TAX RULINGS AND SELECTIVE ADVANTAGE – TRANSFER PRICING ASSESSMENT IN THE CONTEXT OF EU STATE AID LAW

Sampsa Myllymäki
Master's Thesis
EU Law
University of Turku
Faculty of Law
January 2020

UNIVERSITY OF TURKU
Faculty of Law

SAMPSA MYLLYMÄKI:

Master's thesis, 92 pages.
EU Law
01/2020
The originality of this thesis has been checked in accordance with the University of Turku quality assurance system by using the Turnitin Originality Check -service.

Abstract

The purpose of EU state aid law is to protect the internal market and prohibit those state measures that could possibly distort effective competition. An undertaking, which is granted with a selective aid measure may be in more favorable position in comparison to its competitors. Therefore, as part of the tool pack of competition law policy, the Commission is in charge of making sure national measures granted by the Member States to undertakings are not made in selective basis and they comply with common regulation.

As Article 107(1) TFEU makes no distinction between the type of state measures as such, state aid regulation is similarly applicable to any fiscal measure despite of the question of competence, including tax regulation. However, rules of international taxation, especially in transfer pricing and tax rulings related cases, may create difficult questions on the exact application and coherent combination of these two areas.

This research analyzes the current state aid policy from the transfer pricing point of view by going through the recent decisions of the Commission and judgments of General Court if tax rulings can be regarded as prohibited state aid, particularly, when applying and interpreting the arm's length principle. The Commission has the burden of proof to point out the existence of prohibited aid and the research seeks to explain what the current interpretation standard may be for evaluating the correct application of arm's length principle in the context of EU state aid law.

To fully understand the position for combining state aid law and transfer pricing, basic doctrines, related case law and other relevant regulation with respect to both fields of law will to be gone through and explained. This includes the evaluation of the legal problem at hand in the light of competition law as well international and national tax law, which, in this case, can be traced back to OECD Transfer Pricing Guidelines.

There are four major cases on which this report will be primarily focusing – so called tax ruling related cases regarding Fiat, Starbucks, Apple and Amazon of which the former two have been also reviewed and judged by the General Court of the EU. These cases relate all to individual aid measures, that are only designed and agreed between the Member State and undertaking through a tax ruling/APA. The primary objective is to give a thorough overview on the current legal situation in this regard and possible consequences and developments taking place in the future.

Keywords: transfer pricing, state aid, EU law, international tax law, tax rulings, competition law, tax law

TURUN YLIOPISTO
Oikeustieteellinen tiedekunta

SAMPSA MYLLYMÄKI:

Pro gradu -tutkielma, 92 s.
EU-oikeus
01/2020
Turun yliopiston laatujärjestelmän mukaisesti tämän julkaisun alkuperäisyys on tarkastettu Turnitin Originality Check –järjestelmällä.

Tiivistelmä

EU:n valtiontuki-sääntelyn tarkoituksena on suojella sisämarkkinoita ja kieltää jäsenvaltioiden toimenpiteet, jotka saattaisivat vääristää tehokasta kilpailua. Yritys, jolle myönnetään tuki, saattaa olla paremmassa asemassa kilpailijoihinsa verrattuna. Sen vuoksi Komissio vastaa kilpailulainsäädännön avulla siitä, että jäsenvaltioiden yrityksille myöntämät kansalliset tukitoimenpiteet eivät ole valikoivia ja että ne noudattavat yhteistä sääntelyä.

Koska SEUT 107 artiklan 1 kohdassa ei tehdä eroa valtion tukitoimityppien välillä, valtiontukia koskevaa sääntelyä voidaan soveltaa samalla tavoin myös verotuksellisiin toimenpiteisiin, vaikka verotus kuuluu jäsenvaltion omaan toimivaltaan. Kansainvälisen verotuksen säännöt, erityisesti siirtohinnoittelussa ja veroviranomaisten ennakollisissa päätöksissä (verotuspäätös), voivat kuitenkin aiheuttaa vaikeita oikeudellisia kysymyksiä näiden kahden oikeudenalan samanaikaisesta soveltamisesta ja yhdistämisestä.

Tutkielma analysoi nykyistä valtiontukisääntelyä siirtohinnoittelun näkökulmasta arvioimalla Komission päätöksiä ja EU:n yleisen tuomioistuimen tuomioita, mikäli verotuspäätöksiä voidaan pitää kiellettynä valtiontukena silloin, kun sovelletaan ja tulkitaan markkinaehtoperiaatetta. Komissiolla on todistustaakka osoittaa kielletyn valtiontuen olemassaolo. Tutkimuksessa pyritäänkin selvittämään, miten todistustaakkaa arvioidaan, kun analysoidaan markkinaehtoperiaatetta kielletyn valtiontuen määrittelemisen yhteydessä.

Tutkimuksessa selitetään siirtohinnoittelun ja valtiontukisääntelyn perusoppeja, asiaan liittyvää oikeuskäytäntöä ja muuta sääntelyä. Tämä liittyy käsillä olevan oikeudellisen ongelman arviointiin sekä kilpailulainsäädännön että kansainvälinen ja kansallinen verolainsäädännön valossa, joka suurelta osin viittaa OECD:n siirtohinnoitteluohjeisiin.

Tässä tutkimuksessa keskitytään Luxembourgin Fiatille ja Amazonille, Alankomaiden Starbucksille ja Irlannin Applelle myöntämiin verotuspäätöksiin. Fiatiin ja Starbucksiin liittyen EU:n yleinen tuomioistuin on myös antanut tuomionsa. Nämä tapaukset koskevat kaikki siirtohinnoittelun ennakkosopimuksia (APA), jotka Komissio on katsonut valtiontukisääntelyn vastaiseksi. Tutkimuksessa perehdytään tapauksien oikeudellisiin ongelmiin ja tavoitteena on antaa perusteellinen kuvaus tämänhetkisestä oikeudellisesta tilasta sekä mahdollisista seurauksista ja kehityksestä tulevaisuudessa.

Avainsanat: siirtohinnoittelu, valtiontuki, EU-oikeus, kansainvälinen vero-oikeus, siirtohinnoittelun ennakkosopimus, kilpailuoikeus, vero-oikeus

Contents

Table of contents .... **I**

References .... **III**

Abbreviations .... **XIII**

1. Introduction **1**

1.1 Background 1

1.2 Scope of the research and limitations 4

1.3 Research questions and method 6

1.4 Structure of the report 7

2. EU state aid law **10**

2.1 Basis of the substantive regulation 10

2.1.1 Advantageous 11

2.1.2 Selectiveness 13

2.1.2.1 Commission's three-step test to analyze selectivity 14

2.1.3 State Measure 15

2.1.4 Effect on competition and intra-community trade 16

2.2 Other regulation 17

3. Transfer pricing **20**

3.1 OECD Guidelines 20

3.1.1 Transfer pricing in the European Union 21

3.2 Definition of an arm's length price 22

3.2.1 Determining the appropriate level 22

3.2.2 Transfer pricing methods 23

3.2.3 Traditional transaction methods 24

3.2.3.1 CUP method 24

3.2.3.2 RPM method 25

3.2.3.3 Cost plus method 25

3.2.4 Transactional profit methods 26

3.2.4.1 Transactional net margin method 26

3.2.4.2 Transactional profit split 27

3.2.5 Most suitable method for assessing the arm's length level 27

3.3 Advance pricing agreements 28

3.3.1 Definition 28

3.3.2 Content of the ruling 29

4. Tax ruling as prohibited state aid 32
4.1 Tax rulings and Article 107(1) TFEU..32
4.1.1 Tax ruling as selective 33
4.2 Challenging the APAs against the multinational enterprises..36
4.2.1 Background..36
4.2.2 Establishing a reference system...40
4.2.3 Arm's length principle within the reference system..44
4.2.4 Derogation from the reference system...47
4.2.4.1 Netherlands (Starbucks) v Commission 47
4.2.4.2 Luxembourg (Fiat) v Commission 51
4.2.5 One-sided approach or two-sided approach 54
4.2.5.1 Ireland (Apple) v Commission 55
4.2.5.2 Luxembourg (Amazon) v Commission 58
4.2.6 Consequences of the taken actions 60
5. Assessment of the measures 64
5.1 Reshaping the framework of taxation and competition law...64
5.1.1 Consistency with the transfer pricing regulation 67
5.1.2 New role of transfer pricing in selectivity assessment 69
5.2 Burden of proof in the light of Court's review 71
5.3 Importance of legal certainty 77
5.4 Aftermath and further developments 81
5.5 Direction of the regulation 84
6. Conclusions 88
6.1 Summary of the main findings..88
6.2 Concluding remarks 90

References

Bibliography:

Aarnio, Aulis: Laintulkinnan teoria. WSOY, Helsinki 1989. (*Aarnio 1989*)

Brankin, Sean-Paul: "Introduction" pp. 1-18 in Willis, Peter: Introduction to EU Competition Law, Informa Louisiana from Routledge 2013. (*Brankin 2013*)

Craig, Paul; de Burca, Gráinne: EU Law – Text, Cases and Materials, 6th edition, OUP Oxford 2015. (*Craig – de Burca 2015*)

da Cruz Vilaca, José Luís: "The intensity of judicial review in complex economic matters – recent competition law judgments of the Court of Justice of the EU" in Journal of Antitrust Enforcement, 2018, Vol. 6, pp. 173–188. (*da Cruz Vilaca 2018*)

De Cecco, Francesco: State aid and the European economic constitution, 2nd edition, Hart Publishing 2013. (*De Cecco 2013*)

van Gestel, Rob; Micklitz, Hans-Wolgang: "Why Methods Matter in European Legal Scholarship" in European Law Journal, No 3 (2014), pp. 292-316, 2014. (*van Gestel – Micklitz 2014*)

Moreno Gonzalez, Saturnina: "State Aid and Tax Competition 2016" in European State Aid Law Quarterly, No 4 (2016), pp. 556-574, 2016. (*Gonzalez 2016)*

Eden, Lorraine; Byrnes, William: "Transfer Pricing and State Aid: The Unintended Consequences of Advance Pricing Agreements" in Transnational Corporations, Vol. 25 (2018) No 2, pp. 9-36, 2018. (*Eden – Byrnes 2018*)

EU Joint Transfer Pricing Forum, JTPF report: Guidelines on low value adding intra-group services, meeting of 4 February 2010. (*EU JTPF 2010*)

Giraud, Adrien; Petit, Sylvian: "Tax Rulings and State Aid Qualification: Should Reality Matter" in European State Aid Law Quarterly, No 2 (2017), pp. 233-242, 2017. (*Giraud – Petit 2017*)

Hancher, Leigh; Sauter, Wolf: EU Competition and Internal Market in the Health Care Sector, Oxford University Press, Oxford, 2012. (*Hancher – Sauter 2012*)

Helminen, Marjaana: EU-Vero-oikeus: Välitön verotus, e-book, Talentum 2018. (*Helminen 2018*)

Joutsamo, Kari; Kaila, Heidi; Aalto, Pekka; Maunu, Antti: Eurooppaoikeus, Talentum 2010. (*Joutsamo – Kaila – Aalto – Maunu 2010*)

Kyriazis, Dimitros A.: "From Soft Law to Soft Law through Hard Law: The Commission's Approach to the State Aid Assessment of Tax Rulings" in European State Aid Law Quarterly, No 3 (2016), pp. 428-439, 2016. (*Kyriazis 2016*)

Lang, Michael; Cottani, Giammarco; Petruzzi, Raffaelle; Storck, Alfred: Fundamentals of Transfer Pricing: A Practical Guide, Wolters Kluwer, Vienna 2019. (*Lang – Cottani – Petruzzi – Storck 2019*)

Lang, Michael; Pistone, Pasquale; Schuch, Josef; Staringer, Claus: Introduction to European Tax Law: Direct Taxation, 4th edition, Spiramus Press 2018. (*Lang – Pistone – Schuch – Staringer 2018*)

Lopez, Juan Jorge Piernas: The concept of state aid under EU law: from internal market to competition and beyond, 1st edition, e-book, Oxford University Press 2015. (*Lopez 2015*)

Lowe, Philip: EU State Aid Investigations: A View From Both Sides of the Atlantic" in Tax Notes International, 21 March 2016, pp. 1037, 1038. (*Lowe 2016*)

Luja, R.H.C: "Will the EU's State Aid Regime Survive BEPS?" in British Tax Review, No 3 (2015), pp. 379-390, 2015. (*Luja 2015*)

Malmgren, Marianne: "OECD:n hanke veropohjan rapautumisen ja voitonsiirron estämiseksi" in Verotus 1/2015 pp. 38-46, 2015. (*Malmgren 2015*)

Myrsky, Matti: Piirteitä viimeaikaisesta vero-oikeudellisesta tutkimuksestamme. Oikeus 2009/1, p. 60–67, 2009. (*Myrsky 2009*)

Myrsky, Matti; Ossa, Jaakko: Verotuksen perusteet. Talentum 2008. (*Myrsky – Ossa 2008*)

Nicolaides, Phedon: "Grants versus Fiscal Aid: In Search of Economic Reality", European State Aid Law Quarterly, No 3 (2015) Vol. 14: pp. 410-416, 2015. (*Nicolaides 2015*)

Nicolaides, Phedon: "The Definition of the Reference Tax System is still a Puzzle" in European State Aid Law Quarterly, No 3 (2018), pp. 419-428, 2018. (*Nicolaides 2018*)

OECD 1994: Attribution of Income to Permanent Establishments, Issues in International Taxation No. 5, OECD, Paris, 1994; reproduced in Volume II of the loose-leaf version of the OECD Model Tax Convention at page R(13)-1, approved by the OECD Council of 26 November 1993. (*OECD 1994*)

OECD 2008: 2008 Report on the Attribution of Profits to Permanent Establishments, approved by the OECD Council of 17 July 2008. (*OECD 2008*)

OECD 2010: Transfer pricing methods, July 2010. (*OECD 2010a*)

OECD 2010: Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. (*OECD 2010b*)

OECD 2013. Action Plan on Base Erosion and Profit Shifting, OECD/G20 Base Erosion and Profit Shifting Project, 19 July 2013. (*OECD 2013*)

OECD 2017: Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. (*OECD Guidelines*)

OECD 2017: Model Tax Convention on Income and on Capital published, Condensed Version 2017.http://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capitalconde nsed-version-20745419.htm. (*OECD 2017*)

Panci, Lorenzo: "Latest Developments on the Interpretation of the Concept of Selectivity in the Field of Corporate Taxation" in European State Aid Law Quarterly, No 3 (2018): pp. 353-367, 2018. (*Panci 2018*)

Perez-Bernabeu, Begona; "Refining the Derogation Test on Material Tax Selectivity: The Equality Test" in European State Aid Law Quarterly, No 4 (2017), p. 582-592, 2017. (*Perez-Bernabeu 2017*)

Peroni, Robert; Gustafson, Charles; Pugh, Richard: International Income Taxation: Code and Regulations, Selected Sections, CCH Wolters Kluwer business 2008. (*Peroni – Gustafson – Pugh 2008*)

Pinto, Carlo: Tax Competition and EU Law, Kluwer Law International 2003. (*Pinto 2003*)

Poscic, Ana: 'Procedural Aspects of EU State Aid Law' in EU and Comparative Law Issues and Challenges Series 1 (2017), pp. 490-501, 2017. (*Poscic 2017*)

Quigley, Conor: European State Aid Law and Policy, 3rd edition. Bloomsbury 2015. (*Quigley 2015*)

Mason, Ruth: State Aid Special Report – Part 6: Arm's Length on Appeal, Tax Notes Special Report, 5 February 2018: pp. 243-252, 2018. (*Mason 2018*)

Micheau, Claire: "State aid and taxation in EU law" in Research Handbook on European State Aid Law by Szyszczak, pp. 193-218, e-book, Edward Elgar Pub 2011. (*Micheau 2011*)

Miladinovic, Alexandra; Petruzzi, Raffaelle: "The Recent Decisions of the European Commission on Fiscal State Aid: An Analysis from a Transfer Pricing Perspective" in International Transfer Pricing Journal, No 4 (2019), 2019. (*Miladinovic - Petruzzi 2019*)

Raitio, Juha: Eurooppaoikeus ja Sisämarkkinat, Talentum Media Oy, Helsinki 2010. (*Raitio 2010*)

Raunio, Merja; Karjalainen, Jukka: Siirtohinnoittelu. Alma Talent, Helsinki 2018. (*Raunio – Karjalainen 2018*)

Siikavirta, Kristian: Valtiontuki oikeuden ja politiikan yhtymäkohdassa, Helsinki 2006 (*Siikavirta 2006*)

Sauter, Wolf: Coherence in EU Competition Law, Oxford University Press, Oxford 2016 (*Sauter 2016*)

Stuart, Eugene: "Whether or Not to Bite the Apple: Some Implications of the August 2016 Commission Decision on Irish Tax Benefits for Apple" in European State Aid Law Quarterly, No 2 (2017), pp. 209-232, 2017 (*Stuart 2017*)

Schön, Wolfgang: Tax Legislation and the Notion of Fiscal Aid: A Review of 5 Years of European Jurisprudence, pp. 3-26 in Richelle Isabelle; Schön, Wolfgang; Traversa, Eduardo: State Aid Law and Business Taxation, 2016. (*Schön 2016*)

Taferner, Anja; Wouda Kuipers, Jurjan: "Tax Rulings: In Line with OECD Transfer Pricing Guidelines but Contrary to EU State Aid Rules?" in European Taxation, No 4 (2016), Vol 56, 2016. (*Taferner – Kuipers 2016*)

Terra, Ben; Wattel, Peter: European Tax Law. 5th edition, Kluwer Law International 2008. (*Terra – Wattel 2008*)

Tuori, Kaarlo: Kriittinen oikeuspositivismi. WSOY, Helsinki 2000. (*Tuori 2000*)

Türk, Alexander: Judicial review in EU law, Edgar Elgar Publishing 2009. (*Türk 2009*)

Verhagen, Han: “State Aid and Tax Rulings – An Assessment of the Selectivity Criterion of Article 107(1) of the TFEU in Relation to Recent Commission Transfer Pricing Decisions” in European Taxation, No 7 (2017), Vol 57, 2017. (*Verhagen 2017*)

Viitala, Tomi 2017: ”Yhteinen yhtiöveropohja (CCTB) – vihdoin myötätuulessa?” in Verotus 2/2017, 2017. (*Viitala 2017*)

Legislation

Primary law

Consolidated version of the Treaty on European Union, OJ, No. C 326, 26 October 2012 (*TEU*)

Consolidated version of the Treaty on the functioning of the European Union, OJ, No. C 326, 26 October 2012 (*TFEU*)

Secondary law

Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, 2014

Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (Text with EEA relevance), 2015

Commission Proposal for a Council Directive on a Common Corporate Tax Rate COM(2018)0148 – C8-0137/2018 – 2018/0073(CNS), 2016

Commission notices, communication and other

Commission Notice on the application of the State aid rules to measures relating to direct business taxation (98/C 384/03), 1998. (*Commission Notice 1998*)

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, 2016. (*Commission Notice 2016*)

Communication from the Commission to the European Parliament and the Council: An Action Plan to strengthen the fight against tax fraud and tax evasion COM/2012/0722, 2012

Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU COM/2007/0071, 2007

European Parliament, Resolution Tax rulings and other measures similar in nature or effect, 25 November 2015 (2015/2066(INI), 2015

European Parliament, Policy Department A: Economic and Scientific Policy: State Aid Law and National Tax Rulings IP/A/TAXE/2015-02, October 2015

DG Competition working paper on state aid and tax rulings – Internal Working Paper – Background to the High Level Forum on State Aid of 3 June 2016, (*DG Competition working paper 2016*)

Protocol (No. 27) to the TEU and TFEU on the internal market and competition 12008M/PRO/27, 2008

Communication from the Commission to the European Parliament, the European Council and the Council, 15.1.2019, Towards a more efficient and democratic decision making in EU tax policy, COM/2019/8 2019

Commission, Europe 2020: A strategy for smart, sustainable and inclusive growth, COM/2010/2020, 3 March 2010

Commission - Press release - Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules, IP/15/5880, 21 October 2015

Commission - Press Releases - Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million, IP/17/3701, 4 October 2017 and 18 December 2017

Commission - Press Releases - Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules, IP/15/5880, 21 October 2015 and 30 August 2016

Case law

Court of Justice of the European Union

C-30/59, Gezamenlijke Steenkolemijnen in Limburg v. High Authority (1961), ECLI:EU:C:1961:2

Joined Cases C-6/69 and C-11/69, Commission v France (1969), ECLI:EU:C:1969:68

C-173/73, Italian Republic v. Commission of the European Communities (Italy v Commission) (1974), ECLI:EU:C:1974:7

C-78/76, Steinike & Weinlig v. Federal Republic of Germany (1977), ECLI:EU:C:1977:52

C-82/77, Openbaar Ministerie v. Van Tiggele (1978), ECLI:EU:C:1978:10

C-730/79, Philip Morris Holland BV v. Commission (1980), ECLI:EU:C:1980:209

C-170/83, Hydrotherm Gerätebau GmbH v. Compact del Dott. Ing. Mario Andreoli & C. Sas (1984), ECLI:EU:C:1984:271

Joined cases C-6/90 and C-9/90, Andrea Francovich and Danila Bonifaci and others v. Italian Republic (‘Francovich’) (1991), ECLI:EU:C:1991:428

C-301/87, France v. Commission (‘Boussac’) (1990), ECLI:EU:C:1990:67

C-188/89, Foster and others v. British Gas plc. (1990), ECLI:EU:C:1990:313

C-387/92, Banco Exterior de España v. Ayuntamiento de Valencia (1994), ECLI:EU:C:1994:100

C-39/94, SFEI v. La Poste (1996), ECLI:EU:C:1996:285

C-241/94, French Republic v. Commission of the European Communities (1996), ECLI:EU:C:1996:353

C-256/97, Déménagements-Manutention Transport SA ('DMTransport') (1999), ECLI:EU:C:1999:332

C-83/98, French Republic v. Ladbroke Racing Ltd and Commission of the European Communities (2000), ECLI:EU:C:1999:577

C-379-98, PreussenElektra AG v. Schhleswag AG, in the presence of Windpark Reußenköge III GmbH and Land Schleswig-Holstein (2001), ECLI:EU:C:2001:160

C-156/98, Germany v. Commission (2000), ECLI:EU:C:2000:467

C-143/99, Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v. Finanzlandesdirektion für Kärnten (2001), ECLI:EU:C:2001:598

C-482/99, France v. Commission (2002), ECLI:EU:C:2002:294

C-74/00, Falck y A. di Bolzano v. Commission (2002), ECLI:EU:C:2002:524

Joined Cases C-328/99 and C-399/00, Italy and SIM 2 Multimedia v. Commission (2003), ECLI:EU:C:2003:252

C-280/00, Altmark Trans GmbH and Regierungspräsidium Magdeburg v. Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht (2003), ECLI:EU:C:2003:415

C-409/00, Kingdom of Spain v. Commission of the European Communities (2003), ECLI:EU:C:2003:92

C-126/01, Ministère de l'Économie, des Finances et de l'Industrie v. GEMO SA (2003), ECLI:EU:C:2003:622

C-159/01, Kingdom of the Netherlands v. Commission of the European Communities (2004), ECLI:EU:C:2004:246

C-66/02, Italy v. Commission (2005), ECLI:EU:C:2005:768

C-88/03, Portuguese Republic v. Commission of the European Communities (2006), ECLI:EU:C:2006:511

C-182/03 and C-217/03 (Joined cases), Belgium and Forum 187 ASBL v. Commission (2006), ECLI:EU:C:2006:416

C-172/03, Wolfgang Heiser v. Finanzlandesdirektion für Tirolpara (2005), ECLI:EU:C:2005:130

C-451/03, Servizi Ausiliari Dottori Commericalisti (2006), ECLI:EU:C:2005:410

C-408/04, Commission v. Salzgitter (2008), ECLI:EU:C:2008:236

C-211/05, Italy v. Commission (2009), ECLI:EU:C:2005:760

C-341/06 P & C-342/06 P, Chronopost v. UFEX (2008), ECLI:EU:C:2008:375

C-487/06 P, British Aggregates Association v. Commission of the European Communities and United Kingdom (2008), ECLI:EU:C:2008:757

C-494/06 P, Commission v. Italian Republic and Wam SpA (2009), ECLI:EU:C:2009:272

C-290/07 P, Commission v. Scott (2010), ECLI:EU:C:2010:480

Joined cases C-78/08 and C-80/08, Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v Paint Graphos Soc. coop. arl (C-78/08), Adige Carni Soc. coop. arl, in liquidation v. Agenzia delle Entrate and Ministero dell'Economia e delle Finanze (C-79/08) and Ministero delle Finanze v. Michele Franchetto (C-80/08) (2011), ECLI:EU:C:2011:550

C-279/08, European Commission v. Kingdom of Netherlands (2011), ECLI:EU:C:2011:551

C-399/08 P, Commission v. Deutsche Post (2010), ECLI:EU:C:2010:481

Joined Cases C-106/09 P and C107/09 P, 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 (2011), ECLI:EU:C:2011:732

C-138/09, Todaro Nunziatina & C. (2010), ECLI:EU:C:2010:291

C-269/09, Commission v. Spain (2012), ECLI:EU:C:2012:439

C-452/10 P, BNPParibas v. Commission (2012), ECLI:EU:C:2012:366

C-610/10, Commission v. Spain (2012), ECLI:EU:C:2012:781

C-6/12, P Oy (2013), ECLI:EU:C:2013:525

Joined cases C-533/12 P and C-536/12 P, SNCM and France v. Corsica Ferries France (2014), ECLI:EU:C:2014:2142

C-559/12 P, France v. Commission (2014), ECLI:EU:C:2014:217

C-518/13, Eventech (2015), ECLI:EU:C:2015:9

C-15/14 P, European Commission v. MOL Magyar Olaj- és Gázipari Nyrt. (2015), ECLI:EU:C:2015:362

Joined cases C-20/15 P and C21/15 P, European Commission v. World Duty Free Group SA and Others ("Santander S") (2016), ECLI:EU:C:2016:981

C-270/15 P, Belgium v. Commission (2016), ECLI:EU:C:2016:489

C 486/15 P, Commission v. France and Orange (2016), ECLI:EU:C:2016:912

C-156/98, Germany v. Commission (2000), ECLI:EU:C:2000:467

General Court of the European Union

T-67/94, Ladbroke v. Commission (1998), ECLI:EU:T:1998:7

Joined Cases T-298/97 and T-312/97, Alzetta (2000), ECLI:EU:T:2000:151

Joined Cases T-116/01 and T-118/01, P&O European Ferries (Vizcaya) SA and Diputacion Floral de Vizcaya v Commission (2003), ECLI:EU:T:2003:217

T-137/02, Pollmeier Malchow v. Commission (2004), ECLI:EU:T:2004:304

T-68/03, Olympiaki Aeroporia Ypiresies v. Commission (2007), ECLI:EU:T:2007:253

T-369/06, Holland Malt BV v. Commission (2009), ECLI:EU:T:2009:319

T-219/10, Autogrill España v. Commission (2014), ECLI:EU:T:2014:939

T-385/12, Orange v. Commission (2015), ECLI:EU:T:2015:117

T-305/13, SACE and Sace BT v. Commission (2015), ECLI:EU:T:2015:435,

T-760/15, Netherlands v. European Commission (2019), ECLI:EU:T:2019:669

Joined cases T-755/15 and T-759/15, Luxembourg v. European Commission (2019), ECLI:EU:T:2019:670

