2005), Commissioner Mr. McCreevy replied on behalf of the Commission on 17 February 2006 in the following terms: "(...) Spanish (tax) rules related to the write off of a "goodwill" are applicable to all undertakings in Spain, independently from their sizes, sectors, legal forms or if they are privately or publicly owned because they constitute general depreciation rules. Therefore, they do not appear to fall within the scope of application of the State aid rules (...)". It thus confirmed two fundamental aspects:

a. This is not an advantage but rather a technical rule on fiscal amortisation.
b. The measure is not selective.

European competitor company (the complainant), which appealed against the part of the decision regarding the existence of legitimate expectations, so as to obtain a ruling that there were no undertakings protected by this principle and a court order for the return of all the amounts deducted since the entry into force of article 12.5 of the TRLIS until the present.

Moreover, the first decision adopted in 2009 found that intra-EU operations closed after 21 December 2007 were subject to a recovery order, i.e. Spain had to identify the beneficiaries, regularise the Corporate Tax years in which fiscal goodwill had been deducted and prohibit the continued amortisation thereof in the future. In addition, Spain was requested to eliminate article 12.5 of the TRLIS, with respect to acquisitions within the EU, from its corporate tax legislation.

After the Commission's first decision, the Spanish tax authority, the *Agencia Estatal de la Administración Tributaria española* (AEAT) started to request from the taxpayers data in relation to the acquisitions of shares in foreign subsidiaries (inside and outside of the EU). Subsequently the AEAT proceeded to send tax demands to taxpayers with operations in the EU after 21 December 2007, requesting recovery. Appeals were then brought against these requests before the economic-administrative courts and the ordinary courts. As is well known, this first decision was appealed to the GCEU which, as we will see below, annulled it.

5.4 The Second Commission Decision (Concerning Acquisitions Outside of the EU) and Its Effects

On 12 January 2011, the European Commission published a press release in which it made known that it had adopted a new decision in a case concerning amortisation of Spanish financial goodwill (OJEU of 21 May 2011).

As noted above, in its first decision the Commission decided to separate the investigation into two parts, the second of which concerned the purchases of stakes in subsidiaries resident outside of the EU. The Commission took this step based on one of the arguments put forward by the parties who argued in favour of article 12.5 of the TRLIS in the administrative phase of the procedure, which related to the impossibility (legal or fiscal) of carrying out cross-border mergers. It should be recalled that, as already noted, under Spanish Corporate Tax legislation the possibility existed, under certain conditions, of depreciating fiscally the financial goodwill arising in a merger (a merger which without doubt was simpler to carry out between Spanish companies and which justified the fact that, in the event of an acquisition abroad, the financial goodwill would be accounted for in fiscal terms in the purchase itself, without having to wait for the subsequent merger).

In relation to intra-EU acquisitions, the Commission considered that there was no such impossibility of cross-border mergers, given that in EU law the directive on the fiscal effects of business restructurings existed (Directive 90/434/EEC, now recast as Directive 2009/133/EC) as well as the Directive concerning the cross-border merger of limited liability companies (Directive 2005/56/EC, which has been implemented in Spain through Act 3/2009, of 3 April, on structural modifications on commercial companies). In addition, it stated that "*[a]lthough the Commission considers that under the present procedure the Spanish authorities and the 30 interested parties have provided insufficient evidence to justify different tax treatment of Spanish shareholding transactions and transactions between companies established in the Community (as described in recitals 92 to 96), the Commission cannot a priori completely exclude this differentiation as regards transactions concerning third countries*." For the reason given, the Commission decided to continue its investigations regarding the impossibility (legal and fiscal) of carrying out cross-border mergers in relation to third countries.

Nevertheless, in the second decision the Commission did not alter the substantive analysis of the first decision on intra-EU operations. Thus, it declared that the measure constituted illegal State aid while also recognising that some operations could benefit from legitimate expectations, thereby allowing the companies concerned to escape recovery and maintain deductions from their tax bases over the 20 years foreseen in the Spanish legislation.

In relation to defining the measure contemplated in article 12.5 of the TRLIS as State aid, in our opinion the Commission's application of the principle of selectiveness continues to be very wide and even questionable if compared with previous decisions. The Commission appears to depart from its usual practice and extend this concept beyond what Article 107(1) TFEU would appear to allow, as in fact the GCEU subsequently held, as will be seen below.

In relation to legitimate expectations, the decision maintains the situations recognised in the first decision (for all those operations carried out before publication in the OJEU of the decision to initiate the formal investigation procedure in December 2007). However, it adds a different situation, namely one of the cases of acquisition of majority shareholdings in certain third countries carried out since the opening of the procedure and until the publication of the second final decision (the final decision in the second part of the procedure).

The new exception to recovery refers to operations that simultaneously comply with three conditions: (i) more than 50 % of the capital in the company has been acquired, (ii) the acquisition took place prior to the date of publication in the OJEU of the second final decision (21 May 2011), and (iii) the subsidiary is resident in a third country whose legislation expressly prohibits cross-border mergers between companies.

