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# The Commission's Notice on State Aid and the Tax Ruling Cases: Clarification or Justification?

Christian Grobecker (Sidley Austin LLP) · Friday, July 15th, 2016

On 19 May 2016, the Commission released its Notice on the notion of state aid. The aim of this Notice is to provide legal certainty by clarifying the key concepts relating to the notion of state aid. Ironically, many argue that the Commission has stretched this notion in the tax ruling cases, harming the same legal certainty that the Commission seeks to propagate.

Given the controversy that the tax ruling cases have spawned, it comes as no surprise that the Notice contains a section on tax rulings and settlements. However, the intention of this section seems unclear. Rather than clarifying pre-existing concepts of state aid, the text instead seeks to justify the Commission's approach in the tax ruling cases. As such, the text is provides an insight in the arguments that the Commission may be putting forward in the pending court cases.

**The background: three infringement decisions, three on-going investigations, six appeals**

Following the infamous Lux-leaks, in which an employee of an accountancy firm leaked information on more than five hundred Luxembourgish tax rulings, the Commission quickly requested access to over a thousand national tax rulings to look for any clear infringements of the EU state aid rules. Under Article 107(1) TFEU, unless the EU Treaties provide otherwise, any aid granted by a Member State or through State resources in any form whatsoever is prohibited if it distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods. For their part, tax rulings of national tax authorities intend to give multinational undertakings clarity on the application of the national tax rules to, for example, transfer pricing arrangements or IP licenses. Tax rulings can fall afoul of EU state aid rules if they distort competition by favoring the addressees of the rulings in relation to their competitors. Since the end of 2015, the Commission has adopted infringement decisions against Luxembourg, the Netherlands and Belgium finding that tax rulings by their authorities violated the state aid rules. In addition, the Commission took a preliminary conclusion that another Luxembourgish tax ruling concerned state aid and two further investigations into Ireland and Luxembourg are still on-going.

The Member States targeted by the infringement decisions and several companies concerned by them have now filed appeals to the EU General Court seeking annulment of the decisions. Their pleas in law focus for a large part on the Commission's use of the so-called "arm's length principle" in assessing whether tax rulings constitute prohibited state aid. This principle, defined in the context of the OECD, states that transfer pricing between related undertakings in different countries should be based on a market price, i.e., that the related undertakings are to act as if they

are unrelated in setting their transfer prices. The appellants claim that a Commission state aid assessment cannot rely upon the arm's length principle in assessing the legality of tax rulings under EU state aid rules, as it is not a principle laid down in EU law. They also claim that the Commission is not able to show that the arm's length principle is incorrectly applied, and that the Commission's use of this principle in assessing tax rulings breaches the EU law principles of legal certainty and legitimate expectations.

**The Notice on the use of the arm's length principle in a state aid assessment of tax rulings**

In the three pages of the Notice regarding tax rulings, the Commission relies heavily on the ECJ's 2006 judgment in the *Coordination centres* case (Joined Cases C-182/03 and C-217/03, *Belgium and Forum 187 v. Commission*, ECLI:EU:C:2006:416). In this case, the Court confirmed that, in assessing whether a tax ruling results in prohibited state aid, the Commission must compare the method used by the tax authority for assessing taxable income in the ruling with the method used in the ordinary tax system. If the calculation of transfer prices does "not resemble those which would be charged in conditions of free competition", the tax scheme confers a selective advantage for the purposes of a state aid assessment. As such, the Court focuses on the effects of the tax regime.

In the Notice, the Commission confirms that where "uncertainty justifies an advance ruling", a national tax authority may indicate how it will set arm's length profits for intra-group transactions. However, the method for calculating arm's length profits must give a reliable approximation of a market-based outcome. If not, the tax ruling confers a selective advantage. So far, therefore, the Notice follows the approach of the Court in the *Coordination centres* case.

Interestingly, the Commission then concludes that the arm's length principle is inherent in, and is even an application of, Article 107(1) TFEU. Because of this, the Commission considers that it has a bigger role to play in assessing transfer prices than merely comparing the effects of a method of calculation to a market-based outcome. Rather the Commission concludes that it may have regard to the guidance of the OECD for two reasons. First, because the OECD Transfer Pricing Guidelines for Multinationals Enterprises and Tax Administrations capture an international consensus on transfer pricing. Second, because these guidelines equally aim to produce the outcome that transfer pricing is in line with market conditions. As such, the Commission asserts that it may even assess whether a national tax authority applies the most appropriate method of calculation.

**A clarification or justification of the Commission's practice?**

The Commission's views on the application of state aid rules to the assessment of tax rulings will not come as a surprise for those who have followed the debate over the past few months. However, the Notice leaves the pleas that are raised in the appeals concerning the application of the arm's length principle unanswered. The section on tax rulings seems to justify the Commission's position in the recent infringement decisions more that it seeks to clarify the Commission's practice since the 2006 judgment in the *Coordination centres* case. Especially the Commission's competence to have regard to the OECD Transfer Pricing Guidelines and to assess the appropriate method of calculating transfer prices will be heavily debated in the pending Court cases.

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