European Commission (EC)

C(2003) 564 (2003/755/EC) on the aid scheme implemented by Belgium for coordination centres established in Belgium, 17 February 2003

2004/339/EC on the measures implemented by Italy for RAI SpA, 16 October 2003

C(2009) 4511 (2009/809/EC) on the Groepsrentebox Scheme which the Netherlands is planning to implement, 8 July 2009

C(2009) 8130 on State aid C 10/07 (ex NN 13/07) implemented by Hungary for tax deductions for intra-group interest, 28 October 2009

C(2014) 7156 State Aid SA.38944 2014/C alleged aid to Amazon by way of a tax ruling, 7 October 2014

C(2015) 8343 State Aid SA.38945 2015/C alleged aid to McDonald´s, 3 December 2015

C(2015) 7143 State Aid SA.38374 2014/C implemented by the Netherlands to Starbucks, 21 October 2015

C(2015) 7152 State Aid SA.38375 2014/C, which Luxembourg gave to Fiat, 21 October 2015

C(2015) 9837 SA.37667 2015/C The excess profit exemption State Aid Scheme implemented by Belgium, 11 January 2016

C(2016) 5605 State Aid SA.38373 2014/C implemented by Ireland to Apple, 30 August 2016

C(2018) 3839 State aid implemented by Luxembourg in favor of ENGIE, 26 June 2018

C(2019) 2526 UK tax scheme for multinationals (Controlled Foreign Company rules), 2 April 2019

Opinions of Advocate General

Opinion of Advocate General Fennelly of C-251/97 France v Commission, C-251/97 (1993), ECLI:EU:C:1998:572

Opinion of Advocate General Kokott of C-66/14 Finanzamt Linz (2015) ECLI:EU:C:2015:661

Other (internet sources)

American Chamber of Commerce to the European Union, 'Letter to Commissioner Vestager on the European Commission's state aid investigations, available at https://www.amchameu.eu/system/files/position_papers/amcham_eu_letter_to_commissioner_margrethe_vestager.pdf (visited 5 September 2019)

European Union – Preserving and promoting fair competition practice, available at https://europa.eu/european-union/topics/competition_en (visited 2 December 2019)

European Commission - The Lisbon Treaty and Tax Legislation in the EU, available at https://ec.europa.eu/taxation_customs/general-information-taxation/eu-tax-policy-strategy/lisbon-treaty-tax-legislation-eu_en (visited 15 November 2019)

European Commission – Taxation and Customs Union – Business - Company Tax - Transfer pricing in the EU context, available at https://ec.europa.eu/taxation_customs/business/company-tax/transfer-pricing-eu-context/joint-transfer-pricing-forum_en#heading (visited 18 November 2019)

EU Commission – Competition State Aid – Tax Rulings, available at https://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html (visited 3 October 2019)

Exhibits of hearing of Offshore Profit Shifting and the U.S. Tax Code Part 2 (Apple Inc.) of the Permanent Subcommittee on Investigations of the US Senate, 21 May 2013, available at https://www.govinfo.gov/content/pkg/CHRG-113shrg81657/pdf/CHRG113 shrg81657 .pdf (visited 1 December 2019)

Government of the Netherlands: Response by State Secretary Snel to the ruling of the General Court of the European Union on Starbucks, 24 September 2019, available at https://www.government.nl/latest/news/2019/09/24/response-by-state-secretary-snel-to-the-ruling-of-the-general-court-of-the-european-union-on-starbucks (visited 29 November 2019)

Finnish Tax Authorities, Verohallinto – Advance Pricing Agreements, available at https://www.vero.fi/en/businesses-and-corporations/about-corporate-taxes/transfer _pricing /guidance-and-procedures/advance-pricing-agreement/ (visited 1 September 2019)

Monsenego, Jérome: "Some observations on Starbucks, Fiat, and their potential impact on future amendments to the arm's length principle" in Kluwer Competition Law Blog, September 26, 2019, available at http://competitionlawblog.kluwercompetitionlaw.com/

2019/09/26/some-observations-on-starbucks-fiat-and-their-potential-impact-on-future-amendments-to-the-arms-length-principle/. (*Monsenego 2019*) (visited 4 January 2020)

Working together for fairer taxation, available at https://ec.europa.eu/commission/commissioners/20142019/vestager/announcements/working-together-fairer-taxation_en (visited 16 September 2019

OECD, BEPS Actions 8-10 address transfer pricing guidance to ensure that transfer pricing outcomes are better aligned with value creation of the MNE group, 8 – 10 Transfer pricing, available at http://www.oecd.org/tax/beps/beps-actions/action8-10/ (visited 22 October 2019)

State Aid and Taxation update: General Court rules on Fiat and Starbucks appeals. available at https://www.linklaters.com/en/insights/publications/2019 /september/state-aid-and-taxation-update-general-court-rules-on-fiat-and-starbucks-appeals (visited 8 December 2019)

The Guardian: Tim Cook condemns Apple tax ruling", 1 September 2016 available at https://www.theguardian.com/business/2016/sep/01/political-crap-tim-cook-apple-tax-ruling (visited 5 January 2020)

The U.S. Department of the Treasury on the European Commission's recent state aid investigations of transfer pricing rulings, available at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/White-Paper-State-Aid.pdf (visited 5 November 2019)

Valtioneuvoston kanslian julkaisusarja 17/2014: Siirtohinnoittelu – opas kansainvälistyvälle yritykselle, Team Finland, available at http://julkaisut.valtioneuvosto.fi/bitstream/handle/10024/79688/J1714Team%20Finland%20Siirtohinnoitteluopas_net.pdf?sequence=1&isAllowed=y (visited 2 September 2019)

Abbreviations

AG	Advocate General
APA	Advance Pricing Agreement
BEPS	Base erosion and profit shifting
CIT	Corporate income tax
CUP	Comparable Uncontrolled Price
CPM	Cost plus method
CJEU	The European Court of Justice
EP	European Parliament
EU	European Union
GC	General Court of the European Union
IC	Inter-company
OECD	The Organization for Economic Co-operation and Development
Member States	28 Member States (including the UK) of the European Union
MNE	Multinational enterprise
RPM	Resale price method
TEU	Treaty on the European Union
TFEU	Treaty on Functioning of the European Union
TNMM	Transactional net margin method
TP	Transfer pricing
VAT	Value added tax

1. Introduction

1.1 Background

Tax competition can be defined as a form of competition where governments try to tempt as many tax payers as possible into their jurisdiction by regulatory means to increase their tax revenues for fiscal purposes. A well-functioning tax system should also boost the competitiveness of the Member State.[1] Reality being more complex as in this example, similarly to game theory, the national governments must take the actions of other states also into account in their legislative measures. As a result, at least in theory, the taxable income or the companies that in the end create the taxable profit should by rational means try to locate into a place where it can maximize its gains or minimize its costs. Usually, as paying tax can be defined as a cost for an undertaking, such location refers to a situation where tax burden for the entity becomes as simple – or even low – as possible. For the government, the state actions relate to direct taxation as fiscal measure more closely. On the other hand, the less the tax payer pays tax, the lower the tax revenue being created is. Due to the low amount of harmonization in direct taxation in the EU, collecting tax revenues falls into the full competence of Member States. At a more general level, EU has not much authority in exercising of fiscal policy since taxes paid by the individuals and companies are collected by the Member States. EU has tried to create some sort of harmonization in this regard but, so far, all attempts have met resistance and there is no change in sight.[2] It can be concluded that direct taxation is characterized as one of the topics that very much divide the opinions on fiscal autonomy and appropriate level of harmonized regulation in the EU.

Transaction flows between the different countries but within the same globally operating group of companies, in which the value may factually be created in one place but ends up being taxed in another country, makes the allocation of profit for taxation purposes difficult to track for any tax authority. It has been estimated that nearly 60% of the world trade is taking place in related party transactions.[3] Understandably, considering the sharing of mutual interest between companies belonging to the same group, intra-group transactions make – at least in principle –

---

[1] For more information, see Pinto 2003.
[2] For more information, see the Commission Proposal for a Council Directive on a Common Corporate Tax Rate (2016) and Viitala 2017.
[3] Valtioneuvoston kanslian julkaisusarja 17/2014: Siirtohinnoittelu – opas kansainvälistyvälle yritykselle, Team Finland.

profit shifting from country to another possible. Bearing this in mind, it is no wonder that during the last ten years more and more countries are publishing, expanding and redefining their transfer pricing regulation to prevent erosion of their tax bases.[4] Since it is practically possible for integrated companies to price their intra-group transactions, i.e. *transfer price*, regardless of the normal market conditions, *the arm's length principle* has been created. This means that the undertakings need to show the compliance with this principle for the relevant tax authorities regarding their intra-group transactions that an unrelated party in similar circumstances would pay the same price in a transaction as the related party does in a controlled transaction for the same product or service.

The intergovernmental organization OECD has established itself as the main and primary source relating to interpretation and calculation of the arm's length level for the transfer price.[5] For the sake of understanding the nature of international taxation, transfer prices are merely relevant for those companies having business activities in more than one country. Tax authorities are in most cases only interested in cross-border transactions due to that domestic transactions do not usually shift taxable profit away. As the Member States have become more worried about losing tax revenue, domestic legislations include provisions on how they may intervene on possible infringements of arm's length principle.[6] In addition, from multinational enterprises' perspective, considering that the transfer pricing related disputes and litigations may turn out to be extremely expensive, time-consuming and all in all burdensome, ensuring the correct level of transfer prices beforehand together with the relevant tax authorities would seem to make perfect sense for both parties. Therefore, companies and tax authorities may negotiate an agreement on the appropriate level of intra-group pricing, that are referred to as *advance pricing agreements*.

APAs are formal arrangements for the purpose of national tax authorities and MNEs, where the parties agree on the MNE's relevant transfer pricing methods, estimation of its taxable income, and other tax payments during a period of time to avoid any possible income tax dispute in the future.[7] It is designed for resolving transfer pricing disputes that may be more or less open to

---

[4] Raunio - Karjalainen 2018, p. 3.
[5] OECD Guidelines.
[6] The Finnish tax authorities may intervene transfer prices based on Article 31 of Act on Taxation Procedure in cases "where conditions are made or imposed between the two associated enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly".
[7] https://unctad.org/en/PublicationChapters/diae2018d4a3.pdf.

interpretation of correct price level.[8] The power and usefulness of APA is therefore bringing legal certainty to the upcoming tax treatment. However, as the tax provisions differ from Member State to Member State, corporate income taxation may become very affordable in some cases due to, e.g., margin of discretion by the tax authority. Eventually, if the APA holder holds clearly deviant treatment from other undertakings, this can be even interpreted as advantageous and selective in comparison.

Are these types of potentially selective agreements completely applicable to the internal market? At least the Commission has not settled for a passive role regarding the tax treatment of MNEs as this may appear as 'tendering out' different tax jurisdictions or purely taking advantage of different legislation of the Member States. Despite of the taxation competence related question, the Commission has been accusing MNEs for having tax arrangements in place confirmed by national tax authorities that violate the state aid regulation. However, these actions have also led to accusations of Commission's wrongful measures and, on the other hand, even to a conflict referred to as "tax war" between the EU and the United States.[9] The Commission decisions made under state aid law may amount to extensive recoveries for the tax payer and therefore draw much public attention in the media. For example, the bill for accused unprohibited APA between Ireland and Apple that represented the amount of aid for Apple in Ireland between 2004-2013 and was, thus, deemed to be recovered by Ireland amounted to over EUR 13,0 billion.

By taking the competition law measures against the tax decisions, one could argue that the Commission is trying to further extend its competence to direct taxation. On the other hand, EU has the authority to protect the fair competition with two general objectives: (1) deal with the problems and collisions that may take place when different undertakings are operating in the same markets and (2) to establish a well-functioning single market in the EU.[10] The Member States have given away their competence for harmonizing regulation whereas state aid law has been designed to make sure unfair and unequal conditions would not take place to pursue for more innovation, shared standards as well as gain for small European businesses and companies.[11] Indeed, EU state aid policy is in the very core of the objectives of establishing an internal market. The purpose of these rules is to prevent companies to receive advantageous

[8] https://www.vero.fi/en/businesses-and-corporations/about-corporate-taxes/transfer_pricing/guidance-and-procedures/advance-pricing-agreement.
[9] Lang – Cottani – Petruzzi – Storck 2019, p. 506 and Lowe 2016, p. 1037, 1038.
[10] Brankin 2013, p. 1 and 2.
[11] https://europa.eu/european-union/topics/competition_en.

and selective gains over other companies and it is ultimately defined in the Article 107(1) TFEU. The main focus in the analysis must be given whether advantage in whatever form conferred on a selective basis to undertakings by national public authorities exists, which would hinder competition and trade between Member States. APAs or tax rulings could potentially fulfill the requirements listed in the Article 107(1) TFEU in certain circumstances and the Commission's record is rather impressive in this field: Since 2014, eight final decisions have been given on prohibited tax rulings so far and three investigations are currently ongoing.[12] The MNEs that have been targeted by the Commission include *inter alia* Apple, Fiat, Starbucks and McDonald's. General Court has ruled in favor and against Commission's results in its investigations, although we are still waiting for the CJEU's view on the matter. All in all, the functioning of the internal market is very much dependent on sufficient competition regulation but, yet, we may also come across with problems relating to determining concepts unfair or unequal treatment.

1.2 Scope of the research and limitations

The scope of this research is to analyze the state aid policy from the transfer pricing point of view by going through the decisions of the Commission and judgments of General Court as whether APAs can be regarded as prohibited state aid particularly when applying and interpreting the arm's length principle. In order to fully understand the combination of state aid law and transfer pricing, basic doctrines, related case law and questions with respect to international taxation as well as concept of state aid regulation need to be gone through and understood. Therefore, the framework for legal assessment as well as the applicable sources for transfer pricing will be explained in this research, primarily focusing on the developments, trends and current status of state aid regulation. At the end, these two segments sought to be considered and analyzed together in order to review the case law regarding prohibited tax rulings.

The Commission has the burden of proof to point out the existence of prohibited aid and the analysis seeks to explain what the current interpretation standard is for evaluating arm's length principle in the context of EU state aid law and how much margin of discretion is left for Commission in this task that will be eventually reviewed by the Court. For example, how might a deviation from arm's length principle in the tax ruling constitute a selective advantage for certain undertaking. In this context, OECD guidelines are the primary source for the evaluation.

[12] https://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html.

The General Court's judgments and Commission's recent decisions on state aid will also be analyzed when seeking to evaluate the selective and advantageous nature of an APA. Current existing case law, legal literature as well as opinions of the legal scholars and academics will support the findings presented in this report. As the compliance of the arm's length principle between Member State's legislation and EU state aid regulation may differ, the report also discusses the topic if we should aim to uniform and systematic application of arm's length principle in this field for maintaining legal certainty.

After the arm's length principle and its status has been discussed, its possible consequences and result of actions will be analyzed. The framework for this analysis needs to be set in the light of what the actual and aim of the EU state aid regulation is and when is the deviation from arm's length principle violating the objectives given for the single market as selective advantage, which may result to recovery of aid from the tax payer. As there are no judgments given by the CJEU on the application of Article 107(1) TFEU regarding advance pricing agreements as prohibited state aid, the primary source of case law will relate to Commission's and General Court's interpretation on the matter. However, some CJEU case law related to direct taxation may also bring help to interpretation on how should the APAs be evaluated in front of the CJEU. Additionally, there are number of cases dealing with state aid that may further be interpreted in the light of taxation. Many academic articles discussing the topic and other official EU sources offer relatively good amount of views from both critical and supportive stand.

There are four major cases that this report will be focusing on – the tax ruling related cases *Fiat, Starbucks, Apple* and *Amazon* from which the former two have been also reviewed and judged by the General Court.[13] These cases relate all to individual aid measures, in other words, agreed between the Member State and undertaking through a tax ruling. Other similar cases, such as the *Excess Profit exemption in Belgium* and *UK tax scheme for multinationals* cases, are not APA related but rather so-called *schemes,* dealing with the actual tax legislation of the Member State.[14] Further, *McDonald's* did not include prohibited aid and transfer pricing assessment with regard to interpretation of arm's length principle were not discussed in the Commission's decision as well as, in *ENGIE,* the case regarded tax technical question instead of application

[13] See T-760/15 Netherlands v European Commission (2019); Joined cases T-755/15 and T-759/15 Luxembourg v European Commission (2019); C(2014) 7156 State Aid SA.38944 2014/C alleged aid to Amazon by way of a tax ruling (2014) and C(2016) 5605 State Aid SA.38373 2014/C implemented by Ireland to Apple (2016).
[14] C(2015) 9837: The excess profit exemption State Aid Scheme implemented by Belgium and C(2019) 2526 UK tax scheme for multinationals.

of transfer pricing methods and arm's length principle.[15] Therefore, these two decisions are excluded from the analysis. As this report is concentrating on application of arm's length principle and transfer pricing related questions, the exclusion of above-mentioned cases can be deemed to be reasonable and in accordance with the objective of the research.

1.3 Research questions and method

Research questions relate to the understanding of the current approach in the EU state aid regulation towards direct taxation measures and evaluation of arm's length principle as part of transfer pricing assessment therein. As for the burden of proof, the Commission needs to indicate the existence of selective advantage. The research question aims also to analyze when it may be considered sufficient amount of proof from transfer pricing point of view in order for the selective advantage to exist. Since the objective of EU competition law in general is to maintain existence of fair competition in the internal market, the research tries to clarify why and how APAs may trigger doubts from the Commission's point of view as being prohibited aid and underline the possible issues the regulators and companies may face due to this approach. This can be done by analyzing the status of arm's length principle. At the same time, the analysis evaluates the amount and intensity of review required to conduct by the Court in the light of maintaining objectiveness of the review.

Due to the heated debate ongoing between different interest parties, from the tax payers' point of view, the aim is also to try to understand the framework and different circumstances that one should take carefully into account while considering negotiations of an APA with the tax authorities. Whatever stand is taken towards arm's length principle and evaluation of APAs in the state aid context, this will have far-reaching effects in the internal market, thus, political interests around the measures, regulative outcomes and consequences of such application and interpretation are also being discussed. To conclude, my research questions can therefore be seen as twofold as follows:

1) What is the primary status of arm's length principle in EU state aid related assessment in the case of tax rulings?

[15] C(2015) 8343 State Aid alleged aid to McDonald´s, 3 December 2015 and C(2018) 3839 State aid implemented by Luxembourg in favour of ENGIE.

2) What is the level of burden of proof for the Commission to show the existence of selective advantage from transfer pricing point of view in the framework of the Court's review?

As pointed out in the legal literature, the use of legal dogmatic method is generally acceptable in the field of tax related legal debate and, therefore, it is reasonable to trust the basis of the research on this method.[16] The application may also be expanded to the field of EU and competition law and therefore the legal tradition speaks in favor of use of this alternative.[17] The method may be used to interpret and systematize the current state of law and, in this function, give further guidance on its understanding in interpretation process, e.g., for the judges dealing with related cases.[18] Taking the nature of taxation as a balance between the interests of common good and tax payer, the analysis will be conducted on the neutral basis considering legal and reasonable arguments from both sides. From this point of view, the objective is to clarify the existing situation of regulation (*de lege lata*), possible upcoming challenges and changes for parties involved (*de lege ferenda*) as well as to bring forth the potential objectives behind actions, which also advocates the use of legal domestic method in this report.

1.4 Structure of the report

Firstly, the legal framework of EU state aid regime will be gone through to fully understand the full concept of regulation. Articles 107 and 108 TFEU are the treaty-based fundamental sources for the regulative assessment, but there are also procedural provisions that give further the guidance on the state aid process. Case law has also left its mark on the assessment. In case Articles 107 and 108 TFEU have been violated, the Member State needs to recover the amount of prohibited aid from the undertaking for which it was granted. It is good to remember that the Commission is challenging the Member State measure and not the actions of the undertaking, which can be defined as an interest party to the case at hand. After this part, the basis of transfer pricing regulation will explain the nature of international taxation and cross-border intra-group transactions. In general, transfer pricing assessment is based on OECD Guidelines even though this is a soft law instrument. Usually, however, most of the national tax authorities have agreed on the use as the primary reference in cross-border taxation matters. Arm's length principle forms the fundamental framework for the assessment of acceptability for intra-group transactions and there are many methods for the actual determination in practice. Additionally,

[16] Myrsky – Ossa 2008, p. 28.
[17] Myrsky 2009, p. 60 and 65; Myrsky – Ossa 2008, p. 28.
[18] Tuori 2000, p. 302 and Aarnio 1998, p. 989–990.

APA as an instrument for tax purposes will be explain. APA itself is not illegal but an agreement bringing legal certainty for undertakings and tax authorities for corporate income taxation for future years.

Thirdly, after the basis of state aid and transfer pricing regulation have been analyzed, the related case law combining and dealing with both will be introduced. APAs have been construed to fulfill the criteria of Article 107(1) TFEU but the assessment of selectivity may generate further questions on its suitable tax related assessment. At this point, the facts indicate how has the arm's length principle been brought by the Commission and further accepted by the General Court to state aid related assessment to measure selectiveness. The selectivity has been tested under the so called *three-step test* that underlines the difference from what could be regarded as normal taxation for other companies in a similar position. In case the Commission is capable of indicating that APA has violated the arm's length principle, undue advantage has been granted to the undertaking and thus corresponding amount needs to be recovered by the Member State. This approach with its conclusion has nevertheless been challenged both by the Member States and recipient of potential aid. Since the OECD Guidelines offers the tool to measure the amount of aid granted, the Commission has trusted its assessment ultimately on the application of 'universal' OECD based transfer pricing methods.

As the measures have raised a lot of questions by the interest parties, fourthly, the report will discuss the assessment procedure, difficulties in the determination of selectiveness and possible consequences. The discussion here passes through tax and fiscal policy in order for the reader to understand the argumentation and motives behind the parties involved. Also, this includes features of economic analysis considering the question of fiscal autonomy of the Member States. The related analysis introduces developments and future trends of international taxation and transfer pricing and systematizes how these have had an effect on the underlying cases in the light of EU state aid policy. With respect to burden of proof and intensity of the review, General Court rejected Commission's reasoning in *Starbucks* as it failed to indicate how is the APA constitution selective advantage but, in *Fiat*, ruled in favor of the Commission. It is worth questioning to what extent possible grounds for the acceptable amount of proof for selective advantage may be interpreted in different ways. It seems also that arm's length principle is most certainly be moving from soft law to hard law in EU context – however not only from taxation point of view but also in state aid related assessment.

The conclusions drawn indicate that there may still be some unanswered questions and caps in the related judgments. Even though the state aid regulation as such acknowledges the

intervention on unequal tax treatment of certain arrangements by utilizing the arm’s length principle as built-in mechanism for EU law within Article 107(1) TFEU, the discussed approach would nonetheless leave unclear when is the burden of proof sufficiently fulfilled regarding the transfer pricing assessment of the content of tax ruling. However, only if the Commission can show the existence of no other than fundamental breach of arm’s length principle, the Court may accept the measure as prohibited state aid after the review. Above all, existence of selective treatment may face difficulties in argumentation both from tax theoretical point of view due to the abstract nature of transfer pricing as well as, with respect to state aid regulation, analyzing non-integrated and integrated undertakings in a similar factual position for comparison purposes. Even though the prevention of aggressive tax planning can be regarded as a desirable objective, it is not necessarily state aid regulation that should be the tool for it. Considering the number of alternative conclusions and opinions, there may be a risk of putting too much administrative pressure on the Member States concerning the evaluation of the transfer pricing assessment in the tax ruling, not only as a domestic tax issue but also in the context of state aid policy and fair competition.

2. EU state aid law

2.1 Basis of the substantive regulation

The main objective of the EU internal market regulation is to maintain an equal market conditions for every operator in each form of competition, including state aid.[19] According to the Article 3(1) TFEU, the EU has exclusive competence in the establishing of the competition rules necessary for the functioning of the internal market and the articles of action from 101 to 109 TFEU include the valid and applicable basis and framework for substantive regulation on competition within the internal market. As the rules aim to prevent the harmful conduct by the undertakings, some of the regulation is equally applicable to Member States as well. In this context, in addition to anti-competitive behavior of the operators themselves, if any Member State granted subsidies or supported only particular competitors, this would lead to asymmetric and favoring positions of certain undertakings and, thus, possible welfare losses and unequal treatment.[20] In practice, it is the Member State granting the subsidy and the violating party. The EU state aid regulation has its foundation in Articles 107 and 108 TFEU and, according to the former one:

> "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 favoring 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."

Therefore, the Article 107(1) TFEU requires four criteria to be fulfilled before aid granted by the state would be interpreted as prohibited state measure and these are also all cumulative in nature:

1. Measure needs to be advantageous for the undertaking;
2. It needs to be made on a selective basis;
3. It has been granted by the state or state resources; and
4. It must distort or threaten to distort competition and hinder intra-community trade.

Even though the wording in the Article 107 TFEU itself does not define precisely, which measures are considered as aid, this division of four different criteria is applied by the CJEU in its assessment of any possible state measure constituting aid confirmed in *Servizi Ausiliari*

[19] See Protocol No. 27 to the TEU and TFEU on the internal market and competition.
[20] Lang – Cottani – Petruzzi – Storck 2019, p. 507 and Quigley 2015, p. 255.

Dottori Commericalisti.[21] The Commission has listed general principles with respect to evaluation of the state aid in its notice on notion of state aid but many of these doctrines have also been developing through the case law of CJEU.[22] However, due to the lack of precise nature, the notice provides further clarification and explanation on the key concepts relating to assessment of aid and, therefore, one of the most sufficient sources for state aid purposes. It must also be noticed that the Article 107(1) TFEU states "any aid in form whatsoever", which leaves a lot of open room for interpretation and therefore, the treaty provision does not automatically exclude any measure *per se* outside of the application.

Given the Article 107(1) TFEU vague wording, the Article 107(2) TFEU also exempts certain types of aid granted by the member state as well as the conditions listed in the Article 107(3) TFEU leaves some discretion to grant of aid that may be coherent with the internal market for, e.g., those that are promoting a good cause.[23] Applicability of Articles 107(2) and 107(3) TFEU are however in the discretion of the Commission. Despite of the exemptions provided in the treaty, due to the current open form of the article, the Commission has been active in intervening arrangements that, for instance, would otherwise be in the sole competence of the member state – most notably tax arrangements. However, as mentioned, for Article 107(1) TFEU to fully apply, the measure needs to fulfill the four above mentioned criteria.