With respect to the last of the conditions mentioned, the Commission analysed the legislation of the 15 countries which received the bulk of Spanish investment abroad and concluded as follows:

- There are express obstacles to cross-border mergers of companies in China and India (paragraphs 118–120 of the second decision).
- There are no such express obstacles in the USA, Mexico, Brazil, Argentina, Ecuador, Peru and Colombia (paragraph 115). The same conclusion appears to

have been reached, without sufficient reasoning being given, as regards a second group of companies, namely: Chile, Venezuela, Algeria, Canada, Australia, Japan and Morocco (paragraph 116).
- The second decision does not make any declaration with respect to the rest of the countries in the world.

As a result, it would appear that the exception would automatically apply to any operations for the acquisition of majority shareholdings in China and India. By contrast, the Commission declared that this exception would not apply to the acquisitions carried out in the rest of the territories analysed although it stated that it was prepared to analyse new relevant evidence. The same can be deduced with respect to those countries not analysed.

In our opinion, the second Commission decision can also be criticised with respect to the question of legitimate expectations, for two reasons. The first criticism concerns the scope of the type of operations protected, being limited to those occurring in China and India. By splitting the final decision into two parts, the Commission could have led economic operators to think that the second Decision would be substantially different from the first one since, otherwise, it should have resolved the whole case in a single decision. However, even in the situation such as the one that was finally decided on, the companies that carried out acquisitions outside of the EU would have been treated worse if they had been denied the extension of legitimate expectations to the date on which the procedure was closed, by having moved it back to 21 December 2007, the same cut-off date for legitimate expectations as for operations affected by the first decision. Secondly, the description made of operations involving taking control in subsidiaries in China and India is open to criticism, since this situation is more akin to a situation of no aid on the basis of the logic and nature of the Spanish tax system (since it is the functional equivalent of a business combination which, in Spain, would be entitled to deduction for amortisation of goodwill), than a case of legitimate expectations. As is well known, a large number of undertakings also appealed against this second decision to the GCEU, which, as with the first Decision, annulled it, as will be seen in more detail below.

5.5 The Third Decision of the Commission Concerning Indirect Acquisitions

In its Decision of 15 October 2014 (the "Third Decision") the Commission considered that the possibility of depreciating financial goodwill as a result of indirect acquisitions (direct acquisitions of a holding company which owned shares in the operating undertaking(s)), arose—in its opinion—from a change in the administrative approach which was essentially contained in a reply of the Directorate General of Taxation to a binding consultation, amounted to new and different aid to that analysed by the Commission in its First and Second Decisions which, it should be recalled, were annulled by the GCEU.

In the Commission's Third Decision, it also ordered the Administration: (i) not to grant any new aid with respect to indirect operations, and (ii) to recover the aid which had already been granted.

Unlike its predecessors, the Third Decision did not find legitimate expectations to exist or give any protection at all against recovery, with respect to indirect operations. Nor did it distinguish between operations within the EU and those carried out in third countries.

Although its reasoning was mainly based on the First and Second decisions, the Third Decision is formally different from the Decisions provisionally annulled by the GCEU. Thus the prohibition that it contains, as well as the recovery that it orders, would, in principle, be applicable until the Decision is annulled by the GCEU or the CJEU.

However, on this point it should be noted that the Kingdom of Spain has also appealed against the third decision, requesting at the same time the adoption of interim measures by the GCEU. On 27 February 2015 (Case T-826/14 R, *Spain v Commission*), the GCEU published an order in which it rejected the application for an interim measure seeking the suspension of the enforcement of the Third Decision. Although an initial reading of this order may lead one to think that the Third Decision would be fully effective until the appeal on a point of law is resolved, the fact is that the suspension sought must be considered to have been granted *de facto*. Thus, it should be noted that, as stated in the order in question, the European Commission had sent a letter to the Spanish authorities to suspend the enforcement of the order of recovery pursuant to the Third Decision, which is atypical and suggests that the Commission itself has serious doubts about the legal grounds on which it is based.[31] The GCEU stated as follows: "*Concerning an application for suspension of operation in relation to a decision on State aid which has a close link with earlier decisions annulled by the General Court, the harm liable to be caused to a Member State by recovery of the alleged State aid cannot be regarded as sufficiently imminent to justify the grant of the requested stay of implementation, where the Commission has expressly stated that it has released the authorities of that Member State from their recovery obligation until such time as the Court of Justice has given a decision on the appeals brought against the judgments annulling those earlier decisions, and that such suspension of recovery measures was not in breach of EU law*." (para. 5). In conclusion, in practice the recovery of State aid under the third Decision must be deemed to be suspended until the CJEU decides the appeal on a point of law with respect to the first two decisions.

[31] Cf. Article 278 of the TFEU and Council of the European Union (2015), article 16.3; European Commission (2007b), section 2.2.2., and European Commission (2009), section 2.2.2.

5.6 The Elimination of Article 12.5 of the TRLIS by the Spanish Legislature

Following the Commission's decision, the content of article 12.5 of the TRLIS was amended by the Budget Act for 2011 (Act 39/2010, of 22 December), through a third paragraph being added which stated that "*the deduction laid down in this paragraph will not apply to acquisitions of securities representing equity stakes in undertakings resident in another EU Member State made after 21 December 2007*". Nevertheless, the Spanish legislature reflected the provisions on legitimate expectations recognised by the Commission in the fourteenth transitional provision of the TRLIS. Pursuant to this transitional provision the amortisation of financial goodwill can continue to be deducted fiscally for operations protected by the principle of legitimate expectations.

