Upsetting the Apple Cart: European Commission State Aid Rulings and State Tax Sovereignty

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Abstract

Since its founding as a common market, the European Union has worked to promote a single market without internal borders or trade barriers. Recent years have seen increased attention by nations to the harmful competitive distortion caused by tax measures. Recently the European Commission for Competition has focused on tax measures constituting state aid. Its discretionary executive authority in the area of direct taxation must be balanced against Member State tax sovereignty, reserved to Member States subject to a legislative unanimity requirement in the Treaty on the Functioning of the European Union, Article 115. Legislative guidance would be welcome but has not been forthcoming. In the absence of legislative guidance, the Commission's examination of transfer pricing in state aid cases must be exercised prudentially in circumstances where the action risks upsetting the balance between Member State tax sovereignty and EU treaty authority by implementing new tax principles in national tax legislation.

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Abbreviations

AFPTE	Association for the Promotion of Touristic and Economic Flows
ALP	The Arm's Length Principle
APA	Advance Pricing Agreement
CJEU	Court of Justice of the European Union
ECSC	European Coal and Steel Community
EEC	European Economic Community
EU	The European Union
OECD	Organization for Economic Cooperation and Development (or Organisation for Economic Cooperation and Development)
TEU	Treaty on the European Union
TFEU	Treaty of the Functioning of the European Union

Chapter I.

Introduction

In September 2019, the General Court of the European Union (EU) issued two decisions, *Netherlands v. Commission*, T-760/15 and T-636/16 (Starbucks), and *Luxembourg v. Commission*, T-755/15 and T-759/15 (Fiat), confirming the European Commission for Competition's (Commission) application of European Union (EU) state aid rules to advance tax rulings on transfer pricing, explicitly confirming the Commission's authority to verify the arm's length nature of transactions between related parties. Although the Commission lost the former case, its authority and reasoning were upheld so that the Commission can rightfully claim victory. The Commission did not appeal its loss. Fiat, but not Luxembourg, has filed an appeal.

The legal proceedings continue. Yet an underlying question remains. While the Commission has the authority to examine national tax rulings, should it exercise caution? Historically direct taxation has constituted an essential element of sovereignty. Through treaty, EU member states have agreed to limit sovereignty in many ways. This paper will examine the extent to which they have done so in the area of direct taxation and whether as a prudential matter, the Commission risks upsetting the balance between retaining and yielding sovereignty that is embedded in agreeing to EU membership.

Direct taxation is reserved to the EU Member States, with EU tax legislation requiring unanimity. Member State authority is not unfettered but is subject to EU treaty restrictions. State aid is an example of one type of restriction: the Commission can act to supersede national legislation on direct taxation that distorts trade or competition in the

internal market, but subject to the principle of subsidiarity. As an executive body, the Commission cannot legislate. Neither the Commissioner nor her staff, the Directorate-General for Competition, possess legislative authority. Absent legislative action, prudence would dictate that the Commission respect the boundaries of legislative and executive institutions and exercise restraint in applying state aid where it would have the effect of implementing new tax principles in national law.

This paper seeks to answer the following question: Has the Commission's state aid initiative exceeded its mandate and upset the balance between Member State sovereignty and EU Treaty authority? To answer this question, I will briefly examine the current state of play and then discuss the origins of the European Community as well as describe the institutions relevant to state aid and tax. I will then examine Commission state aid guidance relating to tax as well as recent (since 2015) state aid cases. This paper argues that the Commission's exercise of executive authority, even assuming a valid aim of protecting the internal market, risks upsetting the careful balance reflected in the structure of EU treaties and institutions between reserving key elements of sovereignty to member states and yielding sovereignty to the EU. Recognizing the fluid nature of state aid law and the ongoing court actions, this paper is intended not to be a legal paper but a philosophical one.

Chapter II.

How Did We Get Here? A Recent History

Since it appears that state aid in the area of transfer pricing rulings is here to stay, it is useful to understand how we arrived here. Beginning in June 2013, the Commission started investigating tax rulings granted by individual European Union Member States, and, by 2014, began investigating all Member States.[1] An early target included Luxembourg tax rulings that allowed McDonald's to avoid corporate taxes in the United States.[2] Additionally, the Commission focused on whether three nations had provided state aid to multinational enterprises (MNE) in the form of tax rulings known as advance pricing agreements (APAs). These three countries and the MNEs involved were: Ireland (Apple), the Netherlands (Starbucks and Amazon), and Luxembourg (Fiat).[3] Since 2014

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[1] European Commission "State of Play" http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html. This page reflects the "state of play" of Commission state aid investigations.

[2] European Commission Press Release, "State aid: Commission investigation did not find that Luxembourg gave selective tax treatment to McDonald's," September 10, 2018. https://europa.eu/rapid/press-release_IP-18-5831_en.htm. In September 2018, the Commission concluded that the non-taxation of certain McDonald's profits in Luxembourg complied with national tax laws and the Luxembourg-United States Double Taxation Treaty and therefore was not illegal state aid.

[3] Commission Decision 2017/502 (Oct. 21, 2015) on state aid implemented by the Netherlands to Starbucks, 2017 O.J. (L 83) 38, para. 254; Commission Decision 2016/2326 (Oct. 21, 2015) on state aid implement by Luxembourg to Fiat, 2016 O.J. (L 351) 1, para. 219 and Commission Decision 2017/1283 (Aug. 30, 2016) on state aid implemented by Ireland to Apple, 2017 O.J. (L 187) 1, para. 224.

the Commission has initiated additional investigations against the Netherlands (Nike, Engie) and Luxembourg (Ikea, Huhtamaki).

The Commission rendered its first decisions against the Netherlands and Luxembourg in October 2015. The Commission ordered the two Benelux countries to recoup 20-30 million euros from Starbucks and Fiat.[4] Far more staggering was the Commission's 2016 decision involving Apple. The Commission announced that Ireland's tax rulings had allowed Apple to pay substantially less tax than other businesses and ordered Ireland to recover 13 billion euros from Apple.[5] The EU explained that it was ensuring that "EU rules apply in a fair manner to any company that does business in the EU's single market - regardless of size, sector or nationality"[6] and its actions "(e)liminat(ed) the loopholes and mismatches between national systems."[7]

These investigations sparked outrage from EU nations, MNEs, and the United States. Some argued that the state aid rules were being misused:

> When the State aid rules were enacted, it is hard to imagine that the drafters intended to create an instrument for fighting harmful tax competition within the internal market decades later. Neither would they have realized they would

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[4] European Commission Press Release, "Commission Decides Selective Tax Advantages for Fiat in Luxembourg and Starbucks in the Netherlands are Illegal under EU State Aid Rules," October 20, 2015, https://europa.eu/rapid/press-release_IP-15-5880_en.htm.

[5] Ibid.

[6] EU Commission for Competition, Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Report on Competition Policy 2016 COM (2017), 285, 2. https://ec.europa.eu/competition/publications/annual_report/2016/part1_en.pdf.

[7] European Commission Publication "An EU Agenda for Taxation," November 8, 2016. https://ec.europa.eu/commission/publications/eu-agenda-taxation-two-years_en.

> have such a widespread effect on international tax affairs globally The State aid regime was therefore not designed to pursue the objective of combatting harmful tax competition, and a wide interpretation of the State aid rules may lead to damaging effects, such as uncertainty and unnecessary restrictions of the sovereignty of Member States.[8]

The U.S. Secretary of Treasury protested the targeting of U.S. companies.[9] Others criticized the rulings as an attack on sovereignty or as a novel, unforeseen departure from existing law.[10]

EU supporters applauded the EU's efforts "to stamp out tax avoidance and evasion, boost tax transparency and introduce measures to harmonise taxation across EU member states."[11] Some rejoiced in the move "towards a people's Europe" not controlled by MNEs.[12]

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[8] Emily Forrester, "Is the State Aid Regime a Suitable Instrument to Be Used in the Fight against Harmful Tax Competition?*" EC Tax Review* 27, no. 1 (2018): 30; Liza Lovdahl Gormsen, "By Singling Out Apple over Taxes, Brussels Is Abusing Its Own Rules," *The Telegraph*, August 28, 2016, https://www.telegraph.co.uk/business/2016/08/28/brussels-mustnt-achieve-tax-reform-by-using-state-aid-rules-crea/.

[9] Letter from Jacob J. Lew, U.S. Secretary of the Treasury, to Jean-Claude Juncker, President of the European Commission, February 11, 2016, 1, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Letter-State-Aid-Investigations.pdf.

[10] *See, e.g.*, Caroline Byrne, "Apple Q&A: Kennedy Condemns Commission's Decision," *International Tax Review* 27 (2016): 35-37; Liza Lovdahl Gormsen, "EU State Aid Law and Transfer Pricing: A Critical Introduction to a New Saga," *Journal of European Competition Law & Practice* 7, no. 6 (2016): 382; Forrester, "State Aid Regime," 27.

[11] Anjana Haines and Amelia Schwanke, "Multinationals and the EC Engulfed in State Aid Disputes," *International Tax Review* 27 (October 2016): 27.

[12] Ibid., 34; Molly Scott Cato, "Give Me Faceless EU Bureaucrats over the Tories and Their Corporate Cronies," *The Guardian*, August 31, 2016. https://www.theguardian.com/commentisfree/2016/aug/31/faceless-eu-bureaucrats-tories-corporate-cronies-margrethe-vestager-apple-brexit.

State aid law in the tax arena remains a work in progress. With the Commission's state aid rulings appealable to the General Court of the European Union and then to the European Court of Justice, the legal framework will take years to solidify.[13] While the courts will determine whether the Commission's state aid rulings are legal, Margrethe Vestager's reappointment as the Commissioner for Competition, as well as her expanded powers as the European Commission's Executive Vice-President for a "Europe fit for the Digital Age,"[14] signals that the Commission will continue to actively investigate state aid.

To understand the background to the current debate, the next chapter will provide a brief discussion of the origins of the EU.

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[13] The General Court of the European Union annulled the Commission's finding of state aid in the *Belgian Excess Profits Case* on February 14, 2019. Joined Cases T-131/16 *Belgium v Commission* and T-263/16 *Magnetrol International v Commission*. ECLI:EU:T:2019:91. This case involved a general scheme rather than individual aid.

[14] European Commission, Mission Letter, "Margrethe Vestager, Executive Vice-President-designate for a Europe fit for the Digital Age," September 10, 2019, https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-margrethe-vestager_2019_en.pdf.

Chapter III.

From Then to Now—Key Events in the History of the European Union

Today's EU is rooted in the post-World War II era. Founders Jean Monnet and Robert Schuman envisioned a Europe where states would cede sovereignty "to create among Europeans the broadest common interest, served by common democratic institutions to which the necessary sovereignty has been delegated."[15] Businessman Monnet had long espoused an integrated Europe.[16] In 1914, the 26-year old Monnet met with the French Prime Minister to pitch the idea of a multinational navy to fight the war. His efforts led to the 1918 birth of the Allied Maritime Transport Council (AMTC), composed of delegates from the U.S., France, and Great Britain.[17] By age 31 he was appointed an official of the League of Nations. Like the AMTC, the League was based on cooperation. This cooperative model frustrated Monnet who thought integration was needed.[18] As one commentator explains:

> The main difference between both options lies in the concept of sovereignty, cooperation means that the national sovereignty is kept intact. But in the case of integration, all the members share a part of their national sovereignty between them, creating a new multinational level holder of a new sovereignty. Hence, the member states of the

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[15] Jean Monnet, *Memoirs*, trans. Richard Mayne (Garden City, NY: Doubleday, 1978), 523.

[16] David Ramiro Troitiño, "Jean Monnet before the First European Community: A Historical Perspective and Critic," *Trames: A Journal of the Humanities and Social Sciences* 21, no. 3 (2017): 193.

[17] Ibid., 199.

[18] Monnet, *Memoirs*, 281.

> organization do not surrender their sovereignty but share it, and create a new autonomous institution to manage it.[19]

Monnet was behind Winston Churchill's extraordinary 1940 declaration proposing "that France and Great Britain shall no longer be two nations, but one Franco-British Union."[20] The proposal died with the fall of France, but Monnet's commitment to an integrated Europe did not.

After the war, Monnet promoted a "federation of the West" independent of American economic aid and military protection.[21] When the new Organization for European Economic Co-operation (OEEC), the predecessor to the Organization for Economic Development (OECD), came into being on April 16, 1948 as a permanent organization to promote European recovery and distribute aid, he criticized it as unable to "bring unity, because there it was laid down that anyone could be exempted from decisions that he found difficult" and "which entailed no delegation of sovereignty."[22] Monnet helped draft French foreign minister Robert Schuman's May 9, 1950 Declaration proposing the creation of a European Coal and Steel Community (ECSC) whose members would pool coal and steel production.[23]

> By pooling basic production and by instituting a new High Authority, whose decisions will bind France, Germany and other member countries, this proposal will lead to the

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[19] Troitiño, "Jean Monnet," 202.

[20] Ibid., 208.

[21] Monnet, *Memoirs*, 272.

[22] Ibid., 273.

[23] Ibid., 295-300.

> realization of the first concrete foundation of a European federation indispensable to the preservation of peace.[24]

The declaration led to the 1951 signing of the Treaty of Paris, also known as the European Coal and Steel Community Treaty (ECSC), a pooling of coal and steel communities that would prohibit war between France and Germany by transferring Germany's industrial resources to a European authority for the use of the signatories.[25] It was "a complex commercial treaty establishing the ECSC as a regulated market-sharing arrangement under supranational control."[26]

Building on the Spaak report and the *Travaux Preparatoires* of the EEC Treaty, "two milestones leading to the introduction of the State aid rules in the Rome Treaties,"[27] the ECSC Treaty featured a broad view of state aid. ECSC Art 4(c) abolished "subsidies or aids, granted by States or special charges imposed by States, in any form whatsoever."[28] An early European Court of Justice opinion explained:

> A subsidy is normally defined as a payment in cash, or in, kind made in support of an undertaking other than the payment by the purchaser or consumer for the goods or services which it produces. An aid is a very similar concept, which, however, places emphasis on its purpose and seems especially devised for a particular objective

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[24] Ibid., 298.

[25] Monnet, *Memoirs*, 222.

[26] Martin Dedman, *The Origins and Development of the European Union 1945-2008: A History of European Integration* (London: Routledge, 1996), 55.

[27] Piernas Lopez, *The Concept of State Aid under EU Law*, 36; Juan Jorge Piernas Lopez, "The Evolving Nature of the Notion of Aid under EU Law," *European State Aid Law Quarterly* 15, no. 3 (2016): 400.

