Chapter 19

The Relevance of Primary EU Law on Direct Tax Matters: Lessons From Transfer Pricing Cases

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Abstract

This chapter deals with the relationship of EU law and tax sovereignty of the Member States and serves as an introduction to the national chapters. Given its introductory character, it will provide a general overview of the relevant EU legislation that affects the most the tax sovereignty of the Member States. The main focus of the chapter will be put on primary EU law (leaving the specific issues of harmonization to the national chapters) with particular regard to the recent transfer pricing cases in the light of the EU State aid rules. These cases can demonstrate very well the interdepending relationship between primary EU law and the delicate concept of tax sovereignty of the Member States and that of tax competition in a multilayered legal environment.

Keywords: *tax sovereignty, fundamental freedoms, fiscal state aid, transfer pricing, tax rulings, tax competition, tax harmonization, profit shifting, tax avoidance, discrimination*

1. Introduction

The present contribution constitutes a foundational element of an extended research project entitled *Economic Governance*, which revolves around the balance and

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extent of sovereignty that European Union (EU) Member States retain in the context of the EU's economic integration process. This research scrutinises four key areas: public finance, State aid, taxation, and monetary policy. While the research generally focuses on the perspectives of Central European countries, the introductory chapter, which consists of four subchapters, aims to provide a basic understanding of the relevant EU law rules in all four fields of economic policy mentioned above and to present how EU institutions interpret the economic sovereignty of Member States.

Against this backdrop, this contribution is meant to provide an overview of EU rules that affect the sovereignty of Member States in the field of direct taxation with a focus on primary EU law. The rationale for this structure is to allow the present chapter to work as an integrated part of the research output and the country chapters to address tax sovereignty issues arising from the coexistence of national tax systems and EU law. Furthermore, although secondary EU law clearly affects the tax sovereignty of Member States, it is a product of harmonising measures that, according to the current rules, require the unanimity of Member States. Consequently, no tax-related secondary EU laws can be adopted against the will of any member state. Considering the requirement of unanimity, it is not surprising that secondary EU legislation in the area of direct taxation is sporadic.[1] However, in the last decade, two important directives have been adopted for corporate taxation: the anti-tax avoidance directive (ATAD)[2] and, most recently, the directive on the global minimum tax for corporations (GloBE Directive).[3] These achievements are remarkable. Although their detailed analysis would stretch the boundaries of this subchapter, the relationship between harmonization and the constraints of primary EU law on fiscal sovereignty will be shortly addressed to shed light on the dynamic of such a supranational legal environment like the EU that is based on the foundations of constitutional pluralism.[4]

1 Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast) OJ L 345, 29.12.2011, 8–16 (Parent-Subsidiary Directive); Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States OJ L 157, 26.6.2003, 49–54 (Interest-Royalty Directive) and Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States (Codified version) OJ L 310, 25.11.2009, 34–46 (Tax Merger Directive); Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L 64, 11.3.2011, 1–12 (DAC).

2 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market OJ L 193, 19.7.2016, 1–14 (ATAD 1); Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries OJ L 144, 7.6.2017, 1–11 (ATAD 2).

3 Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union ST/8778/2022/INIT, OJ L 328, 22.12.2022, 1–58 (GloBE Directive).

4 Lanearts and Gutiérrez-Fons, 2013.

This contribution is structured as follows. Following this introductory section (Section 1), Section 2 will shed some light on the interrelationship between positive (harmonization in the form of secondary EU law measures) and negative integration (prohibition of certain domestic tax measures due to the infringement of primary EU law) developments. Subsequently, Section 3 will present the most important primary EU legal rules that shaped the direct tax systems of Member States and thus their fiscal sovereignty – namely, the state aid rules and fundamental freedoms – and very briefly summarise the evolution of their application. Section 4, the core of the chapter, will outline recent trends in the application and interpretation of state aid rules in transfer pricing cases as well as those crystallised in the case law of the Court of Justice of the European Union (CJEU or Court) and in the approach of the Commission. Obviously, an in-depth analysis of the relevant cases cannot and will not be carried out within the framework of the present contribution. Nevertheless, it is still worth attempting to capture the tendencies and impacts that these EU rules exert on the direct tax systems of Member States. The author found two relevant trends that could be further elaborated: the intense investigation of the Commission regarding tax rulings issued by the national tax authorities with respect to the transfer pricing of intra-group transactions and the challenges around the conformity of (progressive) turnover-based taxes with state aid rules and fundamental freedoms.[5] However, it cannot be ignored that the present contribution is part of a research project, and turnover-based business taxes and their legal implications in the context of EU law will be addressed in other chapters. Therefore, to avoid repetition and overlap, this chapter omits these cases and focuses solely on transfer pricing cases. Finally, Section 5 will present the concluding remarks.

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2. The concepts of tax sovereignty and tax competition

Tax sovereignty in the field of direct taxation is considered as one of the sacrosanct of sovereignty for the Member States as it constitutes an essential aspect of collecting revenues.[6] Furthermore, direct taxation remains a very important macroeconomic policy tool for Member States, especially for those which introduced the euro and joined the monetary union and relinquished their sovereign monetary

5 Although the choice of these two aspects of the recent trends in the field of direct taxation is necessarily arbitrary, it can somewhat be justified by their outstanding importance in influencing national tax systems and academic discussions as well as in raising media attention. Nevertheless, it is also worth noting that the focus on taxpayer's rights is also gaining increasing momentum in the jurisprudence of the CJEU, with this trend expected to continue. In this respect, the relevant cases revolve around the interpretation of the Charter on the Fundamental Rights of the European Union in tax procedures. Similarly, see: van Thiel, Pistone and Wathelet, 2021.

6 Kingston, 2007, p. 287.

policy.[7] Thus, tax sovereignty establishes an important instrument in the hand of the Member States to fund public services and achieve their economic goals.

Such economic goals might encompass the attraction of foreign direct investment (FDI) in the country by means of tax incentives. This phenomenon is entitled as tax competition. On the one hand, tax competition can be useful. It was also the original standpoint of the CJEU according to which regulatory (including tax) competition can be beneficial for the internal market whereby Member States compete for foreign investments, which could lead to a regulatory (tax) sandpit, ideally resulting in finding the best regulatory (tax) system.

On the other hand, tax competition can be perceived as a collective-action problem. Although Member States might individually benefit from attracting FDI, tax competition can result in the decrease of the collective EU welfare due to unlimited competition 'race to the bottom'.[8] Such an outcome is harmful as either no funds will be available anymore for financing public goods and services through taxes or Member States must shift on the tax burden towards immobile factors, typically on labor and consumption[9]. It would be likely to lead to a decline of Pareto efficiency in the form of below-the-ideal tax rates, furthermore to an unfair allocation of the tax burden as large companies would get more beneficial treatment and less mobile actors would receive less favorable treatment.[10]

Tax sovereignty is also reflected in the unanimous voting rule in the special legislative procedure in the field of taxation. This de facto veto for the Member States means an important bargaining tool.[11] It could be seen in the course of the adoption of the global minimum tax directive where Hungary was the last Member State to give consent to the directive in exchange for certain concessions related to both the directive and other areas.[12]

The power resulting from the veto indeed ensures higher level of tax sovereignty but – as certain authors note – it also prevents higher level of fairness within the EU that could be achieved by means of harmonization.[13] Furthermore, a seemingly paradox phenomenon can be observed: cooperation or harmonization in the field of direct taxation might result in the preservation of a higher level of tax sovereignty because the lack of any harmonization or cooperation between the Member States could entail pressure to participate in (extreme) tax competition,[14] which may result in involuntary reductions to tax sovereignty.