First of all it should be pointed out that we are dealing here with a rule that is both unfavourable to the taxpayer and retroactive in nature. The Budget Act came into force on 1 January 2011 and yet it retroactively eliminates a tax benefit from 21 December 2007. This issue of constitutional legality goes beyond the remit of this chapter and, therefore, will not be examined here.

Secondly, it is worth pointing out that the decisions of the Commission which we have commented on were not yet final, neither with respect to the definition of State aid nor the scope of legitimate expectations. Moreover, they were subsequently annulled by the GCEU. This annulment does not legally mean that the elimination of article 12.5 of the TRLIS by the Spanish legislature in 2011 be annulled or repealed but it does give rise to doubts about the validity of operations that take place between 21 December 2007 and January 2011, during which time the rule (which the GCEU subsequently held did not amount to State aid) had yet to be eliminated by the Spanish legislature.

5.7 The Judgments of the GCEU Annulling the First and Second Decisions of the Commission and the Appeal on a Point of Law to the CJEU

On 7 November 2014 the GCEU passed judgment in Case T-219/10, *Autogrill España v Commission*, and Case T-399/11, *Banco Santander and Santusa v Commission*. These two cases decided the actions for annulment brought against the two Decisions of the European Commission referred to above, in which the latter had considered that the possibility, laid down in article 12.5 of the TRLIS, of tax amortisation of the financial goodwill arising in the acquisition of stakes in non-resident entities (whether resident in EU countries or not) amounted to unlawful and incompatible State aid and had ordered, subject to certain limits, the recovery of such aid.

The European Commission appealed both judgments on a point of law to the CJEU (Case C-20/15 P, *Commission v World Duty Free Group* and Case C-21/15 P, *Commission v Banco Santander and Santusa*), which has yet to issue its rulings.

In its judgments of 7 November 2014, the GCEU decided in favour of the appellant Spanish undertakings and annulled the First and Second Decisions on the basis that the Commission had not shown the selective nature of article 12.5 of the TRLIS, and had therefore erred in defining this provision as State aid.

To reach this conclusion, the GCEU underlined the fact that article 12.5 of the TRLIS could be applied by any company in any sector, regardless of its size, the sole condition being that it had to engage in conduct (acquire shares in foreign companies) that was open to any Spanish company. It was, therefore, not selective.

In our opinion, these judgments are extremely important. Not only because of their effects in this case but also for the case law that they include (or perhaps, more accurately, that they reiterate) as regard the notion of State aid of a fiscal nature. In this regard, two aspects of the judgments should be pointed out (identical in their fundamental content).

First, the judgments focus on the concept of the selectivity of the measure, which is essential in establishing the existence of State aid. As is well known, a measure that, despite offering an advantage, forms part of a Member State's general tax legislation cannot be considered as State aid. In the light of Article 107 TFEU, selectivity requires not only that the measure may amount to an exception from the given framework—that is, the tax system—but also that the measure favours certain undertakings or production, giving an advantage to certain firms over others that are in a comparable situation.

According to the Commission's approach, one which, in our opinion, is debatable and which has been openly questioned by the GCEU, it would be sufficient for a fiscal measure to apply to certain undertakings but not others for there to be, at least at first sight, selectivity. *Under this—undoubtedly broad—definition of selectivity, the conditions of applicability of the measure in question automatically determine the group of beneficiaries. This ineluctably leads to a certain circular reasoning (the measure is selective because it only benefits those to whom it applies).*[32] In other words, *the fact that the only ones who can benefit from a measure are those who satisfy the requirements for its application does not make it selective. If this were the case, any fiscal measure of any EU Member State would be selective for the same reason.*[33]

Thus, selectivity does not exist when potentially all undertakings can have access to the tax regime in dispute. The Commission had the burden of proving the existence of a category of companies that were the only ones favoured by the measure and, in the GCEU's opinion, it failed to discharge this burden.

Secondly, the Court reiterated two important qualifications with regard to the Community case law on State aid:

[32] Calvo Salinero (2015), p. 402.

[33] Calvo Salinero (2015), p. 407.

First, it stressed that a measure is not in principle selective when its application does not depend on the activity of the beneficiary companies. The Court thereby justified why its ruling differed from that in the judgment of 15 July 2004 (Case C-501/00, *Spain v Commission*) regarding the deduction for export activities, since in that case the measure in dispute did affect a category of undertakings, albeit a wide one, namely all firms engaging in export activities, and the acquisition of shares in the context of that measure was related to the carrying on of that activity.

Secondly, the Court added that a tax measure does not become State aid simply because it amounted to a fiscal benefit for the companies of a given Member State, since selectivity must be assessed within each Member State and not by comparing the rules applicable in that Member State and other Member States, such as, for example, with respect to the rate of Corporate Tax in countries like Ireland, amongst others. The latter could come within the field of harmful tax competition among Member States, which goes beyond the scope of this chapter and will not be examined here.[34]

As a result, the GCEU held that the Spanish measure in dispute did not constitute State aid since the requirement of selectivity was not complied with.

After considering that the Commission had erred in its description of the nature of article 12.5 of the TRLIS as State aid for the purposes of Article 107(1) TFEU, the GCEU also annulled the part of the Commission decisions that ordered the Kingdom of Spain to recover the amounts which the country’s tax authorities had not received.

