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Recent EU State Aid Judgments Offer Mixed Results

by Jacques Derenne and Dimitris Vallindas

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In this article, Derenne and Vallindas explore the significance of two recent General Court of the European Union judgments confirming the EU's jurisdiction under state aid rules to review tax rulings granted to multinationals by EU member states.

In two eagerly awaited judgments issued on September 24 — *Netherlands v. Commission*, T-760/15 and T-636/16, and *Luxembourg v. Commission*, T-755/15 and T-759/15 — the General Court of the European Union (GCEU) confirmed the European Commission's jurisdiction to assess, under state aid rules, tax rulings granted by EU member states to multinationals.

In particular, the GCEU clarified that the arm's-length principle as described by the commission in the contested decisions is a tool that allows it to check that intragroup transactions are remunerated as if they had been negotiated between independent companies. Nevertheless, the GCEU annulled *Netherlands*, highlighting the need for the commission to conduct a rigorous analysis. Specifically, the court found that the commission had erred in demonstrating that the beneficiary of the tax ruling, despite any methodological errors by the member state, effectively benefitted from a reduction of its normal tax burden.

I. The Crusade Against State Aid Rulings

Since 2013 the European Commission has been investigating, under EU state aid rules, tax rulings offered by EU member states to multinationals. The commission's policy has drawn criticism for using the state aid rules to assess tax strategies commonly used by many companies.

EU state aid law is unique in the world: To protect EU market integration and avoid protectionist measures among member states, it provides for the ex ante control of member states granting economic advantages to enterprises (defined as "aid"). EU member states must notify the commission of those measures before implementation with the commission holding exclusive approval power. Any member state implementation before approval can be challenged before member state national courts. These courts are required to safeguard third parties' subjective rights until the commission reaches a decision on their compatibility with EU rules. The EU courts (the GCEU and the Court of Justice of the European Union) adjudicate the legality of commission decisions.

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This portion of EU competition law is addressed to the member states themselves. Unlike U.S. antitrust law, EU competition law includes competition rules addressed to member states, constraining their freedom to adopt measures that could distort competition.

EU state aid tax rulings have been making headlines across the EU since 2013, when the commission launched investigations into the tax ruling practices of several member states. This followed public allegations of favorable tax treatment for some multinationals (allegations that originated from the U.S. Senate). Furthermore, the LuxLeaks and Paradise Papers crises prompted the commission to request information from all member states.

The problem of state aid through tax rulings arises in part because EU tax legislation harmonization is blocked by the unanimity required to adopt EU taxation legislation. Member states are therefore pursuing a commercial war to attract investment. In parallel with many EU legislative initiatives to fight tax evasion, the commission launched a "crusade" against some forms of tax rulings, which it considers to be "outliers."

To this end, the commission is creatively using EU state aid rules to maintain a level playing field among member states. Since 2015 it has ordered Ireland to recover €13 billion of state aid from Apple and issued decisions against the Netherlands, Luxembourg, Belgium, and the United Kingdom, ordering the recovery of an additional €2 billion. There are ongoing investigations against the Netherlands and Luxembourg. These cases have concerned companies such as ENGIE, Amazon, IKEA, and Nike.

All commission decisions finding impermissible state aid have been challenged before the GCEU.

II. First Setbacks for the Commission

The commission suffered its first setback in November 2018, when the GCEU annulled its decision against a Belgian tax scheme for 39 multinationals in *Kingdom of Belgium and Magnetrol International v. Commission*, T-131/16 and T-263/16. The annulment was, however, based only on a technicality relating to the definition of an aid scheme. Because of its narrow holding, this case did not clarify the main issues raised by the state aid investigations into tax rulings:

- whether these rulings confer an "advantage" on the beneficiaries; and
- whether this advantage is "selective."

These are the two conditions for a state measure to qualify as state aid under EU competition law. The commission has not given up its objections to the Belgian tax scheme, and in September opened new separate investigations into the 39 companies. The commission also lodged an appeal (C-337/19 P) of the annulment before the CJEU.

III. The September GCEU Judgments

On September 24 the GCEU delivered its first two judgments on the tax rulings granted by the Netherlands to Starbucks and by Luxembourg to Fiat Chrysler Finance Europe. Because of these rulings, the commission had ordered each member state concerned to recover up to €30 million in back taxes. This was far less than in the Irish case involving Apple, which will be decided by the GCEU later this year or early 2020. The GCEU annulled the commission's Netherlands decision and confirmed the Luxembourg decision.

These judgments will influence commission actions in the coming years over whether to open similar cases. Many EU member states have already tweaked their tax systems in response to commission actions, but the likelihood of numerous future cases remains. EU Competition Commissioner Margrethe Vestager has been nominated by European Commission President-elect Ursula von der Leyen for a second term when the new commission takes office November 1. Vestager has also been nominated to the position of executive vice-president coordinating the commission's agenda for "A Europe Fit for the Digital Age." If Vestager is reappointed, it is unlikely that the commission will change its focus in the digital taxation area.

Both tax rulings concern transfer pricing.