7 de la Feria, 2023, p. 4.
8 Mason, 2023, p. 22.
9 Mason, 2023, p. 22.
10 de la Feria, 2023, p. 10.
11 de la Feria, 2023, p. 5.
12 *EU Member States unanimously adopt Directive implementing Pillar Two Global Minimum Tax rules*, 2022.
13 de la Feria, 2023, p. 2.
14 de la Feria, 2023, p. 2.

Nevertheless, tax sovereignty has limitations. It is restricted by the obligation of Member States to devise their tax systems in conformity with EU law, particularly with fundamental freedoms and State aid rules. Such negative integration – the prohibition of domestic tax measures that fall foul of primary EU law – is dominant in the field of taxation and is carried out by the CJEU.[15] Furthermore, positive integration also restricts the tax sovereignty of Member States: once a certain area of taxation has been harmonised at the EU level, Member States must transpose the EU rules into their national tax systems and cannot regulate the given field anymore at their wish.

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3. Primary EU law and direct taxation

3.1. Preliminary remarks

If one looks into the main sources of primary EU law, the texts of the Treaties, i.e., that of the Treaty of the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU), they can come across hardly any explicit tax provisions. The few tax related rules encompass the prohibition of fiscal measures levied at the event of goods crossing the borders within the Union, i.e., the prohibition of customs duties and measures having an equivalent effect necessary for the establishment of a customs union,[16] the prohibition of discriminatory taxation of products of a foreign origin,[17] the general legal basis for the harmonization of rules (including direct tax rules) that affect the internal market[18] and indirect taxation.[19]

Then, the question might be raised how primary EU law plays a crucial role in the negative integration process of national direct tax measures in the jurisprudence of the CJEU. The roots of it lie in the internal market idea. As Art. 26 paras. (1)–(2) of the TFEU states, the primary economic aim of the EU integration is to establish and ensure the functioning of the internal market, which is defined as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties. In other words, the idea of an internal market entails that the Member States do not apply internal rules that restricts the free movement of production factors (labor and capital) and production outputs (goods and services). The CJEU recognized that direct tax measures could

15 Kingston, 2007, p. 290.

16 Arts. 28–30 of the Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, 47–390 (TFEU).

17 Art. 110 of the TFEU.

18 Art. 115 of the TFEU.

19 Art. 113 of the TFEU.

also be susceptible to cause such an undesirable restriction.[20] Yet another primary EU law instrument that is meant to ensure that the internal market functions without distortion is the EU State aid rules that is currently enshrined in Arts. 107–109 of the TFEU. As a main rule, it prohibits measures that involve '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.'[21] The CJEU pointed out already in an early stage of the EU integration that such an unlawful aid could also be granted by the Member States via tax measures by means of mitigating the tax burden of certain undertakings that they normally must bear.[22]

These two sets of rules, that is the fundamental freedoms and the State aid rules have become the cornerstone of the negative integration of the national direct tax systems of the Member States. Although by interpreting these provisions, the CJEU did not prescribe what provisions the national tax systems should contain, it ruled on which provisions were incompatible with primary EU law and should be changed. Such a negative integration process is especially a delicate exercise because very vaguely and generally phrased EU law provisions must be applied to often very technical and nuanced tax measures. In the next section, a brief history of the evolution of these rules will be presented.

3.2. Evolution of the application of fundamental freedoms and State aid rules to direct tax measures

3.2.1. Fundamental freedoms and direct tax measures

As noted, the fundamental freedom provisions of the TFEU do not explicitly address tax rules other than customs duties. However, the direct tax measures have not been carved out from their scope either, which solution can be observed in various international trade agreements.[23] Consequently, the CJEU started to apply the fundamental freedoms to direct tax measures as early as 1986. The first case was revolving around the discriminatory treatment of a permanent establishment of foreign companies by France in the *Avoir Fiscal* case.[24] From this point up to now, we can distinguish three eras in the CJEU's jurisprudence[25]. In the evolution of its case law, it can be observed that the language of the judgments varied, swinging

20 CJEU, 28 January 1986, C-270/83, *Avoir Fiscal*, ECLI:EU:C:1986:37.

21 Art. 107 para. (1) of the TFEU.

22 For more details, see Section 3.2.2.

23 To some extent, this is the case for certain WTO agreements. For instance, an exception from the national treatment and most favored nation treatment provisions applies to direct tax measures in the GATS agreement.

24 C-270/83.

25 Kingston, 2007, pp. 289–303.

from a discrimination approach towards a restriction-based approach and back.[26] Originally, the compatibility assessment was clearly based on a discrimination test. The second generation of tax cases starting from the 1997 with the *Futura* judgment, the CJEU adopted a restriction-based language that was also applied to non-tax fundamental freedom cases and subsequently, a return to discrimination test can be experienced starting from 2005.[27] However, it was argued by several scholars that the CJEU, even when it used its restriction-based terminology in substantive tax measures, in effect, it checked whether the measure concerned created a difference in treatment between comparable domestic and cross-border situations.[28] Consequently, the application of the free movement provisions to direct tax measures boils down to a discrimination test in most of the cases. Such discrimination test entails three steps. First, a disadvantage test is carried out, assessing whether cross-border situations suffer from an unfavorable treatment compared to domestic situations. Then, closely related to the first step, the comparability of the domestic and cross-border situations is examined. This is decided in the light of the objective of the tax measure. If an unfavorable treatment is identified for a cross-border situation that is comparable to the domestic situation, then the prima facie discriminatory measure can still be justified by an overriding public interest under the third step, provided that it fulfils the requirement of proportionality.[29]

In the Court's case law, the following justifications have been accepted for a discriminatory direct tax measure: the need for effective fiscal supervision,[30] the need to maintain a balanced allocation of power to tax,[31] the need to maintain the coherence of the tax system,[32] and the prevention of abuse (tax evasion and avoidance).[33] As Wattel and Brokelind convincingly argue, all of these justification grounds boil down to one single concept: the protection of tax base integrity.[34] It entails the right of the Member States to tax the economic activity that is carried out within their territory and thus to tax the value increase in the given jurisdiction.[35]

In the case law of the Court, the effective fiscal supervision constitutes the procedural side of tax base integrity, while the fiscal cohesion and balanced allocation of

26 Cordewener, 2006, pp. 1–2.

27 For an overview of the three generations of tax cases, see: Bammens, 2012, pp. 534–542.

28 Zalasinski, 2009, p. 288. and cases referred to therein; Snell, 2007, p. 349.

29 In detail, see: Károlyi, 2022.

30 See, for example: CJEU, 20 February 1979, C-120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon),* ECLI:EU:C:1979:42, para. 8; CJEU, 15 May 1997, C-250/95, *Futura Participations SA and Singer v Administration des contributions,* ECLI:EU:C:1997:239, para. 31.

31 See, for example: CJEU, 12 September 2006, C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*, ECLI:EU:C:2006:544, para. 56; CJEU, 20 January 2021, C-484/19, *Lexel AB v. Skatteverket*, ECLI:EU:C:2021:34, para. 59.

32 See, for example: CJEU, 30 June 2016, C-123/15, *Max-Heinz Feilen*, ECLI:EU:C:2016:496, para. 30; CJEU, 12 June 2018, C-650/16, *Bevola,* ECLI:EU:C:2018:424, para. 45.