[28] ECSC Treaty Art 4(c).

> which cannot normally be achieved without outside help. The concept of aid is nevertheless wider than, that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore, being subsidies in the strict meaning of the word, are similar in character and have the same effect.[29]

This broad prohibition "did not require any sort of distortion of competition, selectivity criteria, or *de minimis* rule."[30] Eliminating all national aid, the ECSC treaty transferred all authority to a supranational authority which would be the only authority to grant state aid.[31] This treatment of state aid reflected the views of Monnet and Schuman, who intended that states would cede sovereignty "to create among Europeans the broadest common interest, served by common democratic institutions to which the necessary sovereignty has been delegated." [32]

In 1957, the Treaty of Rome, or Treaty Establishing the European Community, "established the EEC, a common market in manufactured goods with a Common Agricultural Policy."[33] The EEC treaty served as "a statement of intent" with details and

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[29] Case 30/59, *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority*, ECR 1, 19.

[30] Piernas Lopez, *The Concept of State Aid under EU Law*, 34.

[31] Piernas Lopez, "The Evolving Nature of the Notion of Aid," 402.

[32] Ward, *A Critical Introduction* (Cambridge: Cambridge University Press, 2009), 211.

[33] Dedman, 82. A second treaty established the Euratom, a common market in nuclear materials providing equal access to stocks of uranium 223.

regulations to be negotiated in the future.[34] The Treaty of Rome rejected the ECSC's broad view of state aid in favor of a scheme with three characteristics permitting general measures and measures not affecting trade:

> (1) a broad notion of aid, (2) a supranational monitoring system,[35]and (3) the introduction of flexibility through a number of exemptions.[36]

The Treaty of Rome reflected a change from the ECSC:

> A product of the new approach to European integration adopted after the fall of Monnetism, an approach characterised by the transfer to the European institutions of the minimum powers considered necessary to achieve economic and subsequently political union. The approach was thus significantly different from that followed for the ECSC Treaty, based on the full transfer of sovereignty to the supranational institution (the High Authority), the only one with the competence to grant aid, originally on a sector by sector basis.[37]

Under the Treaty of Rome Art 92(1):

> Save as otherwise provided in this Treaty, 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 common market.[38]

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[34] Ibid., 82-3.

[35] Distinct from supranational institution with full sovereignty.

[36] Piernas Lopez, "The Evolving Nature of the Notion of Aid," 402.

[37] Ibid.

[38] There has been some renumbering of the provisions over the years. The Treaty of Rome prohibited state aid under Articles 92-94. These were then renumbered 87-9 by the Treaty of Amsterdam and finally, after the entry into force of the TFEU through the Lisbon Treaty on December 1, 2009, became Articles 107-109.

This history details not only the long roots of state aid, but also the long running sovereignty debate that has characterized the life of the EU.

Today, two treaties govern the EU: the Treaty on European Union (TEU), which sets out principles and descriptions of EU institutions, and the Treaty on the Functioning of the European Union (TFEU), which provides greater detail on the role, policies, and operation of the EU.

Chapter IV.

Governance

The EU is an entity comprised of Member States. Beyond that, "it is a political arrangement that defies easy categorization," with

> at least five ways to conceptualize (it)—as an international organization, a regional integration association, a political system in its own right, a unique entity, or something that exhibits and combines all four of these.[39]

This chapter provides a basic understanding of EU institutions relevant to tax and the legislative processes.

EU Institutions Relevant to Tax

Several EU institutions play a role in tax policy. The executive of the EU, the Commission functions as the political leadership of the EU.[40] Its twenty-eight commissioners, which include the Commissioner for Competition, are appointed by the President of the Commission in consultation with Member States. The Commission

> consists of a college of appointed commissioners, who function collectively as a national government cabinet in a parliamentary system, and several thousand full-time European bureaucrats each assigned to one of the Commission's directorates-general (DG,) the functional equivalent of national government department.[41]

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[39] Jonathan Olsen and John McCormick, *The European Union* (Boulder, CO: Westview Press, 2017), 13.

[40] European Union, "European Commission Overview," https://europa.eu/european-union/about-eu/institutions-bodies/european-commission_en.

[41] Dedman, *The Origins and Development of the European Union,* 95-96.

The term "Commission" applies "separately and collectively" to the commissioners and the supporting bureaucrats.[42] For purposes of this paper, "Commission" refers to the Commission for Competition.

The EU's website lists the Commission's duties:

- Proposes new laws.
- Manages EU policies & allocates EU funding.
- Enforces EU law,
- Represents the EU internationally.[43]

The President of the Commission determines the policy portfolio to be held by each Commissioner.[44] State aid, as an anti-competitive mechanism, falls within the domain of the European Union Commission for Competition, specifically the Directorate-General (DG) for Competition.[45] As the Commission explains:

> Sometimes governments spend public money to support local industries or individual companies, giving them an unfair advantage and thus damaging competition and distorting trade. This is prohibited by Article 107 on the Treaty of the Functioning of the European Union.
>
> According to Article 108 of the Treaty of the Functioning of the European Union, it is the Commission's job to prevent this, allowing government support only if it is

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[42] Ibid., 96.

[43] European Union, "European Commission Overview," https://europa.eu/european-union/about-eu/institutions-bodies/european-commission_en.

[44] Olsen and McCormick, 98-101. There are three European Union Presidents: the President of the Commission: the President of the European Council, and the President of the European Parliament; European Union, "EU Presidents – who does what?" https://europa.eu/european-union/about-eu/presidents_en.

[45] Directorate-General for Competition webpage, https://ec.europa.eu/dgs/competition/index_en.htm.

> genuinely in the public interest-if the support benefits society or the economy as a whole.[46]

The Commission for Competition is not the only player in the tax arena. The European Commissioner for Economic and Financial Affairs, Taxation and Customs, and its bureaucratic staff, the Directorate-General for Taxation and Customs Union (DG TAXUD), would seem to be a more natural fit for the development of tax policy than the Commissioner for Competition. The European Commission proposes legislation to the EU Parliament and the Council of the EU.

The EU Parliament is a "(d)irectly-elected EU body with legislative, supervisory, and budgetary responsibilities."[47] Together with the Council of the EU, it serves as "the main decision-making body of the EU"[48] and negotiates and adopts EU laws based on proposals from the European Commission.[49]

The Council of the EU includes government ministers. Its 10 different configurations includes meetings of economic and finance ministers known as the

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[46] Directorate-General for Communication (European Commission), "Competition: Making Markets Work Better," February 21, 2017, 6. https://publications.europa.eu/en/publication-detail/-/publication/8200c251-aa42-11e6-aab7-01aa75ed71a1.

[47] European Union, European Parliament Overview, https://europa.eu/european-union/about-eu/institutions-bodies/european-parliament_en.

[48] European Union, Council of the European Union Overview, https://europa.eu/european-union/about-eu/institutions-bodies/council-eu_en.

[49] European Union, European Parliament Overview, https://europa.eu/european-union/about-eu/institutions-bodies/european-parliament_en.

Economic and Financial Affairs Council (ECOFIN).[50] The Council has drawn comparisons to the U.S. Senate, with the European Parliament akin to the House of Representatives.[51] Together, they act as a quasi "bicameral legislature." [52] Under Articles 241 and 255 of the TFEU, these two bodies may request that the Commission initiate legislation.[53]

EU judicial institutions also play a part in developing tax law. The Court of Justice of the European Union (CJEU) consists of two courts, the Court of Justice and the General Court. Commission decisions are appealable to the General Court and then to the Court of Justice.

The Legislative Process

To enact legislation, the EU institutions act as follows:

1. The European Commission submits a proposal to the Council and the European Parliament.
2. The Council and the Parliament adopt a legislative proposal either at the first reading or at the second reading.
3. If the two institutions do not reach an agreement after the second reading a conciliation committee is convened.
4. If the text agreed by the conciliation committee is acceptable to both institutions at the third reading, the legislative act is adopted.[54]

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[50] "Economic and Financial Affairs Council configuration (ECOFIN)," https://www.consilium.europa.eu/en/council-eu/configurations/ecofin/; Mason, "The Tax Subsidy War," 10.

[51] Olsen and McCormick, *The European Union*, 98-101.

[52] Gerard Conway, "Recovering a Separation of Powers in the European Union," *European Law Journal* (May 2011): 309.

[53] Ibid., 310.

[54] European Council of the European Union, "The ordinary legislative procedure," https://www.consilium.europa.eu/en/council-eu/decision-making/ordinary-legislative-procedure/.

Some legislation requires "unanimity." Unanimity is a defined term in the EU: "'unanimity' relates to the requirement for all EU countries when meeting within the Council to be in agreement before a proposal can be adopted."[55] The EU's trend has been to decrease areas requiring unanimity. For example the 1987 Single European Act amended the Treaty of Rome:

> to add new momentum to European integration and to complete the internal market. It reduced the number of policy areas for which unanimity was required in order to adopt legislation.[56]

Although the Lisbon Treaty further reduced the number of areas requiring unanimity when it came into force in 2009,

> [a] limited number of policies judged to be sensitive remain subject to unanimity voting: taxation, social security or social protection, the accession of new countries to the EU, foreign and common defence policy and operational police cooperation between EU countries.[57]

The EU continues to explore removing the unanimity required in the tax arena. In January 2019, the European Commission published a non-binding communication proposing a step-by-step removal of unanimity on the EU's tax decision making.[58] To date tax legislation continues to require unanimity.

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[55] EUR-Lex, "Glossary of summaries," https://eur-lex.europa.eu/summary/glossary/unanimity.html.

[56] Ibid.

[57] Ibid.

[58] European Commission, "Communication from the Commission to the European Parliament, the European Council and the Council," January 15, 2019,

The TFEU's primary tax provisions are found at Articles 110-113. TFEU Article 113 provides that with respect to indirect taxation,

> The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.

The EU's direct tax authority derives from Article 115:

> The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.[59]

The continued exception in the tax arena underscores the enduring vitality of the principle that nation states retain tax sovereignty.[60] Two recent examples of tax legislation include Council Directive 2016/1164 of 12 July 2016 which "lay(s) down rules against tax avoidance practices that directly affect the functioning of the internal

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https://ec.europa.eu/taxation_customs/sites/taxation/files/15_01_2019_communication_towards_a_more_efficient_democratic_decision_making_eu_tax_policy_en.pdf.

[59] TFEU Art. 115; The European Commission, "The Lisbon Treaty and tax legislation in the EU," https://ec.europa.eu/taxation_customs/general-information-taxation/eu-tax-policy-strategy/lisbon-treaty-tax-legislation-eu_en; Mason, "The Tax Subsidy War," 10.

[60] Mason, "The Tax Subsidy War," 11; Lilian V. Faulhaber, "Sovereignty, Integration and Tax Avoidance in the European Union: Striking the Proper Balance," *Columbia Journal of Transnational Law* 48, no. 2 (2010): 187.

market" provides an example of Council tax legislation under Article 115[61] and Council Regulation 2015/1589 (July 13, 2015),[62] providing detailed rules for the application of TFEU Art. 108.[63] These regulations, drafted by the DG TAXUD under TFEU Article 115,[64] illustrate the EU's legislative process and show how the Council and Parliament can enact tax legislation.

Subsidiarity

EU institutions must comply with the principle of subsidiarity set out in the TEU:

> Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.
>
> The institutions of the Union shall apply the principle of subsidiarity as laid down in the Protocol on the application of the principles of subsidiarity and proportionality. National Parliaments ensure compliance with the principle of subsidiarity in accordance with the procedure set out in that Protocol.[65]

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[61] 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, p. 1–14.

[62] 2015 O.J. L 248/9/.

[63] EU regulations and directives are two types of legislation. "A 'regulation' is a binding legislative act. It must be applied in its entirety across the EU." In contrast, a "'directive' is a legislative act that sets out a goal that all EU countries must achieve." European Union, "Regulations, Directives and Other Acts," https://europa.eu/european-union/eu-law/legal-acts_en.

[64] Mason, "Tax Subsidy War," 57.

[65] Treaty on European Union, Article 5, https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=OJ:C:2008:115:FULL&from=EN.

The principle ensures that decisions take place close to the individual and that EU actions are justified in light of the possibilities available at national, regional or local level."[66] The catechism of the Catholic Church provides a useful definition:

> a community of a higher order should not interfere in the internal life of a community of a lower order, depriving the latter of its functions, but rather should support it in case of need and help to co- ordinate its activity with the activities of the rest of society, always with a view to the common good.[67]

As explained in a European Parliament factsheet:

> In areas in which the European Union does not have exclusive competence, the principle of subsidiarity seeks to safeguard the ability of the Member States to take decisions and action and authorises intervention by the Union when the objectives of an action cannot be sufficiently achieved by the Member States, but can be better achieved at Union level, 'by reason of the scale and effects of the proposed action'.[68]

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[66] EUR LEX, Glossary of Summaries, https://eur-lex.europa.eu/summary/glossary/subsidiarity.html.

[67] Catechism of the Catholic Church, https://www.vatican.va/archive/ccc_css/archive/catechism/p3s1c2a1.htm.

[68] European Parliament Factsheet, "The principle of subsidiarity," https://www.europarl.europa.eu/factsheets/en/sheet/7/the-principle-of-subsidiarity.

Chapter V.

State Aid

As part of EU competition law, state aid rules fall within the cognizance of the Commissioner for Competition and the Directorate-General for Competition.[69] State aid involves Government promotion of domestic industry. It serves national purposes that include promoting economic growth or stability as well as social purposes.[70] On the negative side, it may also distort competition and can encourage states to engage in "costly and politically damaging subsidy races."[71] The EU prohibits state aid because state aid allows companies to gain an unfair advantage over competitors[72] and interferes

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[69] Thomas Doleys, "Managing the Dilemma of Discretion: The European Commission and the Development of EU State Aid Policy," *Journal of Industry, Competition and Trade* 13, no. 1 (2013): 23-38; Rita Szudoczky, "Convergence of the Analysis of National Tax Measures under the EU State Aid Rules and the Fundamental Freedoms," *European State Aid Law Quarterly* 15, no. 3 (2016): 358.

[70] Edouard Fort, "EU State Aid and Tax: An Evolutionary Approach*," European Taxation*, (September 2017): 370.

[71] Doleys, "Fifty Years of Molding Article 87: The European Commission and the Development of EU State Aid Policy (1958-2008)," 1. Paper prepared for presentation at the 11th Biennial International Conference of the European Union Studies Association, held April 23-25, 2009 in Marina Del Ray, California.

