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C-885/19 P and C-898/19 P, Fiat on Transfer Pricing Rulings – Did the Commission Lose the Game?

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With its judgment of 8.11.2022, the ECJ's Grand Chamber put an end to the Commission's recent case practice on transfer pricing rulings. In 32 paragraphs (paras 81-112), it seems to have demolished an 8-year laborious effort of the Commission's DG COMP and Legal Service to employ State aid rules against the advance transfer pricing agreements between certain Member States' tax authorities and renowned multinational groups, such as Fiat, Starbucks, Apple and Amazon.

Critical background

The Commission's decision

In its decision of 21.10.2015, the Commission declared a tax ruling issued by Luxembourg on 3.9.2012 to be an incompatible and illegal State aid due to the miscalculation of the transfer prices of Fiat Chrysler Finance Europe (FFT) for the financing and treasury activities it would provide to the Fiat group companies mainly established in Europe (excluding Italy).

To reach that conclusion, the Commission defined broadly the **reference framework**, as comprising **the general Luxembourg corporate income tax system**. That system's objective was to tax the worldwide profits of all companies resident in Luxembourg irrespective of their legal form or structure and in accordance with the same underlying criteria, namely, for instance, an identical tax rate. Given the **absence of a distinction between integrated and stand-alone companies**, the intention of the Luxembourg tax system was to treat, from a tax perspective, both types of companies on an equal footing. Thus, when assessing whether the tax ruling lowered FFT's fiscal burden *vis-à-vis* the burden that FFT would suffer in the absence of that ruling, the Commission compared the pricing of FFT's intra-group transactions with the prices that would be agreed in comparable uncontrolled transactions between stand-alone companies, carrying on their activities under market conditions.

The Commission noticed that such a comparison **is precisely reflected in the purpose of the 'arm's length principle' (ALP)**. As a result, it went on, the ALP "*necessarily forms part of the Commission's assessment under Article 107(1) TFEU of tax measures granted to group companies, **independently of whether a Member State has incorporated this principle into its***

national legal system". On top, it reflects "***a general principle of equal treatment in taxation*** *falling within the application of Article 107(1) TFEU*".

As with every legal term in EU law, the ALP deployed by the Commission enjoyed an autonomous meaning. While not mirroring it, the newly fledged 'EU law – ALP', as Kyriazis accurately calls it, could be at least inspired by the ALP enounced in Article 9 of the OECD Model Tax Convention and analysed in the more than 300 pages of OECD Transfer Pricing Guidelines, which, in the Commission's words, 'capture the international consensus on transfer pricing'.

Against those findings, the Commission **refuted the pertinence of the way Luxembourg incorporated the ALP into its national legislation** through Article 164(3) of the 2012 Luxembourg Tax Code and the less than 10 pages Circular No 164/2 of 28.01.2011 which specifically addressed transfer pricing within group financing companies, such as FFT.

Given its deviation from the 'EU law – ALP', the tax ruling constituted a derogation from the reference system and, consequently, a selective advantage in so far as it differentiated between integrated company FFT and stand-alone companies who, in the light of the objective intrinsic to that system, were in a comparable factual and legal situation.

The General Court's judgment

With its judgment of 24.9.2019, the General Court endorsed the Commission's theory. After finding that the Commission also adequately *applied* the ALP, the General Court dismissed the actions for annulment.

Attention though shall be drawn to the nuance provided by that judgment. By reading the contested decision into "*context*", the General Court found the Commission to have perceived the ALP "***only as a tool*****",** and not as a general principle of law. The 'EU law – ALP' was thus turned into the 'Commission's ALP'. Still, the Commission could not be criticised for having used a methodology for determining pricing that it considered appropriate in order to give substance and teeth to the objective pursued by the Luxembourg tax system itself.

The ECJ's judgment

The Court, mainly building on Advocate General Pikamäe's Opinion in Ireland's appeal, decided to set aside the General Court's judgment and annulled the Commission's decision. Its reasoning is straightforward.