33 See, for example: CJEU, 12 September 2006, C-196/04, *Cadbury Schweppes*, ECLI:EU:C:2006:544, para. 55; CJEU, 20 January 2021, C-484/19, *Lexel AB v. Skatteverket*, ECLI:EU:C:2021:34, para. 49.

34 Brokelind and Wattel, 2018, p. 689.

35 Wattel, 2018, p. 631.

taxing power justifications, often complemented with the principle of territoriality, have basically identical meaning.[36]

What these concepts mean is that taxpayers should not be able to choose freely where they want their income to be taxed and expenses/losses to be deducted and these elements of the tax base cannot be disconnected from the territory where the corresponding economic activity is performed.[37]

The question of tax base integrity is therefore closely related to the question of whether a certain item of income/transaction is taxed in a given jurisdiction. The latter issue, i.e. the issue of being subject to tax is also used by the Court to determine the comparability of internal and cross-border situations. Consequently, there is no sharp distinction between the comparability and the justification phase. As Advocate General Kokott noted, these two phases are often conflated by the Court.[38] This opinion is also shared by Wattel who states that there are plenty of cases where the Court found the differential treatment of domestic and cross-border situations justified by the overriding public interest of balanced allocation of taxing rights, however, the situations should not have been considered comparable (i.e. no discrimination) at the first place because one of them – the cross border situation – was not subject to tax, while the given Member State taxed the domestic situation.[39] Advocate General Bobek is also of the view that when a Member State delineates the boundaries of its tax jurisdiction on non-resident taxpayers in accordance with the territoriality principle, it does not amount to a discriminatory measure, therefore the justification phase should not be reached.[40]

Seemingly, it is immaterial whether the substantive comparability test / tax base integrity test is conducted in the comparability or justification phase. However, besides the potential procedural implication of the burden of proof, there is a very important, substantive difference: to reach the justification phase, Member States' measures must pass the proportionality requirement.[41] Thus, finding the measure prima facie discriminative is the gateway to the proportionality test.[42]

36 Brokelind and Wattel, 2018, p. 680.

37 CJEU, 18 July 2007, C-231/05, *Oy AA*, ECLI:EU:C:2007:439, paras. 53–56.

38 Opinion of Advocate General Kokott, C-48/13, *Nordea Bank Danmark A/S v Skatteministeriet*, paras. 21–28.

39 Wattel, 2018, pp. 640–641 with particular reference to the *Oy AA* case in which the Court held that the Finnish regime on intra-group financial transfers entailing the deduction of an intra-group financial transfer from the taxable income of the transferor and the assimilation of that transfer to income in the hands of the transferee was discriminatory as foreign group companies (not taxed by Finland whatsoever) were excluded from the benefit of the regime. Nevertheless, the Court found this 'discrimination' of comparable situations justifiable based on the need for a balanced allocation of taxing rights. See: C-231/05, paras. 51–56.

40 Opinion of Advocate General Bobek of 14 December 2017, C-382/16, *Hornbach Baumarkt AG*, ECLI:EU:C:2017:974, para. 133.

41 Opinion of Advocate General Kokott, C-48/13, *Nordea Bank Danmark A/S v Skatteministeriet*, paras. 27–28.

42 Wattel, 2018, p. 627.

3.2.2. State aid and direct tax measures

3.2.2.1. The definition of State aid

Art. 107 of the TFEU contains the definition of State aid, which states, 'save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market'. It was already enshrined in the Treaty of Paris of 1951 establishing the European Coal and Steel Community (ECSC).[43]

It is formulated in a rather vague way and consequently its meaning and application has been crystallized in the jurisprudence of the CJEU throughout the years. The CJEU clarified that four cumulative criteria must be met in order to conclude that a measure constitutes State aid.

First, it must be granted by the State or through State resources. Second, it must confer a benefit, an advantage of an economic nature to the recipients compared to their situation in the absence of the measure.[44] It also entails that the measure granting the benefit must be selective, i.e., it must benefit only certain undertakings or the production of certain goods discriminating to the detriment of other, comparable undertakings or productions.[45] Third, the domestic measure must distort or threaten to distort competition. This criterion is given very limited weight in the State aid analysis of the Court,[46] which is surprising in the light of the competition law character of the State aid rules.

The fourth criterion involves that the domestic measure must be liable to affect trade between Member States. It often overlaps with the criterion of distortion of competition[47] as it also entails a change in competitive positions. However, it is also easily satisfied because it only requires that the products or activities affected by the measure are subject to trade between Member States[48] and there is no minimum threshold or percentage under which it is presumed that trade is not affected.[49]

43 Micheau, 2014, p. 55.

44 Quigley, 2015, p. 6.

45 Opinion of Advocate General Wahl, C-524/14 P, *Commission v. Hansestadt Lübeck*, para. 74.

46 Lang, 2012, p. 411. Quigley also states that this criterion is easily fulfilled because any effect (or the mere threat of an effect) on production cost is sufficient. This standard renders this criterion synonymous with having an effect on competition. See: Quigley, 2015, pp. 8, 76 and cases referred therein.

47 Nicolaides and Metaxas, 2014, p. 56; Quigley, 2015, p. 83.

48 Quigley, 2015, p. 8. For a critical view on neglecting this criterion in case law, see: Englisch, 2019, p. 24.

49 CJEU, 21 March 1990, C-142/87, *Belgium v. Commission*, ECLI:EU:C:1990:125, para. 43; CJEU, 21 July 2005, C-71/04, *Xunta de Galicia*, ECLI:EU:C:2005:493, para. 41; CJEU, 17 July 2008, C-206/06, *Essent Netwerk Noord and Others*, ECLI:EU:C:2008:413, para. 76.

3.2.2.2. State aid rules in the context of direct tax measures

The Court maintained the four criteria developed in its non-tax-related case law. However, the crucial aspect of the State aid analysis in tax matters became the selectivity criterion, which is often examined together with the existence of an advantage; that is, a selective advantage often creates a single criterion in the tax related case law of the CJEU.[50] The central position of the selectivity test can be explained by the fact that the other criteria are easily met in the field of taxation.

The original application of the selectivity test can be named as the derogation approach and it involves a three-step analysis.[51] Under the first step, the CJEU determines the relevant reference framework or normal system of taxation. In the second step, it examines whether the measure at issue derogates from the reference system in a way that it discriminates between economic operators that are in a comparable factual and legal situation, having regard to the objective pursued by the tax system. If this is the case, the Member State concerned has the possibility under the third step to justify the prima facie selective measure by proving that the differentiation flows from the nature and general structure of the reference system.[52]

Thus, the selectivity test of the State aid analysis can be regarded as a sort of discrimination test, which has been explicitly confirmed by the CJEU itself.[53] Another proof that selectivity boils down to a discrimination test is the CJEU's judgment in the *Gibraltar* case, where it did not even require the finding of a derogation and found the general tax system to be selective in itself in so far as it resulted in a discriminatory treatment between comparable undertakings (de facto selectivity).[54] In other words, de facto selectivity exists when the tax system does not grant a selective advantage at face value but factually does so by setting the requirements to enjoy the benefit in a manner that it can be fulfilled in practice only by certain enterprises or sectors.[55] In the underlying case, Gibraltar planned to repeal its existing

50 Miladinovic, 2021, pp. 39–41; Miladinovic and Szudoczky, 2019, p. 519; Lang draws attention to AG Jääskinen's opinion that the *Gibraltar* case described advantage and selectivity as key but separate terms (although Jääskinen failed to clearly distinguish them). See: Lang, (2012), p. 413; I note that similar observation can be made regarding the opinion of Advocate General Wahl in the *Hansestadt Lübeck* case in which he plead for the distinction between the criterion of advantage and that of selectivity but did not clearly separate them in his analysis. See: Opinion of Advocate General Wahl, C-524/14 P, *Commission v. Hansestadt Lübeck*. Schön also questions whether separate tests regarding the advantage and selectivity make sense. See: Schön, 2016, p. 17. Quigley also uses the notion of selective advantage based on the application of the general principle of equal treatment. See: Quigley, 2015, pp. 7, 64.