[72] European Commission, "State Aid Control," European Commission Competition website, https://ec.europa.eu/competition/state_aid/overview/index_en.html.

with the objective of economic and social cohesion and impair(s) the development of the single market."[73]

The former Commissioner for Competition Neelie Kroes explained:

> Our starting point is that **free and open markets force companies to compete on their merits** and to become more efficient, more productive and more innovative. Fair competition means that our companies are not only **better placed to compete globally**, but also, and most importantly, they provide **consumers** with better quality goods and services at cheaper prices. All of which contributes to creating a **virtuous circle of economic growth, better standards of living, and more and better jobs**.
>
> State aid control is essential to maintaining a **level playing field** for free and fair competition in the Single Market. State aids discipline exists to **ensure that national governments do not engage in old fashioned "beggar thy neighbour" policies,** using aid to protect companies from competition while doing nothing to prepare them for competitiveness. National, regional and local governments should be made to think twice before embarking in bidding wars to attract investments, or protecting and supporting perceived national champions. Such outdated policies can only lead to lower overall competition in the European market place, companies which are ill-prepared for global competition, and higher prices for citizens who are taxpayers as well as consumers.[74] (bolding in original).

More succinctly, EU competition law scholar Liza Gormsen stated:

> Without any form of State aid control, Member States could be tempted to enter into a wasteful subsidies race,

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[73] Nikolaos Zahariadis, "Winners and Losers in EU State Aid Policy," *Journal of Industry, Competition and Trade* 13, no. 1 (2013): 143; Forrester, "State Aid Regime," 24.

[74] Speech by Commissioner Neelie Kroes: "Reforming Europe's State Aid Regime: An Action Plan for Change," June 13, 2015, https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_05_347.

> with each Member State giving more and more support to its own national industries at the expense of the taxpayer.[75]

There is no all-inclusive list of state aid.

> (S)tate aid can take a variety of forms: subsidies; preferential rates on loans; cash injections to public enterprises; deferrals of tax, social security or other payments; sale or rental of land or property at discounted rates; preferential electricity or natural gas rates; infra-structural projects benefiting identifiable end users; and others. In effect, any intervention by a Member State, i.e., by a state body or through the direction of the state, which intervention benefits a firm or a group of firms by increasing the resources they would normally obtain or by decreasing the costs, including taxes, they would otherwise incur, qualifies as a state aid irrespective of whether the benefit is conferred in money or in kind.[76]

In nontax cases

> States confer illegal aid when, to benefit specific enterprises, they take actions that independent investors would not have taken. Thus, a member state loan to, or investment in, a company constitutes illegal aid if independent investors would not have made the same loan or investment on the same terms.[77]

State Aid in Practice

Ryanair

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[75] Gormsen, *European State Aid and Tax Rulings* (Northampton, MA: Edward Elgar Publishing, 2019), 2.

[76] Frederic Yves Jenny, "Competition and State Aid Policy in the European Community," *Fordham International Law Journal* 18 (1994): 532.

[77] Ruth Mason, "Arm's Length on Appeal," *Tax Notes* 158 (2018): 772.

Ryanair is often in the news for its cost-savings initiatives. Recently it has been in the news as the subject of a state aid case. The European Commission found that the marketing agreements between the local Association for the Promotion of Touristic and Economic Flows (APFTE), funded by regional and local French public entities, and Ryanair and its subsidiary AMS Montpellier airport were illegal under EU State aid rules.[78]

Commissioner Margrethe Vestager explained:

> *Competition between airports and between airlines is crucial for consumers, growth and jobs. Our investigation showed that certain payments by the French local authorities in favour of Ryanair to promote Montpellier airport gave Ryanair an unfair and selective advantage over its competitors and caused harm to other regions and other regional airports. This is illegal under EU State aid rules. France must now recover the illegal State aid*.[79] (italics in original).

According to the EU's press release:

> •The agreements with Ryanair were financed through State resources and were attributable to the State. APFTE is an association unrelated to the airport operator, funded almost entirely by regional and local French public entities. These public entities closely control the use of the association's budget.
>
> •The payments in favour of Ryanair on the basis of the marketing agreements did not correspond to effective marketing needs of APFTE but only served as an incentive for Ryanair to maintain its operations at Montpellier airport.

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[78] EU Press Release, "State aid: France to recover €8.5 million of illegal aid to Ryanair at Montpellier airport," 1 August 2019, https://ec.europa.eu/commission/presscorner/detail/en/IP_19_4991.

[79] Ibid.

•APFTE either concluded the agreements directly with Ryanair and AMS and not with other airlines or organised public tenders that were biased towards Ryanair.

Finding that the marketing agreements gave an undue and selective advantage to Ryanair over its competitors, the Commission concluded that the agreements amounted to illegal and incompatible aid under EU State aid rules.[80]

Gibraltar

The *Gibraltar*[81] case provides an example of state aid in the tax arena. Gibraltar proposed a new tax requiring all Gibraltar companies to pay a payroll tax on employees in Gibraltar and a tax on property in Gibraltar. The Commission determined that the tax was materially selective in that it favored companies with no profits or employees in Gibraltar and regionally selective because companies in Gibraltar would be taxed at a lower rate than in the United Kingdom.[82] This case illustrates the complexity of state aid with different approaches from the General Court, the Court of Justice, and the Commission: On appeal, the General Court[83] ruled against the Commission. The Court of Justice, however, upheld the Commission's decision on material selectivity, leaving

[80] Ibid.

[81] Joined cases C-106/09 P and C-107/09, *Commission and Spain v Government of Gibraltar and United Kingdom*, EU:C:2011:732.

[82] Commission Decision, *2005*/261/EC, *OJ L 85/1*, *2005*, paras. 151-152; John Temple Lang, "The Gibraltar State Aid and Taxation Judgment – A Methodical Revolution," *European State Aid Law Quarterly* 11, no. 4 (2012): 805

[83] At the time called the Court of First Instance.

the lower court's finding that the aid was not regionally selective intact.[84] While it is not the purpose of this paper to go into the details of the *Gibraltar* case and what one commentator has called "the curious features of the reasoning of the judgment,"[85] the Analysis section of this paper will return briefly to this case. It is notable that both the "Court of First Instance and the Advocate General warned strongly against encroaching on the powers of Member States to choose their own tax policies."[86]

The Current State Aid Treaty Provisions: TFEU Articles 107-109

Articles 107-109 of the TFEU detail the current state aid regime. TFEU Article 107(1) TFEU reflects the change to an "internal market" from a "common market" and refers to "Treaties" rather than "Treaty" but is otherwise identical to Article 92(1) of the Treaty of Rome:

> Article 107(1) 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.

Aid under Article 107 has been interpreted expansively.

> The concept of aid is more general than that of a subsidy. It embraces not only positive benefits, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without therefore being subsidies in the strict

[84] Lang, "The Gibraltar State Aid," 806.

[85] Lang, "The Gibraltar State Aid," 807.

[86] Ibid., 812.

> meaning of the word, are similar in character and have the same effect.[87]

TFEU Article 107's component parts have variably been listed as four or five separate elements. Tax professor Ruth Mason describes the test as

> (1) an advantage (2) granted by a member state (3) to an undertaking. The advantage must be granted (4) selectively, and it must (5) distort trade or competition in the internal market.[88]

The Commission and the courts typically use a four part test, combining elements one and four as selectivity or selective advantage.[89]

Consistent with the Treaty of Rome, TFEU Article 107 delineates limited categories of allowable state aid. For example, permitted aid includes "aid to make good the damage caused by natural disasters or exceptional occurrences" or "aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment."[90] General tax regimes, in which tax is applied

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[87] C-143/99, *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke* [2001] ECR I-08365, para. 38.

[88] Mason, "An American View of State Aid," 157 *Tax Notes* 645 - 662, 645 (October 30, 2017); "Tax Subsidy War," 19; Commission Decision 2016/2326 of Oct. 21, 2015 on State Aid Luxembourg granted to Fiat, 2016 O.J. (L 351) 1, para. 217; Commission Decision 2017/502 of Oct. 21, 2015 on State Aid Implemented by the Netherlands to Starbucks, 2017 O.J. (L 83) 38, para. 226 ; Commission Decision 2017/1283 of Aug. 30, 2016 on State Aid Implemented by Ireland to Apple, 2017 O.J. (L 187) 1, para. 220.

[89] *Apple*, para. 220; Mason, "An American View of State Aid," 645; "Tax Subsidy War," 19; *Fiat*, para. 217.

[90] TFEU Article 107(2); Article 107(3)(a).

to all sectors and firms, do not usually fall within the state aid jurisdiction.[91] Additionally, as the Commission has acknowledged, and as reflected in TFEU Article 115, Member States retain authority in the area of direct taxation.[92] States cannot, however, enact discriminatory taxes and any taxes are subject to the TFEU freedoms.[93]

Article 108 gives the Commission investigative authority:

> 108(1) The Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the internal market.
>
> 108(2) If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the internal market having regard to Article 107, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission.

This power includes the power to demand records from Member States and companies, as well as discretion in choosing cases to investigate:

> Absent a complaint, the Commission investigates according to its own discretion. Commission officials have openly admitted that politics and public opinion guided their investigation decisions. For example, Joaquín Almunia [EC Vice President and European Commissioner for Competition from 2010 to 2014], said, 'It is well known

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[91] Raymond Luja, "Will the EU's State Aid Regime Survive BEPS?" *British Tax Review*, no. 3 (2015): 379. (Luja represents Apple in its appeal of the Commission's decision)

[92] Directorate General (DG) Competition Working Paper on State Aid and Tax Rulings, 1; https://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf.

[93] Mason, "Tax Subsidy War," 13.

> that some multinationals are using tax planning strategies to reduce their global tax burden. These aggressive tax planning practices erode the tax bases in our Member States.' He added that 'when public budgets are tight, and citizens are asked to make efforts to deal with the consequences of the crisis, it cannot be accepted that large multinationals do not pay their fair share of taxes.'[94]

This investigatory power should not be underestimated. The threat of an investigation can change behavior even without the need to find state aid. Arguably this happened in *McDonald's*. Pending the investigation, Luxembourg proposed new legislation changing the exemption for income attributable to a permanent establishment to prevent the double non-taxation that occurred under the Luxembourg – US Double Taxation Treaty.

TFEU Article 109 delineates the respective authority of the Council, Parliament, and the Commission.

> The Council, on a proposal from the Commission and after consulting the European Parliament, may make any appropriate regulations for the application of Articles 107 and 108 and may in particular determine the conditions in which Article 108(3) shall apply and the categories of aid exempted from this procedure.

Historically, there has been limited legislation under TFEU Article 109.[95] As a result, instead of operating under a clear legislative framework, state aid law develops case by case.

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[94] Mason, "State Aid FAQ," *Tax Notes* (January 23, 2017): 460.

[95] Claus-Dieter Ehlermann, "State Aids under European Community Competition Law," *Fordham International law Journal* 18, no. 2 (December 1994): 414. (referencing a predecessor to Article 104, Art. 94 of the EEC Treaty)

Absence of Guidance

Notably, the TFEU does not define state aid.[96]

> To provide a definition in the Treaties would probably be neither feasible nor useful, since concrete definitions would be liable to restrict the scope of the term. However, a broad interpretation is necessary in order that Article 92 of the EEC Treaty may make a meaningful contribution towards ensuring that competition in the common market is not distorted, in accordance with the objective set out in Article 3 (f) of the EEC Treaty.[97]

In the DG Working Paper on State Aid the Commission defines state aid in taxation as

> A measure by which the public authorities grant certain undertakings a favourable tax treatment which places them in a more favourable financial position than other taxpayers amounts to State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union (TFEU).[98]

The absence of Treaty guidance combined with the absence of legislation under TFEU Article 109 enables the Commission to carve out an expansive role. Although TFEU Article 107 gives the Commission legal authority over state aid, without guidance or legislation from the Council, the Commission is free to create policy. This means that the Commission, a non-legislative body, is effectively legislating. Not only is it legislating but it is doing so within the tax arena long considered within the historic

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[96] Forrester, "State Aid Regime," 20-21.

[97] Case 234/84, *Belgium v. Commission*: Meura ECLI: EU:C:1986:152, Opinion of A.G. Lenz, 2269. https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1564854772254&uri=CELEX:61984CC0234.

[98] DG Working Paper, para 1.

sphere of state sovereignty. The Commission should follow the TFEU's legislative procedure and propose legislation to the Council.

Competing Goals

Doleys refers to a "dilemma of discretion" presented by the Treaty's absence of guidance. The Commission must balance its discretion with what Member states will accept:

> For Commission authorities, the malleable language of Article 107 serves as both opportunity and constraint. Imprecision can be a valuable resource. It affords Commission authorities the interpretive space to apply rules in light of pertinent political, economic and/or social circumstances. But the unsettled meaning of the provisions can also constrain Commission actions. The Commission must be aware that any effort to exploit the interpretive space in Article 107 might be challenged by governments whose understandings of the provisions differ. The Commission, mindful that the smooth functioning of the common market depends ultimately on the willingness of governments to observe EU competition strictures, finds itself in the position of having to constantly weigh its treaty-mandated responsibilities to prevent anti-competitive interventions against the threat that its efforts will be challenged, circumvented, or, worse, ignored by national authorities.[99]

The competing goals of state aid policy compound the linguistic imprecision. Mason quotes British Barrister Keyyn Bacon's description of the state aid rules as "a mix of internal market policies, competition concerns, and consideration of economic efficiency and fiscal discipline,"[100] noting,

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[99] Doleys, "Managing the Dilemma of Discretion," 24.

[100] Mason, "Tax Subsidy War," 13.

> None of these goals generates precise guidelines for directing Commission decision-making, and the Commission, General Court, and Court of Justice often take different positions on the same cases. The Commission also regularly stakes out positions that vary from precedent or that go beyond its own published guidance. Moreover, EU law expressly recognizes that the state-aid concept evolves with the common market, so that Member State policies previously judged compliant can become illegal aid due to further EU integration. Thus, the state-aid rules have a reputation for 'permanent expansion.'[101]

Flexibility to respond to evolving conditions is not necessarily objectionable. It raises the danger that precedent will be disregarded and predictability sacrificed. The absence of guidelines creates confusion and uncertainty for tax planners and allows the Commission to preempt the legislative arena and create policy. Having a non-legislative body effectively legislating creates a prudential, if not a legal problem. The TFEU provides a legislative procedure that places responsibility for proposing legislation on the Commission. Under TFEU Article 115 it also imposes a unanimity requirement. The Commission should not disregard these procedures by using a back door to legislate without democratic sanction.