2.1.1 Advantageous

In *De Gezamenlijke Steenkolenmijnen,* notion of advantage determined broadly.[24] CJEU confirmed that the doctrine that flows from the Article 107(1) TFEU regarding any form itself that those measures, which lower the normal charges that usually should be included in the financial budget of the tax payer may give rise to prohibited state aid.[25] Basically, as the definition does not flow from the treaties, this task for evaluation was granted to CJEU to define.[26] An advantage is any economic benefit, which an undertaking could not have obtained in case the State would not have intervened in any way.[27] One could understand this criterion as both active or passive intervention, as long as it deviates from the concept of normal taxation. When evaluating the advantage of the undertaking, the mere effect it has on the undertaking is

[21] See C-451/03 Servizi Ausiliari Dottori Commericalisti (2006) paragraph 56 and C-341/06 P & C-342/06 P Chronopost v UFEX (2008) paragraph 122.
[22] Commission Notice 2016.
[23] Article 107(2) TFEU and Article 107(3) TFEU.
[24] C-30/59 Steenkolenmijnen v High Authority (1961), paragraph 39.
[25] C-30/59 Gezamenlijke Steenkolemijnen (1961), paragraph 3.
[26] Lopez 2015, p. 71.
[27] Commission Notice 2016, paragraph 4.1.

considered relevant, not the actual cause or the objective behind the intervention by the state.[28] This allows the Commission to perform its assessment to the extent that it is not relevant to evaluate whether the treatment would be compulsory or not for the undertaking in the context of national law.[29]

The most straight forward way to analyze this for the CJEU is to consider whether the position of the particular company has improved in any way after it has been provided with the aid measure from the state.[30] In *SFEI v La Poste*, this assessment was referred to the fact whether the undertaking would have received the same advantage under the normal market conditions.[31] If not the case, this may be a sign of possible state aid. The CJEU has in its case law interpreted the notion of aid quite broadly. This approach may also be relatively easy to understand as the tax payer may receive benefit in a way or another and therefore the notion of aid cannot be defined as such.[32] There is a clear extinction between aid and subsidy and the aid has a broader meaning in this sense.[33] As the subsidy only covers monetary reimbursements form the public sector, the notion of aid on the other hand can be deemed to cover all measures from the state that improve the financial or economic position of the tax payer.[34]

The exact form of the advantage is irrelevant as both granting of positively affecting aid as well as relief of certain burden that would normally be in place for the undertaking constitute and advantage.[35] In *GEMO,* the CJEU made a very significant decision in this area as it broadened the definition of measure especially in the field of different types of charges that could be included in the budget of an undertaking:

> "--- the notion of aid can thus encompass not only positive benefits such as subsidies, loans or direct investment in the capital of enterprises, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which therefore, without being subsidies in the strict sense of the word, are of the same character and have the same effect.[36]"

It is important to notice that an undertaking being in a more competitive or favorable position, e.g. position being the result of some various factors having impact on production costs in the

---

[28] C-173/73 Italy v Commission (1974), paragraph 13.
[29] Commission Decision 2004/339/EC on the measures implemented by Italy for RAI SpA, paragraph 69; and Opinion of Advocate General Fennelly of C-251/97 France v Commission, (1998), paragraph 26.
[30] C-173/73 Italy v Commission (1974), paragraph 83.
[31] C-39/94 SFEI v La Poste (1996), paragraph 60.
[32] Raitio 2010, p. 593 and Craig – de Burca 2008, p. 1087.
[33] C-30/59 Steenkolenmijnen in Limburg (1961) paragraph 19; and Raitio 2010, p. 594.
[34] Siikavirta 2006, p. 89-90.
[35] C-280/00 Altmark Trans (2003), paragraph 84.
[36] C-126/01 GEMO (2003), paragraph 28, see also C-156/98 Germany v Commission (2000), paragraph 25, and Joined Cases C-328/99 and C-399/00 Italy and SIM 2 Multimedia v Commission (2003), paragraph 35.

different Member States, than others is not *per se* considered prohibited as the notion of advantage is based on an analysis of the economic circumstances of an taxpayer in its own legal and factual context with and without the measure.[37] This makes the assessment of advantage to somewhat difficult. Should we consider, e.g., the business model of a group of undertakings differing from others and this happens to result to certain amount of tax because the business model and the transactions flows therein may affect overall corporate taxation base, this could also lead to conclusion of prohibited advantage in the evaluation. Therefore, the purpose of state aid policy is not to intervene on effectiveness of an undertaking in relation to others as this is something all companies should pursue. However, for advantageous aid to be against state aid regulation, there also needs to be selective nature as explained in the following section.

2.1.2 Selectiveness

Selectiveness refers to favoring of certain business activities.[38] In order for aid to be prohibited, it needs to be of selective nature. In other words, if the advantage or gain is for every undertaking available, no unequal treatment is necessarily constituting and therefore no aid at hand. Should the advantage to be granted for only certain undertakings or only production of certain goods over other, it receives extra benefit compared to other tax payers on a selective basis and is thus prohibited.[39] In *French Exports Rediscount Rate*, broad meaning for the notion in CJEU assessment was confirmed.[40] For example, material selectivity can be *de jure*, i.e. resulting from the regulative criteria for giving certain measure reserved legally and formally merely for certain undertakings due to their size, active or legal form, or *de facto* meaning that the selectivity factually exists even if the formal criteria is applied in general and objective terms, the structure of the measure nevertheless has an impact on significantly favoring only certain undertakings.[41] After all, as confirmed in *British Aggregates,* state interventions are assessed based on the effects independently from the techniques used to implement these interventions.[42]

Measures that *prima facie* apply equally to all companies but nonetheless still are available through discretion of the public administration may be considered selective.[43] This was already

---

[37] See C-173/73 Italy v Commission (1974), paragraph 17.
[38] Joutsamo – Aalto – Kaila – Maunu 2000, p. 604.
[39] C-409/00 Spain v Commission (2003), paragraph 47; and C-126/01 GEMO (2003), paragraph 35.
[40] Joined Cases C-6/69 and C-11/69 Commission v France (1969).
[41] Joined Cases C-78/08 to C-80/08 Paint Graphos and others (2011), paragraph 52. and Joined Cases C-106/09 P and C-107/09 P Commission and Spain v. Government of Gibraltar and United Kingdom (2011).
[42] C-487/06 P British Aggregates Association v. Commission of the European Communities and United Kingdom. (2008) I-10515.
[43] See C-256/97 DMTransport (1999), paragraph 27.

confirmed in *France v Commission* in 1996.[44] This may very much be the case with different tax related assessments as the tax authorities can obtain a lot of discretion for determining the actual acceptability or the conditions for granting the advantage for the beneficiaries in the first place. It is clear that not only active measures taken by the state is caught by the article but also those measures that lower the usual costs for the undertaking that relate to business activities on a normal basis.[45] What in the end constitutes the notion of selectivity, is that the state measure puts one of the tax payers in a preferable *economic position* compared to other tax payers.[46]

Ad hoc -positive measures that benefit one or even more companies is usually not difficult to consider selective as they grant favorable treatment for these companies.[47] However, the assessment becomes a bit trickier when the fiscal measures mitigate some costs of the undertaking that would normally be in place and could in principle be applicable to every company. For the sake of testing the fiscal measures and taken by the Member State and their selective nature in practice, *three-step test* has been introduced by the Commission.[48]

2.1.2.1 Commission's three-step test to analyze selectivity

In the case of those situations where Member States take broad actions that are applicable to all companies fulfilling the needed criteria for benefits that mitigate expenses. which would normally exist, the Commission's notice includes a three-step test that should be applied in such circumstances to test the applicability with the Article 107(1) TFEU.[49] The CJEU confirmed the utilization of three-step test with respect to fiscal measures in *Paint Graphos.*[50]

According to that test, firstly, the so called 'system of reference' needs to be established and identified, in other words, benchmarkable normal circumstances against which the selectivity of state measure has been granted.[51] The reference system can be characterized as 'set of rules that generally apply to all undertakings falling within its scope as defined by its objective'.[52] This allows to include or exclude characteristics that are justifiable in the light of the facts and circumstances for the case at hand. In this regard, if limits of the system of reference have been

[44] C-241/94 France v Commission (1996).
[45] See Raitio 2010 p. 599.
[46] C-387/92 - Banco Exterior de España v Ayuntamiento de Valencia (1994), paragraph 14.
[47] C-15/14 P Commission v MOL (2015), paragraph 60.
[48] See C-159/01 Netherlands v Commission (2004).
[49] Commission Notice 2016, paragraph 127 and 128.
[50] Joined Cases C-78/08 to C-80/08 Paint Graphos (2009).
[51] Lang – Cottani – Petruzzi – Storck 2019, p. 519.
[52] Commission Notice 2016, paragraph 133.

put in place in a similar manner or, in a clearly one-sided and partial way, reasoning may be also be easily open for challenges. System of reference will eventually very much affect the outcome of the case as the undertakings will be considered comparable in legal and factual manner in such reference system.[53] The correct definition indeed plays a huge role in the application as too broadly determined reference system does not necessarily reflect the reality of the relations of the operators as there might be big differences between them. To find a framework of similar undertakings position is therefore the key for rightful analysis in each case.

In the second part of the test, determination is needed whether the state measure under evaluation differs from this identified system of reference so far as it puts comparable undertakings to different economic positions. The assessment is directly related to the nature of the aid measure. This is the key element of the assessment of selectivity through the test and the conclusion can be made to so far as if the measure is *prima facie* selective.[54] On the other hand, in case the particular state measure is not different from the established reference system, it cannot be deemed to be selective in nature and the state measure can be regarded as acceptable and no third part of the test is needed. However, in case it is derogating and can be regarded as *prima facie* selective, third part of the test need to be proceeded with. At this stage, it needs to be established whether the difference can be justified by the nature or the general scheme of the reference system.[55] For example, in *Commission v Netherlands*, the CJEU has held that this is the duty of the Member State, that has introduced such difference in question between charges of different undertakings to indicate that it can be deemed 'to be justified by the nature and general scheme' of such reference system.[56] In case the selective state measure be justified 'by the nature or the general scheme of the system', it will neither be considered selective.

2.1.3 State Measure

In comparison to other EU competition law rules, such as dominant market position or cartels, that tend to apply only to actions taken by the private companies themselves, the core of state aid provisions considers mainly the measures by Member State. Nevertheless, in case a measure is deemed state aid, the recovery of the aid in question surely affects also the undertaking and thus they also bear the ultimate burden of risk.[57]As it has been stated in the famous *Foster* by

[53] Commission Notice 2016, paragraph 129.
[54] Ibid. paragraph 128.
[55] Ibid. and C-159/01 Netherlands v Commission (2004), paragraph 42.
[56] See C-279/08 P Commission v Netherlands (2011), paragraph 62.
[57] Lang – Cottani – Petruzzi – Storck 2019, p. 507.

CJEU, the notion of state can generally be defined to include various private or public operators merely if they happen to have a connection to state e.g. through shareholding or other link to organ of state.[58] In *Steinike and Weinlig*, the notion catches both aid granted directly by the State or indirectly through its resources by public or private authorities established or granted to it to administer the aid.[59] The uniform application could require the same approach to state aid but, however, it needs to be proven that the state has actually exercised control over the company and has been also involved in the granting of the measure.[60] The CJEU has further defined in its case law, such as *Ladbroke Racing* and *PreusenElektra*, the basis of state measure that any finance or aid from state resources can be deemed to activate the application of Article 107(1) TFEU.[61]

With respect to fiscal measures, a loss of tax revenue can be deemed to be comparable to the same effect what would have existed in the case of state spending the same amount.[62] On the other hand, the aid needs to also entail a financial burden for the State as confirmed in *Van Tiggele*.[63] This is due to that, analogically, the measure e.g. in the form of tax relief is equivalent to the amount of loss of resources for the Member State since it loses tax revenues and thus results to a loss in the overall fiscal budget.[64] However, in each case related to tax rulings as state aid, the notion of state measure does not require significant assessment whatsoever as the aid can be directly indicated to be granted by the state.

2.1.4 Effect on competition and intra-community trade

In accordance with the judgment in *Philip Morris*, the state measure is deemed to distort or threaten to distort competition when it has an effect to make the competitive position of the recipient compared better to other companies with which it competes.[65] Distortion of competition is usually at hand and deemed to exist in case the Member State is granting a financial advantage to an company in a liberalized sector where could in principle be competition under normal conditions.[66] Therefore, the threshold for this to be exceeded cannot

---

[58] C-188/89 Foster (1990).
[59] C-78/76 Steinike & Weinlig v Federal Republic of Germany (1977), paragraph 595.
[60] See Craig – de Burca 2015, p. 1137; and C-482/99 France v Commission (2002).
[61] See Raitio 2010 p. 597 and C-83/98 P Ladbroke Racing (2000) and C-379-98 PreussenElektra (2001).
[62] See Nicolaides 2015, p. 415.
[63] C-82/77 Van Tiggele (1978).
[64] T-67/94 Ladbroke v Commission (1998); and C-66/02 Italy v. Commission (2005).
[65] C-730/79, Philip Morris (1980), paragraph 11.
[66] Joined Cases T-298/97 and T-312/97 Alzetta (2000) paragraphs 141 to 147.

be seen to be relatively high and the Commission is very sensitive to intervene on possible hindering effects on competition.

The state measure must hinder or have an impact on the trade between the member states. Purely inner state measures should be excluded from the application of Article 107 TFEU. However, in practice, this criterium may usually be fulfilled in case the aid has been designed to support undertakings with export activities.[67] Therefore, in case aid makes the financial position of the taxpayer stronger as compared with other in the EU, it is regarded that the intra-community trade has been affected.[68] In *Boussac*, it was confirmed that the Commission is not under an obligation to show the actual effect on competition and on trade between Member States and aid which aims to release an undertaking from expenses, which it would normally have in its business activities distort the conditions of competition.[69] The effect on trade between Member States cannot either be only hypothetical as it needs to be indicated by the Commission what is the reason for the measure distorting or threatening to distort competition and having an effect on trade between Member States with respect to on the foreseeable effects of the measure. Anyway, it is not needed to point out the actual market or to analyze in detail the effect of the measure on the competitive position of both the beneficiary in question and competitors.[70]

In *Heiser*, the CJEU stated that in accordance with to the CJEU's previous case-law, "there is no threshold or percentage below which it may be considered that trade between Member States is not affected" and also "relatively small amount of aid or the relatively small size of the undertaking which receives it does not as such exclude the possibility that trade between Member States might be affected".[71] It is clear from the wording that the threshold for application of Article 107 TFEU cannot be seen to be set too high and even the small scope or size may refer to possibility of hindering the intra-community trade. It is also enough for the Commission to show that trade might be affected instead of actually being affected.[72]

2.2 Other regulation

It is also important to understand the procedural rulings and its function in state aid matters as the Member State eventually need to recover the granted aid back. The Commission has the

[67] See C-730/79 Philip Morris (1980), paragraph 21 and Raitio 2010, p. 605.
[68] Ibid. and C-T-369/06 Holland Malt BV v Commission (2009).
[69] C-301/87 France v Commission (1990), paragraphs 33, 44 and 50.
[70] C-494/06 P Commission v Italian Republic and Wam SpA (2009), paragraph 62 and C-730/79 Philip Morris (1980).
[71] C-172/03 Heiser (2005), paragraph 32.
[72] Craig – de Burca 2016, p. 1139 and C-211/05 Italy v Commission (2009), paragraphs 151 to 155.

competence in the first place to evaluate and conclude whether and aid granted by a Member State can be deemed compatible with the internal market. It holds its competence under Article 108 TFEU to decide on the compatibility of measure within the internal market by going through possibly hindering aid granted by Member States and afterwards taking necessary actions regarding non-compliance with its decisions.[73] In accordance with the Article 108 TFEU that defines the procedural basis for the regulation it states that the Commission shall:

1) review the aid that already exists;
2) decide that the State concerned shall abolish any prohibited aid or alter such aid within a period of time to be determined by the Commission; and
3) may, in derogation from the provisions of Articles 258 and 259 TFEU, refer the matter to the Court of Justice of the European Union direct in case the State does not comply with the decision.

In this regard, Council Regulation laying down detailed rules for the application of Article 108 TFEU has been given to deal with procedural approach to state aid related cases. Treaty articles are not the only source of law in this regard and some secondary legislation has also been given with respect to state aid. More specifically to regulation declaring so called General Block Exemptions, in other words, the Commission may declare certain State aid categories being compatible with the state aid regulation only if they happen to be in accordance with mentioned conditions and, therefore, excluding them from the requirement of notification obligation and approval of the Commission required by the procedural rules.[74] There are guidance given on application of Article 108, i.e. so called Procedural Rules. [75] In addition, the Commission publishes notices, practical guidance and other communication on a regular basis to achieve legal predictability and certainty in the context of state aid regulation.[76]

Had the measure in force been decided to be unprohibited in the internal market in the investigation procedure resulting to negative decision given by the Commission, Member State must recover the amount of aid from the tax payer according to the recovery decision of the Commission in accordance with its national law.[77] The authority of the Commission decide a recovery of amount of state aid is only subject to a limitation period of ten years.[78] It is worth

[73] EU Council Regulation 2015/1589 laying down detailed rules for the application of Article 108 TFEU.
[74] EU Regulation 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 TFEU.
[75] EU Council Regulation 2015/1589 laying down detailed rules for the application of Article 108 TFEU
[76] Lang – Cottani – Petruzzi – Storck 2019. p. 508-509.
[77] EU Regulation 2015/1589, Article 16.
[78] Ibid. Article 17(1).

mentioning that no fines as such under EU State aid rules can be given. However, the undertaking needs to pay the amount of aid back as it would have been in the absence of state measure, but the recovery does not represent the penalization of the undertaking in question. It can be regarded as terminating the selectivity, implementing the equal treatment in force and finally being in a similar situation. Nonetheless, as stated in the secondary law of EU, the Commission should not require the Member States to recover the aid in case this would in violation of any general principles of law within the EU.[79] Such principles may include, for example, the principle of legitimate expectations and legal certainty, which have been confirmed in the case law. However, it is for the undertaking's responsibility and not for the Member State in question to indicate the applicability of any violation of general principal, for example, on to which it had relied on the existence legitimate expectations to be in place that would eventually lead to decline to repay the prohibited state aid.[80] Should the decision of the Commission be appealed, in accordance with the Article 256 TFEU, the General Court shall have the jurisdiction in order to hear and determine at first instance actions or proceedings that have been taken place. After that, decisions given by the General Court under this paragraph are subject to a right of appeal to the CJEU on points of law only, under the conditions and within the limits laid down by the statute.

[79] EU Regulation 2015/1589, Article 16(1) and Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 355.

[80] See T-67/94 Ladbroke Racing v. Commission (1998), paragraph 183; see also Joined Cases T-116/01 and T-118/01 P&O European Ferries (Vizcaya) SA and Diputacion Floral de Vizcaya v. Commission (2003), paragraph 203.

3. Transfer pricing

3.1 OECD Guidelines

Considering the interest of tax authorities to maintain their full competence to tax undertakings subject to taxation, globalization brings some challenges to national fiscal policy measures. In the field of international taxation, OECD has done its best efforts to come up with a *soft law* instrument that would build the basis for solving taxation disputes and transfer pricing related matters. The most updated OECD Guidelines for MNEs states the international standard that OECD member countries have mutually agreed to be primarily used for international taxation purposes.[81] OECD countries have agreed on similar meaning and interpretation of the content therein, e.g. arm's length principle, on which the world of transfer pricing related assessment is mostly based.[82] The need to address regulation in the field of cross-border taxation arose from the concern to avoid double taxation as, e.g. in comparison to profit subject to completely domestic context, cross-border intra-group transactions and its allocation may result to corporate income taxation in more than one jurisdiction while no superior authority has been established for resolving disputes between countries. Therefore, double taxation may also be the outcome for the undertaking operating in more than a one country.[83] One of the main functions of arm's length principle in the OECD framework is also to prevent double-taxation of entities that could take place e.g. due to the adjustments to the corporate income taxation since the national tax authorities are applying their own transfer pricing regulation in their jurisdictions.[84] The meaning behind the arm's length principle has eventually been set up in another OECD source, namely in the Article 9 of the OECD Model Tax Convention:

> "Where conditions are made or imposed between the two associated enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

The principle sets up the rule that the associated enterprises should apply similar prices, terms and conditions as they would be in a similar condition between unassociated enterprises. It is understood from the above that an enterprise in the MNE group should be treated as separate entity i.e. as if they were independent entities and, therefore, the focus should be on the nature

[81] OECD Guidelines 1.1.
[82] Ibid. 1.15.
[83] See the U.S. Department of the Treasury on the European Commission's recent state aid investigations of transfer pricing rulings, 2016.
[84] Ibid.

of the transaction itself.[85] Principle of separate entities lies on the basis for the application of the principle, meaning undertakings are seen as they were stand-alone companies instead of belonging to a group.[86] In this sense, undertakings are therefore seen to have their own interest in conducting business activities. Evaluation of market-conditional arm's length price must consider hence these fundamental concepts.[87] The OECD Guidelines was developed for the first time in 1995 for offering framework for the assessment with regard to arm's length principle for both tax paying entities as well as the tax authorities. Currently, the most recent edition of OECD Guidelines was set up in 2017 and forms the fundamental basis of assessment for the cases after the year in questions and includes the many new revisions reflecting the clarifications and changes compromised in the BEPS Actions 8-10 Aligning Transfer pricing Outcomes with Value Creation and on Action 13 Transfer Pricing Documentation.[88]

3.1.1 Transfer pricing in the European Union

In addition, EU has its own instance, which also underlines the use of arm's length principle as a basis for transfer pricing assessment. The purpose of the forum is only to give guidelines as well as work as a supplementary opinion for the application of arm's length principle and OECD Guidelines.[89] In addition to the forum, the Commission has also given its own further opinions on transfer pricing of intra-group services, which are nonetheless also based on the advice of forum.[90]

In the Commission's notice on the notion of state aid, the Commission states that when analyzing if a tax ruling is complying with the arm's length principle pursuant to Article 107(1) TFEU, the Commission may regard to the guidance provided by the OECD Guidelines.[91] The Commission has also published a working paper relating to state aid and tax rulings, where the Commission determine how the arm's length pricing should be determined and additionally provides guidance on how a market based result would be defined in a rightful manner to comply with Article 107(1) TFEU.[92] As the OECD Guidelines has been agreed and established between the international parties and enjoys therefore credibility, it provides useful guidance on how to get into good final outcome for the Commission.[93] For example, it is said by the

[85] OECD Guidelines 1.6.
[86] Karjalainen – Raunio 2018, p. 46.
[87] Miladinovic – Petruzzi 2019, p. 246.
[88] For more information on BEPS, See Malmgren 2014.
[89] Karjalainen – Raunio 2018, p. 42.
[90] Helminen 2018, p. 267.
[91] Commission Notice 2016.
[92] DG Competition working paper 2016.
[93] Lang – Pistone – Schuch – Staringer 2018, p. 109.

Commission that in case the tax ruling and the tax model therein would have its interpretation of arm's length principle on the OECD Guidelines, it is unlikely that this would be construed as prohibited state aid in the context of EU state aid law.[94] It is clear from this statement that even though the Commission admits the applicability and fundamental basis of OECD Guidelines, it still reserves room for its own interpretation in state aid related cases irrelevant from the compatibility of the principle in national law.[95] This aspect will be further analyzed in the section 4 of this report. Nevertheless, as the Commission accepts the mutual understanding of arm's length principle with OECD Guidelines, the application is compatible also with the state aid context.

3.2 Definition of an arm's length price

3.2.1 Determining the appropriate level

The starting point for the assessment should be the transaction between related parties due to the contractual arrangements between the legal entities as well as the comparison between the conditions for related parties and unrelated parties.[96] This is supposed to reflect the economic reality behind the assessment. As said, arm's length price can be deemed to correspond the relevant market price but, however, this is very theory-based approach while the reality may differ in practice due to different factors will most likely affect the price setting of intra-group transactions. As a result, both tax payers and tax authorities may lack some of the information or it may be incomplete.[97] For example, selling goods or services for related party may take much less total effort e.g. in sales and marketing from the selling party and therefore the lower price for the related party than for the unrelated party can be also deemed acceptable. Synergies are one reasons behind the price setting as some companies may even only provide services or manufacture goods to its related parties, some of them may even be so specific and unique that no other entity in the world is involved in the same activities, which makes comparison to perfect market-conditions as such basically impossible.

Therefore, financial relations between the associated enterprises need to be carefully examined, such as terms and conditions of the transaction, functional profile of the companies, characteristics of the selling item as well as the business strategies.[98] After analyzing the

[94] DG Competition working paper 2016, paragraph 173.
[95] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 139 and Joined cases T-755/15 and T-759/15 Luxembourg v. European Commission (2019), paragraph 26.
[96] Miladinovic – Petruzzi 2019, p. 247.
[97] OECD Guidelines 1.13.
[98] Ibid. I section.

transaction in the light of functional analysis, examination whether it is possible to compare this to other transactions under similar circumstances needs to be performed.[99] First, we need to evaluate the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated need to be identified, e.g. that the MNEs operate at relatively same industry, and, second, the conditions and the economically relevant circumstances of the controlled transaction need to be compared as accurately as possible with the conditions and the economically relevant circumstances of comparable transactions between independent enterprises e.g. contractual terms, characteristics of the products and economic circumstances of the parties.

Some results may also require adjustment to correspond the correct fact pattern but, however, the line between acceptable adjustments and so called 'cherry-picking', i.e. adjusting in order to get to the wanted end result, may sometimes be challenging to define. It is also noted in OECD Guidelines that as transfer pricing lacks the nature of *exact science,* and therefore it is more important for the tax payer and tax administration to have *exercise of judgment* while assessing the appropriate level of the transaction.[100] It could be concluded that the thoroughly performed transfer pricing analysis at each step indicates the best approximate of the correct level. In the OECD Guidelines, the most suitable way to proceed with the best approximate is to provide *an arm's length range,* which takes the different factors and adjustments more carefully into account.[101] Nonetheless, when the transaction has been deemed ready to be evaluated, the most suitable method for analyzing the arm's length level has to be found. After applying the selected method, this should provide an approximation of the appropriate level of the transfer price compatible with the arm's length principle.

3.2.2 Transfer pricing methods

As the arm's length principle merely sets out only the basis for the evaluation, there must also be practical ways for actual determination of the suitable level for the transfer prices. OECD Guidelines lists methods that can be used in order to define the arm's length level of different transactions. The methods are also largely accepted and mostly used and applied in the transfer pricing related assessments as it is safe to say that the OECD countries in the context of transfer pricing relies heavily on these methods. There are five different and primary methods that

[99] Miladinovic – Petruzzi 2019, p. 247.
[100] OECD Guidelines 1.13.
[101] Ibid. 3.55–3.62.

OECD Guidelines suggests being used by the tax payers and tax authorities in evaluation of arm's length transfer price:

(1) Traditional transaction methods
    a. the comparable uncontrolled price method (CUP),
    b. the resale price method (RPM)
    c. the cost-plus method.
(2) Transactional profit methods
    a. transactional net margin method and
    b. transactional profit split method.

3.2.3 Traditional transaction methods

3.2.3.1 CUP method

The CUP method could be probably described as the most straight-forward way to reliably compare transactions with each other. It is designed to compares the price charged for products, e.g., tangible property and intellectual property, or services that are transferred in an intra-group transaction to another price that would be charged for a comparable or similar product or service transferred in a comparable uncontrolled transaction in circumstances that can be compared with each other.[102] The transactions between unrelated parties and related parties are deemed comparables in case (a) no such differences between the companies or the transactions being analyzed are not affecting substantially the price in the open market or (b) such differences can be excluded from the analysis by performing adjustments.[103] Therefore, comparable transactions are those that:

1. The same or comparable product or service is being sold or bought by both the related party and the unrelated party (so called internal CUP); or
2. The same or comparable product or service is being sold or bought between the unrelated parties (so called external CUP).