Given that the judgments are based on the lack of selectivity, the GCEU did not declare on the rest of the arguments raised by the parties nor, specifically, on whether the measure was justified on the basis that it was a functional equivalent to the treatment given to mergers between undertakings, given the logic of the Spanish tax system.

The judgments of the GCEU can only be considered to be final if the CJEU rejects the appeal brought by the Commission and, therefore, confirms them.[35] Notwithstanding this, the appeal on a point of law does not cause the suspension of the judgments of the GCEU (Article 60 of the Statute of the CJEU, without prejudice to the provisions of Articles 278 and 279 TFEU). As a result, the decisions must be deemed to be provisionally annulled.

Finally, it should be noted that in the appeal on a point of law, Spain, Ireland and Germany have appeared as parties that support the companies involved. The written phase of the procedure was completed in 2015 and therefore it is expected that the judgment will be issued some time in 2016.

[34] In this regard Villar Ezcurra states that “most Member States with an interest in maritime transport have implemented tonnage tax regimes but, in terms of unfair competition, some (for example, Germany) were considered under the Code of Conduct to be questionable measures that needed to be analysed by the Group”. See Villar Ezcurra (2014), p. 440. For more information regarding the limits between harmful tax competition and the control of State, see Buendia Sierra (2015), pp. 9–12.

[35] 15 January 2015, Cases C-20/15P and C-21/15P.

6 Some Examples (II): The Spanish Tax Lease System (STL)

6.1 The Formal Investigation Procedure

On 21 September 2011 (Decision C(2011) 4494 final) the decision to open the formal investigation procedure with respect to State aid pursuant to Article 108 (2) TFEU in relation to the tax lease system for vessels was published in the OJEU.[36] After a complicated procedure for both legal and political reasons, on 17 July 2013 the Commission adopted its final decision,[37] in which it concluded that the tax regime applicable to certain finance lease agreements for the construction of ships (STL) constituted aid that was unlawful and incompatible with the internal market.

Between these two dates, on 20 November 2012 it was announced that the European Commission had approved a new regime that replaced the previous one (the one investigated), accepting the proposal notified by Spain.[38] According to the Commission, the notified regime (which modified, through Act 16/2012, article 115.11 of the TRLIS and repealed article 48.4 of the TRLIS, as well as articles 49 and 50(3) of the Tax Regulation as of 1 January 2013) was a general measure, whose effects were temporary, subject to objective requirements (no authorisation was required) and open to assets build outside of Spain. For these reasons, it did not constitute State aid.

By contrast, in the Commission's opinion the STL (i.e. the previous regime, in force until Act 16/2012 came into force) combined both accelerated—typical of leasing—and early amortisation prior to the vessel being put into service with the tonnage regime in a way that gave rise to an advantage contrary to the TFEU. In summary, the financial leasing company that had acquired the vessel leased it to an economic interest grouping (EIG), which benefitted from the fiscal effects of the aforementioned accelerated and early amortisation (which, in turn, required the authorisation of the Spanish Directorate General for Taxation). Subsequently, when the vessel was practically depreciated, the EIG switched to being taxed under the tonnage tax regime, which significantly reduced the capital gain in the transfer of the vessel to the shipping company.

According to the Commission, switching to the tonnage tax regime meant that the tax deferred by the accelerated and early amortisation was not paid in accordance with the general rules on Corporate Taxation. The Commission detected in said combination an economic advantage paid for out of State resources, whose application was exclusive (selective) and as a result of administrative authorisation

[36] European Commission (2011), p. 5.

[37] European Commission (2014c), p. 1.

[38] European Commission (2012).

given to vessels being built, eligible for the tonnage tax and leased by EIGs. In addition, the vast majority of these vessels were built in Spain by Spanish shipyards. In the Commission's opinion all of the foregoing meant that the advantage in question was unlawful (State aid).

According to the Decision, the beneficiaries of this aid scheme would be the investors in the EIG when these are entities with an economic activity, i.e. companies, since the tax losses generated by the EIGs were attributed to them. It was these beneficiaries who, therefore, were obliged to respond to the orders for recovery/return of the benefits received to the Spanish tax authority, plus the corresponding late interest.

Equally, the Commission took the view that, in application of the general principles of European law (legitimate expectations), there should be no requirement to recover the incompatible aid granted prior to 30 April 2007, date of publication of the final decision in the *French GIE Fiscaux* case, in which the tax system in force in France,[39] which was similar to the STL, was declared to be State aid. The Commission considered that precisely because of the similarities between the two schemes, following publication of the French decision a diligent economic operator should have had doubts about the legality of the STL.

According to the Commission, neither the ship companies nor the shipyards were the beneficiaries of the aid schemes. On this point, the Commission maintained that to the extent that there were private agreements that meant that the consequences of the recovery order fell on the shipyards, these agreements were contrary to EU law, since it contravened the *effet utile* of the State aid rules as regards recovery.

Apart from its clear media and economic impact (for the sector and for companies obliged to return the aid), the legal structure of the Decision is complex and gives rise to various debatable points of both a procedural and substantive nature, as we will see below and as the GCEU has ultimately recognised.