A conflict between TFEU Articles 109 and 115 could conceivably occur. The Commission could propose state aid legislation under Article 109 that is not subject to the unanimity requirement. The Treaty should not be interpreted to allow such a conflict. However, even that would be preferable to the current situation. At least there would be Council action which would be a step towards democratic sanction.

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[101] Mason, "Tax Subsidy War," 13-14.

Chapter VI.

State Aid and Tax

While state aid law is not new, its scope has changed. No longer just focused on preventing distortions in the internal market, the Commission's actions in tax law expand the notion of traditional state aid beyond what could have been envisioned by the EC founders.[102] The Commission's focus has shifted from preventing barriers to trade to preventing anti-competitive behavior.[103]

Current tax practitioners, however, cannot claim surprise as the Commission has been active in the tax arena since the 1990s, particularly in the area of direct taxation.

Taxation is often considered to be a quintessential element of sovereignty. According to tax professor Allison Christians,

> (T)axation seems plausibly identifiable as an inherent right or entitlement attaching to sovereign status. Further, some argue that taxation is so essential to sovereignty that autonomy in designing the tax system deserves greater protection than autonomy in other regulatory areas.[104]

Christians caveats,

> The conflation of autonomy in designing the regulatory machinery of taxation with the political institution of sovereignty itself may not be universally supported by

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[102] Jean Jorge Piernas López, *The Concept of State Aid under EU Law: From Internal Market to Competition and Beyond* (Oxford: Oxford University Press, 2019), 58; Luja, "Will the EU's State Aid Regime Survive BEPS?" 379.

[103] Piernas Lopez, *The Concept of State Aid under EU Law*, 57.

[104] Allison Christians, "Sovereignty, Taxation and Social Contract," *Minnesota Journal of International Law* 18 (2008):105.

> theory or historical fact, but the principle is generally accepted in the literature: sovereign status seems to include a right to tax in some form, so that infringing on the right of taxation is an infringement on sovereignty itself.[105]

Even accepting the mythic nature of tax sovereignty, and allowing for the ability of states to contract with other nations to limit tax sovereignty, direct taxation still presents a problem for the Commission.

> Since the Treaty of Rome came into force in 1958, Member States within the EU have retained the sovereign right – exclusive competence – within the area of direct taxation. Any new tax measure, which involves implementation by all Member States in the EU, requires unanimity between the Member States. Thus, it is important to distinguish between enforcing the State aid rules to (i) achieve a level playing field by ensuring that Member States are not selectively giving certain companies an economic advantage and (ii) implementing new principles into national tax law. Only the former is acceptable. If the Commission's interpretation of the State aid rules in recent decisions is being interpreted to allow the Commission to transpose the so-called arm's length principle (ALP) into national law and thereby invades Member States' exclusive competence over national tax law, it violates the rule of law.[106]

While calling the Commission's actions a violation of the rule of law overstates the case, the concern is valid. "(T)ax sovereignty implies that there is an inseparable relationship between a sovereign state and its inherent prerogative to levy taxes within its territorial jurisdiction."[107] There is no question that the EU as a whole does have tax authority, but with the exception of indirect taxes, the EU has largely left taxation to

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[105]Ibid., 105-6.

[106] Gormsen, *European State Aid and Tax Rulings*, 2.

[107] Fort, "EU State Aid and Tax," 372.

member states.[108] Laws, regulations or administrative provisions that take precedent over national tax law must comply with the TFEU's legislative procedures including TFEU Article 115's unanimity requirement. As a result, there has been only limited direct tax legislation.[109]

The tension between tax and state aid is evident:

> The rules of State aid of the European Community apply to all public measures, even those for which no explicit or precise provisions exist in the Treaty. This means that direct taxation falls within the scope of State aid rules, although the EC lacks any general competence to regulate national tax measures that concern individuals or corporations.[110]

The Commission needs to ensure that it does not encroach on either state competences or the competences of other EU institutions by acting as a

> co-legislator in the tax sphere. Unlike the traditional free movement provisions, which only allow for a certain degree of positive integration, the strategic utilisation of State aid provisions by the Commission can have the same effect as positive integration: namely, the prescription of economic regulation at the EU level. State aid law was originally meant as a negative integration tool as it entails a prohibition, but now it appears to be used for positive integration by imposing the Commission ALP on the Member States.[111]

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[108] Subject to the Council Directive (EU) 2016/1164 on Anti-Tax Avoidance. European Commission, Taxation and Customs Union, "The Anti-Tax Avoidance Directive," https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en

[109] Tracy A. Kaye, "Direct Taxation in the European Union: From Maastricht to Lisbon," *Fordham International Law Journal* 35, no. 5 (June 2012): 1238.

[110] Phedon Nicolaides, "Fiscal State Aid in the EU: The Limits of Tax Autonomy," *World Competition* 27, no. 3 (2004): 396.

[111] Gormsen, *European State Aid and Tax Rulings,* 115.

As Gormsen explains:

> Contrary to negative integration, which is concerned with the removal of obstacles to trade, positive integration is about replacing national rules and standards with pan-European ones. In the EU context, positive integration is something to be pursued through the legislative route, in particular under Articles 113–115 TFEU. The legislative process – either the 'ordinary legislative procedure' or a 'special legislative procedure' – ensures the participation of different institutions, which represent different interests, in the decision-making process. Whereas negative integration is about the interpretation of existing primary Union law, positive integration is about adopting new rules and standards. The direction that positive integration may take is not predetermined by a particular technocratic wisdom but it is a matter of political choice.
>
> Having said that, it can be presumed that utilising Article 107(1) TFEU in pursuit of positive integration exceeds the legitimate purpose of State aid law. The *ratio legis* of the EU system of division of competences is exactly to preclude positive integration in policy fields reserved to the Member States.[112]

Gormsen's argument doesn't consider that enforcement of ALP can also be considered an example of negative integration because it prevents enactment of barriers to trade when the ALP is not enforced equally. The ease with which negative integration blends into positive integration underscores the need for the Commission to act prudentially when dealing with tax matters.

Both practitioners and scholars have questioned the Commission's actions. When the Commission issued its 2016 Notice on State Aid after its investigations had begun, one practitioner commented that the "Commission's interpretation of EU state aid is not necessarily shared by EU Member States nor the European Courts, and should be

[112] Ibid., 113 (footnotes omitted).

considered critically."[113] The Commission appears to be issuing new law and imposing it retroactively. Adding to the uncertainty for corporate planners, succeeding Commissioners can further revise the law in accordance with policy preferences.

The application of state aid to tax has been recognized since 1974 when the European Court of Justice (ECJ) made clear that state aid applied to direct taxation.[114] In 1995, in a case involving a tax law, the ECJ ruled that although "direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law."[115]

The Commission showed little interest in direct taxes prior to 1997.[116] Then, in a 1997 ECOFIN Resolution, the Council, acknowledging the potential for tax measures to violate state aid, announced it would issue guidance on the "application of the State aid rules to measures relating to direct business taxation."[117] Guidance appeared in 1998 with the "Commission Notice on the application of the State aid rules to measures relating to

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[113] Robert van der Jagt and Barry Larking, "Commission Issues Notice on the Notion of State Aid," *Tax Planning International Review* 43, no. 6 (2016): 33.

[114] C-173/73, *Italy v Commission* ECLI: EU: C: 1974: 71 (involving a law on the restructuring, reorganization, and conversion of the textile industry); DG Working Paper, 1.

[115] C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker*, ECLI:EU:C:1995:31.

[116] Nicolaides, "Fiscal State Aid in the EU," 365.

[117] Resolution of the Council and the Representatives of the Governments of the Member States, Meeting Within the Council, of 1 December 1997 on a [Code] of Conduct for Business Taxation, 1998 O.J. (C 2) 2, 2 (Code of Conduct); Mason, "State Aid FAQ," 458.

direct business taxation."[118] This Notice, since recalled, has been called the "starting point of a new EU state aid policy on business taxation."[119]

In the annual report for the year 1998, the Commissioner for Competition acknowledged the Notice's alignment "with its commitment to strict control of state aid in all its forms" and announced that it would "assess or reassess, case by case, all specific tax schemes in the Member States."[120] Further, the report stated that "(d)evelopments in the concept of state aid over time and a stricter interpretation of Article 87 of the EC Treaty [the precursor to TFEU 107] may lead to a revision of earlier Commission decisions, in which case the Commission will propose appropriate measures under Article 88(1) of the EC Treaty."[121] In 2001, the Commission started examining tax schemes,[122] examining 15 national tax measures in 12 member states.[123] These investigations all concluded with a finding of state aid.[124]

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[118] Commission notice on the application of the State aid rules to measures relating to direct business taxation (98/C 384/03) Repealed by the 2016 Notice.

[119] Fort, "EU State Aid and Tax," 373.

[120] The Twenty-eighth Report on Competition Policy, SEC (99) 743 final, para. 191, https://ec.europa.eu/competition/publications/annual_report/1998/en.pdf.

[121] Ibid., para.192.

[122] European Commission Press Release, "Commission launches large scale state aid investigation into business taxation schemes," July 11, 2001, https://europa.eu/rapid/press-release_IP-01-982_en.htm.

[123] Nicolaides, "Fiscal State Aid in the EU, 366.

[124] Ibid.

The Commission renewed its interest in fiscal state aid in 2013. This time, rather than investigating tax schemes it, focused on multinational tax rulings."[125] It rendered its first decisions on October 21, 2015, finding Luxembourg had granted state aid to Fiat and that the Netherlands had granted aid to Starbucks.[126]

Then in 2016, the Commission issued new guidance on the law of state aid in tax rulings:

> 1) the DG Competition Working Paper on State Aid and Tax Rulings (Working Paper) and
>
> 2) the Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU (Notice on Stage Aid).This document "updated the 1998 notice with the Commission's current understanding of the TFEU based on recent investigations and court opinions."[127]

These documents address transfer pricing and the arm's length principle (ALP) and lay out the Commission's state aid test.[128] Citing *Belgium and Forum 187 v Commission*,[129] the 2016 Notice on State Aid provides:

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[125] Mason, "State Aid FAQ," 458; European Commission Press Release, "Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules," October 21, 2015, https://europa.eu/rapid/press-release_IP-15-5880_en.htm.

[126] European Commission Press Release, "Tax advantages granted by Luxembourg and the Netherlands to Fiat and Starbucks are illegal under EU state aid rules," https://europa.eu/rapid/press-release_IP-15-5880_en.htm.

[127] Fort, "EU State Aid and Tax," 373.

[128] Phedon Nicolaides, "State Aid Rules and Tax Rulings," *European State Aid Law Quarterly* 15, no. 3 (2016): 416.

[129] *Belgium and Forum 187 v Commission*, Joined Cases C-182/03 and C-217/03, ECLI:EU:C:2006:416 (*Forum 187*).

> The Court of Justice has held that a reduction in the taxable base of an undertaking that results from a tax measure that enables a taxpayer to employ transfer prices in intra-group transactions that do not resemble prices which would be charged in conditions of free competition between independent undertakings negotiating under comparable circumstances at arm's length confers a selective advantage on that taxpayer, by virtue of the fact that its tax liability under the ordinary tax system is reduced as compared to independent companies which rely on their actually recorded profit to determine their taxable base. Accordingly, a tax ruling which endorses a transfer pricing methodology for determining a corporate group entity's taxable profit that does not result in a reliable approximation of a market-based outcome in line with the arm's length principle confers a selective advantage upon its recipient. The search for a 'reliable approximation of a market- based outcome' means that any deviation from the best estimate of a market-based outcome must be limited and proportionate to the uncertainty inherent in the transfer pricing method chosen or the statistical tools employed for that approximation exercise.[130]

While the Notice sources the Commission's ALP to *Forum 187,* that opinion doesn't mention the arm's length principle. *Forum 187* involved Belgium tax legislation that allowed MNEs to provide intercompany services such as accounting and advertising in centralized coordination centers on a tax preferred basis. The CJEU reasoned that

> to determine whether there was an advantage, the commission had to compare the challenged member state tax regime ''with the ordinary tax system, based on the difference between profits and outgoings of an undertaking carrying on its activities in conditions of free competition.''[131]

[130] Notice on State Aid, para. 171.

[131] *Forum 187*, paras. 95-96.

Therefore, the coordination center tax regime constituted an advantage because it derogated from the ordinary Belgian tax regime. Belgium had incorporated the arm's-length principle in its national legislation but whether the CJEU would have ruled differently if Belgium had not, is unclear.[132]

The interpretation of *Forum 187* as endorsing the ALP has been challenged.[133]

> In other words, out of the entire body of Court jurisprudence and its own decisional practice, the only sources the Commission could apparently find to support its assertion that a departure from a reliable approximation of a market-based outcome confers a selective advantage were its very own recent decisions.[134]

Organization for Economic Cooperation and Development

Both the Notice and the Working Paper acknowledge the Organization for Economic Co-operation and Development's (OECD) role in transfer pricing by acknowledging that transfer pricing following OECD guidelines "is unlikely to give rise to State aid."[135] This deference is appropriate given the OECD's extensive tax expertise guidance developed by subject matter experts on transfer pricing.[136]

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[132] Tony Joris and Wout De Cock, "Is *Belgium and Forum 187 v. Commission* a Suitable Legal Source for an EU 'At Arm's Length Principle,'" *European State Aid Law Quarterly* 16, no. 4 (2017): 614.

[133] Nicolaides, "State Aid Rules and Tax Rulings," 421; Mason, "Arm's Length on Appeal," 793.

[134] Dimitrios A. Kyriazis, "From Soft Law to Soft Law through Hard Law: The Commission's Approach to the State Aid Assessment of Tax Rulings," *European State Aid Law Quarterly*, no. 3 (2016): 431; Joris and De Cock, "*Belgium and Forum*," 607.

[135] Notice, para. 273; DG Working Group, para. 18.

[136] Mason, "Tax Subsidy War," 29. The United Nations has provided similar guidance for non-OECD countries.

The OECD defines "(t)ransfer prices [as] the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises."[137] A parent company can potentially set the intercompany pricing for goods and services of related subsidiaries to move profits from high tax jurisdictions to low tax jurisdictions. Tax authorities prevent this using transfer pricing rules, often relying on the OECD arm's length standard to ensure intracompany pricing approximates that of pricing between unrelated entities.[138] Transfer prices determine a MNE's taxable profits so they matter for both MNEs and national tax authorities. This importance, together with the difficulty in determining the appropriate transfer price, sets the stage for contention. To provide certainty in complex transfer pricing matters, companies and tax authorities often enter into prospective tax agreements known as advance pricing agreements (APAs).[139] The OECD defines an APA as

> an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time.[140]

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[137] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, 17.