Even though there is no directly applicable hierarchy between the different methods in the most recent version of OECD Guidelines, the CUP method is the most favorable method to be applied by the OECD guidelines when there are sufficiently reliable internal or external

[102] OECD Guidelines 2.14.
[103] Karjalainen – Raunio 2018, p. 110.

comparables available.[104] The Commission has been in favor of applying this method over others when it comes to its recent state aid decisions.[105] However, from all of the methods listed herein the requirement of similarity for the comparable may be deemed to be the most significant and hence should there be any specific factors, e.g. in the characteristics of the product in question, the CUP method is not necessarily the most appropriate one to be used.

3.2.3.2 RPM method

The application of resale price method starts with determining the resale price. Resale price is equivalent to the price that is being paid from a product that is firstly acquired from a related party and after that resold to an unrelated buyer. After that, an appropriate gross margin will be reduced from the resale price in order to determine the "resale price margin" that represents the appropriate amount of reseller's target to make profit and amount to cover its expenses from this activity considering its functions undertaken, risks assumed, and assets used.

The remaining amount, after reducing the gross margin, may be defended to be in line with an arm's length price level for the transfer or product or service between the related parties. According to the OECD Guidelines, RPM method may be considered to be most useful to be used in a scenario where it concerns for example marketing operations.[106] In comparison to CUP method, the requirement of similarity for the comparable products is not as significant in the RPM method but instead the similarity between the functions undertaken, assets used and risk assumed, is essential.[107]

3.2.3.3 Cost plus method

The cost-plus method and its application is based on the expenses of the supplier of product or service in a controlled transaction for this product transferred or services provided to a related party. After that, cost plus mark-up being at appropriate level is added to the expenses in order to reflect the appropriate amount of profit to be earned in light of the functions performed and the market conditions.[108] This is justified as all the operators in the market usually seek to make a profit. The result when the cost plus mark-up has been calculated, i.e. expenses from the

---

[104] OECD Guidelines 2.18; see also Karjalainen – Raunio 2018, p. 111.
[105] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraphs 299 and 445 and DG Competition working paper 2016, paragraph 19.
[106] OECD Guidelines 2.17.
[107] Karjalainen – Raunio 2018, p. 117.
[108] OECD Guidelines 2.45.

activity plus the appropriate mark-up, may be regarded as an arm's length price of the transaction between related parties.

Cost plus method usually is most useful where services are being provided or semi-finished goods are being transferred between related parties. The arm's length mark-up can be either be compared with internal comparable, i.e. a mark-up that the buyer earns from an transaction between unrelated parties, or with external comparable, i.e. mark-up that is earned by an external buyer in its business activity.[109] However, in the case of internal comparable, it must be also understood that the mark-up with unrelated parties may be higher due to the reasons that the expenses in those transactions may usually be higher, e.g. due to the marketing expenses and other sales services needed for third party customers.

3.2.4 Transactional profit methods

3.2.4.1 Transactional net margin method

The first transactional based profit method, transactional net margin method, analyses the net profit realized from the controlled transaction in relation to an appropriate base, such as net sales, costs or assets. The comparable from this relation is called a PLI as it examines the amount which is realized by the taxpayer realizes from related party transaction.[110] Flowing from this explanation, it can be noticed that a transactional net margin method is very similar the cost plus and RPM. Similarly to those methods as explained above, the comparable PLI may also be either internal or external. The tested party in TNMM may be either the seller or the buyer to the transaction.[111]

To fully apply the TNMM, a proper functional analysis of the related and unrelated transactions must be performed in order to determine whether the transactions are fully comparable and, in case not, if any adjustments are considered to be conducted for establishing reliable end results. The functions performed, risks assumed, and assets utilized in the business activities must be carefully analyzed in order to have the correct conclusion on the nature of the company within its group. The tested party, in other words the party to the intra-group transaction whose operating profit from the transaction may be verified by using the most accurate information, will eventually be the least complex entity in the transaction.[112] This is due to the reliable data.

---

[109] Karjalainen – Raunio 2018, p. 122.
[110] OECD Guidelines 2.64.
[111] OECD 2010a, section B.2. 45: In case of seller, the tested financial indicator is generally the net profit on costs or the net profit on assets. In the case of buyer, the tested financial indicator is generally the net profit on sales.
[112] See Peroni – Gustafson – Pugh 2008, p. 1245.

TNMM has been applied by the Commission in its decisions as well as by the tax payers and Member States in the recent tax ruling cases concerning prohibited state aid, however the application of it has generated different views and therefore it is crucial to understand the importance the functional and comparability analysis in this area.[113]

3.2.4.2 Transactional profit split

In the transactional profit split method, the primary aim is to exclude the effect on profits of unusual conditions that are being made in or put into a transaction between related parties by determining the share of profits that unrelated parties in similar circumstances, e.g. by agreement, would have expected to realize from taking part to the transaction.[114]

In the first phase, the transactional profit split method identifies all of the profits that are being split between the related parties generating from the intercompany transactions in which the both of these undertakings are taking part.[115] References to these profits ought to be similarly into account when applying the same method to losses. In the second phase, the method then splits the determined combined profits between the associated enterprises on *an economically valid basis* that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.[116] Hence, the purpose is to test the division of profits between the related parties in question. In transactional profit split method, both of the parties in the intra-group transaction are tested and, therefore, this method can be also referred to as two-sided approach, e.g. in comparison, TNMM, RPM and cost plus method on the other hand may be referred to as one-sided approaches.[117]

3.2.5 Most suitable method for assessing the arm's length level

When it comes to selecting the most suitable method from the different alternatives, all relevant factors at each case need to be considered that could potentially distort receiving reliable results or have an effect on the assessment of arm's length price or price formation in the markets into account. For the sake of the assessment, selecting the method must take the strengths and weaknesses of each of these above-mentioned methods into account in the light of facts and circumstances in question. For example, in accordance with the OECD Guidelines, not every method is applicable to each case at hand due to their characteristics, but it is necessary to prove

[113] Commission final decisions 2017/1283 on State aid implemented by Ireland to Apple and 2018/859 on State aid implemented by Luxembourg to Amazon.
[114] OECD Guidelines 2.114.
[115] Ibid.
[116] Ibid. 2.114.
[117] OECD 2010a.

that the method is or is not suitable under the established circumstances. Much is also depending on the possibly available information for the taxpayer or tax authorities or the correctness of data.

Some major differences between the methods can also be found. Traditional transaction methods are regarded as the most direct ways to determine whether conditions in the commercial and financial relations between the related parties can be deemed to be arm's length as they measure the terms and conditions of the actual transaction and compare them with to those between unrelated parties.[118] This approach however requires stricter comparability between the transactions themselves. There may also be a situation where transactional profit methods can be better applicable when parties make certain unique contributions in relation to the controlled transaction, e.g. fashion or certain products that contain such know-how that is not related to other products, where the parties engage in highly integrated activities, or where there is very limited publicly available reliable gross margin information on third parties. In such cases, measuring the net operating profit realized from related transactions in comparison to unrelated transactions may be the way to proceed even though they may give less accurate results than traditional transaction methods. Usually, in many cases, if the tax payer has seen the effort in trying to convincingly explain the pricing of any transaction in a coherent manner with respect to application of OECD Guidelines, this could as such hint towards the fact that the tax payer is usually giving a good and reliable estimation of the assessed arm’s length level of transfer prices. However, as said, transfer pricing is not an exact science and therefore disputes between tax authorities and tax payers may easily arise due to different views on facts and circumstances for profit allocation purposes through intra-group pricing.

3.3 Advance pricing agreements

3.3.1 Definition

According to the OECD Guidelines, ‘advance pricing arrangement is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time’.[119] It practically sets the basic principles and criteria for the determination of a certain transfer

[118] OECD Guidelines 2.3.: This is because any difference in the price of a controlled transaction from the price in a comparable uncontrolled transaction can normally be traced directly to the commercial and financial relations made or imposed between the enterprises, and the arm’s length conditions can be established by directly substituting the price in the comparable uncontrolled transaction for the price of the controlled transaction.
[119] OECD Guidelines 4.134.

price of related undertaking for taxation purposes. OECD Guidelines refers to these preliminary agreements as arrangements but nevertheless this can be concluded to be equally applicable to advance pricing agreements as well as there is no distinction between them.

The Commission has given its own notice on the guidelines of advance pricing agreement with a main objective of it being to prevent transfer pricing disputes and double taxation for un undertaking from arising in the first place.[120] With this notice, the Commission seeks to encourage MNEs and tax authorities to conclude with the transfer prices open to interpretation. In addition to this, almost all member states in the EU have negotiations on APAs with different undertakings based either on the domestic legislation or to the Article 25 of OECD Model Tax Convention regarding mutual agreement procedure.[121] When it comes to the content of such ruling, APA does not itself necessarily contain specific information regarding the exact arm's length level of certain transfer prices, but is merely of general nature even though precise and concrete enough to lay down the rules for resolving transfer pricing related issues between the taxpayer and the tax authorities.[122]

Why would the parties then agree on such arrangements? Above all, APA has been designed for this purpose and from the perspective of legal certainty for both parties in hypothetical disagreement as it excludes or minimizes the possibility of transfer pricing disputes. This is because APAs tend to be in force many years for a fixed time forward from the time of forming the agreement since during the years the transaction flows may differ. Before application, the parties usually discuss the different topics and possible controversial transfer pricing issues regarding the company. To conclude, the APA is the framework to which the transactions therein will be reflected in the assessment.

3.3.2 Content of the ruling

The term *tax ruling* itself is mainly being used as a general term for every type of formal or informal tax arrangements and preliminary agreements between tax authorities and the taxpayer but, in more detail, a tax ruling in the context of state aid regulation usually refers to an advance pricing agreement, advance tax ruling or some other preliminary agreed tax arrangement between the tax payer and the tax authorities. APA application made by the tax payer should

---

[120] Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU 2007, paragraph 1.4.
[121] OECD 2017, Article 25.
[122] Karjalainen – Raunio 2018, p. 411.

contain the information included the most relevant topics regarding the circumstances of the undertaking e.g. describe its business activities, different intra-group transactions covered by the agreement, each taxpayer that the APA concerns, the preferred transfer pricing methodology for the intra-group transactions (i.e. the arm's length price), length for the agreement to be in force, business strategy of the group and each countries to be party to the agreement.[123]

This list is not exhaustive and, in reality, the amount of information to be included in the APA may become very comprehensive. The power of APA is aimed to be binding upon both parties and after the parties have concluded the agreement, the tax authorities cannot present opposite interpretations on the transactions included in the APA.[124] However, as mentioned, the agreements tend to be more general than totally accurate, which leaves also room for challenging. The tax authorities may for example supervise that the terms and conditions agreed in the APA will be followed by the tax payer in its business activities.[125] On the contrary, in the context of state aid regulation, the purpose of tax rulings in general is to establish the correct way of applying common rules in the ordinary tax system taking into consideration its factual and legal circumstances.[126]

The Commission's view of tax rulings is nevertheless not to question the Member States' competence to grant APAs to different undertakings.[127] However, the state aid context brings very much a new dimension to the whole discussion on the relevance and acceptance of the advance pricing agreements. This is due to that the domestic tax administration is no longer the only public authority involved in the evaluation of the correctness of APA as the Commission is also taking this role for itself. However, whether the agreement is in compliance with the EU law is however dividing opinions and will be further discussed in this report. In fact, the Commission has emphasized that the objective of investigations in general that have been made in the field of state aid and transfer pricing is not to target the tax ruling as an illegal instrument *per se,* considering that it has very much supported the Member States and its tax payers to be in favor of the APAs for obvious reasons, but, in more detail, to analyze the tax rulings or APAs that apply any transfer pricing method to certain extent in order to determine the taxable corporate profit at the group or its entity level that may not be seem to result 'in a reliable

[123] Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU 2007, paragraph 246.
[124] Helminen 2018, p. 277.
[125] Karjalainen – Raunio 2018, p. 420.
[126] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 255 and Lang – Cottani – Petruzzi – Storck 2019, p. 523.
[127] DG Competition working paper 2016.

approximation of a market-based outcome in line with the arm's length principle' and therefore could potentially be deemed to grant a selective advantage only to certain recipients, which is contrary to Article 107(1) TFEU.[128]

[128] Commission Notice 2016, paragraph 171.

4. Tax ruling as prohibited state aid

4.1 Tax rulings and Article 107(1) TFEU

Member States may 'freely decide on their economic policy, which they consider most appropriate and, in particular, to spread the tax burden as they see fit across the various factors of production'.[129] However, despite of this, national tax rules in Member States need to respect and comply with the fundamental freedoms provided by the TFEU.[130] Naturally, this should also apply in the field of taxation and transfer pricing as well as the application of APA between the Member State and the MNE. Adapting the state aid regulation to taxation measures may however raise questions as it crosses through tax law, competition law, EU law, economic concerns and, after all, it deals with direct taxation that is a sovereign area of Member States.[131] Direct taxation measures however are not out of the scope from the application of Article 107(1) TFEU as confirmed by the CJEU in *Italian Textile* as the fiscal aid can be in any form.[132] Hence, every measure of fiscal measure by the state may be critically reviewed by the Commission even without considering or trying to answer the question on competence. In the legal literature as well as in the Commission notion, three different types of aid from fiscal resources in the EU can be identified that eventually flow to the benefit of tax payer through tax system and can be considered prohibited.[133] The following three forms of aid may be incompatible with the internal market:

1. Aid may be granted fiscally through the domestic legislation, for example, provisions that grant the tax payer an advantageous treatment in case they fulfill the criteria or conditions that are expressly required in the tax treatment provision (*de jure selectivity*) but also rules that seem to be general but in practice only benefit certain tax payers (*de facto selectivity*).[134] [135]
2. Aid may be granted through the assessment of taxation, e.g., by the tax authorities by applying tax law in a way that is different from its normal application and favoring a tax payer.[136] For example, this refers to granting a treatment that directly or indirectly lowers the tax burden of that company.

[129] Commission Notice 2016.
[130] https://ec.europa.eu/taxation_customs/business/company-tax/transfer-pricing-eu-context/joint-transfer-pricing-forum_en#heading_1.
[131] Micheau 2011, p. 193.
[132] C-173/73 Italy v Commission (1974), paragraph 2.
[133] Lang – Cottani – Petruzzi – Storck 2019, p. 517-518 and Commission Notice 1998.
[134] Schön 2016, p. 4, and Lang – Cottani – Petruzzi – Storck 2019, p. 518.
[135] Commission Notice 1998, paragraph 120.
[136] Ibid. paragraph 123.

3. Aid may be granted through tax enforcement, such as tax authorities evaluating the tax liability of a tax payer in the light of the relevant tax rules but, in the end, does not collect tax payments from the undertaking by rescheduling or cancelling the debt.[137]

As the all above mentioned three types of aid above could seem potentially to fulfill at least the criteria of advantage and national measure mentioned in the Article 107(1) TFEU, the second type of aid, assessment of taxation, relates most notably to tax rulings and agreements. Such tax arrangements may violate the rules by referring to tax rulings granted by the Member States to the tax payers fulfilling also rest of the criteria listed in the Article 107(1) TFEU and capable of hindering competition by granting selective advantage only to specific tax payers and, thus, prohibited. Such measures are also, in the light of the case law, of nature that may have been designed to release an undertaking from costs, which it would normally need to pay in its normal business activities and therefore deemed distorting the conditions of competition.[138] In any case, further evaluation on the selectiveness of such treatment must be done.

The line between violating and complying with the state aid regulation seems to be blurry for the tax payer in case this perspective has not been considered while preparing the APA and whether the complying with arm's length principle in national tax legislation nevertheless leads to infringement of the same principle under EU state regulation. Thus, we need to understand that even complying with the tax legislation and being in that sense perfectly legal, rulings may still lead to breach of state aid regulation in case selectiveness in comparison to other undertakings As APAs have been also viewed by the Commission as a well-functioning instrument for both tax payers and tax administration, how did the tax rulings end up being analyzed in negative light for competition regulation purposes?

4.1.1 Tax ruling as selective

In order for a state measures to not be regarded as prohibited state aid, "they must be effectively open to all firms on an equal access basis, and they may not be *de facto* reduced in scope through, for example, the discretionary power of the State to grant them or through other factors that restrict their practical effect".[139] This can be regarded as the difference between a general and selective treatment.[140] However, in *Santander*, the CJEU held that mere derogation from

[137] See Schön 2016, p. 4, and Lang – Cottani – Petruzzi – Storck 2019, p. 518.
[138] C-156/98 Germany v Commission, (2000), paragraph 30, and C-172/03 Heiser (2005), paragraph 55.
[139] Commission Notice 1998, paragraph 13.
[140] Ibid.

the normal tax system is sufficient to show the existence of selectivity.[141] The problem and difficult part in the assessment is to evaluate whether all tax payers may have equal and similar access to same treatment or is it only for certain undertakings especially when it comes to APAs.[142]

APAs are not containing any illegal tax regulation or loopholes but indicating the transfer pricing principles and methods of certain intra-group transactions for which the tax authorities have certain amount of discretion. In this context, selective as a criterion is also somewhat tricky to determine. For example, it could be said that while the meaning of 'advantage' can be more easily defined by evaluating the tax treatment and its volume with respect to action by the Member State, on the other hand, selective as such also requires a benchmarking or reference system, i.e. comparable, in order to actually define the selective treatment.[143] In tax rulings, it can be concluded that it is advantageous for the tax payer as it removes the risk of the transfer pricing audit by tax authorities for making false conclusions that would be in contrary to APA and the overall tax burden may de facto become more affordable thanks to procedural discretion of the national authorities. Yet, this does not mean that it is violating state aid regulation in any ways as the selectivity criterion needs to be assessed too.

It is not easy to assess tax related cases since merely Member States and their governments are able to put taxes into effect and no private organization for comparison purposes with the state that acts an *independent market operator* is not available.[144] The three-step analysis need to be utilized to determine whether a certain tax measure in the form of tax ruling could be of selective nature. The benchmarking system should be able to set up a framework in which each of the undertakings can be regarded to be in a similar legal and factual situation and therefore comparable, which is another condition for selectivity.[145] Those tax measures that are *de jury* available for all undertakings, measures *de facto* only benefitting certain undertakings can still be selective under Article 107(1) TFEU although de facto selectiveness may still be open to interpretation, especially, in the case of general tax schemes.[146]

---

[141] Joined cases C-20/15 P and C21/15 P Santander S (2016), paragraph 67.
[142] Schön 2016, p. 16.
[143] Quigley 2015, p. 109.
[144] Mason 2018, p. 771 to 796.
[145] See C-106/09 P and C-107/09 P Commission and Spain v. Government of Gibraltar and United Kingdom, (2011), paragraphs 75 and 101; and C-518/13 Eventech (2015), paragraphs 53 to 55; and C-15/14 P Commission v MOL (2015), paragraph 59.
[146] Commission final decision 2009/4511 on the Groepsrentebox Scheme which the Netherlands is planning to implement.

Thus, reference system should first be determined for the valid rules of taxation. The exact way this is done remains still to some extent unclear as can be seen in the judgments of *BNP Paribas* and *Adria-Wien Pipeline*.[147] With this regard, CJEU has been criticized for not pointing out anything but that the reference system has been identified as normal in a region by the Commission and being the prevailing measure. Nevertheless, national tax system of one state could be determined as one reliably appropriate system in this example and this has also been used by the Commission in their recent cases.[148] In the field of transfer pricing, as we have our system established, we should assess whether the tax ruling, including for example transactions and possibly questionable application of arm's length principle, favors the tax payer in comparison to those tax payers that are in factually and legally comparable situation. National tax system as a whole could also be too broad for establishing a reference system as it considers integrated and non-integrated undertakings and, in this scenario, any different treatment from what is considered normal taxation could potentially lead to existence of state aid.[149] For example, the transfer pricing rules and arm's length principle may be a part of that reference system to which only integrated companies apply but its application in the tax ruling is constituting the derogation from it and therefore may be considered selective.[150] On the other hand, too narrow establishment of reference system could let every measure outside of the scope of Article 107(1) TFEU and, hence, instead, opting for even too extensive reference framework would seem to be the more suitable way to proceed by the Commission and CJEU.[151]

In *Amazon*, the Commission stated the fact that if the application of the transfer pricing method included in the APA is in line with the OECD Guidelines, the APA cannot as such be considered state aid under Article 107(1) TFEU but explained that the use of the possibly most appropriate method does neither exclude as such the possibility of a state aid.[152] This leaves a lot of margin of discretion for the Commission in evaluation considering that the transfer pricing does not grant the tester with precise results. In order to be compatible with the regulation, the method that has been chosen as well as the reasoning in favor of its application to the particular case need anyway to be compared with the market-based outcome -standard by the tax payer.[153] Eventually, it is the Commission in this regard ultimately challenging the determination of most

[147] C-45 2/10 P BNPParibas v. Commission (2012), paragraph 66; C-88/03 Portugal v. Commission (2006), paragraph 56; and C-143/99 Adria-Wien Pipeline (2001), paragraph 41.
[148] See for example Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon.
[149] Micheau 2011, p. 203.
[150] Lang – Cottani – Petruzzi – Storck 2019, p. 524-525.
[151] Micheau, 2011, p. 204 and C-143/99 Adria-Wien Pipeline (2001).
[152] See Eden – Burnes 2018, p. 24.
[153] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraph 599.

suitable market-based outcome in state aid cases when it decides to investigate and further conduct its own analysis.

The DG competition working paper pointed out that the 'approximate nature of the arm's length principle cannot be used to justify a transfer pricing analysis that is either methodologically inconsistent or based on an inadequate comparable selection'.[154] However, it is not only the contested APA including 'an estimation' but also a potential competing result for a decent market outcome – in this case performed by the Commission – should also be deemed as another approximation. The "search for a 'reliable approximation of a market-based outcome' means that any deviation from the best estimate of a market-based outcome must be limited and proportionate to the uncertainty inherent in the transfer pricing method chosen or the statistical tools employed for that approximation exercise".[155] Due to these circumstances, estimation is the only realistically available option. In the end, as the Commission has referred in its tax ruling decisions against this background, the aim of transfer pricing is to be able to reasonable estimate of an arm's length outcome on the basis of reliable information.[156] The basis and framework for assessment is therefore in scenarios including *a manifest breach* of the arm's length principle.[157] As a rule, the main reasoning needs then to be economic advantage is due to non-compliance of the transactions with arm's length principle. From transfer pricing perspective, this may exist in case the ruling is applying the wrong method for transfer pricing purposes or applies the right method but not sufficiently or in an incorrect manner.[158] The Commission has indeed applied this test in its recent case law in the context of state aid.

4.2 Challenging the APAs against the multinational enterprises

4.2.1 Background

In 2013, Task Force Tax Planning Practices was set up by the Commission to 'follow up on public allegations of favorable tax treatment of companies voiced in the media and in national Parliaments'.[159] State aid regulation was a powerful intervention tool and the focus has in particular been in tax schemes and rulings between MNEs and Member States. Political support from other EU institutions has been offered as the European Parliament has been in favor of the Commission's role as ultimate competition authority also in the assessment of tax rulings as

[154] See DG Competition working paper 2016, paragraph 23.
[155] Commission Notice 2016, paragraph 171.
[156] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraph 404.
[157] See DG Competition working paper 2016, paragraph 23.
[158] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraph 404.
[159] https://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html 23.9.2019.

these practices by the MNEs and Member States have been seen to be incompatible with the objective of internal market.[160] State aid regulation has offered the framework for the Commission to strengthen its powers to prevent harmful tax arrangements. More resources have been channeled to the Commission for strengthening the ability to intervene Member States and tax payers' practices.[161]

In 2014, the first companies to be accused of were caught and the Commission started formal investigations against three Member States regarding tax rulings granted by the tax authorities. The proceedings related to Fiat in Luxembourg, Starbucks in the Netherlands and Apple in Ireland.[162] These investigations were soon followed by cases with respect to *inter alia* Amazon in Luxembourg as well as IKEA in the Netherlands.[163] The list of companies in questions shows that the challenging has focused on big multinational undertakings, most of being US based. For *Fiat* and *Starbucks*, the General Court has given its judgments to those cases; *Starbucks* was ruled in favor of the Netherlands and no state aid was deemed to exist but, on the other hand, Luxembourg was found to provide illegal state aid contrary to Article 107(1) TFEU in *Fiat.* At the moment, due to the lack of CJEU's involvement in the field of state aid and APAs, interpretation assistance in combination of transfer pricing and state aid can be found from another related cases. Further, in *Fiat* and *Starbucks*, General Court's approach seemed also to favor the Commission's approach on getting tax arrangements caught under the state aid regulation although the deeper analysis and assessment related to transfer pricing is more open to interpretation.

In famous *Belgium and Forum 187 ASBL,* the CJEU assessed whether Belgian coordination centers and the direct corporate taxation that was conducted for other companies than coordination centers that fulfilled the criteria for application – in several respects, such as granting property tax exemptions and application of cost-plus method for calculating the taxable income at the flat rate of 8%, that corresponded the operating costs, were derogating from the ordinary tax regime and constituted a prohibited aid according to the Article 107(1) TFEU. In order to enjoy such benefits as mentioned in the tax regime, the criteria for the undertaking required several conditions to be fulfilled, *inter alia* certain amount of people to be employed, form part of a multinational group with certain amount of annual consolidated turnover, capital and reserves. Afterwards, these coordination centers were therefore treated

---

[160] See EP resolution of on tax rulings and other measures similar in nature or effect.
[161] Ibid.
[162] Commission - Press Releases 21 October 2015 and 30 August 2016.
[163] Commission - Press Releases 4 October 2017 and 18 December 2017.

specially from others due to the criteria that was applied to them. the Commission had taken a stand that the assessment with respect to the cost-plus method was in contrary to the *principle of equal treatment* and therefore granting selective advantage for the beneficiaries of the tax regime.[164] To assess whether this was considered as a selective advantage, the court needed to assess whether such arrangement derogated from the ordinary tax system. As for transfer pricing and the comparison of selective taxation with normal taxation, the CJEU does not specifically refer to arm's length principle but rather defines the importance of free competition and equal treatment in the field of direct corporate taxation:

> "In order to decide whether a method of assessment of taxable income such as that laid down under the regime for coordination centers confers an advantage on them, it is necessary --- to compare that regime with the ordinary tax system, based on the difference between profits and outgoings of an undertaking carrying on its activities in conditions of free competition."[165]

The CJEU did not take a stand on whether deviation from the arm's length principle is the reason behind derogation from the ordinary tax system or whether it should have been used as a standard to assess the profit allocation through cost-plus method but rather pointed out that such tax regime granted unequal advantage for only certain undertakings and is different from treatment of those that are operating in the same system. Even though the system of reference and the derogation from it was indicated, CJEU did not accept the counter argument of its nature to avoid risk of double taxation due to the lack of showing how this would be achieved.[166] More interestingly, the CJEU points out the following:

> "--- the effect of the exclusion of those costs from the expenditure which serves to determine the taxable income of the centers is that the transfer prices do not resemble those which would be charged in conditions of free competition"[167]

It is clear from the reasoning that the comparison of the prices is not made to correspond with the arm's length principle but rather to *the condition of free competition* as the CJEU puts it and justifies the challenge of the method used by the Member State to calculate the taxable profit in comparison to other companies. As the measure related to national legislation or tax scheme, there was no need to intervene to the use of methods therein and the amount of advantage generating as the selectivity was more easily to prove by the application of criteria, which makes the CJEU's approach more understandable. However, in tax ruling related cases, the circumstances are to some extent different as the evaluation is made for the individual measure

[164] C-182/03 and C-217/03, Belgium v Commission (2006), paragraphs 168 to 175.
[165] Ibid. paragraph 95.
[166] Ibid. paragraphs 120 to 126.
[167] Ibid. paragraph 96.

as well as the supposedly correct level of transfer prices has been indicated that also generates the alleged advantage for the undertaking.