The General Court's validation of the Commission's analysis concerning **the determination of the reference framework is vitiated by an error of law**. The Court underlined that "***only the national law*** *applicable in the Member State concerned* ***must be taken into account in order to identify the reference system*** *for direct taxation*" (para. 74). Such identification must be carried out following an exchange of arguments with the Member State concerned and an objective examination of the content, structure, interaction and the concrete effects of the applicable rules under the national law of that State (paras 72 and 92). Therefore, the General Court erred in law when confirming that the ALP's application is justified *independently* of whether a Member State

has incorporated this principle into its own legal order.

The Court admitted that, in the present case, Luxembourg law reflected the purpose of the ALP. However, it stressed that that national law also defined **the specific detailed rules for the application of that principle**, namely Article 164(3) of the Tax Code and Circular No 164/2 regarding financing integrated companies (paras 93 and 98). Those instruments reflected Luxembourg's **legislative choices** aimed at clarifying the scope of the ALP and its implementation in the national legal order (para. 99). The Commission was thus bound to examine how the ALP, as enshrined therein, **had been interpreted and applied** (para. 100).

That is because, although the member States of the OECD recognise the merits of using the ALP, "***there are significant differences between those States in the detailed application of transfer pricing methods***", whereas, on top, the OECD Guidelines endorse several alternative methods (para. 95).

Hence, in the absence of harmonisation in EU law, any fixing of the methods and criteria for determining an ALP's outcome falls within the discretion of the Member States (para. 95). Parameters and rules external to a national tax system cannot be considered unless the latter makes "***explicit*** *reference to them*" (para. 96). This finding is an expression of **the general principle of legality of taxation**, which requires that "*any obligation to pay a tax and all the essential elements defining the substantive features thereof must be provided for by law, the taxable person having to be in a position to foresee and calculate the amount of tax due and determine the point at which it becomes payable*" (para. 97).

The Commission thus lacked any competence to impose an ALP different from that defined by Luxembourg law. That competence belongs to the Member States. Having ruled otherwise, **the General Court also infringed Articles 114(2) and 115 TFEU** relating to the adoption by the EU of measures for the approximation of Member State legislation to direct taxation (para. 94).

Against those findings, the Court unsurprisingly scraped away the Commission's persistence in invoking *Belgium and Forum 187 v Commission* (paras 107-112). In that case, the Belgian legislator had explicitly opted for an ALP method similar to the OECD 'cost-plus' method.

The Court concluded that the General Court's error of law in the determination of the reference framework necessarily invalidates the entirety of its reasoning relating to the existence of a selective advantage (para. 118).

Comment

Fiat was the only case the Commission had won before the General Court in the transfer pricing rulings cases. Conversely, it had lost in *Starbucks*, *Apple* and *Amazon*. The Commission had certainly blown its lead but had not yet been defeated. In those cases, the General Court had left intact the Commission's theory – albeit transforming the 'EU law – ALP' into a 'Commission's ALP' – and had annulled the contested decisions only due to their failure to satisfy the requisite evidential requirements.

One could assert that upon the delivery of the Court's judgment in *Fiat*, the Commission finally lost the game. **However, drawing such a conclusion presupposes the delimitation of what that**

'game' was about.

- If the game was confined to establishing the existence of an autonomous 'EU law – ALP', the Commission undoubtedly lost it. The Court dismantled both of its overarching features:

First, an ALP cannot apply *independently* of whether a Member State has incorporated such a principle into its national legal system. If that system attributes income to an integrated company pursuant to specific rules which though do not explicitly implement a principle analogous to the ALP, that system's objective is **not** to fiscally treat the transactions of integrated and stand-alone companies in the same way and, in that respect, **does not** place those companies in a comparable factual and legal situation. The reference framework is narrow, solely encompassing the specific transfer pricing rules of group companies. In such a case, any allegedly favourable tax treatment of those companies as compared to stand-alone ones falls outside the remit of State aid rules. That might indeed undermine a level playing field for all economic operators in the internal market and distort free competition. However, in the absence of harmonisation, it is for the Member States, by exercising their fiscal autonomy, to determine the characteristics constituting their tax system and define the reference framework. State aid rules cannot impose a principle of equality between two different types of taxpayers whom a Member State has chosen **not** to treat on an equal footing in relation to the pricing of their transactions.