6.2 *Possible Breach of the Principle of Legal Certainty in the Commission's Decision*

The final Decision expressly acknowledged that "*[t]he Commission cannot rule out that legal uncertainty may have been created by the 2001 Decision on Brittany Ferries, as alleged by Spain and the recipients, regarding the classification of the STL as aid. But this can only have been the case until the publication in the Official Journal on 30 April 2007 of the Commission Decision on the French GIE Fiscaux, where the Commission established that that scheme constituted State aid*"

[39] European Commission (2006), p. 4.

(paragraph 261).[40] As a result, in application of the principle of legal certainty, the Commission did not order the recovery of the aid received by the beneficiaries before 30 April 2007 (paragraph 262 and Article 4 of the Decision).

Thus, as the Commission recognised, a situation of legal uncertainty had existed, created, *inter alia*, by the positive conclusion (specifically, the lack of aid) reached in *Brittany Ferries*,[41] which prevented the recovery of aid, as we have seen. However, contrary to what the Commission found, in our opinion it is debatable whether this situation had been corrected by the decision in the French *GIE Fiscaux*[42]; consequently, the *dies ad quem* should have been extended to at least the date on which the formal investigation procedure was opened.

As we have just indicated, the Commission based its decision not to order recovery of the aid prior to 30 April 2007 on the application of the principle of legal certainty. However, there appears to be some confusion in the Decision's reasoning between this principle and that of legitimate expectations.[43] In this regard, we refer to the section in which we explain these two principles and the differences that exist between the two. The sections below explain the reasons for the existence of legal uncertainty in relation to the STL case.

6.2.1 The Brittany Ferries Case

In *Brittany Ferries*, the Commission investigated certain State aid in favour of the company *Bretagne Angleterre Irlande* (BAI or *Brittany Ferries*[44]). Together with other measures, including aid for restructuring, the tax advantages which French law granted to economic interest groups (EIG) were analysed, which made it possible to acquire vessels for their subsequent lease to public-private companies (paragraph 31 of *Brittany Ferries*). As with the STL, EIGs have fiscal transparency and enjoy a system of special amortisation.[45] Brittany Ferries had recourse to the financing of its vessels through EIGs, which obtained certain tax advantages in this way. According to the decision, "*[EIG's] financing mechanisms come under common law. Forming an EIG opens the door to tax optimisation when acquiring heavy*

[40] The same line was taken in point 256 of the Decision, where it states that "[t]he situation of uncertainty created with respect to the lawfulness of the STL as a result of the statement made in the 2001 Commission Decision concerning Brittany Ferries stopped on the date of publication of the Commission Decision on the French GIE Fiscaux." See European Commission (2006).

[41] European Commission (2002), p. 33.

[42] European Commission (2006), p. 4.

[43] European Commission (2006), Points 256, 261 and 262 of the final decision.

[44] European Commission (2002), p. 33.

[45] According to the decision "the acquired ships are written off degressively over a period of around eight years. Degressive amortisation produces fiscal deficits at the beginning of the contract; given the EIG's fiscal transparency these are passed on to the EIG members." European Commission (2002), point 34.

industrial assets. [. . .] EIGs are common in France and may be set up in any sector of economic activity." (paragraph 31).

In other words, both the system for acquiring the vessel and its amortisation (described in paragraphs 33 and 34 of the decision) were very similar to the legal measures applicable in Spain to the financing of assets whose production was both lengthy and costly.

The Commission concluded (in our opinion correctly) that "*with regard to economic interest groupings and the tax advantages they may confer, the Commission considers that they constitute a general measure, given that they are common in France, can be set up in all sectors of economic activity and come under common law.*" (paragraph 193). For this reason, investors in Spain expected the Spanish measures to be given the same legal definition.

These conclusions were also in line with the provisions of paragraph 13 of the Notice on State aid,[46] according to which: "*Tax measures which are open to all economic agents operating within a Member State are in principle general measures.*" As an example of a general measure, reference is made to "tax measures of a purely technical nature" such as depreciations. In addition, as paragraph 16 of the same Notice makes clear, when carrying out the analysis of the selectivity of a public measure, "*[th]e main criterion [. . .] is therefore that the measure provides in favour of certain undertakings in the Member State an exception to the application of the tax system.*"

Given these considerations, the investors in the Spanish EIGs could hardly have foreseen that a rule such as that of early amortisation (a tax measure of a purely technical nature) would be considered to be a selective measure, let alone that the measure would not be analysed individually, as in *Brittany Ferries*, but rather combined with the tax tonnage rules in order to artificially create the so-called STL.

6.2.2 The French GIE Fiscaux

Having established the legal uncertainty created by *Brittany Ferries*, it is necessary to examine whether—as the Decision concludes—it is possible that the Decision in the *French GIE Fiscaux* brought to an end the legal uncertainty in relation to the measures that are the subject matter of the challenged Decision.

In fact, the Commission avoids analysing *Brittany Ferries* in detail, stating instead that the Spanish case was in any event also similar to the regime analysed in the *French GIE Fiscaux* decision, and therefore any possible uncertainty must have been removed by the publication of this second decision.[47]

However, the *French GIE Fiscaux* decision does not clarify at all that the rules on amortisation (tax measures of a purely technical nature) applicable to the

[46] European Commission (1998), p. 3.

[47] European Commission (2006), p. 4.