As confirmed in judgment of *Commission v Deutsche Post*, first, the Commission needs to find the breach of the Article 107(1) TFEU through the four conditions - intervention by the State or through State resources, able to have an impact on trade between Member States, it must grant a selective advantage on the tax payer and it must distort or threaten to distort competition - therein.[168] The easiest work for the Commission is to find that the condition of state resources being fulfilled as, in accordance with the judgment in *Gibraltar,* all of the tax rulings have been granted by the public authorities to certain undertakings in form of tax exemption, which places the undertaking in a more favorable financial situation than others.[169] Secondly, since the undertakings are part of a group operating in all or many of the Member States, any measure can be deemed to have an effect on internal market and intra-union trade as well as, in so far as the tax ruling has had an lowering effect on the undertakings tax liability in the Member State, tax ruling has improved its financial position and therefore distorted or threatened to distort fair competition, hence fulfilling the second and fourth conditions.[170] As this requires no further analysis, these effects can also be deemed potential.

As confirmed in *Heiser*, the existence of selectivity will be benchmarked against a statutory scheme.[171] Surprisingly, the Commission does not evaluate advantage and selective separately but together – as a selective advantage. Nevertheless, with regard to this condition, in Commission's view in so far as the tax ruling has ended up in a lowering of the tax liability for the undertaking in the Member State by differencing from the amount of tax, which the undertaking would have been liable to pay under the ordinary corporate income tax system, this advantage may be regarded as selective in nature.[172] Three-step analysis must be used in case a particular fiscal measure can be deemed to be selective as the CJEU has confirmed in *Paint Graphos*.[173] This brings also the analysis closer to application of arm's length principle from the EU state aid point of view due to that fact that it is necessary to evaluate the level of selective measure for the transfer prices in a certain framework – the APA and its application of arm's length principle and other transfer pricing related matters in this case is the instance creating

[168] C-399/08 P Commission v Deutsche (2010), paragraph 38.
[169] See Joined Cases C-106/09 P and C-107/09 P Commission v. Government of Gibraltar and United Kingdom (2011), paragraph 72 and the case-law cited.
[170] C-730/79 Phillip Morris (1980) paragraph 11; and Joined Cases T-298/97 and T-312/97 Alzetta (2000), paragraph 80.
[171] C-172/03 Heiser (2005), paragraph 40.
[172] T-760/15 and T-636/16 the Netherlands v European Commission (2019).
[173] Joined Cases C-78/08 and C-80/08 Paint Graphos (2011).

the benefit for the tax payer. As the advantage, in this case the tax ruling between the Member State and the tax payer and its result, has been identified, the framework for the selectivity analysis of the advantage in accordance with the three-step test is as follows:

1) Establishment and identification of system of reference
2) Did the tax measure constitute a derogation from the reference system and would it generally be comparable with identification of the advantage granted to the beneficiary under that measure?
3) Could the derogation be justified by the Member State?

4.2.2 Establishing a reference system

The advantage may only be deemed to exist by establishing a comparison between the aid measures benefitting the tax payer and the situation in the absence of such aid and thus a reference system needs to be 'composed of a consistent set of rules that apply on the basis of objective criteria to all undertakings falling within its scope as defined by its objective'.[174] In *Starbucks,* the reference system was considered to be the entire Dutch CIT system.[175] This is a similar approach in the previous decisions because in every tax ruling related case the reference system was deemed to be the CIT system or the ordinary rules of corporate taxation of that in the aid granting Member State, i.e. Luxembourg's corporate tax system in *Fiat*[176] and *Starbucks*[177] as well as Ireland's corporate tax system in *Apple.*[178] Indeed, the determination plays an important role with respect to the final outcome of the assessment.[179]

As discussed in section 4.1.1, by making the reference to the entire CIT system as ordinary rules, the system will take both group companies as well as stand-alone companies into account without making distinction between them. This conclusion by the Commission is crucial for their argumentation, since, should the integrated and non-integrated be deemed in different legal and factual position, it would also practically be acceptable to treat them differently without violating the state aid regulation. In *Starbucks*, according to the Commission, as they are all taxed in a similar manner with the same objective of taxing all Dutch companies subject to tax irrespective their company type and there is no derogation in the Dutch tax legislation

[174] See Verhagen 2017.
[175] Commission final decision 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraph 232.
[176] Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 193.
[177] Commission final decision 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraph 599.
[178] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 228.
[179] Nicolaides 2018, p. 419.

either.[180] The objective of Dutch CIT system indicated that undertakings established in the Netherlands are resident taxpayers and are subject to corporate income tax on their worldwide income in comparison to undertakings not established in the Netherlands are non-resident companies and are subject to tax with regard to income from Netherlands sources.[181] Even though a difference in determining the taxable profits of non-integrated companies and integrated companies would exist, this would not have a bearing on the objective of the general CIT system.[182] Thus, the line of reasoning considers no need for distinction between types of undertakings and both non-integrated and integrated companies are considered to be comparable and factually and legally similar positions. This is somewhat straight-forward interpretation and broadens the system of reference as much as possible.

This reasoning by the Commission finally ends up to a conclusion that the different way of calculating the taxable corporate income profit of unrelated undertakings had no reasoning on the objective of the system of reference, which is usually ‘taxation of the profits of all companies subject to tax in the Member State’.[183] The distinction between drawing a line to what is to be included in the reference system is not easily determined. There are still certain problems with this approach as pointed out by the tax payers and Member States in their response. Stand-alone and integrated undertaking are not always in a similar situation legally and factually. There are usually differences between them, e.g. related to pricing policy.[184] References are made to *Groepsrentebox* decision where the Commission took a stand that related companies cannot be seen to be in a similar position legally and factually similar to that of unrelated companies.[185] Same reasoning was made also in *Apple* and *Fiat.*[186]

The parties involved argued for instance that the reference system determined by the Commission was erroneous and correct system of reference should have been identified to indicate more precisely to the corporate income tax law with the arm’s length principle under domestic legislation providing guidance on the right application and thus could not be result to

---

[180] Commission final decision 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraphs 236 and 237.

[181] T-760/15 and T-636/16 the Netherlands and Starbucks Manufacturing Emea v European Commission (2019), paragraph 35.

[182] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 23.

[183] Commission final decision 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraphs 231 to 244.

[184] Ibid. paragraphs 185 and 235.

[185] Commission final decision 2009/4511 on the Groepsrentebox Scheme which the Netherlands is planning to implement.

[186] Commission final decisions 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 178 and 2017/1283 on State aid implemented by Ireland to Apple, paragraph 231.

conclusion of selective advantage.[187] This line of reasoning is however dismissed by the Commission by referring to the intrinsic objectives of tax systems to tax all the companies for fiscal purposes, which does not seem to leave that much room for interpretation.[188] The most importance in the assessment is apparently given to the fact that eventually the aim for the taken state measures in the contested tax ruling is to determine the basis for taxable profit for each undertaking in question on their local income in a similar manner to all companies within the tax jurisdiction, including stand-alone resident companies, and under the CIT system or ordinary rules of corporate taxation.[189] With regard to decision in *Groepsrentebox,* the Commission recalls that it is not bound by its previous decisional-practice and potential aid measures need to be assessed on the basis of their own merits under the objective criteria.[190]

Taxation of profits of each undertaking residing in the Member State similarly without any distinction between them and justifying this by objective of the tax system as the main argument for establishment is perhaps more simply created system of reference without reviewing the actual content of the national tax legislation.[191] Eventually, arm's length principle as equally relevant for both non-integrated and integrated companies will include elements that are part of the system of reference without any limits and thus allows the Commission to proceed with its assessment in this regard even though transfer pricing regulation does not concern non-integrated companies at any level in domestic legislation. This makes the argument by Member States easily supportable: If there is special regulation available related to the matter, should this be the starting point for the evaluation? Otherwise, the threshold for selectivity is more likely to fulfill too easily as there are always differences between prices between unrelated and related parties as pointed out above. In this case, it would have still been also possible to evaluate whether APA and the application of arm's length principle creates a derogation from that system of reference creating a selective advantage to the tax payer.

In *Fiat*, Luxembourg and FTT did not only have different opinion on incorrectly established reference framework by the Commission but also their views were slightly different from each other. Luxembourg had considered that the most relevant reference system would only include those group companies that fall under Article 164(3) L.I.R.99, that lays down the arm's length principle in Luxembourg tax legislation, whereas, on the other hand, the tax payer would have

[187] Commission final decision 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraph 183.
[188] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraphs 242 and 243.
[189] Ibid.
[190] See C-138/09 Todaro Nunziatina & C. (2010), paragraph 21.
[191] Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 199.

rather gone even further in the determination that the system of reference in this case should have been based on the Circular of Article 164(3), which sets up the regulation that is only applicable to those integrated companies that are engaged in financing activities.[192] The domestic tax legislation also points out in this scenario that there is a difference between determining the taxable profit although the objective, i.e. taxation, is anyhow the same. In General Court's opinion, this did not have an effect to the fact that the aim of the general Luxembourg CIT system is to tax the profits of all undertakings having their place of residency in Luxembourg irrelevant on the fact if they are integrated or not as well as that both non-integrated and integrated undertakings are however 'in a similar factual and legal situation in the light of the intrinsic objective of that system'.[193]

In every case, transfer pricing regulation has been implemented to national legislation, although in Apple Ireland noted that it is not applied for branches.[194] The conclusion regarding reference system with respect to transfer pricing could be seen as twofold from the line of reasoning.[195] One is that in case transfer pricing regulation is deemed to be part of the general system of reference, it should not be possible to consider an advance pricing agreement as prohibited state aid on a selective basis in that scenario unless the rules are not being applied consistently to non-integrated and integrated companies.[196] For the evaluation of consistency, we need to assess the selectivity, e.g., through deviation from market based outcome.

Second, in case there are no transfer pricing related regulation in the national tax legislation when tax ruling was appointed, it would be possible to argue that in any case this is the same reference for each undertaking and profit being determined in a similar manner, it is not possible for selectivity standard to exist as the benchmarking system is simply non-existent.[197] However, it stands out that the arm's length principle forms part of Article 107 TFEU irrelevant from the incorporation of that principle into the domestic legal system.[198] Due to this reason, with respect to the standard of actually determining consistency, similar manner, and whether selectivity would be in place, we need to be able to further analyze the different factors within the benchmarking system, which in this case seem to refer to the use of arm's length principle.

---

[192] Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 210.
[193] Ibid. paragraphs 212 to 214.
[194] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 197.
[195] Taferner – Kuipers 2016, p. 138.
[196] Ibid.
[197] Ibid.
[198] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 139.

4.2.3 Arm's length principle within the reference system

It is necessary to determine how and to what extent is that ruling constituting a derogation from the reference system, leading to unequal treatment between undertakings that are considered similar. [199] The outcome in case APA may result to non-compatible conclusion, the Commission is obliged to reasonably analyze the application of transfer pricing methodology included in the APA. This would eventually lead to that only wrongful application and deviation from the arm's length level could create such an advantage as the choice, application or result of a particular transfer pricing method could be contested by the Commission. Since the Member State has accepted the content of APA, there should also be some leeway for contesting. According to case law of CJEU, in the event of an individual aid measure, the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective.[200] Hence, it needs to be proven that the methodology for determining the taxable profit in APA does not reflect the market conditions, i.e. same result that would take place for the non-integrated parties, and thus the allocation of profit is wrongful. Taking these aspects into account, the Commission states that:

> ”[arm's length principle] is used to establish whether the taxable profits of a group company for corporate income tax purposes has been determined on the basis of a methodology that approximates market conditions, so that that company is not treated favorably under the general corporate income tax system as compared to non-integrated companies whose taxable profit is determined by the market.”[201]

The deviation is therefore measured through the arm's length principle, which can be deemed to be independent part of the application of Article 107(1) TFEU.[202] In fact, when it comes to definition of such arm's length principle is applied in the context of state aid assessment, the principle does not flow from Article 9 of the OECD Model Tax Convention but is connected to a general principle of equal treatment in taxation that is falling in the application of Article 107(1) TFEU and therefore binding the Member States and its the national tax rules cannot be excluded from this scope.[203] In *Fiat* for example, tax payer reasoned that the Commission had failed to provide any legal basis for its application of arm's length principle and, in *Apple*,

[199] Commission final decisions 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 216; and 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraph 252.

[200] See C-15/14 P Commission v MOL (2015), paragraph 60; see also T-385/12 Orange v Commission (2015).

[201] Commission final decisions 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 228; and 2017/1283 on State aid implemented by Ireland to Apple paragraph 257; and 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraph 264.

[202] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 139.

[203] Commission final decisions 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 228; and 2017/1283 on State aid implemented by Ireland to Apple, paragraph 257; and 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraph 264.

Member State contested that the Commission had significantly differed from its previous position in the Opening Decision, which originally made reference to the Irish Revenue's alleged failure to apply the OECD arm's length principle. Nevertheless, the Commission in the end stated that the principle existed independently in the EU law irrespective whether the principle was implemented into the national legal system.[204] For example, also in *Apple*, the Commission already states that in the light of case law 'reduction in the taxable base that results from a tax measure that enables a taxpayer to employ transfer prices in intra-group transactions that do not resemble prices, which would be charged in conditions of free competition between independent undertakings negotiating under comparable circumstances at arm's length confers a selective advantage on that taxpayer for the purposes of Article 107(1) TFEU'.[205]

All in all, the Commission did not examine whether the tax ruling at issue complied with the arm's length principle of the national law of Luxembourg or Article 9 of the OECD Model Tax Convention.[206] Instead, whether tax administration conferred a selective advantage on the tax payer pursuant to Article 107(1) TFEU by issuing a tax ruling that endorses a profit allocation that departs from the amount of profit that would have been taxed under similar transactions had been executed by independent companies.[207] This should nonetheless be assessed in the light of OECD Guidelines as it states the importance 'not to lose sight of the objective to find a reasonable estimate of an arm's length outcome based on reliable information' due to the non-exact nature but the principle itself is included in the Article 107(1) TFEU too.[208] This reasoning allows the Commission to test the difference from a methodology that would lead to a reliable approximation of a market-based outcome.[209] However, 'reliable approximation' is anyway subject to interpretation.

As General Court confirms in *Starbucks* and *Fiat*, due to that intra-group transactions are not priced in the perfect market conditions, 'when examining, pursuant to the power conferred on it by Article 107(1) TFEU, a fiscal measure granted to such an integrated company, the Commission may compare the fiscal burden of an integrated undertaking resulting from APA with same burden with respect to application of the normal rules of taxation under national law of an undertaking, placed in a comparable factual situation, carrying on its activities under

---

[204] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 149 and Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 197.
[205] C-182/03 and C-217/03 Belgium and Forum 187 ASBL v. Commission (2006).
[206] Ibid.
[207] Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 229.
[208] Ibid. paragraph 230.
[209] Ibid. paragraph 231.

market conditions'.[210] Therefore, the arm's length principle can be characterized as a tool for determining by the Commission if there is a mitigation of the undertakings burden normally included and advantage in the light of Article 107(1) TFEU.[211] Even though Commission's approach could receive some support from the argumentation in *Belgium and Forum 187 v Commission,* General Court is of the opinion that the arm's length principle is an instrument for determination whether an related undertaking was granted, pursuant to a tax measure determining its transfer pricing, an advantage.[212] As this is used for analyzing the breach of Article 107(1) TFEU, this offers a legal basis for Commission's investigations independently on whether the arm's length principle has been complied with in the light of domestic tax regulation.

This results to a conclusion that arm's length principle is part of Article 107(1) TFEU and enabling the Commission to 'identify an advantage in its burden of proof if the difference between the comparables goes beyond the inaccuracies inherent in the methodology used to obtain that approximation'.[213] This relates also to the intensity of review for the Court as will be explained in section 5.2. Despite of its status under EU law, the deviation from the market-based outcome would still be tested under the OECD Guidelines. From the legitimate point of view, this could still possibly arise further questions about creating a secondary meaning for arm's length principle for taxation purposes as it is connected to the principle of equal treatment, which could be seen as some sort of side path for achieving the desired end result. This is due to that the Commission is not obliged to analyze the compatibility with the meaning of the principle in national tax legislation. The practical assessment procedure for transfer pricing methods is nevertheless trusted to the hands of OECD Guidelines and the Commission is required to justify its use of methodology in accordance with it. When the nature of arm's length principle in the state aid context has been analyzed that is forms a tool for the analysis, this leaves us to the part that we need to evaluate the applied methodology in the APA whether there could potentially be an advantage for the undertaking. Hence, it will be necessary to verify in case the advantage is contrary to the established system of reference from the transfer pricing point of view.

---

[210] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 149, and T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 141.

[211] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 151, and T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 143.

[212] Ibid.

[213] Ibid. paragraph 152, and T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 144.

4.2.4 Derogation from the reference system

In first two decisions by the Commission was given in *Starbucks* and *Fiat* cases, both with the same preliminary negative result with a duty for the Member State to recover the amount of prohibited aid. In general, even though the APAs are fully compatible with the internal market in general, these APAs that were investigated by the Commission supported *artificial and complex methods* to establish taxable profits for the companies and therefore not reflecting economic reality by pricing intra-group transactions in contrary with the arm's length principle.[214]

4.2.4.1 Netherlands (Starbucks) v Commission

In *Starbucks*, Starbucks Manufacturing EMEA BV ("SMBV") was based in the Netherlands as a coffee roasting entity, which was the only such entity of the Group in Europe selling and distributing coffee as well as other related products to its related party outlets in EMEA region.[215] Green coffee beans were the main raw material component of that roasting process and they were acquired from a related party located in Switzerland, Starbucks Coffee Trading SARL ('SCT'). In addition, Alki LP ('Alki'), which is a group undertaking located in the UK and owning the IP related to green coffee bean-roasting know-how, was remunerated by SMBV in the form of royalty payments for the use of *inter alia* know-how and roasting methods concluded under a roasting agreement. As the SMBV was a manufacturing and distribution company in the group, the purpose of the APA was to determine, in addition to the amount of royalty payments, the level of remuneration for those activities on the basis of the TNMM.[216] Regarding amount of royalty, APA included that it would be fixed and based on the difference between the operating profit made in the production and distribution activities, before royalty expenses, and SMBV's remuneration.[217] Royalty payments were also deductible in corporate taxation and subject to withholding tax for SMBV. In the contested APA with the Dutch tax authorities, which was entered into force in 2017 on a ten-year-basis, the tax authorities had accepted the remuneration of the royalty payment to consist of a mark-up of 9-12% of the preliminary agreed cost base of the company. The use of TNMM method in the determination was also reasonably justified and documented.[218]

[214] Commission – Press release IP/15/5880.
[215] Commission final decision 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraphs 49-55.
[216] Ibid. paragraph 187.
[217] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 16.
[218] Commission final decision 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraphs 55 to 61.

The Commission had made the conclusion that if the Netherlands had accepted the remuneration for SMBV's activities constituted an arm's length remuneration, a derogation from the reference system was at hand due to level of the royalty payment from SMBV to Alki, which does not lead to equal treatment between factually and legally similarly defined undertakings.[219] Also, instead of applying TNMM in the case, which had led to a reduction in the corporate income tax paid, the CUP method would have been more appropriate method to determine the arm's length level of the royalty payments and to determine the net profit of SMBV's production and distribution activities.[220] It was argued that the level of the royalty paid by SMBV to Alki should have been zero and the level of the prices of green coffee beans from 2011 onwards was in general too high.[221] Since SMBV did not gain profit from the use of the IP rights from which it paid royalties to Alki in so far as it did not exploit them on the market, zero level of royalty payments should have been the correct level.[222] For challenging purposes, internal comparable manufacturing agreements were found, i.e., which was advocating the use of CUP method.

In addition, even in the case of TNMM would have been appropriate for identifying the remuneration for SMBV, in Commission's view, the APA included also incorrect application of TNMM. In Commission's view, purchase price for green coffee beans had not been examined even if that was identified as one of the main transactions for SMBV – the Commission calculated the average gross margin on the costs of green coffee beans and, in its view, the amount was overvalued and thus lowering the SMBV's profits and taxable base, constituted a selective advantage.[223] Commission's reasoning is based on contesting both the used and applied transfer pricing method in the tax rulings, which led to incompatible end result with the internal market. Should TNMM applied in the case, the undertaking had not applied it correctly since SMBV was not the least complex entity and thus not be established as the tested party for the purpose of applying the TNMM. Alki would have suited for this purpose better. In addition, since SMBV functioned as reseller of coffee products, sales instead of operating costs should have been used as a primary profit level indicator as well as adjustments made to the cost base while applying TNMM were such that they eventually granted advantage to

[219] Commission final decision 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraph 252 to 262.
[220] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 173.
[221] Ibid.
[222] Ibid. paragraph 43.
[223] Ibid. paragraph 46.

SMBV. The adjustments made with respect to profit level indicator were also deemed wrongful.[224]

The Netherlands however argued that if the legal issue was merely means of determining the compatibility of intra-group transactions with the arm's length principle and if the method chosen by the tax payer led to an arm's length outcome, the Commission cannot cast it into doubt on the ground that the royalty and the mark-up applied to the resale price of green coffee beans were not examined individually. The Dutch authorities also pointed out that the Commission did not take the stand that the OECD Guidelines would put the use of traditional methods as primary since the undertakings are not obliged to choose a certain transfer pricing method, nevertheless considering that the chosen method would lead to an arm's length end result.[225] Secondly, the Netherlands consider that the only transactions being analyzed within the APA are the roasting of coffee beans and the provision of logistics as well as some administrative services for Alki. Therefore, the purpose as such is not to determine whether the royalty payment is in conformity with the arm's length principle taking into account that the Commission did not explain the reasons for opposite assumption.[226] In any case, TNMM would be the best method to assess the arm's length principle due to the lack of similar unrelated external or internal transactions that would be needed in order to apply the CUP method. After all, all of the methods listed in OECD Guidelines aim to find the reflection of profit allocation to be in line with the arm's length level.

Indeed, in the General Court's view, the Commission's argumentation fails to indicate the existence of non-compliance with arm's length principle and dismisses the argumentation when it regarded derogation from the reference system. In rather straight-forward way of going through the six line of reasoning that as the Commission has the burden of proof[227], mere non-compliance with methodological requirements does not necessarily lead to a reduction of the tax burden for the undertaking and the Commission was not entitled to conclude that the CUP method had to be given priority over the TNMM.[228] The conclusion made here by the General Court is very much in line with the interpretation of OECD Guidelines. Additionally, the royalty rate determined in the APA could not be deemed to be lower than it was due to that the

[224] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraphs 47 to 51.
[225] Ibid. paragraph 175.
[226] Ibid. paragraph 176.
[227] T-68/03, Olympiaki Aeroporia Ypiresies v Commission (2007), paragraph 34; and T-305/13, SACE and Sace BT v Commission (2015), paragraph 95.
[228] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraphs 194 to 216.

Commission had failed to demonstrate from the basis of the functional and comparability analysis that there would a reason to exclude the actual use of method by the tax payer.[229]

With regard to level of the price of green coffee beans purchased from group company in Switzerland and their hypothetical overvaluation, the General Court confirms that it considers such costs of SMBV that fall outside of the scope of the contested state aid measure in question.[230] This is simply not included in the APA and cannot be challenged or added therein. Due to the lack of determination of the level for the purchase of green coffee beans in the APA, the price of coffee beans for the years from 2011 to 2014 should probably have been contested through annual tax assessments, which is in the competence of Member State. Further, as for subsidiary line of reasoning, even though the more complex company in Commission's opinion was SMBV, which was also the tested in the APA, and therefore not the most suitable as tested party for TNMM, choosing either entity will have an impact on the transfer price obtained, considering that the purpose of APA is to determine the level for taxable profit of SMBV and not Alki, since it does not mean that the choice of the more complex entity as tested entity would supposedly not indicate a reliable arm's length result to be achieved more perfectly.[231]

Further, if the choice of the least complex entity as tested party is erroneousness, it cannot be concluded that applying the TNMM to the more complex undertaking would lead to an arm's length outcome and, in so far as the residual profits are allocated to the other party, the outcome should in theory be the same irrespective which entity is tested in the analysis.[232] The Commission also lacks the reliable information on showing that the use of profit level indicator of operating costs would not suffice as an arm's length price, which is supported by the OECD Guidelines.[233] Neither the adjustments used for obtaining more reliable set of comparability could not be set in violation of the arm's length principle. As the tax payer had seen the effort and reasonably explained the alignment with the arm's length principle, there was no reason whatsoever to believe that the Commission would have had a better reasoning in their argumentation. The line for burden of proof to show that there is a deviation from the arm's length principle in the APA and can therefore be deemed violating the Article 107(1) TFEU is nonetheless relatively high. The Commission did not appeal and it would have been also

[229] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraphs 217 to 373.
[230] Ibid. paragraphs 374 to 403.
[231] Ibid. paragraphs 413 to 438.
[232] Ibid. paragraph 437.
[233] Ibid. paragraph 459.

questionable whether the CJEU's view would have been any different from General Court's opinion.