[138] Nicolaides, "State Aid Rules and Tax Rulings," 416; Eden, Lorraine, and William Byrnes. "Transfer Pricing and State Aid: The Unintended Consequences of Advance Pricing Agreements," *Transnational Corporations* 25, no. 2 (2018): 31.

[139] Nicolaides, "State Aid Rules and Tax Rulings," 417; Eden and Byrnes, "Transfer Pricing and State Aid," 31.

[140] OECD Transfer Pricing Guidelines, 23.

Because APAs involve taxpayer privileged information that is not disclosed to the public they may "trigger 'smell test' concerns" by regulatory bodies.[141] The potential exists for APAs to

> move over from the tax realm (where the APA is viewed as a beneficial policy that reduces MNE–state tax disputes) and into the – at least perceived – realm of competition policy (where the APA is viewed as a misused policy that inappropriately affects MNEs' location decisions and competitive behaviors among rival firms).[142]

MNEs must square OECD transfer pricing guidance with the Commission's rules. Despite the Commission's apparent deference to the OECD, the Commission endorses its own definition of ALP linked to Article 107(1) of the TFEU[143] and infers that arm's length pricing will apply regardless of state law.[144] The Commission endorsed this inference in its decision holding Apple's APAs violated the ALP even though Irish domestic law had not adopted the APL. The US Treasury argued that the approach in the Notice differed from the standard applied in the Commission investigations from the 2000s, where Member State transfer pricing rulings were evaluated against OECD rules incorporated into state law.[145]

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[141] Eden and Byrnes, "Transfer Pricing and State Aid," 11.

[142] Ibid.

[143] Notice, para. 172.

[144] Nicolaides, "State Aid Rules and Tax Rulings," 419.

[145] White Paper at 9; Ruth Mason, "Tax Rulings as State Aid — Part 4: Whose Arm's Length Standard?" *Tax Notes* 154 (2017): 951.

Selectivity

Among the criteria for state aid, selectivity, the favoring of "certain undertakings or the production of certain goods" under TFEU Article 117, is the most important in tax cases.[146]

> In assessing the applicability of Article 107(1), there is normally no doubt that they involve transfers of public funds [because, for example, tax reductions result in loss of tax revenue], that they confer an advantage [because they reduce liabilities that are normally covered by the revenue of the beneficiary undertakings] and that they affect trade and distort competition [because the concept of trade is very wide and once trade is affected it is very easy to show that some firms in other Member States are harmed by the extra competition from lower taxes] (brackets in original).[147]

Traditionally, states could discriminate in their domestic law and not violate state aid restrictions.[148] Therefore, the Court of Justice found no illegal state aid in the following instances:

> a tax on companies limited to 15% of their profits, an exemption for pass-through companies that was denied to corporations, a procedural rule allowing companies with tax disputes that were more than ten years old to settle those disputes by paying five percent of the deficiency, and an accelerated depreciation rule limited to certain tangible assets custom-built for leasing.[149]

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[146] Mason, "Tax Subsidy War," 20, referencing Case C-66/14, *Finanzamt Linz v. Bundesfinanzgericht* (opinion of Advocate General Kokott), ECLI:EU:C:2015:242, para. 114-5; Mason, "Arm's Length on Appeal," 772.

[147] Nicolaides, "Fiscal State Aid in the EU," 367-8. (Referring to former Article 87(1) of the EC Treaty).

[148] Mason, "Tax Subsidy War," 23.

[149] Ibid., 23-24.

The Court of Justice found illegal state aid in the following circumstances: Tax exemptions given to members of the textile but not other industries; incentives for investment in East Germany but not other parts of Germany; credits for manufacturers, but not service-providers.[150] The objectionable discrimination

> favored members of suspect classes selected on the basis of sector, region, size, nationality, or whether the enterprise engaged in cross-border economic activities (such as exporting). Each case employed the domestic-law-reference-base approach; the Commission and Court of Justice established state aid by comparing the state's treatment of the favored taxpayers to that same state's treatment of taxpayers outside the privileged class (i.e., taxpayers in other sectors, regions, or of different nationalities, and so on). Thus, until recently,[151] tax cases have consistently used the domestic-law reference base, and the main determinant of whether a regime constituted illegal aid has been whether it unjustifiably favored a particular company or a suspect class.[152]

"A measure is selective when it 'confers the benefit ... exclusively on certain undertakings or certain sectors of activity.'"[153] Selectivity has been called "a principle of equality test (i.e., a determination of whether or not the undertakings subject to a different tax treatment are deemed to be in a legally and factually comparable situation)."[154]

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[150] Ibid., 24-25.

[151] *Starbucks* and *Fiat* used a domestic law reference base since both Netherlands and Luxembourg had adopted the arm's-length principle.

[152]Mason, "Tax Subsidy War," 25.

[153] Mason, "Arm's Length on Appeal," 772, quoting Joined Cases C 20/15 P and C 21/15 P, *World Duty Free Group*, EU:C:2016:981, para. 55 (citing Case C270/15 P, *Belgium v. Commission*, EU:C:2016:489, paras. 49 and 50).

[154] Fort, "EU State Aid and Tax," 377.

The cases illustrate the difficulty in defining selectivity.[155] Advocate General Ruiz-Jarabo Colomer observed:

> I recognise that the dividing line between measures which may constitute public subsidies, on the one hand, and measures forming part of a State's general system of taxation, on the other, may sometimes be difficult to draw.[156]

In the recent state aid cases the Commission has been criticized for needlessly contributing to the existing complexity by conflating the separate elements of selectivity and advantage:[157]

> the requirement as to selectivity under Article 107(1) TFEU must be clearly distinguished from the concomitant detection of an economic advantage, in that, where the Commission has identified an advantage, understood in a broad sense, as arising directly or indirectly from a particular measure, it is also required to establish that that advantage specifically benefits one or more undertakings. It falls to the Commission to show that the measure, in particular, creates differences between undertakings which, with regard to the objective of the measure, are in a comparable situation. It is necessary therefore that the advantage be granted selectively and that it be liable to place certain undertakings in a more favourable situation than that of others. [158]

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[155] Ibid., 376.

[156] Ibid., 374, quoting, Case C-6/97 *Italian Republic v Commission of the European Communities* (opinion of Advocate General Ruiz-Jarabo Colomer), ECLI:EU:C:1998:416, para. 27.

[157] Kyle Richard, "Are All Tax Rulings State Aid: Examining the European Commission's Recent State Aid Decisions," *Houston Business and Tax Law Journal* 18, no. 1 (2018): 1-55.

[158] C-15/14 P, *European Commission v MOL Magyar Olaj- és Gázipari Nyrt*, ECLI:EU:C:2015:362.

In conflating the two elements the Commission may have "go(ne) beyond its prerogative by creating a new set of rules and acting as a supranational tax authority."[159] The two concepts are similar, however.[160]

With selectivity, the Commission has few boundaries. Although traditionally selectivity has been found where a state deviates from its own law in favor of certain taxpayers, TFEU Article 107 neither defines selectivity nor indicates how it will be measured.[161] According to the Notice on State Aid,

> not all measures which favour economic operators fall under the notion of aid, but only those which grant an advantage in a selective way to certain undertakings or categories of undertakings or to certain economic sectors.[162]

An APA that violates the ALP would constitute illegal state aid. But Mason points to two unanswered questions:

1) Are APAs selective because they only apply to MNEs and not stand alone entities?

2) Are APAs selective because they apply to individual taxpayers?[163]

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[159] Fort, "EU State Aid and Tax," 382.

[160] *See, e.g.*, Mason, "Whose Arm's Length Standard?" 947, Footnote 3.

[161] Mason, "Tax Subsidy War," 20.

[162] Notice, para. 117.

[163] Mason, "State Aid FAQ," 454.

Traditionally, general tax measures did not constitute state aid,[164] unless they generated a bias for or against certain sectors or disproportionally benefitted certain undertakings. [165] Only specific tax measures, those that applied not to the whole economy but to a specific region or which provided an exception to a general tax measure, constituted state aide.[166]

> [W]hen a few or even one firm is excluded from a policy, that policy is selective. This is especially pertinent in the case of a complex measure, where it would be sufficient to find a single selective feature to make the whole measure selective.[167]

The characterization of a tax measure as general or specific matters for the selectivity test.

> It must, however, be noted that the selectivity requirement differs depending on whether the measure in question is envisaged as a general scheme of aid or as individual aid. In the latter case, the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective.[168]

Selectivity's Three-Part Test.

The 2016 Notice on State Aid established an additional three-part test for selectivity which applies when "Member States adopt broader measures applicable to all

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[164] Lang, "The Gibraltar State Aid," 805; Luja, "Will the EU's State Aid Regime Survive BEPS?" 381.

[165] Ibid.

[166] Lang, "The Gibraltar State Aid," 805.

[167] Nicolaides, "Fiscal Aid in the EU," 371.

[168] Case C-15/14 P, *Commission v. MOL*, ECLI: EU:C:2015:362, para. 60.

undertakings fulfilling certain criteria, which mitigate the charges that those undertakings would normally have to bear (for instance, tax or social security exemptions for undertakings fulfilling certain criteria)."[169] Mason explains that this additional test is necessary in tax cases "(b)ecause only states impose taxes, there are no comparables that the commission can use to establish whether the state acted as a private market economy operator would have."[170] The test requires an identification of the reference system, determination of any deviation, and a justification for any deviation.

> First, the system of reference must be identified. Second, it should be determined whether a given measure constitutes a derogation from that system insofar as it differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. Assessing whether a derogation exists is the key element of this part of the test and allows a conclusion to be drawn as to whether the measure is prima facie selective. If the measure in question does not constitute a derogation from the reference system, it is not selective. However, if it does (and therefore is prima facie selective), it needs to be established, in the third step of the test, whether the derogation is justified by the nature or the general scheme of the (reference) system. If a prima facie selective measure is justified by the nature or the general scheme of the system, it will not be considered selective and will thus fall outside the scope of Article 107(1) of the Treaty.[171]

Step one in the three-part selectivity test is the determination of the reference system. One commentator has written:

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[169] Notice, para. 127.

[170] Mason, "Arm's Length on Appeal," 772.

[171] Notice, para. 128.

> the reference system can truly make or break a state aid case, because the larger the Commission tends to define the reference system, the more likely illegal state aid results.[172]

The 2016 Notice on State Aid calls the reference system "the benchmark against which the selectivity of a measure is assessed":[173]

> The reference system is composed of a consistent set of rules that generally apply — on the basis of objective criteria — to all undertakings falling within its scope as defined by its objective. Typically, those rules define not only the scope of the system, but also the conditions under which the system applies, the rights and obligations of undertakings subject to it and the technicalities of the functioning of the system.[174]

It presents a policy dilemma:

> Fewer constraints on the commission's choice of reference base mean greater state aid enforcement powers in the commission and reduced tax powers in the states.[175]

In discussing the reference system the Notice on State Aid references the *Gibraltar*[176] CJEU opinion. In *Gibraltar*, the Commission invalidated a corporate payroll and property tax scheme which in applying to all taxpayers, did not deviate from the

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[172] Christopher Bobby, "A Method inside the Madness: Understanding the European Union State Aid and Taxation Rulings." *Chicago Journal of International La*w 18, no. 1 (2017): 210.

[173] Notice on State Aid, para. 132.

[174] Notice on State Aid, para. 133.

[175] Mason, "Arm's Length," 779.

[176] Judgment of the Court of Justice of 15 November 2011, *Commission and Spain* v *Government of Gibraltar and United Kingdom*, Joined Cases C-106/09 P and C-107/09 P, ECLI:EU:C:2011:732.

domestic reference system.[177] In effect, the tax exempted offshore companies which typically lack payroll and property taxes.[178] The Court of Justice agreed with the Commission that state aid could exist even without a deviation from a domestic-law-reference system.[179] The CJEU's decision suggested that "the state-aid rules also place *content restrictions* on Member State tax policy choice" and moreover, "that some tax bases are illegal, even when they do not facially benefit suspect classes."[180](italics in original) The ruling potentially imposes restrictions on domestic tax policies.

Relying on *Gibraltar*,[181] the Commission reserves latitude to find state aid even where a measure is consistent with the reference system, so that

> in certain exceptional cases it is not sufficient to examine whether a given measure derogates from the rules of the reference system as defined by the Member State concerned. It is also necessary to evaluate whether the boundaries of the system of reference have been designed in a consistent manner or, conversely, in a clearly arbitrary or biased way, so as to favour certain undertakings which are in a comparable situation with regard to the underlying logic of the system in question.[182]

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[177] Mason, "Tax Subsidy War," 27.

[178] Ibid.

[179] Ibid., 27.

[180] Ibid., 26-27.

[181] Judgment of the Court of Justice of 15 November 2011, *Commission and Spain* v *Government of Gibraltar and United Kingdom*, Joined Cases C-106/09 P and C-107/09 P, ECLI:EU:C:2011:732.

[182] Notice, para. 129, referencing *Gibraltar.*

Mason rejects *Gibraltar* as precedent for expanding the notion of state aid.[183] Instead, she suggests that the concept of a reference system is a Commission invention with no basis in EU Treaties or regulations.[184] Invoking Justice Potter Stewart, she explains the problem of the Commission's policymaking without legislative guidance:

> But a lesson from *Gibraltar* is that the commission and the CJEU know state aid when they see it, and they are prepared to prohibit it under novel theories if precedent and published guidance are unable to supply established methods.[185]

If the reference system is an invention, it is one that the CJEU has accepted, as Mason acknowledges.[186] In the *Fiat* appeal, the General Court relied on case law existing prior to the 2016 Notice for the three-part test:

> It is also apparent from settled case-law that, in order to classify a national tax measure which is not an individual measure as 'selective', the Commission must begin by identifying the ordinary or 'normal' tax system applicable in the Member State concerned, and thereafter demonstrate that the tax measure at issue is a derogation from that ordinary system, in so far as it differentiates between operators who, in the light of the objective pursued by that ordinary tax system, are in a comparable factual and legal situation (judgments of 8 September 2011, *Paint Graphos and Others*, C 78/08 to C 80/08, EU:C:2011:550, paragraph 49; of 21 December 2016, *Commission v World Duty Free Group and Others*, C 20/15 P and C 21/15 P, EU:C:2016:981, paragraph 57; and of 13 December 2017, *Greece v Commission*, T 314/15, not published, EU:T:2017:903, paragraph 85).[187]

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[183] Mason, "Tax Subsidy War," 26.