Second, even if national legislation expressly incorporates an ALP, the parameters feeding that principle lie within the purview of the Member States. Such parameters are not to be perceived as a merely technical "*tool"* that simply reflect an undisputed economic reality. That was actually the tacit admission by the General Court – the inventor of the "*tool*" term – when reproaching the Commission in *Amazon* for using versions of the OECD Guidelines adopted *after* the issuance of the contested tax ruling, holding that certain modifications were not simple clarifications but "***entirely new elaborations*** (…) *which were not contained, including implicitly, in the earlier versions"* indicating that OECD's recommendations *"**have evolved significantly***" (paras 152 – 155 of that judgment).

Given that transfer pricing analysis is not an exact science and domestic laws differ in their detailed application, the parameters adopted by a Member State reflect "***legislative choices***". Therefore, the endorsement of the 'Commission's ALP', which seemingly embodies the OECD Guidelines and the limited work of the EU Joint Transfer Pricing Forum (see recitals 265-268 of the Commission's decision in *Amazon*), would have inevitably led to harmonisation in disguise, at variance with the **allocation of competences** between the Union and the Member States.

It will be interesting to see how the Court's *dicta* in *Fiat* will affect the pending transfer pricing cases before the EU courts. In *Belgian Excess Profit* [1], it will depend on the precise content of the parties' pleas and whether they are sufficiently directed against the Commission's theory on the existence of an 'EU law – ALP'. In *Apple* [2] and *Amazon* [3], it will depend on whether, and on what exact grounds, the parties have lodged cross-appeals against the Commission's appeals. Those considerations are vital since, as delicately demonstrated by AG Pikamäe's Opinion on Fiat's appeal (points 58 et seq.) if a party has not criticised the foundations of the Commission's theory as such, the EU courts will probably not do it on their own motion.

- If the game was about the Commission seeking clarity about how it can efficiently enforce State aid rules in transfer pricing cases, it is not over yet.

The Court, after debunking the 'Commission's ALP', gives the impression to have left the door ajar for the Commission to pursue transfer pricing rulings through State aid rules. It held: "[i]*n particular, after having observed that a Member State has chosen to apply the arm's length principle in order to establish the transfer prices of integrated companies, the Commission must, in accordance with the case-law cited in paragraph 70 of the present judgment* [C?106/09 P and C?107/09 P, Commission v Gibraltar and, '*to that effect*', C?374/17, A-Brauerei], *be able to establish that the parameters laid down by* ***national law*** *are* ***manifestly inconsistent*** *with the objective of non-discriminatory taxation of all resident companies, whether integrated or not, pursued by the national tax system, by* ***systematically*** *leading to an undervaluation of the transfer prices applicable* ***to integrated companies or to certain of them****,* ***such as finance companies****, as compared to market prices for comparable transactions carried out by non-integrated companies.*" (**para. 122**).

While the Court accepts that the incorporation of the ALP into national legislation broadens the reference system and renders the situations of integrated and stand-alone companies comparable, it sets the bar particularly high. At first sight, and considering the citation to *Commission v Gibraltar*, the Court seems to envisage a possible existence of incompatible State aids in situations where an **aid scheme** is found to exist.

Accordingly, a clarification is needed. A meticulous reading of the entire judgment leads to the conclusion that by "*national* ***law***", the Court is not exclusively referring to domestic *legal* provisions but also to the relevant *administrative* soft law and practice.

Still, an aid scheme, whether of legal or administrative nature, that *manifestly* benefits *all* integrated companies is hardly conceivable. National provisions implementing the ALP *vis-à-vis* all such companies usually lay down a limited number of criteria for calculating transfer prices (sometimes also pointing to the OECD's soft law). Such criteria will unlikely be considered as manifestly inconsistent with the ALP's purpose. At the same time, the General Court itself has considered such criteria to be objective – even if merely articulated in the national provisions without being explained – thus not vesting the tax authorities with an overly broad discretion (paras 493-500 of its judgment in *Apple*). In addition, one may wonder *which* ALP will be the benchmark to assess the national transfer pricing rules applying to *all* integrated companies.