Spanish EIGs cease to be a general measure. In *French GIE Fiscaux*, what was found to be State aid were certain exceptions that were offered to a certain type of EIG with regard to the general taxation to which they were subject.

The *French GIE Fiscaux* decision analysed the regime contained in article 39 CA of the French General Tax Code (GTC) with the amendments inserted by the Act no. 98-546 (*French GIE Fiscaux* decision paragraph 8). That is, it did not review what was already analysed in *Brittany Ferries* (which coincides with the Spanish system and is what had caused the uncertainty) but rather something different.[48]

Specifically, the decision in *French GIE Fiscaux* analysed the amendments made to the GTC by Act 98-546. Article 39 C, second paragraph, of the GTC stated that the tax deductible amortisation of an asset leased by an EIG may not exceed the amount received by way of rent (paragraph 9 of *French GIE Fiscaux*). However, despite this general rule—applicable to all EIGs—the Act 98-546 lays down an exception, according to which the maximum amortisation limit would not apply to the financing by the GIEs of amortisable assets through the diminishing balance method over a period of at least 8 years, when this operation had been previously authorised by the Ministry responsible for the budget. It should also be noted that in addition to eliminating the amortisation limit of the EIGs, they were allowed to increase by one point the amortisation coefficient that normally applied, and, moreover, they were also declared exempt from paying capital gains tax in the event of an early sale of the asset. This exemption was agreed with the ministerial authorisation referred to above.

It was precisely these exceptions to the general tax regime of the EIGs which the Commission finally declared to be selective, not the general system of tax benefits (specific amortisation rules) obtained by EIGs when they finance large industrial assets (with regard to this question, the conclusions in *Brittany Ferries* were not examined). In addition, the French authorities themselves accepted that they had discretionary power to approve the operations, which they selected in accordance with subjective criteria (significant economic and social interest of the project).

As can be seen, the analysis of this case differs from the rules existing in Spain[49] and, therefore, it should not be concluded that the Commission Decision in *French GIE Fiscaux* had resolved the legal uncertainty existing which, by contrast, is indeed clarified in the Commission Decision in the STL case, which fixes the *dies ad quem* for the purpose of legitimate expectations as the date of publication of that decision in 2007.

[48] This issue is clearly dealt with in point 192 of *French GIEs Fiscaux*. See European Commission (2006). The decision underlines the fact that in that case the regime in force was that prior to 1998.

[49] Villar Ezcurra (2014), pp. 442 et seq.; and García Novoa and López Gómez (2014), pp. 4–5.

6.2.3 Letter of Commissioner for Competition

In addition to everything said already in relation to the legal uncertainty generated in relation to the tax lease case, it is also worth mentioning the conclusions reached by the then Commissioner for Competition, Mrs. Kroes, with respect to the STL when asked about this measure by a letter from the Norwegian Industry Ministry dated 13.2.2009.

The terms of the Norwegian Minister's letter were clear, making reference to the existence of possible State aid. After stressing the importance of maintaining free competition, the letter went on: "*It is unfortunate if there does exist a scheme which implies subsidies to the Spanish shipyards exceeding the limits set by the EU state aid guidelines*".

By contrast, in her reply Mrs. Kroes insisted that there was no distortion of competition at all and confirmed that as a result "*no further action is considered at this stage in this respect*". This conclusion of the Commissioner for Competition should, in our opinion, be based on at least a cursory prior material analysis of the matter.

The existence of this letter was public knowledge and therefore the Commission's statement on its lack of public nature in paragraph 233 of the Decision is inaccurate, since the letter is even available online.[50]

In conclusion, it can be stated that the letter of the former Commissioner for Competition appears to increase the legal uncertainty generated in relation to this case.

6.2.4 Legal Uncertainty Caused by the Duration of the Examination of the Measures by the Commission

In addition to all of the above, legal uncertainty also resulted from the length of time which the Commission took to handle this procedure. The Commission itself should have also taken this fact into account when accepting the application of the principle of legal certainty and not limit its origin to the confusion created after *Brittany Ferries* (see paragraphs 256 and 261 of the Decision). This question is highly relevant since it is clear that once the legal uncertainty was created by the extremely long time taken by the Commission in examining the measures in this case, the conclusions reached in *French GIE Fiscaux* could have no bearing on matters.

Thus, it does not matter when and what the conclusions were in *French GIE Fiscaux*; the only relevant fact, it must be stressed, is that the examination which led to the Decision in the STL case lasted more than 12 years. The time taken was clearly disproportionate.

[50] Norwegian Minister Letter (2009).

The case law of the European courts has already had the opportunity to establish that the excessive length of a State aid case is capable of infringing the principle of legal certainty,[51] a point agreed on by certain academics.[52]

As can be seen from the Decision itself, on 21 December 2001 a first request for information was made in relation to the financial lease system (paragraph 222). Independently of the conclusions reached by the Commission in the light of the replies given by the Kingdom of Spain, which in any event, as can be deduced from the Decision, appeared to focus on excluding the existence of aid, the fact is that the Commission itself recognised that in 2001 it began to take an interest in the matter. The opening of the procedure only occurred in 2011, the decision being published on 21 September of that year. In other words, not less than 10 years elapsed—and this figure rises to more than 12 years if we bear in mind that the final decision was adopted on 17.7.2013.