51 Szudoczky, 2014.

52 CJEU, 8 September 2011, C-78/08 to C-80/08, *Paint Graphos and Others*, ECLI:EU:C:2011:550, para. 49.

53 CJEU, 21 Dececmber 2016, C-524/14 P, *Commission v. Hansestadt Lübeck*, ECLI:EU:C:2016:971, para. 53; CJEU, 6 October 2021, C-51/19 P and C-64/19 P, *World Duty Free Group SA and Kingdom of Spain v. Commission*, ECLI:EU:C:2021:793, para. 33.

54 CJEU, 15 November 2011, C-106/09 P and C-107/09 P, *Commission v Government of Gibraltar and United Kingdom*, ECLI:EU:C:2011:732.

55 Schön, 2016, p. 21.

corporate tax system and to introduce a new corporate tax regime for all companies in Gibraltar.[56] The proposed system comprised a payroll tax, a business property occupation tax (BPOT) and a lump-sum registration fee.[57] The aggregated tax liability of the payroll tax and the BPOT was capped at 15% of the corporate profits and it followed from this rule that without profit no tax liability arose for the purposes of these two taxes.[58] Thus, the proposed new rules seemingly applied to all undertakings without any derogation. Yet, the Court concluded that the system constituted a selective advantage for offshore companies (which were de facto exonerated from corporation tax due to the lack of business property and employees onshore) because a selective advantage can be granted not only by way of derogating tax measures but also by way of 'adjusting and combining the tax rules in such a way that their very application results in a different tax burden for different undertakings'.[59] The mere existence of the different level of taxation would not have been sufficient for de facto selectivity, it was also necessary as to the CJEU that the design of such system characterized the recipient undertakings by virtue of the their specific properties (i.e. being offshore) as a privileged category.[60]

3.2.2.3. The evolution of the application of State aid rules to direct tax measures

The theoretical possibility to apply State aid rules to tax measures was recognized by the CJEU as early as in 1961 when it already ruled in its judgment in *De Gezamenlijke Steenkolenmijnen* that interventions that mitigate the charges which are normally included in the budget of an undertaking are similar in character and have the same effect as subsidies.[61]

Nevertheless, the number of direct tax cases in the context of EU State aid rules remained relatively few until the mid-2000 years.[62]

The change could be attributed to the Commission's intent to use the State aid instrument to national direct tax measures more intensely. It was first signaled by the issuance of a Commission Notice in 1998 on the application of the State aid rules to measures relating to direct business taxation, in which the Commission explicitly recognized that a strict application of State aid rules to direct tax measures is necessary in order to effectively contribute to the tackling of harmful tax competition.[63]

56 C-106/09 P and C-107/09 P, para. 8.

57 C-106/09 P and C-107/09 P, para. 12.

58 C-106/09 P and C-107/09 P, para. 12.

59 C-106/09 P and C-107/09 P, para. 93.

60 C-106/09 P and C-107/09 P, paras. 103–104.

61 CJEU, 23 February 1961, C-30/59*, De Gezamenlijke Steenkolenmijnen v. High Authority of the European Coal and Steel Community,* ECLI:EU:C:1961:2., p. 19.

62 Lang, 2021, p. 516.

63 Commission notice on the application of the State Aid rules to measures relating to direct business taxation, 98/C 384/03, OJ C 384, 10.12.1998, 3–9 (hereinafter: Comm. Notice, 1998), para. 1. Report of the Code of Conduct Group of 28 November 1999, Council Doc. SN 4901/99 (hereinafter: 'Report of the Code of Conduct Group, 1999).

Thus, the enhanced activity of the Commission in investigating direct tax measures in the light of the State aid rules connected to a parallel project at Community level, namely the fight against harmful tax competition, the distortive effects of which have been seen as a threat on the internal market objective.

Pursuant to the work of the Code of Conduct Group, the ECOFIN Council managed to reach a non-binding political commitment to dismantle harmful tax regimes in 1997. The Code of Conduct for Business Taxation[64] was created to monitor and reduce harmful tax competition within the Community. The Code of Conduct sets certain criteria for identifying harmful tax regimes. A peer review process among the Member States was meant to ensure that tax regimes that are considered harmful would not be introduced (the standstill clause) and that existing ones would be repealed (the rollback).

It became obvious that an overlap between State aid rules and provisions of the Code of Conduct could exist, as certain tax measures could fall foul of both. This created uncertainty regarding how State aid rules should be applied to tax measures, and the Commission attempted to provide for a remedy by the issuance of its 1998 Notice.[65] Although the Commission issued the Notice with the explicit objective of supporting the fight against harmful tax competition that the Code of Conduct Group carried out, it also emphasized the independent nature of State aid analysis from that of the Code of Conduct.[66]

In this Notice, the Commission provided guidance on how to interpret the criteria of State aid in the context of business tax measures. It put forward that measures that are generally open to all operators on an equal access basis, i.e., are not de facto reduced in scope, do not constitute State aid.[67] Furthermore, it already pointed out that the condition of selectivity could be fulfilled by means of administrative practices, including tax rulings.[68] The Commission acknowledged that tax rulings can serve as a legitimate tool to provide legal certainty for taxpayers, however, it raised the attention that they must constitute a mere confirmation of the general rules rather than discretionary practices.[69] It also cautioned against the lack of transparency of tax rulings.[70]

The Code of Conduct Report of 1999 identified 66 tax measures with harmful features. Some of them granted benefits to certain taxpayers on a discretionary basis by means of advance rulings issued by the national tax authorities. In that regard, the Group found some regimes harmful on account of the fact that albeit

64 Code of Conduct for Business Taxation, (1997). Resolution of the Council and the Representatives of the Governments of the Member States, Meeting within the Council of 1 December 1997, on the code of conduct for business taxation (hereinafter: Code of Conduct, 1997).

65 van Thiel, Pistone and Wathelet, 2021, p. 238.