[184] Mason, "Arm's Length," 773.

[185] Ibid., 791.

[186] Ibid., 773.

[187] *Fiat*, para. 334.

As a result, it may be hard to claim that the Commission lacked precedent.

Moreover, as Mason acknowledges, the TFEU does not prohibit the Commission's selectivity analysis. She describes the Commission's "traditional" domestic law based analysis in which "the state had to deviate from its own law for the benefit of some, but not all, similar taxpayers."[188] This differs from its current approach in which under a "normative reference base, a state confers illegal aid whenever it deviates from the Commission's view of good tax policy."[189]

> If the Commission has the power not only to strike selective subsidies, but also to articulate ideal tax rules, conformity with which represents the only defense from a state-aid claim, then policy control has moved from the Member States to the Commission. Loss of democratic accountability attends this move.
>
> Of course, the idea that the Commission's lack of a democratic mandate should constrain its enforcement power has limits, too. A rank preference for tax policy produced by national democratic processes would counsel in favor of no state-aid control at all. The domestic-law reference-base approach may not be the perfect answer to this conundrum, but as compared to the normative-reference-base approach, it seems to err on the right side of both caution and Article 115, which reserves tax powers to the Member States.[190]

Mason believes that *Gibraltar* may be fatal to Apple's appeal

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[188] Mason, "Tax Subsidy War," 20.

[189] Ibid., 6.

[190] Ibid., 44.

> because it expands the commission's enforcement discretion by unmooring the state aid concept from the domestic law reference base. That's just what the commission seeks to do by applying a state-aid-specific arm's-length standard that is independent of domestic law.[191]

[191] Mason, "Arms-Length on Appeal," 790.

Chapter VII.

Cases

September 24, 2019 marked a legal victory for the Commission. On this day, the General Court of the European Union published two decisions, *Netherlands v. Commission*, T-760/15 and T-636/16 (Starbucks), and *Luxembourg v. Commission*, T-755/15 and T-759/15 (Fiat). The General Court upheld the Commission's finding that Luxembourg had given state aid to Fiat but annulled the *Starbucks* decision because the Commission failed to demonstrate a selective advantage. Both cases represented wins for the Commission as the Court endorsed the application of the EU state aid rules to tax arrangements for multinationals and upheld the use of the ALP as a tool to assess whether transfer pricing rulings provide a selective advantage.[192]

In both cases the General Court affirmed the Commission's authority to compare the tax position of the relevant Fiat and Starbucks entities with the tax burden imposed by normal national taxation rules on undertakings operating in comparable factual situations under similar market conditions,[193] regardless of whether domestic law incorporated the ALP.[194]

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[192] *Fiat*, para. 155; *Starbucks* para. 261.

[193] *Fiat,* paras. 141-2; *Starbucks* paras. 149-150.

[194] *Starbucks,* para. 156; *Fiat*, para. 131.

The General Court rejected the argument that the Commission engaged in "tax harmonisation in disguise."[195] According to its press release announcing the *Starbucks* decision:

> The Court makes clear that the arm's length principle as described by the Commission in the contested decision is a tool that allows it to check that intra-group transactions are remunerated as if they had been negotiated between independent companies. Thus, in the light of Netherlands tax law, that tool falls within the exercise of the Commission's powers under Article 107 TFEU. The Commission was therefore, in the present case, in a position to verify whether the pricing for intra-group transactions accepted by the APA corresponds to prices that would have been negotiated under market conditions.[196]

The decisions dealt a blow to critics claiming that the Commission had retroactively applied a novel interpretation of state aid law or that it had infringed on state sovereignty. Specifically, the General Court

1. Accepted a reference base that included domestic and multinational enterprises; and

2. Accepted a reference base that included the ALP regardless of whether or not it was included in domestic law.

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[195] *Fiat*, paras. 103-4; *Starbucks*, paras.158.

[196] General Court of the European Union, Press Release No119/19, 24 September 2019, "The General Court annuls the Commission's decision on the aid measure implemented by the Netherlands in favour of Starbucks," https://curia.europa.eu/jcms/upload/docs/application/pdf/2019-09/cp190119en.pdf.

Identical language appears in the Fiat press release, General Court of the European Union, Press Release No118/19, 24 September 2019, "The General Court confirms the Commission's decision on the aid measure granted by Luxembourg to Fiat Chrysler Finance Europe," https://curia.europa.eu/jcms/upload/docs/application/pdf/2019-09/cp190118en.pdf.

Although the Commission lost *Starbucks*, it won on the broader point that an APA can give rise to selective advantage. To find selective advantage, however, the Commission, must have substantive proof beyond solely procedural missteps.

As *Fiat* and other cases move through the appellate process, it remains to be seen whether the Court of Justice will affirm the General Court. To say that the Commission's use of a tool is not tax harmonization ignores the practical effect of such a tool. While the statement of the law may be correct, as a political matter, states may regard this tool as de facto tax harmonization and reject it as a violation of sovereignty. As one practitioner notes

> EU member states, who… are calling the shots on EU tax dossiers, in practice are displaying more centrifugal tendencies these days, resorting increasingly to unilateral solutions.[197]

Both decisions have implications for the *Apple* and *Amazon* appeals. Additionally they will no doubt embolden the Commission to continue, if not expand, its investigations. These investigations are appropriate to the extent they address trade barriers. The danger is that the Commission is moving from the traditional concept of selectivity which prohibits a state from "deviat(ing) from its own law for the benefit of some, but not all, similar taxpayers"[198] to a regime where it can substitute EU Member State tax policies with its own tax policy preferences.[199] The threat of investigation may

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[197] Bob van der Made "EU: Full tax harmonisation under the new Von der Leyen Commission?" August 29, 2019, https://www.internationaltaxreview.com/article/b1gtsh7n5788fw/eu-full-tax-harmonisation-under-the-new-von-der-leyen-commission

[198] Mason, "Tax Subsidy War," 20.

[199] *Ibid*., 6.

induce behavioral changes on the part of nation states, which arguably occurred in the *McDonald's* case when Luxembourg proposed new legislating to prevent future incidents of double non-taxation under the Luxembourg – US Double Taxation Treaty. This behavior-changing outcome may not necessarily be a bad result, but achieving this end without resorting to the requirements of TFEU Article 115 is problematic.

Because the Court endorsed the Commission's approach, and because this paper focuses on the Commission's policy, this paper will only discuss the legal issues to the extent it is necessary to understand the policy.

First, some general comments about the cases to be discussed.

Apple, *Amazon, Fiat*, and *Starbucks* all involve APAs, "tax rulings which validate transfer pricing arrangements."[200] All raise the issue of the appropriate reference systems.[201] In each case the Commission applied the general corporate tax system as the reference system but alternatively, also applied a narrower reference system.[202] In *Apple*, for example, the Commission used Ireland's rule of profit attribution to permanent establishments as a reference system.[203] As a double-tax case under the United States-Luxembourg Tax Treaty, *McDonald's* will not be discussed.

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[200] Lew Letter to Apple, 6.

[201] Mason, "State Aid Special Report – Part 6: Arm's Length on Appeal," 773; Phedon Nicolaides, "The Definition of the Reference Tax System Is Still a Puzzle," *European State Aid Law Quarterly*, no. 3 (2018): 419.

[202] Svitlana Buriak and Ivan Lazarov, "Between State aid and the fundamental freedoms: The Arm's Length Principle and EU law," 56 *Common Market Law Review*, Issue 4 (2019): 913.

[203] Ibid.; *Apple,* para. 370.

In each case the Commission determined that state aid rules incorporated the ALP.[204] The Commission, however, asserted its right to apply its own ALP independent of OECD guidance.[205] This may have been mere rhetoric because the Commission would likely have reached the same result if it had relied solely on OECD guidance. But countries who have not adopted an explicit ALP should not be held to the OECD standard. All the cases relied on the ALP inherent to TFEU Article 107 with approximately the same formulation, regardless of whether domestic law incorporated the arm's length principle. The Commission did not distinguish between countries which had adopted the ALP as part of domestic law, like the Netherlands and Luxembourg, and countries which had not, like Ireland. It ignored the fact that

> The arm's length principle is not a rule of international law (whether treaty law or customary law) and as such no Member State has a legal obligation to implement it in national law and to apply it consistently with OECD Guidelines.[206]

As Mason points out, *Gibraltar* gave the Commission leeway to depart from a domestic law reference base:

> In *Gibraltar*, the CJEU ratified the commission's total departure from the domestic law reference base approach. In the current cases, the Court may likewise be willing to agree that when the commission uses a reference base, it can choose between a domestic law reference base and a normative reference base, presumably depending on which would better serve state aid goals.[207]

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[204] Mason, "Arm's Length on Appeal," 783.

[205] Ibid., 783.

[206] Gormsen, "New Saga," 380.

[207] Mason, "Arm's Length on Appeal," 790.

Compare *Apple's* discussion of the arm's length principle derived from TFEU Article 107:

> [T]he Commission recalls that the arm's length principle it applies flows from Article 107(1) of the Treaty, as interpreted by the Court of Justice, which binds the Member States and from the scope of which national tax rules are not excluded. That principle therefore applies independently of whether the Member State in question has incorporated the arm's length principle in its national legal system.[208]

With that in the *Fiat* and *Starbucks* cases:

> [The Commission's ALP] is a general principle of equal treatment in taxation falling within the application of Article 107(1) of the TFEU, which binds the Member States and from whose scope the national tax rules are not excluded.[209]

The Commission only announced this new ALP in its final decisions in these cases.[210] As Mason observes, there was no need to develop this independent ALP.

> In *Apple*, *Starbucks*, and *Fiat*, in addition to arguing that the Member States violated the sui-generis arm's-length standard, the Commission also concluded that the Member States issued rulings that resulted in taxation for the multinationals that was more favorable than what those multinationals could have received under each state's own income-allocation rules. The traditional conception of state aid already captures this kind of sweetheart ruling as individual aid, and with the approval of the Court of Justice, the Commission has struck sweetheart rulings as state aid since at least the mid-2000s.[211]

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[208] *Apple*, para. 257.

[209] *Fiat*, para. 228; *Starbucks*, para. 264.

[210] Gormsen, "*European State Aid and Tax Rulings*," 43.

[211] Mason, "Tax Subsidy War," 51 (footnotes omitted).

Mason illuminates the biggest irony of all--the Commission had no need to resort to convoluted reasoning. In the *Apple* case it appears that Ireland entered into an agreement without any economic basis. This suggests that the Commission's conclusion, at least in the *Apple* case, was correct, albeit for the wrong reasons.

Finally, in all cases, the Commission's analysis turns on the reference base.[212]

This discussion will not proceed in strict chronological order. The Commission's decision in *Amazon* postdates its *Apple* decision but will be discussed before *Apple*.

Fiat and *Starbucks*

Unlike Ireland, both Luxembourg and the Netherlands had adopted the arm's length standard in its domestic legislation. In two rulings issued in October 2015, the Commission found that not only had the two countries violated their own law but they had violated the ALP rooted in TFEU Article 107.[213] For the first time, it

> argued that the Commission ALP was an inherent part of Article 107 TFEU …. It was also the first time the Commission applied Article 107 TFEU to individual tax rulings regarding transfer pricing.[214]

Both rulings hinged on defining the reference base. They affirmed that

- The baseline is the object of the tax regime, not state law.[215]

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[212] Mason, "Implications of the Rulings in *Starbucks* and *Fiat* for the Apple State Aid Case," *Tax Notes Federal* (October 7, 2019): 94.

[213] Mason, "Tax Subsidy War," 34, citing *Starbucks*, para. 264; *Fiat*, para. 228; European Commission Press Release, "Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules," October 21, 2015, https://europa.eu/rapid/press-release_IP-15-5880_en.htm.

[214] Gormsen, *European State Aid and Tax Rulings*, 43.

[215] *Starbucks*, para. 232; *Fiat*, paras. 198-199*; Apple*, para. 237.

- Stand-alone companies and MNEs are comparable.[216]
- MNEs, like stand-alone companies, must be taxed as if profits were made on the competitive market.[217]

Fiat

In *Fiat*, the Commission determined that Fiat had benefited from a 2012 APA with Luxembourg involving its Luxembourg financing entity Fiat Finance and Trade (FFT). In a press release announcing the decision, Commissioner Vestager criticized Luxembourg's ruling because it applied an

> extremely complex and artificial methodology to calculate Fiat Finance and Trade's taxable profits, which cannot be justified by economic reality. As a result Fiat Finance and Trade only paid taxes on its underestimated profits. The Commission's analysis showed that its taxable profits in Luxembourg would have been 20 times higher if the calculations had been done at market conditions.[218]

The Commission used the general Luxembourg corporate income tax system as the reference system.[219] However, in a "subsidiary line of reasoning," it also found the

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[216] *Starbucks*, para. 236; 244; 250; *Fiat*, para. 199; *Apple*, paras. 234-235, 352.

[217] *Fiat*, paras. 222, 225; *Starbucks*, para. 249; *Apple*, para. 251.

[218] European Commission Press Release, "Statement by Commissioner Vestager on Commission state aid decisions regarding illegal tax advantages granted by Luxembourg (Fiat) and the Netherlands (Starbucks) and on the optical disk drives cartel," 20 October 2015, https://europa.eu/rapid/press-release_STATEMENT-15-5881_en.htm.

[219] *Fiat*, para. 194.

APA "grants FFT a selective advantage in the context of the more limited reference system composed of group companies applying transfer pricing."[220]

Unlike Ireland, Luxembourg had incorporated the arm's length standard and the OECD Transfer Pricing Guidelines in its national legislation.[221] Again the Commission asserted it was applying a standard independent of the OECD.[222] Despite this assertion, its analysis relied heavily on the OECD rules,[223] suggesting the Commission engaged in rhetoric rather than applying an independent standard. To the prejudice of Luxembourg, which did not specify a transfer pricing methodology, the Commission relied on the hierarchy of methods approach to reject Fiat's transfer pricing methodology even though the 2010 OECD Transfer Pricing Guidelines had abandoned that approach.[224] While it is unclear why the Commission did so, its analysis bolsters the argument that the Commission uses its powers to support its policy preferences regardless of Member State tax policies.

As noted above, on September 24, 2019, the General Court of the European Court of Justice ruled against Luxembourg and Fiat and confirmed the Commission's decision that the Fiat APA was state aid. Fiat, but not Luxembourg, has filed an appeal.