In conclusion, in our opinion the Commission's order to recover all aid granted as regards the operations after 30 April 2007 is an error in law that would make article 4 of the Decision void. Thus, the extraordinary delay in the Commission's examination gave rise to legal uncertainty and this fact cannot be revised, interrupted or resolved by whatever conclusions were reached in the *French GIE Fiscaux* decision.

6.3 Judgment of 17 December 2015 Regarding the Spanish Tax Lease System for Shipbuilding: Analysis and Future Perspectives

On 17 December 2015 the GCEU passed judgment in Joined Cases T-515/13, *Spain v. Commission* and T-719/13, *Lico Leasing, S.A., and Pequeños y Medianos Astilleros Sociedad de Reconversión, S.A. v. Commission*. In its judgment the GCEU annulled the Commission's decision that declared the STL to be unlawful state aid on the basis that the GCEU did not consider that the measures of which this system was composed amounted to a selective advantage.

The judgment, which was based on some of the more recent and important judgments of the GCEU itself on State aid (judgments of 7 November 2014, in Cases T-219/10, *Autogrill España v. Commission* and T-399/11, *Banco Santander*

[51] See, *inter alia*, the CJEU judgment of 24 November 1987, Case 223/85, *RVS* v. *Commission*, ECR. p. 4617, the judgment of the GCEU of 15 September 1998, Case T-95/96, *Gestevisión Telecinco v. Commission*, ECR. p. II-3407. In its decision-making practice, the Commission has also accepted that the excessive duration of the procedure also justifies that the recovery of aid declared to be illegal and incompatible not taking place. See Decision of 31 October 2000, C 57/1997, concerning Spanish legislation on corporate tax (OJEU, 1.3.2001 L 60), or the decision of 20 December 2006, *French GIE Fiscaux* (OJEU of 30.4.2007 L 112, p. 4).

[52] See, for all, Villar Ezcurra (2014), pp. 444 et seq.

and Santusa v. Commission), passed in the Spanish financial goodwill case analysed earlier, starts by verifying whether there was compliance with the conditions for the existence of aid in relation to the beneficiaries of the system (according to the decision) i.e. the investors. In particular, the Court focuses its analysis on the issue of selectivity.

According to the European Commission, the system was selective with respect to the investors since, in the first place, it only applied to a certain type of investment (in vessels) and moreover, it only concerned projects that could be selected on a discretionary basis by the Administration. In addition, it only applied to a specific activity: bareboat chartering by EIGs. The judgment analysed and rejected each of the arguments, applying the reasoning set out below.

1-. The alleged selectivity because the STL would only apply to investments in vessels.
The GCEU directly applied *Autogrill v. Santander* in support of its finding that, since any company from any sector and of any size may invest in vessels, the STL could not be considered to be selective (paragraph 143). The judgment underlined the fact that, at least with respect to investors (the alleged beneficiaries of the aid), the system was undoubtedly a general measure (paragraph 148).

2-. The alleged selectivity because the STL only applied to projects that could be selected on a discretionary basis by the Administration.
The Court concluded that the Administration's alleged discretion to authorise projects only referred to the characteristics of the assets (vessels), and not to the nature of the vessels. In addition, it found that any company from any sector and of any size could participate as an investor in the STL (paragraph 160). In this regard, it observed that, in fact, the identity of the investors could be changed after the project was authorised without the need to obtain permission from the public authority (paragraph 162).

3-. The alleged selectivity because the STL only applied to the bareboat chartering carried out by the EIGs.
The GCEU stated that this contention would make it necessary to sustain that the EIGs and their investors would jointly exercise this economic activity but that the Commission said something different and, in fact, found that the investors did not carry on any shipping activity (paragraph 175). Given these contradictions, the GCEU identified, at least, an absolute failure to give grounds, which led it to reject the decision for this reason too.

In short, given the above, the judgment concluded that the Commission completely failed to show that the STL was selective in relation to the investors (paragraph 180). Since no selectivity existed, there could be no State aid.

In addition to considering that the element of selectivity did not exist (necessary for there to be State aid), the judgment also concluded that there was no proof that the STL affected trade and competition within the EU. In this regard, if the investors operated in all economic sectors, the Commission should have explained with at least some reasoning how the distortion of competition in such a variety of sectors could have occurred, and it did not do so.

6.4 Effects on National Recovery Procedures

The annulment of the Decision means that it, and any acts taken in enforcing it, cannot be relied on. Thus, since the GCEU ruling, operators are not obliged to return any amount whatsoever.

Nevertheless, as we will see, the Commission has appealed on a point of law to the CJEU. Thus, in the meantime the national recovery procedures should stop or, at least, be suspended until such time as the appeal on a point of law is decided. The appeal has been given the case number C-128/16 P. It is very likely that the CJEU's analysis in this case will coincide with the analysis of selectivity in the appeal on a point of law in the financial goodwill case.

In relation to the appeal, it is worth mentioning the judgment of the CJEU of 14 April 2016 in Case C-100/15, *Netherlands Maritime Technology Association v. Commission*, which rejected the appeal on a point of law brought by a European association against the new Spanish tax lease regime. This appeal essentially contended that although it was true that any company could have participated in the regime in question, the Commission and the GCEU should have determined the existence of *de facto* selectivity based on the type of contracts and assets used. This argument was rejected by the CJEU, and following this judgment the approval by the Commission of the "new tax lease" is now final and unappealable. It remains to be seen whether the CJEU will take a similar approach in the appeal brought by the European Commission in the case referred to above.