66 Comm. Notice, 1998, para. 30.

67 Comm. Notice, 1998, point 13.

68 Comm. Notice, 1998, para. 22.

69 Comm. Notice, 1998, para. 22.

70 Traversa and Sabbadini, 2017, §6.04 [C].

the domestic legislation incorporated the arm's length principle (ALP) for profit allocation, the rulings under certain circumstances allowed for a formulaic apportionment between the head office and a branch[71] or the application of fixed margins for headquarters and logistic centres,[72] resulting in lower tax level than under the normal rules.[73]

Several of these identified tax regimes have also been tackled by the Commission as State aid and even confirmed by the CJEU (*Belgium and Forum 187 v. Commission*) that tax regimes that accept an intra-group pricing which does not reflect a market-based outcome (provided that in the given Member State such a requirement exist as a general rule but not to all undertakings) could be selective under certain circumstances.[74]

Nevertheless, a new wave of investigations related to transfer pricing treatment of intra-group transactions provided in tax rulings has emerged starting in 2014[75] as the aftermath of the LuxLeaks scandal. When the sweetheart deals granted by the national tax authorities in their rulings to certain multinational groups became known to the wide public, the Commission took advantage of the momentum and started to extensively investigate their potentially selective nature. Although the Commission emphasized in these cases –similarly to its Notice – that rulings were not inherently problematic, it found in most of the cases that the tax treatment provided by these rulings deviated from the ordinary rules of taxation to the benefit of the taxpayers concerned.[76]

Apart from the more intense investigation of tax rulings, one can also observe an increase in the number of recent direct tax case law of the CJEU, where the Member States' tax systems are challenged by the Commission on the grounds that they allegedly constitute State aid incompatible with the internal market.[77] Within this trend, besides the transfer pricing cases, the challenge of turnover-based taxes stands out for several reasons. First, the challenges affected several taxes of various Member States within a short period of time. Second, they were new in nature in the sense that the proliferation of turnover-based taxes is a new phenomenon and their compatibility with EU law has not been subject to the Commission's and the CJEU's scrutiny up until the mid-2010s. As it was indicated in the introduction, the challenge of turnover-based business taxes in the light of the State aid rules is the topic of a different chapter. Therefore, the core topic of the present contribution is the challenge of tax rulings concerning transfer pricing treatment of intra-group transactions.

71 Report of the Code of Conduct Group, 1999, pp. 12, 38.
72 Report of the Code of Conduct Group, 1999, p. 36.
73 Report of the Code of Conduct Group, 1999, p. 12.
74 CJEU, 22 June 2006, C-182/03 and C-217/03, *Belgium and Forum 187 v Commission*, ECLI:EU:C:2006:416.
75 van Thiel, Pistone and Wathelet, 2021, p. 242.
76 Lopez, 2022.
77 Kofler et al., 2021; Kofler et al., 2022.

4. Transfer pricing cases through the prism of state aid rules

4.1. Preliminary remarks

As shown in the previous section, few hard-law tools are available at the EU level to curb harmful tax competition within the internal market. Although the Code of Conduct proved to be an effective instrument for dismantling several tax regimes that were considered harmful, its soft-law character and peer review monitoring made it less efficient when significant budgetary consequences or cornerstones of national tax policies were at stake. Consequently, the Commission expressed its intention to tackle regimes constituting harmful tax competition through hard law, State aid rules.[78] A new impetus has emerged in the new era starting in 2014, when the LuxLeaks scandal was aired.[79] The Commission began to review the tax rulings of many multinational enterprises obtained from tax authorities in Luxemburg, Ireland, Belgium, and the Netherlands. These rulings typically addressed transfer pricing; that is, the pricing of intra-group transactions. In many cases, the formal investigation of the Commission ended in a negative decision, holding that the tax treatment granted to multinationals in the rulings constituted a selective advantage and, thus unlawful State aid. Although these cases are similar with respect to the subject matter (transfer pricing), they can be classified into various subgroups. The Fiat, Starbucks and Amazon cases can be regarded as transfer pricing cases in the strict sense as they concern the attribution of profits between associated enterprises and the correct pricing of their intra-group transactions. The Apple case dealt primarily with the attribution of intellectual property assets between the head office and branches. Additionally, the Belgian Excess Profit Exemption case (*Magnetro*l) revolved around the primary question whether the practice of the Belgian tax authorities could be qualified as an aid scheme rather than individual aids.

Following the Commission's negative decisions, the Member States at issue lodged appeals against the decisions, and in many cases, the General Court had already ruled on the issue, mostly in favour of the Member States. The only case in which the CJEU has already delivered its final say is the Fiat case whereby the CJEU annulled the Commission decision. AS the cases show similarities, it can be expected that the future judgments will follow suit.

In this section, the three branches of cases (*Apple*; *Amazon-Starbucks-Fiat*; and *Magnetrol*) will be shortly demonstrated with a primary focus on the Fiat case being the only one that is final and that is indicative to the prospective outcome of the other, still pending cases.

78 Comm. Notice, 1998.
79 Brundsen, 2017.

4.2. The allocation of profits in intragroup transactions: The cases of Fiat and Amazon

4.2.1. Preliminary remarks

The Amazon, Starbucks and Fiat cases – albeit based on different fact patterns – all dealt with the correct application of transfer pricing (TP) rules in the light of the State aid rules.[80] In this section, the Amazon and Fiat cases will be dealt in some more detail.

4.2.2. The Fiat Chrysler case

4.2.2.1. Commission Decision

The *Fiat Chrysler* case is the first in the line of the transfer pricing ruling cases where the CJEU delivered its final judgment and it can be expected that the outcome will be indicative for the result of the other cases as well.

Here, the fact patterns also concerned the pricing of intra-group transactions namely intra-group financing. In the rulings, the determination of the profit allocable to the Luxemburgish financing entity was carried out with reference to an estimated level of remuneration of a hypothetical, regulatory capital,[81] which according to the Commission, did not result in a reliable approximation of a market-based outcome. The Commission applied a sui generis ALP standard and held that multinational enterprises must adopt a single particular income –allocation rule on the basis of the OECD TP Guidelines.[82]

In examining the selectivity test, the Commission was of the view that the Luxemburgish corporate tax system constituted the reference framework, whose objective was to tax the profits of all companies.[83] In the light of this reference framework, it considered that group companies and standalone companies were in a comparable legal and factual situation.[84]

In the second step, the Commission held that the tax treatment laid down in the rulings deviated from the ALP and thus from the normal level of taxation because the agreed pricing did not approximate a market-based outcome, resulting in a reduction of the tax base.[85]

Consequently, the Commission pointed out that if it was proven that the chosen methodology departed from a reliable approximation of a market-based outcome,

80 Haslehner and Pantazatou, 2022, p. 98.
81 Opinion of AG Pikamäe, Case C-885/19 P, *Fiat Chrysler*, paras. 20–24.
82 Mason, 2017, p. 947.
83 CJEU, 8 November 2022, C-885/19 P and C-898/19 P, *Fiat Chrysler*, ECLI:EU:C:2022:859, para. 16.
84 C-885/19 P and C-898/19 P, para. 16.
85 C-885/19 P and C-898/19 P, paras. 17–18.

the measure amounts to State aid.[86] It is noteworthy that the Commission came to that conclusion irrespective of whether the Member State itself had incorporated the ALP principle or not because it regarded the ALP as being inherent in Art. 107 of the TFEU.[87] It only examined the tax treatment granted by the rulings in the light of the ALP as enshrined in the domestic law as an alternative line of reasoning.[88]

As the Commission has indeed found such a deviation from the ALP without proper justification, it concluded that the rulings constituted unlawful State aid, the beneficiary of which was the group as a whole.[89]

4.2.2.2. General Court judgment

Following an appeal against the Commission decision, the General Court upheld the Commission decision. Actually, that was the only case where the General Court ruled in favor of the Commission (apart from the *Magnetrol* case that forms a different class of ruling cases). The General Court acknowledged that the ALP could be used as a tool to verify whether intra-group pricing accepted by the tax authority corresponded to the market conditions and whether an advantage was received.[90] Consequently, the Commission was entitled to compare the taxable profit of the Luxemburgish Fiat group company with the taxable profit that would have been under the normal Luxemburgish rules applicable to standalone companies.[91] The General Court dismissed the argument that the ALP was extraneous to the Luxemburgish tax law on the grounds that the use of this principle was permitted by the fact that the Luxembourgish tax rules provided that integrated companies are to be taxed on the same terms as stand-alone companies.[92]