Starbucks

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[220] *Fiat*, para. 316.

[221] Ibid., para. 77.

[222] Ibid., para. 228.

[223] Ibid., paras. 219-311.

[224] Ibid., para. 149.

In 2015 the Commission concluded that a 2008 advance pricing agreement (APA) between a Starbucks subsidiary and the Netherlands resulted in too little tax to the Netherlands and thus constituted illegal state aid.[225] In doing so it rejected Dutch claims that the Commission's "interpretation of tax principles of the Member States, […] would encroach on the sovereignty of the Netherlands."[226]

The case involved a 2008 APA between the Netherlands and Starbucks Manufacturing EMEA BV ("Starbucks Manufacturing"), a seller and distributor of roasted coffee and coffee-related products to Starbucks outlets in Europe, the Middle East and Africa. Under the APA, royalty payments made by Starbucks Manufacturing to United Kingdom based Alki Limited Partnership ('Alki') for 'coffee-roasting know how' were exempt from corporate income tax and not subject to Dutch withholding tax. The Commission's investigation concluded that the APA gave a selective advantage to Starbucks Manufacturing, reducing its tax burden by €20 - €30 million. The Commission found that the Netherlands not only used the wrong transfer pricing method but it applied it incorrectly.[227]

Using the general Dutch corporate income tax system as the reference system, "irrespective of whether corporate income tax under that system is imposed on group or

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[225] Commission Decision of 21 October 2015, State aid SA.38374 implemented by the Netherlands to Starbucks 2017/502/EC, Official Journal L 83.

[226] Ibid., para. 186.

[227] Ibid., paras. 155-160, 378.

stand-alone companies,"[228] the Commission rejected the Dutch claim that the reference system should be the

> corporate income tax law which includes the arm's length principle under [Dutch law] that provides further guidance on the application of the arm's length principle. The Netherlands argues that as long as the SMBV APA does not deviate from [Dutch law] and the Decree, there cannot be a selective advantage.[229]

The Commission also determined that the case involved selective aid, not general:[230]

> Where an APA is based on a method of assessment that deviates from what would result from a normal application of the ordinary tax system without justification, that APA will be considered to confer a selective advantage upon its beneficiary insofar as that selective treatment results in the lowering of that beneficiary's tax liability in the Member State concerned as compared to companies in a similar legal and factual situation.[231]

Although the Netherlands had incorporated the arm's length standard together with 1995 OECD guidelines, the Commission claimed to apply its own standard.[232] The Commission explained:

> Thus, for any avoidance of doubt, the arm's length principle that the Commission applies in its State aid assessment is not that derived from Article 9 of the OECD Model Tax Convention, which is a non-binding instrument, but is a general principle of equal treatment in taxation

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[228] Ibid., para. 252.

[229] Ibid., para. 183.

[230] Ibid., para. 254.

[231] Ibid., para. 255.

[232] Ibid., para. 87.

> falling within the application of Article 107(1) of the Treaty, which binds the Member States and from whose scope the national tax rules are not excluded.[233]

The same language appears in *Fiat*.[234] The Commission may have just been engaging in rhetoric. If so, its language is intemperate.

The Commission ascribes this principle of equality to *Forum 187*.[235] Commentators have challenged the reliance on *Forum 187*, noting that *Forum 187*

> does not legally justify the ALP being a general principle of equal treatment in taxation falling within the application of Article 107(1) TFEU. Rather it is a reminder that national tax rules are not excluded from the scope of Article 107 TFEU. This is not new but has been the position since 1974. Paragraph 81 does not explain how the ALP, which is deeply enshrined in tax law and transfer pricing methodology, suddenly has become a general principle of equal treatment in taxation falling within the application of Article 107(1) TFEU and how it is different from that of the OECD ALP. Furthermore, in its notion of State aid in 2016, the Commission refers to the OECD Transfer Pricing Guidelines to emphasise that compliance with the guidelines is unlikely to give rise to State aid.[236]

The Commission explained it was

> not examining whether the SMBV APA complies with the arm's length principle as laid down [by Dutch tax law], but whether the Dutch tax administration conferred a selective advantage on SMBV for the purposes of Article 107(1) of the Treaty by concluding an APA that endorses a profit

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[233] Ibid., para. 264, Footnote 126; *Fiat*, para. 228, Footnote 112.

[234] *Fiat*, para. 228, Footnote 112.

[235] *Starbucks*, para. 264, Footnote 126; *Fiat*, para 228, Footnote 112.

[236] Gormsen, *European State Aid and Tax Rulings*, 47-8, Footnotes Omitted; See also, Mason, "Arm's Length on Appeal," 785-789 ("While the commission's view is plausible, the analysis it cites from *Forum 187* is ambiguous.")

> allocation that departs from the amount of profit that would have been taxed under the general Dutch corporate income tax system if the same transactions had been executed by independent companies negotiating under comparable circumstances at arm's length.[237]

Inexplicably, the Commission used both the 1995 and the 2010 guidelines, even though the Netherlands had issued its tax ruling in 2008.[238] Not only is this indiscriminate use of the guidelines problematic for planning purposes, it gives credence to the idea that the Commission is making policy in accordance with staff preferences which could shift under a new President.

The General Court annulled the Commission's decision on September 24. 2019. It explained,

> mere non-compliance with methodological requirements does not necessarily lead to a reduction of the tax burden. It follows that the mere finding by the Commission of errors in the choice or application of the transfer pricing method does not, in principle, suffice to demonstrate the existence of an advantage.[239]

In other words, the General Court found that the Commission did not go far enough in its technical analysis. Rather than just finding that the Netherlands chose a faulty methodology, the Commission needed to have shown what the results would have been under the Commission's chosen methodology.

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[237] *Starbucks*, para. 265. Mason notes that despite the Commission claim that it was applying its own arm's length standard, it actually reviewed using OECD guidance; Mason, "Arm's Length on Appeal," 777.

[238] *Starbucks*, para. 293.

[239] Ibid., para. 211.

Like the *Fiat* ruling, the Court affirmed the Commission's state aid authority over tax matters:

> Since the Commission has the power to monitor compliance with [the EU's state aid rules], it cannot be accused of having exceeded its powers when it examined the tax ruling at issue in order to determine whether it constituted state aid and, if it did, whether it was compatible with the internal market.[240]

The EU did not appeal its loss.

Amazon[241]

In April 2017, the Commission concluded that an APA issued by Luxembourg in 2003 and renewed in 2011, lowered Amazon's tax to Luxembourg without any valid justification. The APA allowed Amazon to shift profits from an Amazon group company subject to tax in Luxembourg (Amazon EU) to a company not subject to tax (Amazon Europe Holding Technologies). In particular, the tax ruling endorsed a royalty payment from Amazon EU to Amazon Europe Holding Technologies, which significantly reduced Amazon EU's taxable profits. The Commission termed the holding company

> an empty shell that simply passed on the intellectual property rights to the operating company for its exclusive use. The holding company was not itself in any way actively involved in the management, development or use of this intellectual property. It did not, and could not, perform any activities, to justify the level of royalty it received.[242]

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[240] *Fiat*, para. 107.

[241] Commission Decision of 4 October 2017 on State aid implemented by Luxembourg to Amazon, SA. 38944 (2014/C) (ex 2014/NN)

[242] European Commission Press release "State aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million" October 4, 2017, https://europa.eu/rapid/press-release_IP-17-3701_en.htm.

Finding that the level of royalty payments did not reflect economic reality, the Commission concluded that the tax ruling granted Amazon a selective economic advantage by allowing it to pay less tax than other companies subject to the same national tax rules. According to Commissioner Vestager:

> Luxembourg gave illegal tax benefits to Amazon. As a result, almost three quarters of Amazon's profits were not taxed. In other words, Amazon was allowed to pay four times less tax than other local companies subject to the same national tax rules. This is illegal under EU aid rules. Member States cannot give selective tax benefits to multinational groups that are not available to others.[243]

Luxembourg asserted sovereignty, challenging the

> interference of its sovereign powers in the area of direct taxation. In particular, it considered the Commission to have exceeded its powers in the field of State aid by developing and imposing its own interpretation of the arm's length principle. In this manner, the Commission is seeking to latently harmonise direct taxation rules in breach of Articles 113 and 115 of the Treaty, since the Union can only harmonise substantive law on taxation through unanimously adopted legislative measures.[244]

Luxembourg's incorporation of the ALP makes the sovereignty argument harder to make.[245] The Commission did not apply the ALP in contravention of domestic law. In any event, the Commission ignored the sovereignty argument and rejected Luxembourg's choice of reference system:

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[243] European Commission Press Release October 4, 2017, "State aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million," https://europa.eu/rapid/press-release_IP-17-3701_en.htm.

[244] *Amazon,* para. 290.

[245] *Amazon*, para. 243.

> Luxembourg and Amazon argue that, in order to determine whether LuxOpCo has been selectively favoured as a result of the contested tax ruling, its fiscal treatment by the Luxembourg tax administration should be compared only to other Luxembourg corporate taxpayers forming part of a multinational corporate group. They argue that the contested tax ruling concerns transfer pricing and, since only multinational corporate groups are confronted with pricing cross-border intra-group transactions, companies belonging to such groups are in a different factual and legal situation to independent companies. With that argument, Luxembourg and Amazon advocate for a reference system limited to Article 164(3) LIR, the provision of Luxembourg tax law that was considered to lay down the arm's length principle for the purposes of pricing cross-border intra-group transactions during the relevant period.[246]

Instead the Commission considered the reference system to be the Luxembourg corporate income tax system.[247]

Perhaps responding to criticism, the Commission distinguished advantage from selectivity, unlike earlier cases.[248] Without explanation, the Commission applied the 2017 OECD TP Guidelines, although these guidelines post-dated the APA.[249]

Amazon may illustrate Mason's "sweetheart ruling" assessment.

> [T]he Commission considers the transfer pricing arrangement to be based on the inaccurate and unsubstantiated assumption that LuxSCS would perform unique and valuable functions in relation to the Intangibles, whereas LuxOpCo would perform solely "routine" management functions.[250]

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[246] *Amazon*, para. 590.

[247] *Amazon*, para. 587.

[248] Gormsen, *European State Aid and Tax Rulings,* 31; *Amazon*, para. 399.

[249] *Amazon*, Footnotes 411-413.

[250] *Amazon*, para. 407.

Apple

Ireland granted Apple two tax rulings in 1991 and 1997 that allocated profits to Apple's Irish branch. The Commission concluded that these rulings constituted state aid and "substantially and artificially lowered the tax paid by Apple in Ireland since 1991.[251] It required Ireland to recover 13.4 billion euros plus interest from Apple. The Commission's 2016 ruling corrected a mismatch between US and Irish law which resulted in Apple's two Irish subsidiaries, ASI and AOE, managed and operated in the US through a single branch in Ireland, having no US tax presence and no residency status in Ireland.[252] As a result they were "'stateless' for tax residency purposes."[253]

The Commission applied the traditional four part state aid test:

> It is thus well-established that, for a measure to be categorised as State aid, there must, first, be an intervention by the State or through State resources; second, the intervention must be liable to affect trade between Member States; third, it must confer a selective advantage on an undertaking and, fourth, it must distort or threaten to distort competition.[254]

Relying on ECJ precedent providing that "*the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective*," the

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[251] European Commission, "EU rules Apple state aid €13 billion must be re-paid to Ireland," https://ec.europa.eu/ireland/news/%C3%A9-cinneadh-aontais-eorpaigh-nach-m%C3%B3r-do-apple-%E2%82%AC13-billi%C3%BAn-ais%C3%ADoc-le-h%C3%A9irinn_en; Commission Decision 2017/1283 of Aug. 30, 2016 on State Aid Implemented by Ireland to Apple, 2017 O.J. (L 187) 1.

[252] *Apple*, para 52.

[253] Ibid.

[254] *Apple*, para. 220.

Commission determined the tax rulings constituted individual aid, and therefore, presumptively state aid.[255] The Commission also analyzed the aid using the three-part selectivity test.[256] Applying "the ordinary rules of taxation of corporate profit in Ireland" as the reference system, the Commission disregarded Ireland's argument that the reference system should be its branch profit allocation rules.[257]

Though Ireland did not adopt the ALP until 2011, the Commission determined the ALP was inherent in the application of Irish corporate law since the 1990s.[258] The Commission found that the contested tax rulings "should still be considered to confer a selective advantage on ASI and AOE for the purposes of Article 107(1) of the Treaty, since they would then be the result of discretion exercised by Irish Revenue in the absence of objective criteria related to the tax system."[259] The Commission asserted its right to use an arm's length standard independent of the OECD standard.[260] This assertion did not preclude the Commission from applying the 2010 OECD Transfer Pricing Guidelines as "useful guidance" in an investigation of 1997 and 2001 tax rulings.[261]

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[255] *Apple*, para. 224, emphasis in original.

[256] Ibid.

[257] *Apple*, paras. 152, 226, 228.

[258] *Apple*, paras. 371, 377.

[259] *Apple*, paras. 378-379.

[260] *Apple*, paras. 255, 441.

[261] *Apple*, para. 255.

The Commission's use of alternate bases is problematic. It equates to throwing paint against a wall to see what sticks without regard to legal certainty and allows it unfettered discretion to make policy:

> (L)ocating the arm's-length allocation requirement in the state aid rules (rather than as part of the domestic law reference base) allows the commission to mold the arm's-length allocation standard to suit its needs in the selectivity analysis — picking and choosing among contemporaneous, modern, and potentially even obsolete guidance from the OECD.[262]

Even if the alternate bases are functionally equivalent, the Commission should issue clear standards rather than apply alternate bases which suggest the Commission is making policy.

An underlying factor in the case may have been the Commission's annoyance at Apple's heavy-handedness. Apple's behavior seems to give credence to arguments that powerful corporations act as sovereign entities.[263] In a meeting with Irish Revenue

> [Apple's tax advisor] mentioned by way of background information that Apple was now the largest employer in the Cork area with 1,000 direct employees and 500 persons engaged on a sub-contract basis.[264]

Further, Apple suggested a suitable profit:

> [Apple's tax advisor] stated that the company would be prepared to accept a profit of $30-40m assuming that Apple Computer Ltd. will make such a profit. (The computer industry is subject to cyclical variations). Assuming that Apple makes a profit of £100m it will be accepted that $30-

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[262] Mason, "Arm's Length on Appeal," 784.