In conclusion, in both the STL and the financial goodwill cases, we have observed different effects, in practice, when evaluating a possible suspension in the enforceability of recovery decisions. Thus, for example, in cases where there has been a negative decision and subsequent appeal to the GCEU, recovery of the aid has not been suspended, in application of the rules and legal principles on State aid. However, in cases where a GCEU judgment has annulled a Commission decision, the national judges have, in practice, resisted annulling the effects of the recovery order, which is what EU law would, in practice, require of them. In the examples analysed, both the Spanish tax authority and the courts have chosen to wait until the appeals on a point of law have been heard, instead of annulling provisionally the notices requiring devolution of the aid.

7 Legislative Developments in Spain as Regards the Recovery of Fiscal State Aid

As regards procedural matters arising under EU law, a new Title VII has been added to the Spanish General Tax Act (*Ley General Tributaria* or "LGT")[53] through which the procedures to be followed for the enforcement of Decisions for the recovery of State aid of a fiscal nature are laid down[54] (recovery procedure in cases involving the regularisation of a tax obligation, on the one hand and recovery procedure in other cases—which do not involve regularisation—on the other). This new Title VII of the LGT had brought Spanish legislation into line with EU law as regards unlawful and incompatible aid in implementation of the procedural Regulation, with express mention, for example, of the specific rules on limitation periods applicable in this regard under EU law (10 years) or the fact that the breach of the 6 month period foreseen for the procedure in article 104 of the LGT does not determine the expiry thereof (although the limitation period will not be deemed to be interrupted as a result of the administrative actions taking place during that period). Any late interest payable will also be governed by the provisions of EU law (Regulation (EC) 794/2004).

The impossibility of requesting a postponement or payment in instalments of the debts resulting from the enforcement of recovery decisions is established. Against the decision or calculation resulting from the enforcement decision an ordinary appeal may be brought and, where applicable, an economic-administrative claim. In this regard, it is stipulated that, in the event of review, suspension is only possible if a guarantee in cash is paid into the State entity known as the *Caja General de Depósitos*.

Finally, when a court decision detects formal defects and orders that the matter be returned to the administrative phase, the latter must end within the period remaining for the conclusion of the period of 4 months established in the first paragraph or within 2 months, whichever is greater.

As mentioned, the EU legislation on the recovery of tax aid has been codified in Spain through these legislative developments. Until now it was not specifically legislated for. These legislative changes are probably due to the numerous State aid cases opened against the Kingdom of Spain in recent years and attempt to bring Spanish law into line with EU requirements as regards the recovery of State aid.

[53] Act 58/2003, of 17 December, amended by Act 34/2015, of 21 September, on the issue of recovery of State aid.

[54] On this point see Moreno González (2015). In particular, the draft Bill for the reform of the LGT, this point is examined in section 4, at 20 et seq of the digital edition.

8 Conclusions

The first conclusion to be reached is that the Commission's decision-making practice in relation to the time limit for the protection of the principle of legitimate expectations is inconsistent. It would, therefore, be desirable to have greater clarity about the criteria for applying this principle.

Second, the case law of the EU Courts on this point is not settled, although there would appear to have been a movement towards a more restrictive application of the principle of legitimate expectations in recent years.

More specifically as regards the recovery of State aid, it should be noted that in Spain, in the examples analysed, we have observed different effects when evaluating a possible suspension of the enforceability of recovery decisions. Thus, in cases of a negative decision followed by an appeal to the GCEU, no suspension of the recovery order takes place, in application of the legislation and legal principles on State aid. However, in cases where a GCEU judgment has annulled a Commission decision, the national judge will in practice resist annulling the effects of a recovery order, although under EU law it should be annulled. In the examples given in this chapter, both the Spanish tax authority and the courts have chosen to wait until the appeals on a point of law have been resolved, instead of annulling provisionally the aid recovery orders.

In this regard, in some cases companies have had to give bank guarantees in order to appeal against the recovery orders issued in enforcement of Commission decisions (mainly in the financial goodwill case). The fact that the GCEU has annulled the Commission's decisions in both cases has still not led to the companies in question being released from these bank guarantees. This situation, coupled with the uncertain application of the general principles of EU law by the European Commission, may cause irreparable harm to many well-managed companies. The purpose of the recovery of State aid is to return the competition situation to that which existed before the State intervention in question. In turn, it would be necessary to ensure that, in application of these EU law principles, what does not ultimately happen is that the competitive situation of the companies involved is actually made worse.

Ultimately, in the Spanish cases problems for the beneficiaries of the measures have arisen in two ways. First, as a result of the application of the principles of legitimate expectations and legal certainty and second, as regards material issues concerning the definition of the concept of aid and how selectivity is defined. The measures were considered selective by the Commission yet the GCEU held that they were general in nature. Greater clarity and effectiveness in the application of this concept would also be desirable to prevent the reoccurrence of such situations in the future.

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Juan Salvador Pastoriza is senior associate and professor of European Taxation Law at the Centro de Estudios Garrigues and of the Universidad Complutense de Madrid.