4.2.4.2 Luxembourg (Fiat) v Commission

Fiat -case related to the tax treatment of Fiat Finance and Trade ('FFT'), which had its place of residence in Luxembourg as well as the head office, providing financial and treasury services to related parties in Europe.[234] As FFT had many differently categorized transactions between its related parties, most of the transaction related to intra-group loans and some other services, such as liquidity investment, cash pooling, foreign exchange and its risk management as well as other financing instruments to other related parties.[235] The funding of FTT was mainly collected from the markets, such as banks and by issuing bonds, that were eventually forwarded to the group companies in the form of financing instruments. In *FIAT*, the company had used TNMM in the evaluation of arm's length level of certain transfer prices in the APA that was accepted by the tax authorities and the issue at hand was not the incorrect selection of the method but rather the wrongful application of TNMM method.[236] However, contrary to Starbucks, the issue was not about the appropriate price level of the royalty payments and remuneration for distribution and manufacturing activities but about provision of financial services. APA between FFT and Luxembourg endorsed a transfer pricing method for allocating profit to FFT by intra-group transactions flows and this way enabled FFT to determine its corporate income tax liability to Luxembourg on an annual basis. APA in question included somewhat complex calculations of the taxable income in Luxembourg and, with respect to the use of TNMM, the Commission stated:

> "While the Commission considers the tax advisor's use of the TNMM in the case of FFT to be appropriate, the Commission considers several of the methodological choices, choices of parameters and […] adjustments employed by the tax advisor in the application of that method inappropriate for calculating FFT's tax base in Luxembourg."[237]

The Commission noted the most appropriate method for determining the taxable profit was indeed TNMM and justified on the basis that FTT was providing financial services merely to its related parties.[238] Therefore, due to the nature of the transaction, application of CUP would be more difficult. It was clarified that the remuneration to FFT. which was the basis of the

[234] Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 35 and 36.
[235] Ibid. paragraph 34.
[236] See Lang – Cottani – Petruzzi – Storck 2019.
[237] Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 248.
[238] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 10.

taxable profit in Luxembourg, needed to be established by referring to the capital needed by FFT to take on its functions and to bear the business related risks.[239] The remuneration of FFT equal to the amount, which forms the taxable profit by referring to the 'capital needed by FFT to perform its functions and to bear its risks, in relation to the assets in use'.[240] The calculation of remuneration included in the APA was as follows:

> (i) estimation of FFT's "capital at risk";
>
> (ii) identification of FFT's capital used in order to perform its functions and to support the financial investments;
>
> (iii) estimation of the expected remuneration of FFT's "capital at risk" by using the Capital Asset Pricing Model ("CAPM") and identification of the return to reward the capital used to perform the functions; and
>
> (iv) calculate the overall profitability to be left to FFT to remunerate the risks borne and the functions performed by combining the results of steps (i) to (iii).[241]

For the risk related functions, the APA included the agreement that FFT remuneration has its basis on multiplying the regulatory capital of EUR 28.500.000 of FTT that was estimated by analogically applying the Basel II framework by the pre-tax return on equity of 6.05%, estimated using the CAPM[242] and, on its functions ('functions remuneration'), the result was received by multiplying the designation of FFT's capital used in order to take on the functions that was estimated to be EUR 93.710.000 by the market interest rate applied to short-term deposits to be approximately 0.87%.[243] The Commission considered the amount for return on equity of 6.05% as well as the use of CAPM included in the APA resulted to be much lower in the financial sector than generally would be in normal circumstances, which hinted that the arm's length conditions are not necessarily met.[244]

The profit level indicator used by FFT, namely return on equity estimated through the CAPM, was not seen as sufficient approach as accounting equity considering methodically consistent

---

[239] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 10.
[240] Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 56.
[241] Ibid. paragraph 58.
[242] Ibid. paragraph 11.
[243] See Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat.
[244] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 32.

from accounting point of view.[245] Actually, the Commission found that instead of the used and hypothetical regulatory capital of EUR 28.5 million, they should have used the accounting equity, amounting to EUR 287.5 million in 2011 taking into account that APA was granted in 2012 and, therefore, in other words, this has an equal effect of actually dividing taxable remuneration of FTT by ten. Secondly, the Basel II standard had not been the suitable alternative available in this case with regards to establishing the hypothetical regulatory capital as the Commission believes the conclusion made is erroneous and eventually resulted to underestimation of the capital and lowering of FFT's tax liability. Furthermore, other adjustments applied to the amount of capital, namely choosing beta of 0.29 in CAPM for determining the return on capital and other factors deducting FFT's total capital, were such that did not correspond within the conditions of system of reference.[246]

Luxembourg found the Commission's analysis containing errors on the basis of (i) capital should not have been segmented, (ii) endorsing the use of hypothetical regulatory capital is correct (iii) nor the calculation of the amount of that hypothetical regulatory capital, (iv) no error was made in accepting the deduction of FFT's shareholdings in FFC and FFNA and (v) the calculation of the rate of return of 6.05%, applied to the hypothetical regulatory capital was correct.[247] However, General Court found Commission's reasoning more convincing. In addition to contesting the fulfillment of the criteria included in the Article 107(1) TFEU, FFT tried to argue that infringement of Articles 4 and 5 TEU, in so far as the Commission's analysis would lead to tax harmonization in disguise as well as breach of the principles of legal certainty, protection of legitimate expectations and rights of the defense with respect to the Commission order for recovery of the aid.[248] General Court also dismisses the question on competence as national law nevertheless need to be consistent with EU law and if a tax measure in fact discriminates between comparable companies, it falls within the scope of Article 107(1) TFEU.[249]

The FTT argued that any increase in the tax base in Luxembourg would eventually fully offset by an increased tax deduction in other Member States, i.e. referring to so called 'group effect',

[245] Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 249.
[246] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 30.
[247] Ibid. paragraphs 192 to 194.
[248] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019). paragraphs 94 to 99.
[249] Ibid. paragraphs 100 to 117.

which has been discussed also in *Hungarian group interest tax regime* decision.[250]. The Commission denies the interpretation of the judgment in a similar manner. In the end, an advantage at the level of undertaking in Luxembourg cannot be compensated with the disadvantage at the level of group company in another company.[251] Therefore, also General Court considers Fiat group companies as one economic unit when it compares it to the treatment of stand-alone companies by referring to the case law of CJEU.[252] However, this approach is still in contrary to the conclusion that selective advantage was in Commission's opinion benefitting the whole group, where FFT formed an economic unit with other group entities and also other entities had benefited from the tax reduction granted to FFT through the pricing conditions of its intra-group loans.[253]

4.2.5 One-sided approach or two-sided approach

For the sake of transfer pricing assessment, there are two ways to evaluate the arm's length level of intra-group transaction, two-sided and one-sided approach. In one-sided approach, only the features and functions of that particular party that is requesting the tax ruling will be taken into account, for example in TNMM method, which considers and estimates only the remuneration of the undertaking party to the APA based on its activity and functions performed.[254] Strength in the approach can be seen to be that only one associated enterprise and its financial indicator need to be tested, which can make practically sense since another party to the transaction may be considered more complex on its activities or it may be difficult to receive reliable information on the another party.[255] Regarding the determination, the residual profit will be then allocated by the undertaking to another related party operating in a different tax jurisdiction, meaning that no information is needed regarding the functions and activities of the other related party in question.[256] One-sided method may be applicable to those situations

[250] Commission final decision 2009/8130 on State aid implemented by Hungary for tax deductions for intra-group interest.
[251] Commission final decisions 2009/4511 on the Groepsrentebox Scheme which the Netherlands is planning to implement, paragraphs 80 to 82; and 2009/8130 on State aid implemented by Hungary for tax deductions for intra-group interest, paragraphs 131 and 132.
[252] See C-170/83 Hydrotherm, paragraph 11 and also T-137/02 Pollmeier Malchow v Commission (2004), paragraph 50 and Commission decision, Fiat, paragraphs 341 and 342.
[253] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraphs 38 and 300 to 327.
[254] DG Competition working paper 2016, paragraph 21.
[255] OECD 2010a.
[256] DG Competition Working Paper, paragraph 21.

when the related party, which is located in another tax jurisdiction, is holding some relevant IP being utilized.[257]

In two-sided approach, on the other hand, both undertakings involved in the related transaction will be analyzed and can be argued that it should be defined more accurately and thus similar to actual market outcome.[258] Generally, to be more specific, this method is usually used in the case of profit split method, i.e. when both of the parties in the intra-group transaction will be allocated with a share of the overall profit.[259] This makes sense since the method in question is necessarily not depending on the overall comparable transactions in the market but, instead, aims to split the profits between the related parties in accordance with their functions and activities.[260] Taking these above mentioned characteristics into account, two-sided approaches is more accurate to correspond with the arm's length outcome in comparison to the one-sided approach.[261]

Certain preference towards two-sided approach by the Commission can be observed in the state aid context as well – in *Amazon* and *Apple*, the Commission has its basis of argumentation on the wrongful use of these transfer pricing methodology and approaches.

4.2.5.1 Ireland (Apple) v Commission

Apple has also been largely discussed in the media due its relatively high amount of aid to be recovered, in which the Commission challenged two APAs between Ireland and Apple concluded in 1991 and renewed in 2007, that allowed Apple Sales International ('ASI') and Apple Operations Europe ('AOE') to determine their annual corporate income tax liability in Ireland by applying the profit allocation methods, which were accepted by Irish tax authorities ('Irish Revenue') in those APAs.[262]. In the Apple -group structure, ASI and AOE were under control of Apple Inc. located in the United States. In the more recent 2017 APA of ASI, net profit attributable for the branch was calculated in accordance to represent 10-15% of branch operating costs, excluding certain costs. For AOE, the APA concluded in 2017 established that the net profit that was to be attributed to Irish branch would be calculated as 65% of the branch operating expenses up to an annual amount of USD 60-70 million and, to the amount excessing

[257] DG Competition Working Paper, paragraph 21.
[258] Ibid. paragraph 20.
[259] Ibid.
[260] Ibid.
[261] See Lang – Cottani – Petruzzi – Storck 2019, p. 533.
[262] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 39.

that, 20% of its operating expenses.[263] Both ASI and AOE, under the Irish tax regulation, were considered non-resident companies in Ireland due to that both were ultimately controlled by an undertaking residing in a tax treaty country, namely Apple Inc. in the United States, and both having trading activity in Ireland in their branches, managed and controlled outside of Ireland.[264] In practice, this meant that they did not have taxable presence neither in Ireland nor in the United States.[265] Both made payments for the use of Apple IP under a cost-sharing agreement with Apple Inc, which also related to share of R&D costs with respect to new IP.[266] The payments were paid to their head offices, which in reality were non-existent according to the Commission.

With regard to selectivity and different from Commission's previous decisions, the Commission argues that in the light of *Belgium v Commission* and *Orange,* identification of the financial advantage of individual aid measure is sufficient to support the presumption of selectivity without it being necessary to analyze the measure with the three-step test.[267] However, for the sake of completeness, the Commission has also applied three-step test and the APAs differ from the ordinary rules of taxation for corporate income profit taxation purposes in Ireland due to methods applied in APAs let ASI and AOE to determine the yearly profit in taxation.[268] The Commission argues that Irish Revenue's acceptance of the assumption that the Apple IP licenses, held by ASI and AOE, should be allocated to the head offices outside of Ireland, to which the by the contested tax rulings are based, is wrongful.[269] This also is the factor that constitutes the selective advantage factor. The utilized method for determining the taxable profit of ASI and AOE has been TNMM with Irish branches as tested parties and residual profit being allocated abroad, i.e. one-sided approach.[270] As a subsidiary line of reasoning, the Commission adds that even if Irish Revenue had the basis for acceptance for this license arrangement, the profit allocation methods endorsed in the APAs were still resulting in such taxable profit for ASI and AOE in Ireland differing from a reliable approximation of a market-based outcome in line with the arm's length principle as the methods are all in all based

[263] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple. paragraph 61.
[264] Ibid. paragraph 50.
[265] Exhibits of hearing of Offshore Profit Shifting and the U.S. Tax Code Part 2 (Apple Inc.) of the Permanent Subcommittee on Investigations of the US Senate, 21 May 2013, p. 24.
[266] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 116 to 129.
[267] C-270/15 P Belgium v Commission (2016), paragraph 49 and C-15/14 P Commission v MOL (2015), paragraph 60 and Case T-385/12 Orange v Commission (2015), paragraph 53.
[268] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple. paragraph 259.
[269] Ibid. paragraph 260.
[270] Ibid. paragraph 265.

on inappropriate methodological choices.[271] According to Ireland and Apple, in the light of *territoriality principle* that as it only has the authority to tax the portion of the profits of the company that is corresponding with the activities of the Irish branches and for profit allocation purposes only the activities that take place in the Irish branches need to be considered and the Apple IP licenses could not be allocated to the Irish branches for tax purposes as no management activities are associated with those licenses in those branches. [272] The Commission did not agree with Ireland's view since ASI's and AOE's Irish branches do not have a separate legal personality from the companies to which they belong, in particular to their respective head offices, could be said to separately own the assets, namely the IP assets, or the liabilities of those companies.[273]

The fundamental question herein is indeed where the functions are located and where the profit should be allocated. As the head offices did not have any other the activities than board meetings, the Commission concluded that allocating IP outside of Ireland was incorrect and what would have been agreed in an arm's length context between two unrelated undertakings. Given the lack of functions performed by the head offices, since it did not control or manage, nor were they in a position to control or manage the Apple IP licenses in such a manner as to derive the type of income recorded by those companies, and, on the other hand, *de facto* the functions performed by the Irish branches, the Apple IP licenses for the procurement, manufacturing, sales and distribution of Apple products outside of the Americas should all have been allocated to the Irish branches for tax purposes.[274] In Commission's view, this approach, in accordance with the OECD Guidelines, would better reflect the economic ownership and reality considering that neither ASI nor AOE do not have physical presence or economic activity outside of their Irish branches.[275] The Commission also did neither accept the argument on excluding ASI's and AOE's profit deriving from contributions performed by Apple Inc. employees from the taxable profit of Irish branches, since the contributions in R&D and the management of the Apple IP licenses held by ASI and AOE cannot influence the allocation of profit within ASI and AOE even though Ireland and Apple claimed that such contributions drove ASI's and AOE's profitability and therefore they had right to exclude it and thus that the

[271] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 261.
[272] Ibid. paragraph 266.
[273] Ibid. paragraphs 268 to 275.
[274] Ibid. paragraphs 293 and 305.
[275] OECD Guidelines 1.49: A factor to consider in examining the economic substance of a purported risk allocation is the consequence of such an allocation in arm's length transactions. In arm's length transactions it generally makes sense for parties to be allocated a greater share of those risks over which they have relatively more control; and, also, Commission decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 307.

risk would be assumed and limited for ASI and AOE through Apple's group policy, which is developed in the US.[276]

Hence, IP licenses held by ASI and AOE should have been allocated to the Irish branches in accordance with the normal market condition since, as independent companies, they would not have agreed on arrangement where all of their profit from sales activities beyond a limited mark-up on a reduced cost base would be allocated elsewhere.[277] In the end, the Commission decided that this was deemed to be selective advantage in nature as, in comparison to non-integrated companies that are no table to create such transaction flows through intra-group pricing, it lowered their corporation tax liability under the ordinary rules of taxation in Ireland. Also, considering the almost non-existent and non-complex activities of head offices, the branches as tested and less complex party in the one-sided TNMM analysis with the profit level indicator of operating expenses instead of sales was incorrect. With respect to two-sided approach, the Commission emphasizes the importance of comparison of the assets used, the functions performed, and the risks assumed by both related parties in the transaction in order to conclude the arm's length level.[278]

4.2.5.2 Luxembourg (Amazon) v Commission

Similarly to *Apple*, the primary line of reasoning for granting an advantage was the *presumption of selectiveness* in light of the case law but was also tested under the three-step analysis where the system of reference was also established as the Luxembourg tax regulation.[279] Moreover, the problem arose from the one-sided approach in transfer pricing assessment.[280] The advantage in this case was based via tax ruling for Luxembourg based companies LuxSCS, expected to function only as an IP holding company for group's European activities under an CSA with the US parent company Amazon Inc., and LuxOpCo, which is wholly-owned subsidiary of LuxSCS and the principal company from operative perspective of the group in Europe.[281] In other words, LuxSCS would only receive interest through intercompany loans and royalties from use of IP that it owned. Under CSA License and Assignment Agreements For Pre-existing Intellectual Property (the "Buy-In Agreement"), LuxSCS was granted with the right exploit and

[276] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 308 to 318.
[277] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraph 319 and 320.
[278] Ibid. paragraph 268 and OECD 2010b 1.42.
[279] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraphs 585 to 605.
[280] Ibid. paragraphs 541 and 542.
[281] Ibid. paragraphs 103 and 108.

sublicense certain IP from the US entities.[282] The right to develop, enhance, and exploit the IP for business operating purposes was further sublicensed to LuxOpCo under a License Agreement.[283] With respect to business activities, LuxOpCo was responsible for managing the strategic decision-making related to the retail and services businesses with respect to EU websites, in addition to the management of key physical components as well as treasury management functions.[284] Any IP created or further developed by the LuxOpCo would be granted for LuxSCS.

Above all, the Commission criticized that, contrary OECD Guidelines, the royalty payment in the APA was not related to output, sales or profit but calculated as the residual profit from LuxOpCo's intra-group transactions determined by deduction of a routine return attributed to the functions of LuxOpCo's from its actually recorded profit.[285] In addition, the Commission considered that the functions and risks with LuxOpCo were more complex than those of LuxSCS relating to intra-group license transaction and, considering 'the central and strategic commercial decision-making, concentrating the business risk of the entire European market', the remuneration of LuxOpCo was seen to be too low.[286] Luxembourg argued, with regard to *Autogrill* -case, that the Commission failed to identify category of undertakings, which would be the only ones benefiting from the measure.[287] Also, LuxOpCo has limited rights and responsibilities related to the IP and does not hold any IP itself meaning it has alternatives for using the IP. Therefore, it needs to be the least complex party and therefore suitable for testing in accordance with the TNMM. LuxOpCo's financial return for the years should also be being compatible with the arm's length principle.[288]

However, the Commission argued that this was merely a legal, not economic, ownership and by endorsing an arrangement attributing remuneration to LuxOpCo solely for the allegedly performed routine functions and that allocates the entire profit generated by LuxOpCo in excess of that remuneration to LuxSCS as royalties and leaves the routine profit to LuxOpCo, the APA generates a derogation from a reliable approximation of a market-based outcome.[289] The

[282] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraphs 106 and 110.
[283] Ibid. paragraph 116.
[284] Ibid. paragraph 108.
[285] Ibid. paragraph 279.
[286] Ibid. paragraphs 280 and 281.
[287] T-219/10 Autogrill España v Commission (2014), paragraphs 44 and 45.
[288] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraphs 300 to 303.
[289] Ibid. paragraph 407.

Commission calls for two-sided approach when assessing the profit allocation since, in its view, the applied method was not profit split method even though stated as such but TNMM due to that 100% of residual profit was attributed to LuxSCS for its unique and valuable contribution and this was one-sided approach.[290]

The Commission stated that the TNMM is the correct method and have been applied as most appropriate method for determining the level of remuneration for arm's length purposes.[291] However, since LuxSCS was the least complex entity relating to its functions, it should have been also tested party instead of LuxOpCo as illustrated in the performed functional analysis.[292] In the end, the Commission challenged the grounds that only the legal ownership of the IP was not acceptable to attribute the IP related returns to LuxSCS as it was included the APA and confirmed by the local tax authorities. For LuxOpCo, this approach on the other hand resulted to deductibility of these payments from its taxable income the Commission found that the ruling permitting LuxOpCo to deduct all of the residual profit paid in the form of royalties to LuxSCS from its taxable income constituted an economic advantage to LuxOpCo.[293] The final conclusion made is that this arrangement that deducted the tax base for LuxOpCo granted an selective advantage. With respect to application of TNMM and amount of appropriate mark-up to LuxSCS, arm's length remuneration in accordance under the license agreement would have equaled to a mark-up of 5% to the costs incurring for the maintenance of its legal ownership of the IP, as those costs can be deemed to illustrate actual functions of LuxSCS.[294] Further, in Commission's view, 5% would have been applicable and in line also with the conclusion of 2010 JTPF Report regarding mark-up for low-added intra-group services.[295]

4.2.6 Consequences of the taken actions

Commission's and General Court's approach in this regard is not completely stranger to, for example, what would tax administration argue against a tax payer in domestic situation by derogating from the arm's length level, granted measures may be considered as an economic advantage putting the APA holders in a more favorable situation than others when compared to other companies.[296] The nature of transfer pricing and related assessment nevertheless stays

[290] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraphs 540 and 541.
[291] Ibid. paragraph 542.
[292] Ibid. paragraph 549.
[293] Ibid. paragraph 560 and 561.
[294] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon. paragraph 558.
[295] Ibid. and see EU JPTF 2010.
[296] C-88/03 Portugal v Commission (2006), paragraph 56.

vague with different potential end results. As when it comes to the field of state aid, it must be noticed that the notion of state aid as specified in the TFEU is a legal concept and therefore it needs be construed by taking the objective factors into account. Hence, the CJEU is obliged, after going carefully through both to the specific features on both sides and, considering the technical or complex nature of the assessments of the Commission as well as the counter arguments by the Member States and tax payers, perform a thorough review in order to measure whether these measures fall within the scope of Article 107(1) TFEU and the fundamental status of arm's length principle in this context – whether its evaluation should be based solely on national law or EU state aid regulation.[297]

Additionally, the Commission has recalled that, in the third step of the three-step test, in case the state measure would constitute a derogation from the identified reference system, the State needs to indicate whether that measure in question could be justified by the nature or the general scheme of the reference system. Therefore, selective advantage granted by the Member State as such can also be deemed compatible in case a justification can be shown to exist. Nonetheless, the Commission has clearly stated that the burden of proof for indicating any justification lies solely with the Member State, not the tax payer.[298] In the state aid cases, the existence of justification is somewhat however rare to be pointed out as Member States primarily focus on arguing that no selective aid or advantage was granted at all.

In *P Oy*, the CJEU confirmed that the exercise of discretion by tax authorities with respect to fiscal rules not based on objective criteria related to the tax system, hints towards presumption of selectivity.[299] If the Member State would reason the objective criteria behind the measure, the evaluation could be done based on this. Such criteria were not put into table by the Member States. For instance, Apple argued that the measure was intrinsic to the Irish corporate tax system and that the rulings contributed to the effectiveness of the system and were proportionate.[300] The Commission dismissed these arguments. Had the circumstances been different, preferential and selective treatment of a certain undertaking benefitting its financial position in the form of APA could be justified, for example, based on to be deriving directly from the intrinsic, basic or guiding principles of the tax reference system in question, whether determined by the Commission or by the Member State, or for the ordinary tax system to

[297] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 206, C-533/12 P and C-536/12 P SNCM and France v Corsica Ferries France (2014), paragraph 15, C-486/15 P Commission v France and Orange (2016), paragraph 87.
[298] Commission final decision 2016/2326 on State aid which Luxembourg granted to Fiat, paragraph 337.
[299] C-6/12 P Oy (2013), paragraph 27.
[300] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 405.

function effectively, such mechanisms are necessarily needed.[301] This may leave however a lot of room for discretion and interpretation and would require the existence of sufficient guidelines in order to utilize this type of reasoning.

In comparison to purely domestic situations where tax authorities may challenge undertakings for allegedly violating the tax rules of that particular Member State, the arguments are not coming only from the undertaking or tax payer's side but from the Member State as well. Regarding the objective of state aid regulation, from the legislative side, the breaching party at hand is not the undertaking but the Member State. In this sense, the arguments by the Member State can be seen to defend and justify the ordinary tax system of their own jurisdiction and, indirectly, also the business model of the tax payer that has been accepted by it. After all, all of the measures that come into effect after Article 107(1) TFEU that are applicable to a particular case affect also the Member States since the prohibited aid is required to be recovered. The exceptions when the aid may not be recovered by the Member State can be applied if they are in incompatible with the general principle of EU law, namely the principles of legal certainty or legitimate expectations.[302] When it comes to the interpretation of this doctrine in the related case law, the threshold for this to apply is high.

Excluding the judgment by the General Court regarding Starbucks where no prohibited state aid was deemed to exist and the Commission was ordered to pay the relevant costs back for both the Netherlands and Starbucks, all the other cases ended up to the conclusion of recovering the aid back including the interest calculated from the beginning on which the unlawful aid was granted for the beneficiary until to the date of its recovery.[303] The amount should correspond with the effect that would have been equal to the original arm's length level plus an interest. This might seem like a paradox consequence of non-compliance with Article 107(1) TFEU and has also resulted to different opinions on whether the amounts that have been deemed unpaid due to the tax ruling, i.e. amount, which should have been paid if the generally applicable rule had been applied, to be recovered and given back to those third party Member States that actually have had an negative impact due to the tax competition and erosion of tax bases instead of recovery by that Member State that actually granted the prohibited state aid. Alternatively, creation of a common budget for such recovered amounts in the EU, although this would call on the Commission to amend and change the current rules in order to make sure that such

[301] See for example, Joined Cases C-78/08 to C-80/08 Paint Graphos and others (2009), paragraph 69.
[302] See Gonzalez 2016, p. 572.
[303]Council Regulation 2015/1589 laying down detailed rules for the application of Article 108 TFEU, Article 16.

sanctions would be put into effect against those that have been violating the state aid regulation.[304] As common budget could face huge backlash due to nature of its tax harmonization and common fiscal budget of the EU, it is therefore very unlikely to happen in the future.

[304] European Parliament, Resolution Tax rulings and other measures similar in nature or effect, paragraph. 134.

5. Assessment of the measures

5.1 Reshaping the framework of taxation and competition law

In the light of above explained case law, arm's length principle and transfer pricing seem to be in the scope of application of state aid regulation for EU institutions to evaluate. What are then the practical consequences and legal questions that arise from this conclusion? Firstly, Commission's evaluation of (i) selectiveness from transfer pricing point of view and (ii) using same or different methods for assessing the arm's length level that apply to all undertakings in the established system of reference similarly makes it possible to challenge the APA in an effective manner. As for the concept of arm's length principle, it is defined by the OECD sources and as such fluently applied by the Member States in their domestic legal framework, there is not any other source as a 'competitor' from which the Commission could draw its conclusion or give a different opinion contrary to OECD Guidelines. On the upside of this smoother outcome, there should be no conflict between understanding the concept of arm's length principle as meant by the Commission and defendants, but, on the downside, there are number of reasons why tax authorities, tax payers and the Commission in this context can make a very different conclusions on the amount of appropriate remuneration level. In Commission's view, before proceeding with the detailed transfer pricing analysis in each case mentioned above, it needed to bring the transfer pricing assessment to the framework of state aid regulation.

This has also enabled the assessment of arm's length principle in comparison to non-integrated undertakings in state aid context, even though, for national taxation, no scenario exists when these rules would be applied to them. At this point, for the integrated companies, the arm's length principle in national law is not the only rule they need to apply with but also with the separate construction of the same principle generated independently in the context of EU law. Much of the force and argumentation behind the approach lies on the shoulders of CJEU judgment in *Belgium and Forum 187 v Commission*.[305] There is ambition to intervene unequal competition through aggressive tax planning in the internal market or, as the Member States and undertaking might see it, push forward harmonization within the Member States in the field

[305] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 169.

of direct taxation, which has further raised questions regarding Member States' competence to apply and define the correct regulation for domestic tax purposes.[306]

Secondly, transfer pricing assessment has created the instrument for the Commission to analyze compatibility of the tax treatment with Article 107(1) TFEU. This line of reasoning can also be valid and sufficient. Is it however putting the domestic transfer pricing regulation and assessment at risk if the application is being challenged and interpreted by too many instances? The approach taken by the Commission is not giving the message that only the tax payer may be deemed liable for conducting aggressive tax planning and trying to minimize its tax burden but that the Member States and their tax authorities have failed to apply the OECD Guidelines based arm's length principle correctly. The approach seems twisted as the recovery of such prohibited aid will eventually create a fiscal income for the Member State due to their preliminary failure to accurately and correctly define the framework of APA with the undertaking. Therefore, the indignation by the Member State seems understandable when the issue is seen as a question of setting the limits for fiscal autonomy.

