

State aid and Tax Rulings: *An appropriate way to tackle aggressive tax planning?*

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Introduction

- My perspective: that of a State aid lawyer with some experience in fiscal aid.
- The context: economic crisis -> public outcry -> political pressure -> legal action.
- Transfer pricing issues and multinationals:
 - Multinational companies: undertakings active in more than one jurisdiction. Not necessarily very big undertakings.
 - How to allocate revenue, cost & profits (and therefore taxes) among the different jurisdictions? Not easy or obvious, but unavoidable.
- The issue is sensitive because the different Member States (MS) and third countries have very different fiscal rules and rates.
 - This lack of harmonization is probably the main distortion.
 - But in principle State aid cannot play any role as regards this distortion.
- Need for legal certainty: '*Tax Rulings*' validating '*Advance Pricing Agreements*' (APA's)
 - But there's a risk of 'sweeteners' under the cover of discretionary decisions by the tax administrations.
 - So, EC action is probably needed but...under State aid? If so, how exactly? Why now?

Introduction

- In two decisions issued on October 21, 2015, the European Commission (EC) has concluded that, by issuing certain tax rulings covering transfer pricing matters, Luxembourg and the Netherlands have granted selective tax advantages to *Fiat Finance and Trade* and *Starbucks*, respectively.
- According to the EC, these tax advantages (rulings) are based in complex methodologies leading to the establishment of transfer prices with no economic justification and which unduly shift profits with the purpose of a reduction in taxes.
- Furthermore, these rulings confer to the beneficiary companies an unfair competitive advantage over other companies (typically SMEs not belonging to a group of companies) that are taxed on their actual profits because they (necessarily) pay market prices. Therefore, they are illegal under EU State aid rules.
- In these decisions, the Commission has ordered Luxembourg and the Netherlands to recover the unpaid tax from Fiat and Starbucks, amounting to €20 - €30 million per company. These companies can no longer continue to benefit from the advantageous tax treatment granted by these tax rulings.
- The two decisions are appealable and will presumably be appealed against by the two Member States and the companies in question. They nevertheless confirm the potential state aid risk present in rulings.

The State aid rules in a nutshell

- State aid is a measure:
 - Decided *by the State* and financed by *State resources*,
 - Granting an *advantage*,
 - to certain undertakings only (*selectivity*) and
 - *distorting* competition and trade within the EU.
- If one of these conditions is missing, there is no State aid.
- If it is State aid,
 - it is *prohibited* unless declared compatible by the EC.
 - the EC should normally order the *recovery* from the beneficiaries.
- The form of the measure is irrelevant. *Tax measures* may be State aid.
- It is therefore essential to know if we are faced with State aid or not.
- The critical point in fiscal aid cases is ‘selectivity’.

Some recent case law on selectivity

- General Court (GC) Judgments of 2014 in cases T-219/10, *Autogrill v. Commission* and T-399/11, *Banco Santander v. Commission*:
 - EC reasoning: the measure is selective because only certain undertakings make use of the provision.
 - The GC strikes back: the existence of a derogation from or an exception to a reference framework if proved, does not, by itself, establish that a measure favors 'certain undertakings or the production of certain goods' for the purposes of EU law, since that measure is available, a priori, to any undertaking.
 - And recalls that: a measure which may confer an advantage on all undertakings without distinction within the State concerned does not constitute State aid as regards the criterion of selectivity.
 - EC appeal pending against the GC judgments (Cases C-20/15P and C-21/15P)
- European Court of Justice (ECJ) Judgment of 2015 in Case C-15/14P *MOL*:
 - A general scheme based on objective criteria would only be selective if the EC shows that it can actually only apply to certain categories.
 - This may be the case even if the scheme actually applies just to one company; the essential element is that it is open to all.
 - A discretionary decision by the public authorities does not necessary entail selectivity in all cases, not at least when related to setting charges.
 - Even the fact that rates are the result of a negotiation does not automatically entail selectivity if the administration treats all companies equally as regards these eventual negotiations.

Selective rules & selective decisions

- Until now, we have had two kind of fiscal aid cases:
 - Cases looking at *tax rules* that are based on selective criteria
 - Cases looking at schemes foreseeing *discretionary decisions* by authorities
- With regard to tax rulings, we seem to be in the second category. But are we?
- In both cases – also in the second - the EC has normally condemned the system. It has normally not looked into the way each discretionary decision has been taken.
- Here we have something new. The system of tax rulings in itself is good (this is confirmed in the EC decisions) but there are apparently some abusive cases. And the EC wishes to deal with those with State aid rules.