In that vein, the condition of "*manifestly*" merits further interpretative guidance. The ambiguity of that notion is obvious when considering that, in the Commission's own eyes, the transfer pricing cases discussed here, which were selected among more than 1000 tax rulings looked at by the Commission, reflected *manifest* deviations from the ALP.[4] In principle – and bearing in mind the Court's acceptance of the divergences in national legislations as regards the ALP parameters – any departure from the objective of non-discriminatory taxation of all resident companies shall be so blatant that goes way beyond a range of possible economic outcomes at the discretion of the tax authorities. That's a tall order.

The above concerns are also pertinent for the alleged aid schemes favouring "*certain* [integrated companies], *such as financing companies*". Arguably, such schemes might exist on account either of special legal and administrative provisions, as in *Belgium and Forum 187 v Commission*, or of a systematic administrative practice, as in *Belgian Excess Profit*. However, even such provisions may be succinct, as the Commission argued in its *Fiat* decision (recitals 321-325), while it is often hard to trace administrative tax rulings addressing companies carrying similar activities (see e.g. General Court's judgment in *Apple*, para. 502). At least, if national legislation has generally adhered to the ALP (and, even better, refers to the OECD Guidelines) there is a benchmark to serve as the Commission's starting point.

In light of the above, it is critical to answer whether the Court excluded outright the possibility of the Commission establishing an **individual aid**. In my view, the Court's judgment as a whole leaves such a possibility open. Where a tax ruling manifestly departs from the ALP as stipulated in national law, an individual aid is deemed to exist. For instance, the tax ruling in *Fiat* could indeed be classified as conferring a selective advantage due to its apparent deviation from *Luxembourg's* ALP. One reason why the Commission refrained from using the latter might be traced to its intention to pave the way for its decision in *Apple*, where an ALP was absent in the Irish legislation (with the appropriate acknowledgement, of course, to be made to the Commission's Legal Service appeal to a 1985 judgment of the Irish High Court in its written submissions). Another reason might lie in the Commission's claim about the "*overly broad*" guidance given by Circular No 164/2. If that's the case, the Court's judgment appears to reveal that there *was* a 'national path' for the Commission to follow since a *manifest* breach can be established even in relation to laconic domestic provisions.

- If the game was not merely fought on legal grounds but was extended to the political arena, the Commission seems to have reasons to celebrate, albeit tentatively.

In her reaction to the *Fiat* judgment, Commission Vice-President Vestager noted that "*many Member States have incorporated OECD rules and introduced ruling practices to address loopholes and ensure more tax fairness*". She thus frames a wider agenda, of which even the adoption of the Anti-Tax Avoidance Directive (ATAD) in 2016 could be part of. If that was the ultimate goal of the Commission, then some can discern subtle grounds for contentment. Nonetheless, one could rebut that the Commission's unprecedented targeting of transfer pricing arrangements aimed to nudge the Member States to proceed with the approval of the Commission's proposal for a Common Consolidated Corporate Tax Base (CCCTB), which would entail vast harmonisation in the allocation of income between integrated companies and would essentially wipe out the Commission's novel ALP. That proposal though has long lost its course, although recently trying to be brought back to life through the eventual insertion of an apportionment formula in the Commission's initiative for a 'Business in Europe: Framework for Income Taxation' (or else BEFIT).

All in all, if one looks at the broader picture, the teams in Madou and Berlaymont need only to be regrouped. "*The* [game] *must go on*".

[1] Pending case T-131/16 RENV, *Belgium v Commission*. The case was referred back to the General Court after the Court's annulment of the latter's finding that the national measures at issue did not constitute an aid scheme.

[2] Pending case C-465/20 P, *Commission v Ireland and Others*.

[3] Pending case C-457/21 P, *Commission v Amazon.com and Others*.

[4] DG competition working paper on state aid and tax rulings of 3 June 2016, paras 6 and 23.

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