Thirdly, as defining the domestic tax legislation as the system of reference creates the playing field similarly to all operators therein, the Commission takes the position that mere compatibility with domestic legislation is not sufficient against EU principles. Moreover, due to the lack of actual amount that would be equivalent to arm's length price – as well as the fact that transfer pricing evaluation is not always totally accurate – pointing out the 'artificial and complex methods' being used for indicating the taxable profit requires distinction from the tax payers' choice to individually apply the most suitable method in a particular case. Terms 'artificial' and 'complex' in this context may have been used to refer to cherry-picking of methodology from the company's point of view, but, on the contrary, one can also argue for the use of more detailed analysis with respect to its facts and circumstances. Indeed, it is clear that the OECD Guidelines have also become more and more complex but their diverse and comprehensive application does not mean that exploitation of diverse adjustments would be worse, it in fact may refer to more accurate and up-to-date application.[307] For example, in *Fiat*, the acceptability for performing the adjustments while calculating the amount of remuneration was denied by the General Court.[308] After all, this question of reasoning is directly connected

[306] See for example, T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 131 and T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 156.
[307] See Taferner – Kaipers 2016, p. 140.
[308] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraphs 172 to 175.

to the amount of burden of proof required from the Commission and, as usual, the acceptability of such proof will eventually be judged by the CJEU.

To conclude these three remarks from the case law, the Commission has a lot of interpretation power in the assessment of transfer prices and its newly implemented assessment of arm's length principle may not always be precisely clear.[309] Being said, it is not intended to receive an exact price for intra-group transaction, meaning that the amount of prohibited state aid could be determined by the Commission in case not agreed with the application included in the APA. Even though the Commission claims that the OECD Guidelines is merely a soft-law instrument and not as such binding its actions against Member States, the assessment of arm's length principle in the light of the methodology in OECD Guidelines is of extreme importance in proving the existence of selective advantage. Therefore, as the existence of aid has been drawn from the application of the arm's length principle, the Commission is bringing the arm's length principle as laid down in the OECD Guidelines from soft law towards hard law by making it part of the principle of equal treatment in taxation.

However, if the state aid regulation would be violated purely due to the advantage granted by the application of certain transfer pricing method in the APA, how are the Member States able to notice, considering comments by Vestager that the primary responsibility for ensuring that all tax arrangements comply with EU State aid rules rests fairly with the Member States, when is the limit of certain tax arrangement considered prohibited?[310] It is worth questioning to what extent may the Member States be held liable for not pointing out the applicability of APAs with the Article 107(1) TFEU. Even so, when considering that the Commission should put its efforts on evaluating the manifest breach of arm's length principle. Especially in the case of tax rulings, the problem, which has been largely discussed especially among case participating Member States, may arise further questions to the difficult dilemma of lawful complying eventually leading to a breach of EU law. Had the company followed the rules or guidelines of the national tax authorities, it may in any case be responsible for taking part in breach of EU state aid regulation. This cannot be seen totally valid from legal certainty point of view. Therefore, the more important factor for the acceptance of any aid seem to be the end result for benefit of the internal markets instead of question of legal certainty.[311] In the legal literature, as a logical response to the Commission, it has been presented to accept the used transfer pricing framework

[309] See Kyriazis 2016, p. 437.
[310] See European Commission: Working together for fairer taxation, https://ec.europa.eu/commission/commissioners/20142019/vestager/announcements/working-together-fairer-taxation_en.
[311] See 173/73 Italy v. Commission (1974), paragraph 13; and C-78/76 Steinike & Winlig (1977), paragraph 21.

and methodology between Member State and undertaking in the APA and, when it comes to evaluating the compatibility with the arm's length level and merely to concentrate on clear and manifest errors of application.[312] This may nevertheless be seen already to be in line with the current approach with the Commission as shown in related case law. These aspects however need to be understood before analyzing the amount of burden of proof and intensity of review relating to the case.

5.1.1 Consistency with the transfer pricing regulation

In the light of the evaluation, what makes Commissions reasoning nonetheless impressive is that it has based its transfer pricing assessment on the importance of the functions and value-creation of the companies within the same group, approach that is similar to the development of BEPS Action Plans 8-10.[313] The main idea is that the profit should be attributed and taxed with the company *de facto* performing the functions, bearing the risks and owning the assets and, thus, creating the value. Also, in most of the cases the Commission has challenged the company that should be considered as the least complex for tested party. In *Starbucks*, the Commission contested that Alki, the principal company that was holding the IP, seemed to be limited from its risk-bearing abilities as it, for example, did not have any employees in its operations as the royalty payment represented also entrepreneurial risk of the Alki LP in addition to the use of IP. Thus, this resulted to overvaluation of royalty payments and non-compliance with the arm's length principle.[314] Similar circumstances were also in Apple and Amazon as explained in the section 4.2.5.1 and 4.2.5.2.

This means that the undertaking should not be remunerated for bearing of risk merely through existence of an agreement due to the possibility of, in Commission's view, related companies eventually reallocating risks and prevent any application of the arm's length principle.[315] However, the tax payer argued that since SMBV carried out routine and low-risk activities, administrative and logistical support and, on the other hand, Alki needs to be the more complex entity due to exploitation of the roasting IP – and therefore also risks bearing with regard to SMBV's functions as agreed in their roasting agreement. [316] General Court however dismissed the Commission's approach on the hypothetical artificial reallocation of risk to this extent as it

[312] See Eden – Byrnes 2016, p. 22.
[313] BEPS Actions 8-10 address transfer pricing guidance to ensure that transfer pricing outcomes are better aligned with value creation of the MNE group.
[314] Commission final decision 2017/502 on State aid implemented by the Netherlands to Starbucks, paragraph 319 to 325.
[315] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 45.
[316] Ibid. paragraph 414.

fails to show that more reliable information was available to support its conclusion. Nevertheless, this argumentation is not completely stranger as, in accordance with the BEPS development, since in principle the companies carrying out development, enhancement, management and exploitation ('DEMPE') functions related to IP should be attributed with the share of the royalty payment for remuneration.[317] This argument is strongly brought up in *Amazon*, that it was indeed LuxOpCo that was performing these functions and therefore not suitable for tested party as less complex, which would have actually been LuxSCS. The reasoning may as well succeed in front of CJEU. Indeed, the arguments in *Starbucks* were that the Commission did not indicate whether such less complex would be, e.g., the Dutch SMBV or some other company that would undertake such functions and it would not have any relevance if the receiving entity was some other company as it does not have an effect on the deductibility of the royalty payment in the taxation.[318]

This development in transfer pricing relates to OECD's objective to minimize the incentive of companies to shift profits to so called *cash boxes*, a term which refers to a company existing only on paper with few or no employees and limited economic activity trying to make an advantage of low tax jurisdictions.[319] The rationale behind this is that if such cash boxes plainly provide e.g. funding for the use of another group company but performs only limited activities. and not *de facto* controlling the actual financing risks with respect to its funding, it should therefore be entitled to no more than a risk-free return – or even less.[320] In fact, it has been said that the problem in this issue is not the power to steer intra-group transaction flows through transfer pricing but these so-called hybrid entities, i.e. entities that are not *de facto* located in any jurisdiction and may utilize the different tax systems within the internal market for minimizing their tax burden.[321] This is even more self-evident in the decision in *Apple*, where the Commission argues through OECD Approach for profit allocation to a permanent establishment:[322]

> ”As a first step of the profit allocation process, recourse should be to the physical presence of employees or people performing functions on behalf of the enterprise in the head office and in the permanent establishment as an objective means to allocate assets used, functions performed and risks assumed between a head office and its permanent establishment. This is justified by the fact that there is little ambiguity

[317] See Taferner – Kuipers 2016, p. 141.
[318] Ibid.
[319] OECD, BEPS Actions 8-10, http://www.oecd.org/tax/beps/beps-actions/action8-10/.
[320] Ibid.
[321] Lang – Cottani – Petruzzi – Storck 2019, p. 539.
[322] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraphs 322 to 324; OECD 2008; and OECD 1994.

> about the physical presence of employees or people performing functions on behalf of the enterprise. --- Moreover, the 2010 OECD Profit Attribution Report, in its considerations specific to intangibles, specifies that, regarding the economic ownership of intangibles, it is the active decision taken below senior management level that is determinant for the allocation of the ownership"

The Commission argues that (a) the assets, functions and risks of ASI and AOE, i.e. the related IP licenses for DEMPE located outside of the Americas, needs to be attributed to the Irish branches, as those companies have no employees or people performing functions on behalf of the companies outside of the branches and (b) head offices of the undertakings do not have employees below senior management level.[323] The mere conclusion is that the profit cannot in this scenario be allocated outside of Ireland as this would be contrary to real market conditions. This way, derogation from new developments of international taxation related to transfer pricing and this non-conformity triggers also the concept of selectivity. As concepts and trends within international taxation are still developing all the time at the EU and OECD level as well as in BEPS related discussions, it needs to be remember that even the some fundamental principles in taxation, e.g. the arm's length principle, will constantly develop in order to better align the tax challenges of the future, e.g. arising from the new ways of creating value through, e.g. digitalization and platform economy. Therefore, it is natural that the Commission takes this dimension into account when monitoring compliance of certain measures with Article 107 TFEU.

5.1.2 New role of transfer pricing in selectivity assessment

The foundation for Commission's assessment and eventual burden of proof is based on the fact that it holds the competence for the competition issues. For the sake of clarity, aids that are considered compatible with the internal market are here to stay and no market is purely operating through market forces without any interference by the national authorities. Sometimes aid may even promote legitimate objectives in line with the principle of proportionality.[324] However, the objective of the state aid provisions has always been to prevent detrimental competition of granting aid between Member States which in the end would results to harmful distortions in the internal market.[325] This allows also the transfer pricing related assessment as the Member States have eventually lost their complete sovereignty to decide purely on national basis from the nature of their aid to be granted. Without such established supervisory framework, huge number of tax reliefs could in general result to distorting

[323] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 323 and 324.
[324] Poscic 2017, p. 490.
[325] Sauter 2016, p. 207.

competition and eventually to the detriment of the balance between other undertakings within the same jurisdiction.[326] State aid regulation aims to control the shape and availability of those national tools, which may usually have a strong and politically oriented economic reason behind them.[327] Therefore, in the end, the question about amount of tax paid or unpaid by the company can be seen irrelevant in the core of the issue but, instead, whether treatment may be justified as legitimate practice in the light of equal treatment of all undertakings is more relevant.

At the end of the day, it is indeed up to the Commission to control the new, existing and altered aid in accordance with the Article 108 TFEU. The system is based on *ex ante* -control, where Member States are liable to inform the Commission, which instead holds the power to investigate on its own initiative.[328] This leaves room for discretion as the compatibility with the internal market lies in the exclusive competence of the Commission with the purpose in particular to enforce.[329] Since CJEU has confirmed the principle of equal treatment in taxation, it would implicate that neither tax rulings can be excluded from the scope in this regard. Also, this argument can be brought to the same conversation with tax competition between countries and therefore being in line with the original aim. Ultimately, the assessment of compatibility of the state measure with the internal market is dependable on whether it is not violating the with fundamental principles and objectives of the EU, on which the evaluation is made by the Commission in accordance with the Article 108 TFEU.[330] The General Court has confirmed that it is possible to argue against the application of transfer pricing in tax rulings on a coherent manner without fundamental changes in actual EU regulation and the Commission would most likely use it to the fullest of effect. As there are various instruments for intervening harmful conduct, the rules, related case law and their interpretation themselves are constantly molding and changing its nature to different directions.[331] This is also a natural course of development of law as one measure, or certain application of rules, can be effectively utilized for some years until the other more effective measures in the light of fundamental objectives are being discovered.[332]

As we are getting closer to Commission's 2020 vision drafted in 2010 after financial crisis to generate 'smart, sustainable and inclusive growth, to find the path to create new jobs and to

[326] Hancher – Sauter 2012, p. 262.
[327] See De Cecco 2012, p. 1; and Perez-Bernabeu 2017, p. 596.
[328] Poscic 2017, p. 494.
[329] Council Regulation 2015/1589 laying down detailed rules for the application of Article 108 TFEU.
[330] See also Terra – Wartel 2008, p. 43.
[331] Sauter 2016, p. 222.
[332] Ibid.

offer a sense of direction to the societies', competition law and state aid policy was seen as also contributing effectively and positively to the these objectives.[333] It is reasonable to believe that promoting fiscal measures by intervening action that do not contribute to that objective *via* competition law would be step towards more innovative and effective internal market. Considering this objective, state aid regulation is a well-suited instrument in its attempt also to tackle aggressive tax planning of multinational companies in case the course of its actions would eventually be also accepted by the CJEU. Consequently, if there are no unanswered questions relating to competence at hand and the analysis can thus be proceeded with, it leaves us with two questions: (i) what should be shown and (ii) how and to what extent should it be evaluated by the court in order for a tax measure to violate the Article 107(1) TFEU?

5.2 Burden of proof in the light of Court's review

As we understand how the Commission has gone this far in its analysis, we need to take a closer look to two concepts: The Commission need to show that the APA violates the Article 107(1) TFEU (burden of proof) and the Court needs to carry out a comprehensive review as to whether a measure falls within the scope of the treaty although the intensity of it may be speculated (intensity of review). The case as such usually includes two point of views with respect to the facts and circumstances – one by the Commission and by the Member State. In *Olympiaki Aeroporia Ypiresies,* it was held that the Commission is liable to, in principle, provide sufficient proof in its decision with respect to the existence of the aid.[334] As sufficient is more or less vague term, this is anyhow logical conclusion as the Commission represent usually the challenging party. The Commission needs to perform 'a diligent and impartial examination of the measures at issue' in order to receive the most complete and reliable information possible in the case of incompatibility or unlawfulness of the aid.[335] This is still somewhat general description on the amount of burden of proof to be conducted but, in practice, it is for the Commission to show that the conditions of Article 107 TFEU are sufficiently fulfilled. With respect to transfer pricing, the Commission must find the weak spots of the APA open to contesting with respect to transaction flows. This requires also fundamental expertise not only in competition law but also in transfer pricing and tax law.

[333] See Commission, Europe 2020: A strategy for smart, sustainable and inclusive growth, COM/2010/2020.
[334] T-68/03 Olympiaki Aeroporia Ypiresies v Commission (2007), paragraph 34; and T-305/13 SACE and Sace BT v Commission (2015), paragraph 95.
[335] C-290/07 P Commission v Scott (2010), paragraph 90; and C-559/12 P France v Commission (2014), paragraph 63.

In *Fiat* and *Starbucks*, the General Court held that even though the main rule for the Member State is that it has a margin of appreciation when approving the level of transfer pricing, that margin of appreciation must not nevertheless lead to the deprivation of Commission's competence to test the accepted level of transfer pricing in case it would lead to the grant of a selective advantage pursuant to Article 107(1) TFEU.[336] Within the context of this competence, arm's length principle and transfer pricing methodology are the key instruments for the Commission as it allows to verify (a) whether the level of transfer pricing accepted by national authorities in the APA may be deemed to correspond to a reliable approximation of a market-based outcome and (b) whether any variation that may be identified in the course of that examination does not go beyond the inaccuracies inherent in the methodology used to obtain that approximation.[337]

Despite these tools exist, the verification of being more accurate leaves a relative heavy burden of proof for the contesting analysis. Considering the nature of transfer pricing regarding 'acceptability' of intra-group transactions, it is not uncommon in general that there may be a lot of discretion included in the evaluation as different instances or experts may have a different view even in the event of very similar circumstances of a certain undertaking. The reason behind the different conclusions could be e.g. due to application of different version of the OECD Guidelines, choice of a different method, several applied adjustments as well as completely different view on the facts and circumstances of the case at hand. As mentioned, not all of the transactions being compared and examined have equal degree of comparability. This means that there will be scenarios where applying even the most appropriate method would lead to range of different set of results that may be as equally reliable with each other.[338] As the outcome may be different, assessment requires careful comparison between the data and values received. Typically, due to the existence and effect of multiple factors in the business activity of an undertaking, the received values represented in the arm's length range are regarding possibly different market conditions as only one parameter corresponding with the exact arm's length price would not be sufficient for this purpose.

As a concrete example from the interpretation whether it is argued that the application of arm's length level would be too low or high within the determined range – considering that even the range can be different due to the search criteria of the comparable companies – the mere fact

[336] See T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019) paragraph 204; and T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 196.
[337] Ibid.
[338] See OECD Guidelines 3.55-3.56.

that a range includes different values indicates that different undertakings may or may not even be able to earn the desired amount of profits that is being compared. It flows from this example, that pricing either on the lower or higher end of the arm's length range could not as such violate the arm's length principle due to potential different factors behind the price setting.[339] One needs to consider that set of possibly acceptable results may be obtained that could be easily led from the available financial information. The assessment of the suitable level is more of an analysis of complex contractual and economic situations for which OECD Guidelines offer an international framework for the assessment.[340] Hence, conducting an thorough analysis of the application of transfer pricing related measures that can prove the existence that (a) APA contains a violation of arm's length principle and (b) the transfer pricing assessment conducted by the Commission is more likely to correspond with normal market conditions is very difficult in case the tax ruling as such does not clearly contain the type of questionable application that could be easily challenged.[341] The contesting analysis has thus indirectly questioned the motive and offered its alternative conclusion to the acceptable level of taxation. As it can be concluded from the decisions made by the Commission, strong position towards defending the functioning of the internal market and equal tax treatment of undertakings operating therein has been reason for this.

The Court will eventually be in charge of evaluating this analysis made by the Commission. The Article 263 TFEU grants the Court with the power to review the legality of the acts adopted by the EU. But considering that the case involves a lot of technical aspects from transfer pricing view, the review process as such is not an easy task. According to the Court, in this case, 'the analysis of the pleas in law raised in such an action has neither the object nor the effect of replacing a full investigation of the case in the context of an administrative procedure'.[342] This means that the CJEU will not do the analysis of its own to resolve the case but will trust some of the facts and circumstances to the analysis of the Commission and the APA. This raises a question for the objectivity of review. However, the Court confirms that the state aid as a legal concept must be interpreted on the basis of objective factors. The Court nevertheless needs to go through the specific features of the case with respect to the technical or complex nature of the Commission's assessments and then carry out a comprehensive review as to whether a

[339] Taferner – Kuipers 2016, p. 140.
[340] Ibid.
[341] Giraud – Petit 2017, p. 237.
[342] See Joined cases T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 197; and C-399/08 P Commission v Deutsche Post (2010), paragraph 84.

measure falls within the scope of Article 107(1).[343] Nevertheless, the Court needs to only accept those limits that have already been discussed in the case and is unable to take a stand on any new grounds that have not been brought up by the interest parties. It is only giving the judgment to those pleas that have been listed so far.[344] Professor Jose Luis da Cruz Vilaca however reminds that the difference between the concepts of margin of appreciation and duty to review may be to some extent blurry and that results to more difficult for the CJEU to remain consistent in its case law.[345] If the Court cannot objectively fully support the conclusion of the Commission, it would in this case dismiss such analysis and keep the content of APA compatible with the Article 107(1) TFEU.

How intense should this then be? In *Amazon* and *Fiat*, the General court held that due to the approximate nature of transfer pricing, review is performed by verifying whether the advantage and errors identified by the Commission go beyond the inaccuracies inherent in the application of a method designed to obtain a reliable approximation of a market-based outcome.[346] Since we are discussing relatively complex cases, it would be no wonder if the CJEU would be sitting in Grand Chamber.[347] Also, as the intensity of review seem to be different depending on nature of the act, the Court need to be careful in order to maintain equal treatment and for both Commission and the Member State.[348] For example, problems with the concept of equal tax treatment, especially when the determination of transfer prices are being associated with it, are nevertheless more or less 'roughly right' and open to interpretation. On the other hand, the same margin of discretion regarding APA by the national tax authorities for granting the aid needs to be considered as decisive element.[349] Such power may be a sign of selectivity as this presumption based on discretionary practices should be viewed as being crucial when discussing cases that relate to on ruling methods, transactions or other practices, which hold margin of discretion. Fundamental breach of arm's length principle can be seen as an only conclusion that could lead to violation of state aid regulation.

[343] See Joined cases T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 198; C-533/12 P and C-536/12 P SNCM and France v Corsica Ferries France (2014), paragraph 15; and C-486/15 P, Commission v France and Orange (2016), paragraph 87.
[344] da Cruz Vilaca 2018, p. 187.
[345] Ibid. p. 187.
[346] See Joined cases T-760/15 and T-636/16 the Netherlands v European Commission (2019) paragraph 199; and T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019) paragraph 207.
[347] Grand Chamber is a plenary sitting of fifteen judges and nowadays to some extent rare as the CJEU may also sit in the formation of three or five judges.
[348] Türk 2009, p. 134
[349] Micheau 2011, p. 202.

For instance, CJEU has taken the view that departing from its normal guidelines by having discretion to adjust by the Member State, may put undertakings to unfair positions and thus regarded as a selective.[350] To conclude, the burden of proof set for the Commission remains still ambiguous due to these aspects as eventually the General Court and CJEU need to accept the more reliable analysis. It is clear that the APA cannot be set aside without very heavy proof of poor application of OECD Guidelines. There are several fundamental aspects that affect the determination of the suitable level for the burden of proof and how it should be reviewed afterwards. The purpose of the arm's length principle and the OECD Guidelines in general is to put the integrated companies to the similar position as non-integrated ones. Generally, it can be viewed that, also from the taxation point of view, in case the transactions between unrelated parties should be seen as a benchmark, the transfer pricing analysis includes *ipso facto* built-in mechanism for assessment of selectivity. The transfer prices are being benchmarked against the analysis and level that should correspond the market conditions, i.e. 'normal system of reference'. The different treatment, however, does not arise from the domestic tax regulation as such – instead, it flows mostly from the actual *business model* of the undertaking. What is meant by business model is the overall transaction flows between different geographical locations within the same group. There is no *de jury* unequal treatment that can be found from the national legislation between undertakings belonging to a group and those that do not. In the assessment, the fundamental problem lies in how those preliminary designed transaction flows – that nevertheless need to comply with the arm's length level – end up allocating the profit and expenses that have an impact on the level of tax burden.

For a group of companies, it is neither prohibited to decide on how its business model will be put into effect. There is however no doubt that the functioning of the business model as such does consider the legislative and procedural changes in the business environment. In state aid context, in case arm's length principle has been used to determine the taxable profit of a group company for corporate income tax purposes on the basis of a methodology that approximated market conditions, that company is not regarded to be treated favorably to non-integrated companies whose taxable profit is also determined by the market conditions.[351] As made clear, APA is merely an instrument that seeks to bring stability to the tax environment of the undertaking by preliminary negotiating the treatment of certain transactions in corporate income taxation. In theory, the undertaking may alternatively price its intra-group transaction

---

[350] C-241/94 French Republic v European Commission (1996), paragraphs 22 to 24.

[351] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 140 and, T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 132.

flows at certain level even without the APA and from arm's length point of view back it up by preparing a sufficient transfer pricing documentation for potential tax audits. Therefore, in the absence of APA – but taking the other facts and circumstances for the undertaking's business or tax operating model as permanent and existent – would these tax arrangements have been caught by the state aid regulation? Not necessarily since the state measure would be more difficult to define even though the situation would be *de facto* the same. Considering that the national tax authorities would have accepted the similar tax treatment also through APA, against this fact pattern there would necessarily be no intervention afterwards either.[352]

The purpose of the example above is to demonstrate the difficulty of indication of material selectivity if it through certain level of transfer prices ends up allegedly treating different undertakings by different means.[353] As the transfer pricing regulation is irrelevant for the non-integrated undertakings, more emphasize could be given to the preliminary discussions with tax authorities or actual access to the ruling instead of transfer prices as such. This makes the comparison basically impossible as the ruling includes, again, transfer pricing regulation. Due to this incoherence and discrepancy, as whether the non-integrated undertakings have the similar access to tax rulings, the Commission may have intentionally focused more on the criterion of advantage instead of that of selectivity. Therefore, no in-depth analysis as such was needed to make by the Commission on the fact why integrated undertakings should be considered in a comparable factual and legal situation to non-integrated undertakings but only put reasonable effort on arguing that APA was incompatible with the arm's length principle providing advantage to its holder.[354]

The Court has a difficult task of balancing between the two – possibly also very well-reasoned – alternatives for correct application of transfer prices. However, the Court needs to also take the Member States position and its margin of appreciation into account as this relates heavily on legal certainty for the undertaking's point of view. Therefore, the only conclusion that can be drawn from this is that the actual task for the Court is to consider whether there is so substantial and fundamental deviation from the market conditions that it cannot at any level be seen to be compatible with the correct application of OECD Guidelines. This means also that

[352] In principle, tax returns as such could on the other hand be challenged as well by the Commission but the transfer pricing treatment would be more difficult to indicate.
[353] Commission Notice 2016, paragraph 121.
[354] See Panci 2018, p. 364.

the burden of proof needs to be set high for the Commission and the Court needs to have a certain level of understanding of transfer pricing.

5.3 Importance of legal certainty

As said, even though there would be a high burden of proof set for the Commission, the actions were not foreseeable and take a retrospective effect and they can be seen incompatible with the principle of legal certainty. In *Falck y A. di Bolzano*, the CJEU stated that the principle of legal certainty prevents the Commission from indefinitely delaying the exercise of its powers.[355] The Commission as well as the Courts need to base their analysis merely on information that was not available or reasonably foreseeable when the APA was concluded.[356]

From companies' perspective, the lack of clarity when it comes to application of APAs in state aid context can be deemed to be not only harmful as the certain level of predictability in taxation is generally very crucial for undertakings as they need to be aware of whether they should be a party to tax ruling without getting in trouble in the future.[357] This approach endanger the use of APAs as an instrument of preliminary agreement in case it could nevertheless be challenged based not on any irrelevant information arising outside of the application of arm's length principle but on the actual facts included and agreed by the tax payer and tax authorities in the APA. However, from EU state aid point of view, the Commission defends its actions based on that the measure has been granted without notification, and therefore a delay by the Commission in ordering recovery does not suffice to render that recovery decision as unlawful under the legal certainty principle.[358] There have in any case been legal grounds for the investigations.

On the other hand, the American Chamber of Commerce raised concern that the move towards an arm's length principle based on Article 107(1) TFEU with undetermined scope is not providing sufficient guidance for the companies whether they are able or should comply with it considering that it is systematically independent from the transfer pricing principles under the OECD Guidelines and with national tax legislations of the Member States.[359] Considering the importance of transfer pricing for a MNE as well as the OECD Guidelines' application, unclear guidance within the application of transfer prices for sure creates irrelevant uncertainty on how the setting of acceptable standard. Indeed, there is clearly a need for further clarification

[355] C-74/00 Falck y A. di Bolzano v. Commission (2002), paragraph 140.
[356] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 251.
[357] Kyriazis 2016, p. 437.
[358] C-408/04 Commission v Salzgitter (2008), paragraphs 100 to 107.
[359] American Chamber of Commerce to the European Union, 'Letter to Commissioner Vestager on the European Commission's state aid investigations 2016.

for tax rulings and their correct application. EU – the Commission in this case – should take more initiatives towards communication between different interest parties and Member States with regard to APAs, transfer pricing and their applicability and compatibility with the competition regulation.

Also, one important question that is raised in the legal literature is the ultimate result of the current approach. *Dimitrios Kyriazis* argues that not only having an effect on undertakings possible tax burden with respect to retroactive aspect, the legal uncertainty may in worst case mean that Commission's department of competition may face problems with its efficiency if the approach and application of arm's length principle therein will not be clarified.[360] There is a risk of being overwhelmed with notifications from different Member States with regard to correct application of tax rulings, something that the Commission may struggle with to assess in coherent manner.[361] Also, according to some critics, as the *Commission's notion of aid* as well as *Working Paper on Tax Rulings* have not been drafted to be precisely clear in this sense with regard to correct application of arm's length principle in the context of the EU state aid law, it would be very much useful for the Commission to provide the Member States and tax payers with guidance on the framework of such application that are most likely to be caught by the Article 107(1) TFEU.[362] These concerns are all very true.