4.2.2.3. Court of Justice judgment

However, after the appeal against the judgment of the General Court, Advocate General Pikamäe disagreed with such a stance in his opinion on the grounds that the reference framework could only consist of rules and principles intrinsic to the national legal system and these rules cannot be replaced by extraneous, fictitious reference framework.[93]

The CJEU annulled the Commission decision and – confirming the opinion of Advocate General Pikamäe – has not found unlawful State aid to exist.[94]

86 C-885/19 P and C-898/19 P, para. 18.
87 C-885/19 P and C-898/19 P, para. 19.
88 C-885/19 P and C-898/19 P, para. 21.
89 C-885/19 P and C-898/19 P, para. 23.
90 C-885/19 P and C-898/19 P, para. 31
91 C-885/19 P and C-898/19 P, para. 32
92 C-885/19 P and C-898/19 P, para. 35.
93 Opinion of AG Pikamäe, in Case C-885/19 P, *Fiat Chrysler*, para. 64.
94 C-885/19 P and C-898/19 P, para. 113.

As a preliminary remark, the CJEU stated that the selective advantage test under the State aid scrutiny essentially boils down to a discrimination test.[95]

In order to decide whether discrimination occurs between comparable taxpayers, it is essential to correctly delineate the reference framework which must be carried out following an exchange with the Member State concerned and requires an objective examination of the content, the structure and the specific effects of the applicable rules.[96]

The CJEU pointed out that, as a main rule, in the absence of harmonisation, it is for the Member State to determine the characteristics of its tax system (basis of assessment and taxable event), creating the reference framework.[97] Consequently, only the national law applicable in the given Member State could be taken into account[98] and only national transfer pricing rules should have been examined without reference to an abstract ALP.[99] By accepting that the Commission may rely on rules which were not part of Luxembourg law, it would be tantamount to infringing the autonomy of the Member States in the field of direct taxation.[100]

Consequently, the Commission was not entitled to autonomously define the normal taxation of an integrated group company.[101] Such a finding can also be derived from the principle of legality.[102] Instead, the determination of the reference framework must be judged based on the actual national rules.

Regarding the status of the OECD TP Guidelines, the Court emphasised that it does not bind the Member States, and even if it incorporates some sort of international consensus on the taxation of associated enterprises, the given transactions could only be examined in light of national provisions.[103] Such a statement can be underpinned by the fact that there are significant differences between the detailed rules in the application of the ALP even among OECD countries.[104]

The CJEU dismissed the Commission's interpretation of previous case law (in particular the *Belgium and Forum 187 v Commission*[105]) that the CJEU meant to establish an autonomous ALP inherent in Art. 107 of the TFEU.[106]

As a conclusion, the CJEU ruled that the Commission erred when it did not take into account the national ALP of Luxemburg tax law in the course of determining the reference framework and such an omission was not properly rectified in

95 C-885/19 P and C-898/19 P, para. 67.
96 C-885/19 P and C-898/19 P, para. 72.
97 C-885/19 P and C-898/19 P, para. 73.
98 C-885/19 P and C-898/19 P, para. 74.
99 C-885/19 P and C-898/19 P, para. 93.
100 C-885/19 P and C-898/19 P, para. 94.
101 C-885/19 P and C-898/19 P, para. 94.
102 C-885/19 P and C-898/19 P, para. 97.
103 C-885/19 P and C-898/19 P, para. 96.
104 C-885/19 P and C-898/19 P, para. 95.
105 C-182/03 and C-217/03.
106 C-885/19 P and C-898/19 P, para. 104.

its alternative line of reasoning either. Consequently, the Commission failed to prove that the rulings constituted a selective advantage.

However, the CJEU left alive its Gibraltar judgment, according to which finding a derogation is not a prerequisite for the existence of State aid ECJ if the reference system in itself, in practice, discriminates between comparable undertakings.[107]

Such a persistence of the findings of the Gibraltar judgment raises the question whether it means that the State aid rules can also apply to tackle tax competition or merely to ensure that free trade is not violated. The author agrees with Prof. Mason when she comes to the conclusion that the Gibraltar case involved discrimination, i.e. unequal treatment, rather than mere tax competition.[108]

4.2.3. The Amazon case

4.2.3.1. Commission Decision

The Amazon case revolves around the tax structure that Amazon set up in Luxemburg. It consisted of a tax-transparent Luxemburgish entity, which was entitled to exploit the intellectual property (IP) relevant to EU business operations and sublicense it to another operating Luxemburgish entity (Lux OpCo). The royalty paid by Lux OpCo to the transparent Luxemburgish entity was regarded as attributable to the latter because of its cost-sharing agreement with the US parent company.

Similar to the Apple case, when Amazon obtained a tax ruling from the Luxembourgish tax authorities, only marginal taxable profits were allocated to Lux OpCo. This was achieved by pricing of the intra-group royalty payment that has been determined as the difference between the EU-level group profits and a pre-defined return of the operating entity as a markup on its operating expenses, while capping it at 0.55% of EU revenue.[109]

The Commission challenged this methodology on the ground that it was not in line with the ALP. First, it argued that the tested party should have been the transparent entity since it was the less complex party under the chosen transactional net margin method (TNMM) given that it did not perform the development, enhancement, maintenance, protection, and exploitation (DEMPE) functions related to the IPs.[110] Second, the Commission held that the profit-split method would have been a more appropriate transfer pricing method, furthermore, choosing the operating expense as a profit level indicator was wrong and adding a ceiling to the markup was incompatible with the ALP.[111]

107 C-885/19 P and C-898/19 P, para. 70.

108 Mason, 2023, p. 21.

109 CJEU, 12 May 2021, T-816/17 and T-318/18, *Amazon,* ECLI:EU:T:2021:252, para. 9.

110 Commission Decision (Amazon case) C(2017) 6740 final of 4 October 2017 on State Aid SA.38944 (2014/C) (hereinafter: Commission Decision, *Amazon*), paras. 407–429.

111 Commission Decision, *Amazon*, paras. 519–558.

4.2.3.2. Judgment of the General Court[112]

The General Court accepted the comparability of standalone and integrated companies on the grounds that the underlying corporation tax system did not distinguish them regarding their tax liability and intended to tax the profit arising from the economic activity of such an integrated undertaking as though it had arisen from transactions carried out at market prices.[113]

The General Court ruled that the Commission could use the ALP together with related international documents, such as the OECD TP Guidelines, to compare the tax burdens of standalone and integrated companies. Thus, the analysis could be carried out in the context of a not purely national reference framework because it was not strictly examined to what extent Luxemburgish law and practice incorporated the principles set out in the TP Guidelines.[114] However, the Commission was obligated to prove that deviations between market-based outcomes and the agreed pricing of the transaction go beyond the inaccuracies inherent in the TP methodology[115] and, consequently, a certain margin of appreciation must be given to the authorities of a Member State.[116]

The status of the OECD TP Guidelines has also been addressed by the General Court. It ruled that – despite their non-binding character – they were relevant to interpret the ALP but only to the extent that these guidelines existed at the time of the issuance of the tax rulings or the later versions only provided for useful clarification of already existing guidelines.[117] Against the background, the General Court easily excluded the relevance of the DEMPE functional analysis carried out by the Commission because it was set out only in the 2017 version of the OECD TP Guidelines.[118] The acceptance of explicit reliance on the OECD TP Guidelines even bearing in mind the temporal limitations set by the General Court could be criticized based on the facts that first, these guidelines constitute soft law instruments, second, they are external to EU law, so that the interpretation of the latter should not depend on those guidelines.[119]

112 It must be noted that at the time of the submission of the manuscript, no CJEU judgment has been yet delivered; however, on 14 December 2023, the CJEU ruled that the Commission failed to prove that Luxembourg granted unlawful State aid to Amazon. The CJEU's reasoning resonates with its former position formulated in the Fiat case. See: CJEU, 14 December 2023, Case C-457/21 P, *Amazon,* ECLI:EU:C:2023:985.