The EC opening decisions

- EC decisions initiating - in June and October 2014 - formal investigation procedures on certain specific tax rulings.
 - *Apple* in Ireland, (SA.38373),
 - *Starbucks* in the Netherlands (SA.38374),
 - *Fiat* in Luxembourg (SA.38375) and
 - *Amazon* in Luxembourg (SA.38944).
- February 2015, EC opening decision on ‘Belgian excess profit ruling *system*’. *Caveat*: this case is about the scheme, not about certain decisions. It therefore seems different.
- On top of that, ‘*Lux leaks*’ and request for information to all Member States.
- In parallel, legislative proposals for automatic exchange of information on rulings, harmonized CIT taxable base. Interaction with State aid cases.
- What is the Commission looking for with the State aid cases? A selective advantage? Or the correct application of the OECD criteria? Which criteria?
- Does the case law support the EC reasoning on selectivity? Is this a matter for State aid rules?

The possible approaches

- EC choices:
 - Questioning the *system* of rulings OR questioning *some* rulings?
 - System of reference: all undertakings OR all multinationals?
- The two choices made by the EC in the 4 specific cases seem not entirely compatible:
 - A. Either the EC compares *multinationals* with *normal undertakings* -> then the system of rulings should be put into question
 - This raises difficult questions. As can be taken from the final decisions, the EC wisely denies any intention of doing so (the ruling policy is not a problem *per se*)
 - B. Or the EC compares the treatment normally granted to *all multinationals* to those granted to *some multinationals* -> only certain rulings are aid.
 - Two obvious questions: Which ones? Why those?
- In the Starbucks and Fiat cases the EC has followed approach A, which raises several legal concerns/inconsistencies (see below)

What the EC has done: the final decisions (I)

- What the EC has done in the *Fiat* and *Starbucks* cases (*Amazon* and *Apple* are still pending) is something new (and perhaps questionable).
- The main problem is the *system of reference*: which undertakings are the point of comparison
 - In previous cases (*Forum 187*) the reference system was not all the undertakings but all the multinationals. The scheme was open only to certain multinational companies (those present in more than 4 countries).
 - The EC says now that the system of reference is the treatment granted by tax legislation to all undertakings (including non-multinationals and, in particular, SMEs not belonging to any group).
- However, if the reference system is all undertakings and not only all multinationals, the comparison would probably *a/ways* show an apparent advantage:
 - By definition, undertakings not belonging to multinational groups are not affected/favoured by transfer pricing *arrangements*). Being this the case, only the rulings where OECD principles are applied as the EC likes would have a chance.
 - It would be good to understand why certain cases have been chosen. Has any individual tax ruling been considered as non aid?
- The EC approach claims not to put into question the mechanism of rulings *per se*, but the implications of the EC approach seem to do precisely this.
- “Selectivity” is not about doing what the EC does not like; its about treating certain undertakings better compared with others that are in the same legal and factual situation.

What the EC has done: the final decisions (II)

- The consequence of choosing an overly wide system of reference: to compare certain rulings not with the normal practice by the State but with an “ideal model” reflecting *economic reality*.
 - OECD criteria, as interpreted by the EC
 - But these are not hard law, not EU law and certainly not EU State aid law.
 - The understanding of “economic reality” is an interpretation of the “arm’s length principle” which has nothing to do with what the MS in question actually does, but with what the EC thinks it should be doing (similar approach to the “Market Economy Investor Principle” - MEIP).
 - But MEIP has not been designed for such an exercise. MEIP is about comparing the behaviour of the State vs an ideal private operator. Not about second guessing what a real private operator does.
- State aid is not about comparing what MSs do with an ‘ideal model’ (what the MS should do) but with what the MS *normally does* in that kind of situation.
- The EC approach comes very close to a harmonization of MS practices of transfer pricing. Something perhaps desirable, but Article 107 is probably not the ideal instrument.
- What could probably be done with Art. 107: look into the practice of each jurisdiction as regards rulings and see if there are signs of favourable treatment in some cases.
 - Not easy and apparently not done.
 - If however a jurisdiction does the same with all multinational undertakings, it would probably not be selective.
 - It is however rather unlikely that the selective/advantage approach detected by the EC is applied to all multinationals.

Recovery Issues

- Since the EC has finally decided that the rulings involve State aid, it has also ordered the Member States involved (Luxembourg and The Netherlands) to recover it from the beneficiary.
- Apparently, recovery exceptions like legitimate expectations or legal certainty have not been appreciated
- Some precedents when the EC adopts a totally new approach (FT case).
- As a consequence of recovery orders:
 - The Member States who adopted the ruling would receive ‘windfall profits’ in the form of additional tax
 - This may perhaps lead to tax adjustments in other jurisdictions. Other Member States may feel the impact of recovery without having played any role.
 - Recovery is normally for bilateral situations. It is not really well suited for these kinds of cases.

Conclusions

- What the EC is doing may probably make a lot of political sense.
- It may help the adoption of sensitive legislation by the Council and the Parliament.
- This does not mean that these State aid cases are legally bulletproof.
- Indeed, it seems that in the *Fiat* and *Starbuck* decisions the EC is navigating uncharted waters:
 - System of reference: not multinationals but all companies?
 - Comparing not with what the State does but with an ideal model?
 - Based on part of the OECD Guidelines and pseudo-MEIP?
- It is not impossible that the EC ends up winning before the EU Courts, but this should not be taken for granted.

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