Could this type of argumentation be turned also upside down? In other words, the approach taken by the Commission is providing more legal certainty by taking clear steps by implementing the arm's length principle as a primary source to assess the acceptability of certain tax measure within the Member State. Should this approach be eventually accepted by the CJEU, it is clear after that the arm's length principle *per se* would be part of the very core of assessment with tax rulings and would then affect the Member State measures as well. After all, if the issue was to be considered in the light of legal certainty, who would need to be blamed for? The actions have taken place due to measures by the Member States and, therefore, had the Member States regarded the state aid context already while applying transfer pricing methods and drafting the APA, this would probably encourage to more comprehensive and detailed tax rulings with the tax payer. This is however very theory-orientated. It does neither remove the fact that the Commission could in principle still consider the existence of violation. Therefore, it is clear that more guidance and dialogue between the Commission, Member States

[360] See Kyriazis 2016, p. 437.
[361] Ibid.
[362] Ibid.

and tax payers is welcome. It would make the assessment procedure more clear in case the evaluation of transfer prices, considering that the arm's length principle is a part of the EU principles, would be purely based on OECD Guidelines without any mention that the Commission is not formally bound by OECD Guidelines.[363] This may not only be regarded as 'cherry-picking' from the Commission point of view but also heavily increases the amount of less needed uncertainty. However, EU based arm's length principle would still be a separate principle from the equivalent in domestic legislation.

If legal certainty is under threat, is it because the Member State presumed that APAs could not be caught under Article 107(1) TFEU as direct taxation is out of scope of application for the Commission? In *Fiat*, Luxembourg claimed that that the Commission had gone beyond its competence and thus infringed both Articles 4 and 5 TEU, which draw the distinction between the competences of Member States and the EU, that could be characterized as 'tax harmonization in disguise' even though direct taxation is within the sole and exclusive competence of the Member States as stated in Article 114 TFEU.[364] This type of argumentation tries to hint towards an approach that the Commission would try to established itself as some sort of an appeal instance of national tax authorities as it is reviewing whether the tax ruling in question was unordinary in the light of both national law and the OECD regulation. This is also one of the concerns, which is also indirectly raised by the US Treasury in its criticism, that the purpose of the decisions is merely to achieve tax harmonization via the back door as, according to the critics, this is the mere practical consequence of this legal effect of newly adopted EU law principle in taxation matters. [365] However, the competence in taxation is not solely for the Member States.

From the legitimacy side, the problem with the new adoption of arm's length principle as new EU law principle being part of the equal treatment in taxation could be that this also has an effect on the fiscal sovereignty of the Member States, considering that in the case of application of national law, it may need to put aside and replace them with the supremacy of the EU law principle irrespective from the fact that the regulation has not been set by the national parliament but due to the effect of State aid regulation.[366] The issue is however tricky as basically all of the state aid measures in this context are being viewed as part of the EU

---

[363] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 173.
[364] Ibid. paragraph 100.
[365] Kyriazis 2016, p. 436.
[366] Ibid.

competition rules as listed in the treaties, meaning that they directly fall within the scope of exclusive competence of the EU and taxation is no difference in this regard.[367] This makes also the definition of limits in the field of intervening the national competence difficult to define. Therefore, the notion of selectivity requires careful assessment as noted by the AG considering that all the other criteria listed in the Article 107(1) TFEU are almost always easily being fulfilled.[368]

> "Too broad an understanding of the selectivity of national provisions, however, harbors the risk of adversely affecting the division of competences between the Member States and the European Union, laid down in Articles 2 to 6 TFEU, and the division of internal competences between the EP and the Council, laid down in Article 14 TFEU, on the one hand, and the Commission, laid down in Article 17 TFEU, on the other. For, where there is State aid within the meaning of Article 107(1) TFEU, the Commission usually has broad discretion under Article 107(3) TFEU to determine whether and under what circumstances it will or will not endorse the political decisions taken in the Member States, even though it has no powers of its own under the Treaties to legislate in the policy areas concerned."[369]

The Commission does not see this as a breach of sovereignty as the approach, which eventually was confirmed by the General Court as well, is that the arm's length principle in the application of Article 107(1) TFEU would be irrelevant from the fact how the same principle is or is not taken into account in the tax practice of that particular Member State. Considering the related case-law, even though direct taxation is in the Member States' own competence, they need anyway to exercise competence in accordance with EU law.[370] This principle would set the fundamental basis for the Commission to review the direct taxation related measures. The Commission cannot be seen as a tax-appeal instance in this regard but merely monitoring the compliance with Article 107 TFEU in case the tax measure in questions happens to be favoring certain undertakings. According to General Court, it flows from here that even though the Commission does not at this point of the development and harmonization of EU law possess the competence to define the framework of normal taxation without taking into account the national tax rules, however whether an advantage actually exists needs be determined by reference thereto and a tax measure, which affects the tax base that is taken into account by the tax authorities may come within the scope of Article 107(1) TFEU.[371] This indirect way of assessing the tax measure of the Member State could be concluded as that it is not participating

[367] Kyriazis 2016, p. 436; and Article 3 (1) (b) TFEU and C-269/09 Commission v Spain, paragraph 47.
[368] See Opinion of AG Kokott C-66/14 Finanzamt Linz (2015), paragraph 114.
[369] Ibid. paragraph 113.
[370] C-173/73 Italy v Commission (1974), paragraph 28.
[371] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 112 and 113.

in any tax harmonization but rather exercising its competition law related power in the light of Article 107(1) TFEU.

This was already set out in *Belgium and Forum 187 ASBL*, where the tax payer failed to point out that competence in tax matters relies duly in the hands of the Member States. With regard to transfer pricing, also in *Starbucks*, the Commission recalled that it is merely evaluating if the tax authorities conferred any selective advantage by concluding an APA that makes allocation of profit possible, which is different from that amount of profit that would have been normally taxed for other undertakings at arm's length.[372] This type of approach definitely grants the Commission with a lot of decision-making power when it comes to evaluation of the correct application. It could be construed that the Commission indirectly tries to describe how the amount of taxable profit should be considered by the domestic tax authorities for avoiding any conflicts with EU state aid regulations. Thus, a separate arm's length principle within the Article 107(1) TFEU independent from national legislation may be seen as an attempt towards harmonization of direct taxation within the internal market.[373]

This results to a situation that the Commission would perform a similar evaluation that tax authorities would in normal circumstances perform resembling more or less tax audit, which in the end result to a transfer pricing adjustment proposal. As this is however not a tax audit, there is still a clear distance between tax harmonization and equal competition. In *Amazon*, Luxembourg argued that the Code of Conduct Group (Business Taxation) and the OECD Forum on Harmful Tax Practices had made it clear that tax ruling practice in the country is consistent with the OECD Code of Conduct and the OECD Guidelines.[374] However, the Commission reminds that the objective of those are different from state aid regulation that aim to address distortions of competition resulting from favorable treatment by Member States instead of tackling harmful tax competition. [375] Distinction between the actual objectives and, therefore, competences must be drawn and they need to be made clear for all the parties involved.

5.4 Aftermath and further developments

Finally, the above has explained that (i) the Commission need to provide sufficient proof trumping the original application in the APA and (ii) the Court needs to accept this only if there is a substantial difference to market conditions. The review must be conducted in favor of the

[372] T-760/15 and T-636/16 the Netherlands v European Commission (2019), paragraph 265.
[373] Lang – Cottani – Petruzzi – Storck 2019, p. 540.
[374] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraph 630.
[375] Ibid. paragraph 631.

Member State if it is not a fundamental breach of arm's length principle. However, after *Starbucks* judgment was given by the General Court, Government of the Netherlands, the party to the judgment, published a statement regarding the much-pursued clarity with respect to the case.

Even though the General Court ruled in favor of the Dutch government and the government was of the opinion that potentially prohibited state aid and tax avoidance can be intervened by the Commission by examining the tax treatment of individual undertakings as part of the investigations, it still argued that the Commission had based its ruling under non-existent arm's length principle in EU law and argued that the evaluation should be done purely based on the national law and therefore on the OECD guidelines.[376] There might have also been a lot of public pressure and external influences for the Commission to try to tighten the coherent tax system in the European but the Commission approach has also faced a lot of criticism.[377] The criticism from the Netherlands is a good example of the dilemma as the current approach taken by the Commission will in any case create two separate concepts of arm's length principle.

In general, most of the critic relates wrongly taken interventions on potential distortions of competition due to the completely legally adopted direct taxation policies within Member States. Instead of tax harmonization to combat tax planning – which may be seen practically impossible objective due to its politically loaded nature – it would be easier to achieve these objectives through competition law. Thus, through the established case law, the Commission has taken the stand to use State aid regulation in order to achieve its legitimate policy objectives, *inter alia* to tackle harmful tax competition in the internal market.[378] As many of the US based companies have been targeted by this new approach developed by the Commission, the USS Treasury has been quite active and rather direct in its feedback in exchanges of letters between DG competition of the Commission and its white paper concerning the recent State aid actions.[379] Considering the international nature of transfer pricing assessment, the transatlantic opinion and criticism can be also taken into account when evaluating the actions of the Commission.

---

[376] Government of the Netherlands: Response by State Secretary Snel to the ruling of the General Court of the European Union on Starbucks, 24 September 2019.
[377] See Communication from the Commission to the European Parliament, the European Council and the Council, 15.1.2019, Towards a more efficient and democratic decision making in EU tax policy, paragraph 2.1.
[378] See Panci 2018, p. 367.
[379] US Department of the Treasury, White paper, The European Commission's recent state aid investigations of Transfer Pricing rulings 24 Aug 2016.

The US Treasury criticized the Commission for the approach as it in its view, among other excuses, differs from the prior EU case law and Commission's decisions when it comes to evaluation of the concepts of "advantage" and "selectivity" separately from each other.[380] In the recent decision-making. selective advantage has been the way to assess instead of independently assessing whether an advantage and the selective nature of the aid exist in comparison to prior case law.[381] Although, the Commission has clearly stated that is not bound by its previous decisional-practice and, thus, each potential aid measure needs to be evaluated based on its own facts and circumstances under the objective criteria of Article 107(1) TFEU.[382] Therefore, even if hypothetically a contrary decisional practice could be shown to exist, in Commission's view that does not have an effect to the findings of the decision in question. May the critical voices then be deemed as purely non-legal? They are for sure more political debate than legal opinions. For example, former Head of the State Aid Department of the Irish Ministry of Economy Eugene Stuart argued that *Apple* most of all relates to Ireland's political interest to defend its tax sovereignty, investments to their country especially by the US based MNEs and employment policy. against the EU regulation and, at the same time, the US authorities' see the approach to discriminate its MNEs operating their businesses in Europe.[383]

Moreover, in *Apple*, the interested parties being heard and the joint letter signed by several trade associations are, particularly, concerned that the initiatives under EU state aid regulation would undermine legal certainty and do not tackle harmful tax competition practices as well as under OECD or other policy channels.[384] Additionally, assuming that the Commission and the Courts would eventually conclude that APAs would constitute incompatible measures in the internal market, recovery of the aid should nevertheless be excluded based on the principle of legitimate expectations. According to Ireland, the conclusion in this regard is correct as it points out that a reasonable and diligent taxpayer could not have foreseen the Commission's prima facie finding of incompatible State aid at the time of concluding the APA.[385] Fedil, in *Amazon*, adds that that the Commission is taking the view in its decision-making that there would be only a single truth in transfer pricing related assessment, which makes it impossible for companies to obtain preliminary legal certainty.[386]

[380] US Department of the Treasury, White paper, The European Commission's recent state aid investigations of Transfer Pricing rulings 24 Aug 2016. section II.
[381] Ibid.
[382] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraph 597.
[383] Stuart 2017, p. 230.
[384] Commission final decision 2017/1283 on State aid implemented by Ireland to Apple, paragraph 175.
[385] Ibid. paragraph 178.
[386] Commission final decision 2018/859 on State aid implemented by Luxembourg to Amazon, paragraph 330.

It is safe to say that the interested parties have vested interest on the outcome of the taken measures and the criticism cannot be viewed as completely objective. However, Professor *Jérôme Monsenego* raises few arguments that may be open to argumentation later in front of CJEU. First, since the related and unrelated parties were seen in a factual and legal comparable situation, the General Court did not investigate the determination of reference system and this conclusion in-depth but merely accepted the argumentation of the Commission in its decision. [387] Second, as the Commission confirms that the arm's length principle is of approximate nature, meaning that even the notion of range due to its non-exact characteristics should be accepted and the received notion of range cannot just be dismissed under the State aid rules and claim that only a certain value within that range would correspond with the real market conditions as a deviation constituting the illegal State aid. [388] Above all, coming back to legal certainty as well as determination of the reference system as well as its interpretation, the General Court nevertheless leaves it open in its judgment how to determine this type of arm's length level correctly or apply transfer pricing method to obtain reliable approximation of market-based outcome in a compliant way with EU state aid policy.[389]

5.5 Direction of the regulation

A lot of advocates for the Commission actions in the field of state aid practice are favoring even more use of EU state aid law to prevent tax planning in the internal market as well as tax base erosion of the Member States as it can be seen as an effective tool also to prevent harmful tax distortion and double non-taxation.[390] It must be borne in mind that the purpose of state aid control is not related to the external but to the internal uniformity of tax systems, as said, 'pure tax competition' Member States or in other words discrepancies between the different tax systems are excluded from the scope of application.[391] By double non-taxation it is meant that the undertaking and its intra-group transactions is not being allocated to either country related to the transaction. Double non-taxation does not regard to tax system of one state but exists due to that their domestic tax legislations communicate with each other in different ways, e.g. because of double-taxation treaties or provisions of national legislation and exists merely in the absence of sort of harmonization. Double non-taxation for an undertaking may just take place

[387] See Monsenego 2019.
[388] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 207.
[389] See Monsenego 2019.
[390] Gonzalez 2016, p. 573.
[391] Gestel – Micklitz 2014, p. 297.

due to application of domestic tax regulation is correctly conducted by the Member State despite of the fact that aggressive tax planning could be prevented by state aid regulation.[392]

The issue of tax harmonization on the other hand has been on the agenda of BEPS as well as EU. Should double non-taxation of an undertaking take place because of the actions of Member State, for example in APA, these measures are caught by the Article 107(1) TFEU although it requires the existence of unequal treatment of similarly placed undertakings by the Member State. Although the Commission is accused of seeing the state aid law as a backdoor to intervene the direct taxation, regulation is purely assessing the compatibility with the conditions of Article 107(1) TFEU and may be deemed to be too little when it comes to tackling harmful practices with regard to tax planning.[393] After all, there is simply no competence to interfere with the external differences of the Member States that may even lead to non-double taxation of the companies. The European Parliament has stated that such mismatches are not in the scope of state aid regulation and could only be caught if (a) the tax authorities have confirmed that an intra-group transaction in the tax ruling, but it is in violation of the normal interpretation of domestic tax law or (b) special legislation in the Member State creates the mismatch that only applies to certain companies on a selective basis.[394] All in all, since direct corporate taxation lies on the sovereignty of the Member States, the application and comprehensive tax related assessment in the light of Article 107(1) TFEU remains complex and the Commission is obliged to find the correct balance with regard to economic, political and legal point of view.

As explained the difficulties related to the topic, it is no wonder that the amount of other options for the Commission can be deemed low but not nonexistent. Even though providing of guidance and regulative framework related to prevention of aggressive tax planning is one element for the Commission to fight against tax evasion and tax fraud, lack of harmonization for actual taxation eventually still prevents any heavy interventions. Therefore, state aid regulation is ultimately an effective tool in comparison to other measures. However, from all the other possible alternatives, not taking the consolidation of direct taxation and tax bases in the EU into account as these can be regarded fully hypothetical in the current situation, what would be the best way to proceed and needed in order to achieve fair tax competition in the EU? There should

[392] Gonzalez 2016, p. 573.
[393] Ibid.
[394] EU State Aid Law And National Tax Rulings, p. 15.

at least be other measures increasing legal certainty in the internal market, e.g. more transparency for corporate taxation regulation and information being exchanged.[395]

In the end, the harmonization efforts by interpreting state aid regulation and having a broad concept for construing selectiveness and advantage may still face problems during the assessment of the CJEU. This relates to amount of advantage granted by an individual tax ruling by the Member State or other ambiguously analyzed points related to transfer pricing within the cases that may take a lot of time to resolve. This however may just generate more unnecessary uncertainty among undertakings if the related Member States and undertakings need to wait for the judgment. The current position applied with respect to recovery of tax after prohibited aid could be critically reviewed too.[396] It has been suggested that the Commission could improve its state aid policy to operate more effectively in case, by regulatory means, competitors that have suffered loss due to the existence of prohibited aid measure would be able to sue the particular Member State for compensation under judgment in *Francovich*.[397] This would make a lot of sense and would immediately create an economic deterrent for Member State to lose their tax revenue to other Member States. However, this would require certain additions and changes in regulation, where there is no guarantee of acceptance from the Member States.

The Commission has in long-term concentrated in its actions to increase the effective impact of state aid regulation, i.e. it has been more strict with the criteria regarding when are Member States able to issue aid measures and, additionally, imposed the obligation to thoroughly evaluate the actual effect of any granted subsidies while trying to pursue their public policy objectives.[398] Some have even argued that when considering from the administrative point of view, the cases underlined are largely important for the status of the Commission as the ultimate regulator in the context of EU state aid. This is because the actions taken by the Commission are trying to simplify the related workload and making a clear shift from investigation so called bulk of state aid notifications to bigger cases with more significance and money on the table.[399] Nonetheless, behind every investigation there is a huge workload with many experts involved, which also is probably an attempt to underline the seriousness and effectiveness of state aid

[395] Luja 2015, p. 3.
[396] See Micheau 2011 p. 210.
[397] See Lang, 2014, p. 453 and; joined cases C-6/90 and C-9/90 Francovich (1991).
[398] Verouden 2015, p. 464.
[399] Stuart 2017, p. 230.

regulation. All this in the end speaks for a communication and preliminary discussions between Member States and the Commission as much as possible.

6. Conclusions

6.1 Summary of the main findings

The tax rulings are not prohibited, merely the practical effect as putting different undertakings to unequal position in comparison to similarly determined undertakings and thus they may be critically reviewed in state aid context. The message that is sent by the Commission to the Member States is that state aid aspects should be equally considered while negotiating and applying the arm's length principle in the APAs with tax payers in their jurisdictions. In Commission's opinion, the tax rulings can violate the EU state aid regulation and fulfill the required four conditions to be captured by the Article 107(1) TFEU. However, the Commission still needs to carefully provide sufficient proof and analyze (i) whether there was a fundamental breach of arm's length principle and (ii), in order to show this, conclude a more diligent transfer pricing analysis in comparison to the APA to eventually put a stop on harmful tax arrangements in the internal market. The Commission has chosen to take the path of intervening the tax planning of MNEs within the EU by pursuing the state of equal treatment in the EU, an approach that is criticized and considered by the opponents as a try to harmonize direct taxation through Article 107(1) TFEU regardless of fiscal autonomy of the Member State. The accusations of harmonization can however be argued against. Fundamental breach refers to a situation where the application and use of transfer pricing methodology is substantially incompatible with the OECD Guidelines.

General Court has eventually confirmed the Commission's approach that involves the arm's length principle being part of the Article 107(1) TFEU to assess whether certain tax arrangements or rulings violate the EU state aid regulation. By doing this, it is possible for the Commission to catch practices in the field of cross-border taxation without directly getting involved in breaching the tax competence of Member State, irrelevant from the implementation measures or whether the principle has been followed by the standards of the national tax legislation. The Court shall nonetheless accept no other than substantial and fundamental errors conducted in the APA and review the case as objectively as possible, in other words, not giving too much weight on Commission's analysis over content of APA. Therefore, as long as the Commission is able to reasonably perform a thorough transfer pricing analysis with respect to facts and circumstances of the case and indicate fundamental differences in the level transfer prices in comparison to the APA and normal rules of taxation in that particular Member State, the interference may be justified for maintaining equal treatment of undertakings in taxation. It will thus violate the EU state aid rules by providing the APA holder with selective advantage.

Insofar as the General Court judgments can be concerned, arm's length principle as pointed by the Commission is a tool to assess in case the preliminary agreed level of taxable profit of an undertaking. The Commission may trust its assessment on identifying the existence of an advantage in the case of outcome that can be deemed more than only being inaccurate and that normally are generating in the transfer pricing methodology used to obtain a reliable approximation.[400] This means that the burden of proof is high considering that there number of normal outcomes in transfer pricing methodology as pointed out in this research.

Even though the arm's length principle could be inherent as a part of Article 107(1) TFEU, the fundamental basis can ultimately be traced back to OECD Guidelines. However, the status of arm's length principle forming a part of Commission's assessment as such has an undefined meaning as no clear guidance is given as despite of the reasoning being based heavily on OECD Guidelines, the arm's length principle was still deemed to be independent principle in the EU. Also, even if the direct taxation falls within the competence of the Member States, they must exercise their competence consistently with EU law.[401] This interpretation makes the arm's length principle basically equivalent to hard law instead of being mere OECD soft law instrument. Therefore, with respect to existing law, arm's length principle can be characterized as an independent principle under EU law as the tool eventually creating the extent of derogation from the normal market conditions.

Even the established system of reference can be argued to be too broad pointing out the legislative differences between related and non-related group of companies. This research has pointed the huge impact it has on the actual reasoning throughout the case. Also in this case, the Commission is always under obligation to provide proof on existence of the aid and, in this regard, must conduct a diligent and impartial examination of the measures in accordance with the most complete and reliable information possible available. This requirement on the complete information always speaks out for the use of OECD Guidelines as it is – in the words of General Court – based on important work carried out by groups of renowned experts.[402] Even if Member State has had margin of appreciation when approving transfer pricing methodology in the APA, it is possible for the Commission to verify that the transfer pricing in question does not lead to the grant of a selective advantage. However, the verification process is not as easy as it sounds since the transfer pricing assessment does not lead to an exact result, merely to an

[400] T-755/15 and T-759/15 Luxembourg and Fiat Chrysler Finance Europe v European Commission (2019), paragraph 144.
[401] Ibid. paragraph 134.
[402] Ibid. paragraph 147.

approximation. Hence, the burden of proof and the determination of the limit for thorough analysis for the Commission is of importance question. It must be concluded that it is the analysis by the Commission trumping the APA if the Court reviews it as a fundamental breach of arm's length principle. No minor differences in application of transfer pricing methods however should constitute a violation of Article 107(1) TFEU. Again, for all parties, most likely that the argumentation based on the most relevant international taxation and transfer pricing sources, especially OECD Guidelines, will guarantee the best success in the case.

The eventual consequence of such outcome is that this may have an effect on the mixing of facts and circumstances as understood by the Member States and undertakings in comparison to that of the Commission. As always in transfer pricing related argumentation, recharacterization of one's business model can face many difficulties on the way. Hopefully, the research has managed to underline the difficulty of the analysis as being always based on comparison of two different views on the same fact pattern by applying the same source of law with the different application – to top it all with the fact that political, ideological or economic reasons affect on the background of the process. Thus, as no clear guidance is yet available, the definition of an acceptable tax arrangement with respect to state aid policy remains difficult to define. This, on the other hand, may cause harm to the usefulness and predictableness of tax rulings, and therefore the first judgment by the CJEU is looked forward to great extent. Therefore, the Court must take only relevant technical aspects into account and set the burden of proof high for the analysis of the Commission.

6.2 Concluding remarks

Even though the end results for the Commission in *Starbucks* and *Fiat* were both in favor and against the preliminary decisions of the Commission, the General Court can be seen to be very much supportive regarding the structure of the challenging argumentation related to transfer pricing in Commission's investigations, especially to that extent when the applicability of the arm's length principle has been assessed as if it could constitute a selective advantage to an undertaking belonging to a group. Nether the connection of arm's length principle to Article 107(1) TFEU being dismissed by the CJEU nor the potential outcomes of establishing another system of reference than the entire national tax law that would in principle allow different treatment of integrated and non-integrated companies have not been deeply analyzed in this report. One could make a conclusion that the successful measures so far have impacted the currently ongoing investigations by the Commission with respect to similar tax rulings that have

been granted by the Netherlands to Ikea and Nike as well as by Luxembourg to Huhtamaki.[403] The judgment in *Starbucks* however pointed out that even if this chosen approach was deemed acceptable to intervene, it is not guaranteed for the Commission that the General Court or CJEU would always accept their point of view in case the analysis cannot sufficiently be deemed as diligent and impartial examination. As the CEO of Apple Tim Cook called these measures against Ireland as 'total political crap', it must be noted that this battle, from the tax payers and Member States' perspective, has therefore not completely been lost in ongoing and future cases since, in every case, the proof in Commission's reasoning must overrule the content of APA in order to show potential existence of the state aid.[404] As the capturing of general aid schemes could be in author's opinion more easily to justified as violating the Article 107(1) TFEU for putting different operators to different position *de jure*, individual tax rulings are nonetheless based on the application of transfer pricing methodology, which is very much depending on the margin of discretion allowed for the national authorities and does not necessarily aim to put companies to unequal position even if the outcome may result to *de facto* selective treatment for the company.

The debate on whether this approach is merely an indirect way for which the EU state aid regulations have not been intended and whether the objectives of State aid rules have been breached are most likely to continue between different interest parties so far as the first judgment from CJEU will be received. It can also be said without a doubt that the decisions by the Commission and General Court's judgments have already had an impact on the behavior of MNEs and that the state aid aspects will be considered in the future. More guidance is however definitely required for the Member States as well as for the companies to secure establishment of uniform and reliable framework to operate in. Fairly applicable rules and prevention of aggressive tax planning are important objectives notably in the functioning of the internal market to which the Commission needs to pursue.

In short-term, even though the material meaning and application of arm's length principle in state aid context may be challenged, it is crucial that, in the long-term, the legal certainty and information should be created to avoid discussions of legitimate objectives of EU institutions in creation of equal playing field. After the first final judgment by the CJEU is available, further

[403] State Aid and Taxation update: General Court rules on Fiat and Starbucks appeals - 25 September 2019 Mark Daniel Nayantara Ravichandran, available at https://www.linklaters.com/en/insights/publications/2019/september/state-aid-and-taxation-update-general-court-rules-on-fiat-and-starbucks-appeals.

[404] T-68/03 Olympiaki Aeroporia Ypiresies v Commission, (2017), paragraph 34, and T-305/13, SACE and Sace BT v Commission, (2015), paragraph 95; and the Guardian: "Tim Cook condemns Apple tax ruling", 1 September 2016.

analysis should be conducted, for example, on how the legal questions regarding arm's length principle as a tool in state aid context as discussed in this research have been dealt with. The upcoming years will show, additionally, how state aid regulation and its application will fit into taxation measures in modern information society and to its changes where more and more business activities, value creation and profit-making are purely based on the internet making the allocation of profit becomes more and more difficult. After all, in the current integrated EU, no measure can be analyzed as purely national in nature, meaning the taxation, despite of national sovereignty, is already connected to this development. The Commission and its state aid policy will also need to be able to react and adapt to this new environment to face these challenges in the future.