113 T-816/17 and T-318/18, para. 118.

114 Haslehner, and Pantazatou, 2022, p. 99.

115 T-816/17 and T-318/18, paras. 121, 123.

116 T-816/17 and T-318/18, para. 126.

117 T-816/17 and T-318/18, para. 154.

118 T-816/17 and T-318/18, para. 155.

119 Haslehner and Pantazatou, 2022, p. 106.

4.3. The allocation of intellectual property: The Apple case

4.3.1. Background of the case

The first case in which the Commission made its decision[120] was Apple, which revolved around correct profit attribution to the Irish permanent establishments (PE) of Apple's subsidiaries. Two group companies – Apple Sales International (ASI) and Apple Operations Europe (AOE) – were incorporated in Ireland; however, they were not considered tax residents[121] as they were effectively managed by the US. Meanwhile, owing to the US incorporation rule, these companies were also not considered tax residents in the US. Thus, they became stateless entities.

These two companies entered into a cost-sharing agreement with Apple US to share the costs and risks of the R&D activities necessary to develop IP related to technology for Apple's products. In exchange, although Apple Inc. remained the legal owner of the IPs, these companies received royalty-free licences, enabling the manufacture and sale of Apple products worldwide (except in North and South America).[122] Further, ASI and AOE set up Irish branches to manage the procurement, sales, distribution, and manufacturing of Apple products.[123] Against this background, Apple sought for an advanced ruling whereby the profit attributable to the Irish branches has been determined so as to correspond to a *confidential* percentage of their operating costs, (excluding costs such as sums invoiced from affiliated companies within the Apple Group and material costs) and a confidential percentage of the branch' turnover.[124]

4.3.2. Commission decision

The Commission concluded that the tax treatment of the Irish branches constituted a State aid in the form of renounced tax revenue by Ireland in the amount of EUR 13 billion.

The Commission based its decision on two grounds: on a primary line of reasoning and a secondary line of reasoning. In the primary line of reasoning, the Commission argued that the Apple IP licenses should have been allocated to the Irish branches instead of their artificial allocation to non-resident Irish subsidiaries as no relevant functions were performed by the head offices.[125] This is what Kofler labels as 'exclusion approach': if the IP licenses could not be attributed to anywhere else, they should be allocated to the Irish branches.[126]

120 Commission Decision (Apple case) C(2016) 5605 final of 30 August 2016 on State aid SA.38373 (2014/C) (hereinafter: Commission Decision, Apple, 2016).

121 CJEU, 15 July 2020, T-778/16 and T-892/16, *Apple*, ECLI:EU:T:2020:338, para. 3.

122 T-778/16 and T-892/16, para. 6.

123 T-778/16 and T-892/16, paras. 9–10.

124 T-778/16 and T-892/16, paras. 17–19.

125 Commission Decision, Apple, 2016, para. 264 and seq.

126 Kofler, 2022, p. 184.

The secondary line of reasoning of the Commission states that even if one accepts that the IP licenses could not be allocated to the Irish branches, still the wrong transfer pricing method was chosen and, additionally it was applied in an incorrect manner. According to the Commission, the one-sided transfer pricing method, the transactional net margin method (TNMM) did not enable to come to a market-based outcome of profit allocation, especially because the choice of operating expenses as a profit-level indicator was wrong and the profit margin applied to that indicator was too low.[127]

4.3.3. Judgment of the General Court

Upon appeal against the Commission's decision, the General Court annulled the decision and the recovery of unlawful aid on the grounds that the Commission failed to prove that a selective advantage was granted via the examined rulings. The General Court determined the reference framework as being constituted by the ordinary rules of taxing corporations' profits in Ireland, including the taxation of profits of both standalone and integrated companies as well as resident and non-resident companies[128], the latter category of taxpayers only to the extent that they carry out trade in Ireland via a permanent establishment (PE).[129]

Regarding the taxation of the profits of Irish branches (PEs), the General Court pointed out that the Commission was right to place resident companies and Irish branches of non-resident companies in a comparable situation and assume them to be taxed as if they were operating under market conditions.[130] Consequently, the Commission was entitled to apply the ALP as a tool in its State aid analysis under Art. 107 of the TFEU[131] even if the ALP was not explicitly incorporated into Irish law at the time of the issuance of certain rulings.[132] Thus, the General Court accepted that – due to the actual application of the ALP by Irish tax authorities – the ALP could be used by the Commission as a tool together with the corresponding guidance provided by the current OECD TP Guidelines and the Authorised OECD Approach.[133] This dynamic interpretation of the related OECD documents can be seen as problematic as it goes against the principle of legal certainty, even if the General Court regards them as an international consensus, which is rather questionable.[134]

However, it also clarified that the application of the ALP is not a freestanding obligation of the Member States inherent in Art. 107 of the TFEU.[135] Instead, the

127 Commission Decision, Apple, 2016, paras. 328–359.
128 T-778/16 and T-892/16, paras. 140–165.
129 T-778/16 and T-892/16, para. 161.
130 T-778/16 and T-892/16, paras. 212–214.
131 T-778/16 and T-892/16, para. 214.
132 T-778/16 and T-892/16, paras. 217–220.
133 T-778/16 and T-892/16, paras. 212–220.
134 Kofler, 2022, p. 191.
135 T-778/16 and T-892/16, para. 221.

ALP principle gained relevance with reference to Irish law and practice, which showed that it required the existence of a domestic law proxy.[136] Thus, the General Court did not refuse the Commission's approach in theory. Nevertheless, it rejected its findings because they were not compatible with neither the domestic Irish rules, nor the ALP and AOA approach in respect of the exclusion line of arguments and consequently, the Commission erred in attributing functions and activities to the Irish branches that would have justified allocating the IP licenses to them.[137]

Regarding the subsidiary line of argument, the General Court highlighted that mere inaccuracies and methodological inconsistencies in the applied transfer pricing method were not sufficient to prove the existence of State aid.[138]

It is worth noting that the case also stirred a transatlantic debate as the US was triggered by the Commission's allegedly new State aid interpretation. Not only had it repercussions on the European profits of important US companies with a retroactive effect,[139] but the State aid decision also had an impact on the financial interest of the US itself, as the theoretical recovery of the taxes in Ireland could have raised an obligation of the US to credit them as foreign income taxes upon repatriation.[140] However, as things stand now, the Commission's approach will likely be stricken down by the CJEU.

