Comment

Tax rulings and state aid

Speed read

In its recent decisions on tax rulings and state aid, the European Commission has claimed that it is merely applying established principles of state aid law. In fact, not only is its approach new, but it is based on a highly questionable legal analysis. In recent years, the EU courts and the Commission have whittled down the effect of the criteria for the application of article 107(1) of the TFEU. The Commission's decisions conflate the notions of state intervention, economic advantage and selective advantage, such as to come close to rendering any reduction in tax liability a state aid.

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The recent spate of investigations by the European Commission into the supposed selective advantages given to multinational corporations through tax rulings is portrayed by the competition commissioner Margrethe Vestager as a mere continuation of the Commission's policy of tackling unlawful state aid that distorts competition in the European Union and is prohibited by article 107(1) of the Treaty on the Functioning of the European Union (TFEU). Tax rulings are treated as state measures that may grant selective economic advantages to specific companies; and which should be subject to the supervisory mechanisms of state aid control in the same way as any other distortive subsidy.

To some extent this is correct, but the Commission has extended the scope of its powers in a manner that is highly questionable from a legal perspective. Indeed, it is regrettable that the EU courts have over the years allowed the Commission to eviscerate the various criteria that determine the notion of state aid, thereby encouraging it to adopt such a wide interpretation of its powers, particularly in the area of taxation.

Examining article 107(1)

Article 107(1) provides as follows: 'any aid granted by a member state or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between member states, be incompatible with the internal market'.

This has been interpreted by the CJEU as requiring a number of separate and cumulative criteria to be fulfilled:

1. there must be an intervention by the state using state resources;
2. an economic advantage must be granted to one or more undertakings;
3. that economic advantage must be selective in that it favours certain undertakings;
4. the selective economic advantage must (potentially) threaten to distort competition; and
5. there must be an effect on trade between member states.

Yet, while these criteria seem to impose significant limitations on the notion of state aid, their applicability has been whittled down so as to be largely meaningless. State aid law forms a coherent part of the competition law provisions in the TFEU Treaty, which also include provisions that prohibit agreements between undertakings that distort competition and abuses of a dominant position, in so far as they affect trade between member states. Any distortion of competition and effect on trade must be appreciable, so that these prohibitions do not apply unless the undertakings in question hold a minimum market share, in some cases up to 30%.

In state aid law, by contrast, the Commission, following a strict interpretation of the CJEU's judgment in *Philip Morris* (Case C-730/79), has consistently held that (subject to a *de minimis* rule) any aid to an undertaking operating in a liberalised market is capable of distorting competition and affecting trade. The result of this narrow interpretation is that the Commission generally feels little need to analyse markets to assess whether there is any impact on competition or trade, thereby assuming that conditions (4) and (5) are automatically fulfilled, particularly in the case of state aid schemes.

In the case of criteria (1) to (3), the Commission, through its decisional practice and largely supported by the CJEU, has also managed to render the detailed requirements largely meaningless. In particular, it has moved to a position whereby almost any reduction in tax liability is capable of being characterised as state aid. Clearly, the tax system can be used to grant selective economic advantages. Where a specific provision is inserted into the tax code derogating from the general imposition of tax, an economic advantage arises for those persons able to rely on the specific provision in order to reduce their tax liability, which would otherwise arise under the general scheme of the tax.

Thus, an economic advantage is characterised as a derogation from the general scheme by virtue of the adoption of the new measure, as compared to the pre-existing application of the general measure. In determining whether an economic advantage arises for an undertaking, the relevant comparator is the tax liability of that undertaking before and after the adoption of the new provisions. By contrast, following *Adria-Wien* (Case C-143/99), the separate criterion of selectivity arises where only certain undertakings can rely on the new measure, whilst others in a comparable legal and factual situation cannot. The relevant comparator for this criterion is thus the tax treatment of other comparable undertakings.

It should be incumbent on the Commission, therefore, to identify the pre-existing tax liability under the general scheme and then analyse whether:

- there has been an intervention by the state, which must consist in the adoption by the public authorities of a measure that derogates or differentiates from the general measure;
- there is an economic advantage for one or more undertakings arising from that intervention; and
- that economic advantage applies only to certain undertakings and not to others in a comparable situation.

In the past, Commission decisions on fiscal state aid have generally concerned aid schemes introduced into the general tax code. For example, a new provision allowing for a tax deduction for spending on R&D is clearly an economic advantage for those able to claim accordingly and thereby reduce their tax liability. Where such a deduction is available to all undertakings, it is not regarded as selective (even though only those undertakings that carry out R&D may benefit from it). If, however, enhanced tax deductions (such as accelerated depreciation) are allowed only for certain sectors, that economic advantage would be selective.

