STATE AID AND TAXATION

The European Commission’s decisions on tax rulings in the broader State aid perspective

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While the Commission’s focus on tax rulings is relatively recent (2013), the general application of the State aid rules to national tax measures is a long-settled practice. In fact, as early as 1974, the Court of Justice of the EU (CJEU) clarified that the Commission’s competences in the field of State aid also cover the area of direct business taxation. In 1998, the Commission adopted a Notice on the application of the State aid rules to measures relating to direct business taxation, which was replaced in 2016.

State aid rules prohibit fiscal measures that give a selective advantage to the beneficiary. As a rule, fiscal measures that are not of a general nature and that unjustifiably discriminate between taxpayers in a similar factual and legal situation constitute State aid. According to the CJEU case law, the selective nature of tax measures must be assessed on the basis of a three-step test.
Although the above three-step analysis has not always been closely followed by the European Courts (i.e. Gibraltar, British Aggregates, Heiser), it has consistently been applied in the recent judgments in the Spanish goodwill-cases. More recently, it was confirmed by the CJEU’s Grand Chamber with regard to the German tax exemption for the acquisition of intangible assets by companies owning at least 95% of the shares (A-Brauerei).
THE THREE-STEP SELECTIVITY TEST APPLIED TO TAX RULINGS

The Commission’s application of the three-step selectivity test to tax rulings has been severely criticised. The McDonald’s case demonstrates that correctly applying the test is decisive for the outcome of the State aid assessment. In this final decision, the Commission has recognised that its initial doubts about the existence of State aid were related to the erroneous assumption that Luxembourg misapplied the provisions of the reference system in favour of McDonald’s. The Commission concluded that the double non-taxation of certain profits was the result of differing interpretations of the double taxation treaty by Luxembourg and the US. Consequently, the Commission closed the investigation by concluding that Luxembourg did not grant State aid in the form of a selective tax advantage to McDonald’s.

ASSESSMENT TRANSFER PRICING RULINGS

With respect to the assessment of tax rulings endorsing a transfer pricing methodology to determine a corporate group entity’s taxable profit, the Commission’s application of the three-step test results in two closely-linked issues. These issues relate to the definition of the reference system, and are crucial for the outcome of the State aid assessment:

1. the broad definition of the reference system and its objectives; and
2. the assumption that there is a uniform European ALP

1. The broad definition of the reference system and its objectives

The Commission has adopted a very wide definition of the reference system, namely the national system for corporate income tax, which applies to all corporations, including standalone firms and groups of companies. In essence, the objective of the corporate income tax regime is to tax the profits of all corporations in a non-discriminatory way.

The inevitable consequence of the Commission’s broad definition of the reference system is that transfer pricing rulings endorsing a method that results in a different outcome for a corporate group than a stand-alone company are viewed as a discriminatory derogation from the reference system (second step). This approach seems to be in line with the CJEU’s case law on fiscal measures as confirmed in the recent rulings in the cases on the Spanish goodwill scheme and A-Brauerei. However, if the reference system were to be defined more narrowly, e.g. as the common system applicable to transfer pricing (potentially including the – at times not binding – OECD Transfer Pricing Guidelines), it would be far more difficult to establish deviations from the reference system under the second step, since all corporate groups would be taxed on the same basis. Despite support from the relevant corporate groups and Member States for a more narrowly defined reference system, the Commission’s approach has not changed.

The broad definition of the reference system has actually been applied in all the cases concerning tax rulings. For instance, in Huhtamäki, the Commission found the deemed interest deductions to constitute a derogation from the reference system, since it allowed Huhtamäki to achieve an effective tax rate that is significantly lower than the rate applicable to standalone companies. Likewise, in Nike the
Commission’s preliminary findings are that there is a
derogation from the reference system because of the
higher royalty payments by Nike in comparison to
those negotiated on market terms between
standalone companies. Comparable scenarios can be
found in the Commission’s decisions in Starbucks
and Amazon, which both have appeals pending
before the General Court. We do not expect a final
verdict on the correct definition of the reference
system in the short term, as it is likely that the
General Court’s judgments will be appealed by either
the Commission or the company concerned.

2. The assumption of a uniform European ALP designed to avoid discrimination

Taking into account that the general objective of the
reference system is to tax all companies subject to
this system, corporate groups must select a transfer
pricing method that reflects a market-based
outcome. The Commission views the OECD
Guidelines as useful guidance and it has repeatedly
stated that “if a transfer pricing arrangement
complies with the OECD Transfer Pricing Guidelines,
a tax ruling endorsing that arrangement is unlikely
to give rise to State aid”.

However, in its decisions, the Commission interprets
the ALP as a uniform European principle meant to
ensure an equal tax treatment of all the firms
subject to the reference system. The Commission’s
restrictive interpretation of the ALP is illustrated in
the Fiat, Apple and the Excess Profit case. In these
cases, the Commission considered in essence that
due to the incorrect allocation of profits and the
endorsed transfer pricing methodology (including a
number of adjustments) the respective taxable base
of these multinationals was artificially lowered and
did not reflect a market-based outcome. Arguably,
this view is inconsistent with the OECD Guidelines,
which acknowledge that the ALP is a method aimed
at estimation, which shows that a precise result is
not possible to achieve. Moreover, the Commission’s
interpretation of the ALP limits the margin of
discretion of multinationals and tax authorities to
achieve the result pursued by the reference system,
namely taxing the income of all firms on equal
terms. After all, the essence and the objective of the
common national practice concerning transfer
pricing tax rulings is achieving legal certainty on
taxation on equal terms taking into account the
particularities of corporate groups. It remains to be
seen whether the Commission’s interpretation of the
ALP will be followed by the European courts.

RECOVERY OF UNLAWFUL STATE AID

The conclusion that a tax ruling is State aid may
have severe financial consequences. In addition to
prohibiting the maintenance of the ruling, the
finding that State aid has been granted without prior
notification to the Commission will normally require
the Member State to recover the amount of aid
granted over the ten preceding years, plus interest.

LEGITIMATE EXPECTATIONS

The question is whether a recovery order can be
successfully countered by a claim of legitimate
expectations raised by the tax authority that the
tax ruling is compatible with the State aid rules.

It follows the case law of the European Courts that
such a claim is rarely accepted, since companies
benefitting from State aid are considered to be
responsible themselves for ensuring compliance
with the notification obligation (see e.g. Alcan). In
one of the Spanish goodwill-cases, the General Court
ruled that the beneficiaries of the measure at issue
could legitimately take the view that that measure
did not constitute State aid, because, in its answer to
a parliamentary question, the Commission had provided clear assurances that the measure did not fall within the scope of the rules on State aid.

**NEW RECOVERY REGIME FISCAL AID**

With regard to the recovery of unlawful State aid resulting from Dutch tax measures, including tax rulings issued by the Dutch tax authority, a specific recovery regime has been introduced on 1 July 2018 by means of the new Recovery Act State aid. This act provides a legal basis for the recovery of unlawful State aid ordered by the Commission, a national court or the tax authority via an additional tax assessment (see our Update on the entry into force of the Recovery Act State aid (in Dutch only)).

**CONTACT**

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