4.4. The selectivity of an aid scheme: The Belgian excess profit regime

The fact pattern of the *Magnetrol*[141] case (also known as the Belgian excess profit exemption regime) is slightly different from that of other tax ruling cases. The first issue was whether an aid scheme[142] existed. After confirming the existence of the aid scheme implemented through a consistent administrative ruling practice, the CJEU referred the case back to the General Court and did not rule on the compatibility of the scheme itself.[143]

136 Kofler, 2022, pp. 189–190.

137 T-778/16 and T-892/16, paras. 251–295.

138 T-778/16 and T-892/16, paras. 352–481.

139 *Treasury Department White Paper on The European Commission's Recent State Aid Investigations of transfer Pricing Rulings* [Online]. Available at: https://home.treasury.gov/system/files/131/WhitePaper-EU-State-Aid-8-24-2016.pdf (Accessed: 3 November 2023). See also: Kofler, 2022, p. 182.

140 Kofler, 2022, p. 192.

141 CJEU, 16 September 2021, C-337/19 P, *Belgium v. Commission (Magnetrol),* ECLI:EU:C:2021:741.

142 An aid scheme is defined under Art. 1 point (d) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the TFEU, OJ L 248, 24.9.2015, 9–29, in the following way: an 'aid scheme' means any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount.

143 C-337/19 P, para. 172.

The excess profit exemption scheme was not implemented under Belgian law. Instead, it was de facto applied by the Belgian tax authorities[144] in a way that differed from the ordinary transfer pricing rules of the Belgian corporate income tax system. The excess profit was calculated on a hypothetical basis as a percentage of the average profit using a profit level indicator of standalone companies. Thus, the starting point of the profit calculation was not the actual recorded profit of the Belgian group company, but a hypothetical one.[145] The Commission concluded that the excess profit exemption scheme was not part of the ordinary Belgian profit taxation system because the Belgian transfer pricing rules, which formed part of the reference framework, only allowed for a downward adjustment given a corresponding adjustment in the counterparty's profit in a different jurisdiction.[146]

Such standpoint was confirmed by the General Court. It ruled that in the light of the objective of the Belgian corporation tax system, which was to tax the actual profits of the companies[147] , the excess profit exemption scheme did not take part of the reference framework.[148] The General Court emphasised that the said reference framework could only be determined with reference to the applicable national law.[149] Based on the national law, the calculated excess profit would have been taxed in the absence of the administrative practice of the tax authorities as reflected in the tax rulings.[150] The General Court ruled that the administrative practice created a derogation from ordinary Belgian transfer pricing rules as the excess profit exemption practice did not require any corresponding adjustment or inclusion of profit in order to apply.[151]

As the identified objective of the tax system was to tax all the profits of Belgian companies and PEs,[152] the General Court found that companies that benefited from the excess profit exemption regime were comparable with both other group entities and standalone entities that did not benefit from the regime.[153] Furthermore, the regime was only available for companies forming part of large or at least medium-size groups,[154] that made investment, created jobs, and centralised activities in Belgium and could only be obtained in the form of an advance ruling.[155]

144 CJEU, 20 September 2023, T-263/16 RENV, T-265/16, T-311/16, T-319/16, T-321/16, T-343/16, T-350/16, T-444/16, T-800/16 and T-832/16, *Magnetrol*, ECLI:EU:T:2023:565 (hereinafter: GC *Magnetrol*), para. 64.
145 GC *Magnetrol*, para. 77.
146 GC *Magnetrol*, para. 45.
147 GC *Magnetrol*, para. 46.
148 GC *Magnetrol*, para. 80.
149 GC *Magnetrol*, para. 40.
150 GC *Magnetrol*, para. 30.
151 GC *Magnetrol*, para. 115
152 GC *Magnetrol*, para. 121
153 GC *Magnetrol*, para. 123
154 GC *Magnetrol*, para. 133.
155 GC *Magnetrol*, para. 125

The General Court refused Belgium's assertion that the objective of the excess profit exemption scheme was to avoid double taxation in the absence of any corresponding adjustment. Therefore, it could not be justified by such an aim.[156]

Following the conclusion that the ruling practice constituted an aid scheme, it was relatively straightforward that such practice constituted unlawful aid. In contrast to the other transfer pricing cases, the treatment did not reflect the domestic ALP, resulting in a derogation from general national rules.

4.5. Some observations regarding tax sovereignty in light of the transfer pricing cases

Section 2 pointed out that positive integration (i.e. the challenges of Member States' tax systems in light of primary EU law) and negative integration (adopting harmonising measures) are not two separate worlds. Rather, there is an interaction between them, and their dynamics affect the tax sovereignty of Member States. Such an interrelationship is worth examining in light of the transfer pricing cases.

In the last decade, two very important directives have been adopted at EU level: the ATAD and the GloBE Directives. The former introduced mandatory measures for the Member States to tackle tax avoidance practices, while the latter goes even further: it established a floor to tax competition even in the absence of abusive situations. Although the Commission lost or seems to lose the State aid cases both in the field of TP cases, yet, the fact that it managed to draw the attention of wide public of harmful tax competition can be perceived as incentivizing the harmonization processes.[157] The connection between the lost cases (where the Commission attempted to use a sort of EU arm's length principle instead of national rules) and positive integration is even clearer in the case of the Transfer Pricing Directive Proposal[158] in the framework of the Business in Europe: Framework for Income Taxation (BEFIT) package. Although the Member States did not violate the State aid rules by way of their lenient transfer pricing rules according to the CJEU, the Commission was successful at highlighting the problematic nature of the application of national arm's length principles within the internal market, the recognition of which might result in the adoption of harmonized rules in this field.

It is more desirable also from the perspective of legal certainty: the use of State aid rules to curb tax competition is problematic as the concept of tax sovereignty prevents the Commission from deciding of what is an appropriate national tax because this decision at EU level can only be taken by means of harmonization.[159] Thus, harmonization, which can only occur by the consent of all the Member States is the

156 GC *Magnetrol*, para. 147.

157 Bacon, 2017.

158 European Commission, Proposal for a Council Directive on transfer pricing, SWD(2023) 308–309 final.

159 Recent trends, CJEU – Recent Developments in Direct Taxation 2020, p. 232.

right alternative to the excessive use of primary EU law beyond their scope to rectify phenomena that are harmful to the internal market, yet there is no available hard law at EU level to eliminate them.[160]

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5. Conclusions

The negative integration of the CJEU shaped the area of direct taxation to a large extent, particularly by applying fundamental freedom provisions and State aid rules to national direct tax measures. The convergence of both tests can be observed and they essentially boil down to a discrimination test. Indeed, they were successful and correct tools to dismantle discriminatory tax regimes. However, they have their limitations: they should not be used as a tool to tackle non-discriminatory tax competition among the Member States. This intention could be seen on the side of the Commission in particular when it carried out its State aid investigations regarding the transfer pricing treatment of multinational group companies obtained in tax rulings.

The Commission seems to lose in these cases, as in the Fiat case, the CJEU annulled the Commission's decision. The CJEU is certainly right to rely on its analysis of the applicable domestic rules of a given Member States and to exclude external principles or rules from the reference framework. This is what the principle of legal certainty and a consistent application of law require.

Nevertheless, the Commission successfully raised awareness of how little tax multinationals may pay in certain jurisdictions (even if legally) and the perceived unfairness might be assumed to urged the Member States to take coordinated measures against it. Consequently, Member States could agree on a variety sets of rules on tackling tax avoidance and, even more surprisingly, on the introduction of a global minimum tax that would require multinationals to pay an effective tax rate of 15% in each jurisdiction in which they operate. Eliminating harmful tax competition via harmonisation is the best way forward, as it improves the functioning of the internal market without restricting the tax sovereignty of Member States to a larger extent, as would follow from the Treaties.

160 de la Feria, 2023, p. 6.

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