Recently, the Commission has won approval from the CJEU, in *Commission v MOL* (Case C-15/14P), of its proposition that an ad hoc grant of aid to an individual beneficiary automatically satisfies the selectivity criterion, in that it is presumed to favour the beneficiary without any need to specify any comparable undertakings.

The justification for challenging tax rulings

In order to justify its extension of state aid investigations into the province of tax rulings, the Commission has heavily relied on the judgment in *France v Commission* (Case C-241/94), where the Commission found that the specific treatment afforded to a particular undertaking constituted a departure from the general rules by the public authority in the exercise of its (wide) discretion. In that case, however, there was a liability under the general rules which was reduced by the intervention of the public authority.

The Commission appears to assume that any tax ruling is by its nature an intervention by the state, although the decisions in McDonald's, Starbucks and Apple, in so far as they have been published, do not explicitly say so. In these decisions, the Commission, without analysing the notion of an intervention as being a derogation, merely states that the tax rulings were adopted by the tax authorities and burdened state resources in that they resulted in a reduction of tax.

> The Commission's approach seems to misunderstand the whole purpose of tax rulings concerning transfer pricing

Yet the Commission's approach seems to misunderstand the whole purpose of tax rulings concerning transfer pricing, which in general are merely intended to be a step in the assessment of the profits properly due to a particular company within a multinational group. Any assessment of tax liability of any company necessarily requires the acceptance by the tax authority of the accounts presented by the company, subject to any questions that may arise from the tax inspector and which are dealt with in correspondence prior to the final assessment. In principle, a tax ruling is merely an advance means of determining the allocation of profits that are to be subject to the tax assessment. The tax ruling is not an intervention by the state that derogates from any assessment. On the contrary, it is an integral part of the assessment procedure.

In the McDonald's opening decision, the Commission essentially found that the Luxembourg authorities misapplied Luxembourg tax law. The Starbucks decision is also largely based on a perceived misapplication of Dutch transfer pricing rules resulting in less tax being paid. By contrast, in the Belgian excess profits decision, the Commission explicitly states that the Belgian legislation and practice allowing for the deduction of so-called excess profits is a derogation from the general tax scheme and is thus an intervention.

The combined result of these developments in the Commission's approach to tax rulings and state aid is that any tax ruling applicable to a particular undertaking, which results in a liability to tax that is less than that which the Commission thinks is properly due, constitutes state aid within the scope of article 107(1) and is accordingly prohibited. The Commission draws no distinction between tax rulings that are merely part of the tax assessment process and those which specifically derogate from what would otherwise be a due tax assessment. Indeed, in its Notice on the notion of state aid, published earlier this year, the Commission specifically states that any misapplication of national tax law in a tax ruling constitutes state aid. Interestingly, the Commission does not go so far as to assert that any misapplication of national tax law in a tax assessment constitutes state aid.

Apart from failing adequately to discern the notion of an intervention, the Commission has also sought to develop the notion of an economic advantage arising from a transfer pricing determination. In addition to the issue of whether the tax authorities properly applied their own law, the Commission seeks to assert that state aid arises from any failure to properly apply the arm's length principle, which it claims is inherent in the notion of state aid. This, according to the Commission, allows it to second guess any transfer pricing assessment in order to determine whether it properly reflects what would have been arm's length dealings between companies in a multinational group. Moreover, the Commission specifies that this notion is quite separate from the extent to which a particular tax system has incorporated international transfer pricing rules, such as the OECD Guidelines.

Having found that the tax rulings gave rise to state aid to Fiat, Starbucks and Apple, the Commission proceeded to declare the aid illegal and required repayment. At no stage in its decisions does the Commission attempt to discuss the problems arising from the fact that direct taxation remains a competence that is retained by the member states and is not a shared competence, let alone a sole competence, of the Commission.

Instead, the Commission merely expects Luxembourg, the Netherlands and Ireland to take the necessary steps to recover the aid which entails, effectively, a retrospective tax liability stretching back over more than a decade. Moreover, in the case of Apple, the Commission made the bizarre assertion that other member states might seek to claim a share of the repayment, without specifying the legal basis on which this could be achieved.

Final thoughts

Whilst it has long been established that recovery of aid is the natural consequence of illegality, it is highly questionable whether this should be enforced in the present decisions. It is certainly arguable that the Commission should have recognised that its new approach constitutes a distinct development in the law; and that, given the parallel proposals at an international level concerning tackling the taxation of multinationals, in particular BEPS, it should have refrained from imposing repayment obligations. Moreover, it could have adopted guidelines, or relied on article 109 of TFEU, which allows it to adopt appropriate regulations for the application of article 107, specifying the extent to which tax rulings concerning transfer pricing might give rise to state aid. ■

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