The Luxembourg case concerns a group structure providing treasury services and financing to group companies based in various

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EU member states, operating from Luxembourg. The tax ruling in question concerns a transfer pricing arrangement. The commission established that the ruling endorsed a complex method not appropriate for the calculation of taxable profits in compliance with market conditions. It concluded that the ruling, which enables the group treasury services provider to determine its tax liability in Luxembourg on a yearly basis for a period of five years, constitutes state aid incompatible with the internal market.

The Dutch case concerns a Dutch company whose main function is to sublicense intellectual property rights in respect of which royalties are paid to a U.K.-based company. The commission decided that the royalty paid could not be justified and that the transfer pricing report did not describe the license agreement or the market value. Part of the taxable profits were therefore allegedly shifted to the U.K. company, which is not liable for corporate tax in either the United Kingdom or the Netherlands. The commission found that the advance pricing arrangement entered into between the Netherlands and the company, which enabled the latter to determine its corporate income tax liability annually in the Netherlands for 10 years, constituted state aid incompatible with the internal market.

In both cases, arguments advanced by the Netherlands and Luxembourg, and followed up by the companies, focused on:

- the notion of advantage; and
- the notion of selectivity.

A. The Notion of Advantage

The member states argued that the commission erred in identifying a version of the arm's-length principle particular to EU law. In both cases, the parties cited the complexity of using the arm's-length principle to examine transfer prices. They argued that analysis should be carried out according to methods adapted to the facts of the case, especially the taxpayer's situation. All parties suggested that there was a methodological error in determining whether the tax ruling at issue was an advantage, and that the transfer pricing assessment was not sufficient to prove the existence of an advantage.

In the alternative, and concerning recovery of the aid, Luxembourg and the Netherlands argued that the commission improperly interfered with member state fiscal autonomy because direct taxation falls within the exclusive competence of the member states.

In both cases, the GCEU makes clear that the arm's-length principle as described is a tool that allows the commission to check that intragroup transactions are remunerated as if they had been negotiated between independent companies. Thus, in the light of Luxembourg and Dutch tax law, that tool may be used by the commission.

In both cases, the pricing of intragroup transactions was not determined under market conditions. However, in the Luxembourg case, the GCEU established that the commission was fully entitled to conclude that the tax ruling at issue conferred an advantage on the company because it resulted in a lowering of tax liability. In that specific case, the GCEU confirmed that the commission was entitled to identify the arm's-length principle as a criterion for assessing the existence of state aid.

In the Dutch case, the GCEU found that mere noncompliance with methodological requirements does not necessarily lead to a tax burden reduction. The commission did not justify its choice of the transactional net margin method instead of the comparable uncontrolled price method and did not demonstrate that the royalty was not in conformity with the arm's-length principle. In consequence, the commission failed to demonstrate that an advantage was conferred.

B. The Notion of Selectivity

In both cases, member states argued that the commission did not use the correct reference system to demonstrate to the requisite legal standard that the requirement of selectivity was met. In their view, the commission erred in excluding Luxembourg administrative law and practice from the reference system and was wrong to identify the general Dutch system of corporate income tax as the relevant reference system for assessing selectivity. In both cases, the member states claimed that the commission committed errors of law and inconsistencies in the identification of the relevant reference system.

The GCEU concluded in the Luxembourg case that irrespective of the reference framework used (the general national system of corporate income

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tax), the commission established that the measure at issue was selective based on the usual three-step analysis:

- the identification of the reference system;
- the determination of whether the measure treats operators that are in a comparable legal and factual situation differently; and
- the justification of the measure by the nature of the general scheme of the system itself.

The GCEU agreed with the commission that the conditions required to find selectivity were met. In the Dutch case, the notion of selectivity was not discussed by the GCEU because the commission's errors in relation to the notion of "advantage" were sufficient to annul the decision.

IV. Takeaways

All U.S. multinationals with operations in Europe benefiting from tax rulings or other selective favorable tax provisions could be affected by the state aid investigation trend.

The commission could initiate a state aid investigation against any member state that has concluded tax rulings with one or more multinationals. Although perfectly legal, a tax ruling could be regarded by the commission, in some circumstances, as unlawful and incompatible aid. Such an investigation could result in an obligation for the member state concerned to recover the alleged advantage from the multinational.

Competitors could also lodge recovery, damages, and interim relief claims before the national courts against both the member state concerned and the multinational as an alleged aid beneficiary.

Any multinational that benefits from a tax ruling in the EU that allows, *a priori* legally, the avoidance of tax for any part of its non-U.S. earnings should have it assessed under EU state aid rules. This analysis is critical given that EU institutions and member states are looking at ways to capture tax from large, generally tech-related multinational firms. Furthermore, the commission is examining more than 1,000 tax rulings from about 700 different multinationals.

U.S. multinationals should consider auditing their EU tax rulings in the light of EU state aid law to assess and mitigate any state aid risks. In addition to their usual tax advisers, they should seek specialized EU counsel on state aid law and consider appropriate remedies. ■

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