[263] Theodore DiSalvo, "The Apple-Ireland Tax Case: Three Stories on Sovereign Power," *Duke Journal of Comparative & International Law* 28 (2018): 371.

[264] *Apple*, para. 64.

> 40m (or whatever figure is negotiated) will be attributable to the manufacturing activity. However if the company suffered a downturn and had profits of less than $30-40m then all profits would be attributable to the manufacturing activity. The proposal essentially is that all profits subject to a ceiling of $30-40m will be attributable to the manufacturing activity.
>
> [Irish Revenue] asked [Apple's tax advisor] to state if was there any basis for the figure of $30-40m and he confessed that there was no scientific basis for the figure. However the figure was of such magnitude that he hoped it would be seen to be a bona-fide proposal.[265]

Suggesting an appropriate tax, without supporting financial justification, can easily be seen as aggressive, particularly after Apple's statement that it was the largest employer in Cork. The Commission's criticism of the 1991 ruling as "negotiated rather than substantiated by reference to comparable transactions and that Irish Revenue did not seem to have had the intention of establishing a profit allocation based on transfer pricing"[266] supports this interpretation.

What Mason refers to as Apple's "sweetheart deal" will undoubtedly be problematic on appeal. But even without that, the *Fiat* and *Starbucks* decisions do not augur well. Based on these decisions, the General Court can use the ALP "as a 'benchmark' or 'tool' of state." [267] As a result, the fact the Ireland has not incorporated the ALP into national law is irrelevant.

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[265] *Apple*, para. 64.

[266] *Apple*, para. 147.

[267] *Fiat*, paras. 151, 159; *Starbucks* paras. 151, 157,163, 169.

Chapter VIII.

Analysis

The EU Commission for Competition shows no sign of slackening its enforcement pace. Instead, Vestager's reappointment to a second five-year term, combined with the Commission's General Court victories, suggests it is full speed ahead. While the litigation is far from over, the legal arguments will ultimately resolve themselves through the courts. This section will focus on philosophical criticism.

Policymaking

The Commission's expansive discretionary powers to make policy are problematic. Article 115 of the TFEU provides a procedure for tax legislation that recognizes the retention of state authority. Adherence to this provision would minimize the effects of inherently political tax policymaking which "is a complex affair with profound political and social implications." [268] In applying an arbitrary reference base, the Commission substitutes its policy preferences for those of EU Member States and assumes broad power to shape tax policy.[269]

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[268] Mason, "Tax Subsidy War," 56.

[269] Mason, "Arm's Length on Appeal," 774; Mason, "Tax Subsidy War," 6.

The Commission risks "moving away from traditional selectivity analysis...[by] replac[ing] selectivity's traditional *domestic-law reference base with a normative reference base*."[270] This means that instead of illegal state aid occurring when a state offers aid not generally available under domestic law, state aid exists wherever the Commission determines the aid does not comply with its policy.[271] Wide discretion, which may vary with changes in Commissioners, increases risk and costs for taxpayers while interfering with state domestic preferences.

The Commission's ability to shape policy is facilitated by a lack of guidance which allows the Commission, General Court and the Court of Justice to take different positions in the same case.[272] The arbitrariness in the selection of a reference base illustrates the point.[273] Advocate General Niilo Jääskinen argued:

> That derogation-based approach has been criticised in the legal literature since neither the Commission nor the Court of Justice has succeeded in determining precisely what is covered by the term 'derogation from the norm' or what constitutes the 'norm' or 'a general system' Writers have also emphasised the difficulty in determining a 'normal' tax rate in order to establish the rate which may be regarded as departing from the norm.[274]

Similarly, Advocate Julianne Kokott has stated:

> The referring court has therefore selected three different 'normal' tax regimes as the basis for its examination. In so

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[270] Mason, "Tax Subsidy War," 5.

[271] Mason, "Tax Subsidy War," 6; Mason, "Arm's Length on Appeal," 774.

[272] Mason, Tax Subsidy War," 13.

[273] Mason, "Arm's Length on Appeal," 774.

[274] Joined Cases C-106/09 P and C-107/09 P, *Gibraltar* (opinion of Jääskinen), EU:C:2011:215, para. 184 (citations omitted); Mason, "Arm's Length on Appeal," 773.

> far as it suspects that the goodwill amortisation regime is selective because it is available only to legal but not to natural persons, it selects as its reference framework the entire body of Austrian law on the taxation of profits. On the other hand, in so far as it addresses the preferential treatment, from the point of view of corporation tax, of undertakings subject to group taxation, the referring court takes corporation tax law as its reference framework. Finally, in so far as it focuses, within the context of group taxation, on the preferential treatment of undertakings with domestic as opposed to foreign shareholdings, the reference framework has to be the law relating to group taxation. The reference framework therefore varies according to the difference in treatment under consideration. This makes apparent the fact — as the Court, too, found in the judgment in *Gibraltar* — that the determination of a 'normal' tax system cannot be decisive. The examination of the difference in treatment in question is alone decisive.[275]

A variable reference base deprives states and MNEs of certainty while enabling the Commission to shape the outcome according to the chosen reference system. It also deprives nations of the ability to control their economies. As one practitioner explained:

> I would suggest that the key objectives of the regime are the creation of employment and the generation of taxation revenues in a way that is ethical, consistent with our international obligations and mindful of our reputation.[276]

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[275] Case C-66/14, *Finanzamt Linz v. Bundesfinanzgericht* (opinion of Kokott), EU:C:2015:242, para. 88; Mason, "Arm's Length on Appeal," 773.

[276] Conor O'Brien, "Is Ireland's corporation tax regime fit for purpose?" *Irish Times*, June 11, 2013, https://www.irishtimes.com/business/economy/is-ireland-s-corporation-tax-regime-fit-for-purpose-1.1423602.

This policymaking has consequences for nations. Ireland's success in attracting foreign direct investment "was probably the most significant factor in transforming Ireland's economy."[277] Or, as the singer Bono observed:

> We are a tiny little country, we don't have scale, and our version of scale is to be innovative and to be clever, and tax competitiveness has brought our country the only prosperity we've known.
>
> That's how we got these companies here … We don't have natural resources, we have to be able to attract people.[278]

States can and do enter into agreements to limit their financial powers. The North American Free Trade Agreement (and more recently the United States-Mexico-Canada Agreement) illustrate the point.[279] But where states have specifically withheld authority, as they have with taxation, their restraint should be respected.

It would be a mistake to impose American constitutional principles on the EU. Nevertheless, the EU does incorporate some separation of powers:[280]

> At the EU federal level, that is, horizontally between the EU institutions, the separation of powers is less clear-cut than that within many of the Member States, especially as

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[277] Ibid.; Vincent Boland, "Dublin Ditches Double Irish to Save Low Tax Regime," *Financial Times*, October 14, 2014, https://www.ft.com/content/1f740b46-539b-11e4-929b-00144feab7de.

[278] Rupert Neate, "Bono: Controversial Tax Laws Have Brought Ireland the Only Prosperity its Ever Known," *The Guardian*, October 11, 2014, https://www.theguardian.com/world/2014/oct/12/bono-tax-laws-bring-ireland-prosperity-apple-google-u2.

[279] Edward Guntrip, "Self Determination and Foreign Direct Investment: Reimaging Sovereignty in International Investment Law," *International and Comparative Law Quarterly* 65 (October 2016): 829.

[280] Allan Rosas, "Separation of Powers in the European Union," *The International Lawyer* 41, no. 4 (Winter 2007): 1034.

> far as the distinction between the legislative and executive branches is concerned. In other words, legislation in the form of regulations and directives is passed by the EU Council, which consists of a representative from each Member State at the ministerial level; thus, it is often called the "Council of Ministers." In many cases, the Council acts jointly with the European Parliament, which consists of representatives from the Member States, elected by direct universal suffrage. The European Commission is closer to an executive power, generally responsible for the implementation of the rules laid down by the Council. But, it is also entrusted with the task of proposing new legislation and ensuring that he common rules are applied (the "Guardian of the Treaties"). Additionally, the European Commission enjoys certain decision-making powers of its own, for example, in the fields of antitrust and state aid law.[281]

The Commission argues that its independent ALP is inherent in the TFEU and the General Court has indicated it is "a tool" available to the Commission.[282] If, on the other hand, the Commission is defining new state aid rules, *e.g.*, by declaring an independent arm's length standard, then that is legislation and should be subject to normal legislative procedures. Reflecting the notion that tax authority is inherent to state sovereignty, TFEU Article 115's unanimity requirement makes tax legislation difficult. This is not a mere oversight and has been respected by "successive treaty amendments."[283]

The Commission's policymaking achieves through the back door what it lacks authority to do under the TFEU. Its actions threaten to undermine the compromise struck

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[281] Ibid.

[282] *Fiat*, para. 143; *Starbucks*, para. 151.

[283] Mason, "Tax Subsidy War," 11.

by membership into the EU: the delicate balance between sovereignty retained and yielded by Member States.

Sovereignty

Definitions of sovereignty abound. Ironically, "a State can construe sovereignty so as to justify State conduct, whilst another State will refer to sovereignty to denounce the same act."[284] Indeed, sovereignty appears to be more of an "idea" or "concept"[285] which may refer to the "territorial inviolability of states and the correlated right of self-defense against any violation of a state's territorial borders" or the "responsibility for the common good."[286]

In international law the term "sovereignty" is most frequently used in two senses. It may refer to the status of a country in international relations. Sovereignty is an indispensable condition of possessing the capacity for independent and full participation in international life. The second meaning focuses on the freedom of a state in the exercise of its sole, full and undivided powers. A sovereign state is described as one which is not dependent in either its external relations or internal affairs.[287]

Regardless of the definition of sovereignty, entering into legal arrangements with other nations to limit sovereignty in exchange for various national security and economic

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[284] Guntrip, "Self Determination and Foreign Direct Investment," 830.

[285] James Turner Johnson, *Sovereignty: Moral and Historical Perspectives* (Washington, DC: Georgetown University Press, 2014), 1.

[286] Ibid., 4.

[287] Elzbieta Dynia, "European Integration and National Sovereignty," 7 *Polish Quarterly of International Aff*airs 7, no. 2 (1998): 88.

benefits is commonplace. The EU is just one of many such arrangements. States agreed to a curtailment of authority when they entered the EU. But the Member States did not cede all authority to the EU. TFEU Article 115's unanimity requirement reflects state hesitation to relinquish too much power in the area of direct taxes.[288]

In an early case, the Court of Justice of the European Communities declared:

> The Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals.[289]

Taxation has traditionally not been one of the limited fields. States retain sovereignty over direct taxation, although the CJEU allows the Commission to examine tax matters under TFEU Article 107.[290] Former EU competition commissioner Neelie Kroes stated:

> EU member states have a sovereign right to determine their own tax laws. State aid cannot be used to rewrite those rules. However, the current state aid investigations into tax rulings appear to do exactly that, by suggesting a radical new approach to so-called transfer-pricing rules that determine where profits shall be allocated.[291]

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[288] Mason, "Tax Subsidy War," 11.

[289] Case 26-62, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*, ECLI identifier: ECLI:EU:C:1963:1, cited in Dynia, 85.

[290] Faulhaber, 187; Gormsen, *European State Aid and Tax Rulings,* 144.

[291] Speech by Commissioner Neelie Kroes: "Reforming Europe's State Aid Regime: An Action Plan for Change," June 13, 2015, https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_05_347.

As Mason has noted,

> Thus, taxes remain resolutely the domain of the Member States. The EU has no meaningful tax powers of its own, even though, as the financial crisis and euro crisis revealed, the choice to keep fiscal decisions at the state level has imposed severe costs. The Court of Justice repeatedly has affirmed the Member States' income tax sovereignty, emphasizing their autonomy to define their tax bases, set their tax rates, and choose their international income-allocation rules.[292]

Member State sovereignty is not unlimited and Member States must respect the EU treaties and fundamental freedoms. Respect for tax sovereignty suggests that the Commission should exercise its powers prudentially. A clear understanding and appreciation of the dividing line between EU State Aid rules and national tax sovereignty is desirable. The Commission's investigations risk upsetting the balance the EU strikes between national sovereignty and EU integration. The criticism is particularly apt when the Commission applies the ALP to states that have not incorporated the principle in domestic legislation.

In *Amazon* the Commission rejected the sovereignty argument. Luxembourg unsuccessfully challenged the Commission's investigation into its tax rulings with Amazon, claiming that the Commission had "exceeded its powers in the field of State aid by developing and imposing its own interpretation of the arm's length principle."[293] Forrester elaborates on this argument:

> The principal issue associated with State aid in the field of taxation is the conflict with the ongoing sovereignty of

[292] Mason, "Tax Subsidy War," 11. Citations omitted.

[293] *Amazon*, para. 290.

> Member States over their tax systems. Expanding upon the description of a 'normal' or 'general' tax system, not taking into account the traditions, policies, or needs of a Member State, would be an interference with the sovereignty of States to decide which economic undertakings will be subject to tax within the territory. Similarly, if the Commission were to adopt a test surrounding discrimination analysis instead, State aid control would be transformed into a general non-discrimination test, which would threaten national tax sovereignty. The expansion of the scope of State aid, continually encroaching more within the field of taxation, is a threat to such freedom.[294]

However laudable the Commission's efforts to curtail tax avoidance,

> If effective anti-avoidance legislation, such as proper transfer pricing rules, is missing, it is not for EU State aid rules to act as their replacement in order to avoid non-taxation. That said, the exception to this is where such rules do exist but selective exemptions to their application have been included that are tailor-made for certain undertakings or particular sectors of industry.[295]

Advocate Jääskinen in his opinion in *Gibraltar* cautioned against the use of state aid as an anti-abuse provision:

> It follows that harmful institutional or tax competition between Member States clearly does not fall within the mechanism for controlling State aid established by the Treaty, even though there are cases where measures are liable to amount both to harmful tax competition and to State aid incompatible with the common market. However, the legitimate objective of combating harmful tax competition cannot justify distortion of the European Union's legal framework established in the area of competition law applicable to State aid, or even the

[294] Forrester, "State Aid Regime," 28.

[295] Raymond Luja, "Do State Aid Rules Still Allow European Union Member States to Claim Fiscal Sovereignty?" *EC Tax Review* 25, no. 5 (2016): 323.

> adoption of ad hoc solutions conflicting with the rule of law as enshrined in Article 2 TEU.[296]

While EU Member States have agreed to limit sovereignty in exchange for membership, there remain limits to the EU's authority, particularly in the direct taxation arena. The authority must be exercised in compliance with EU law to prevent illegal state aid. The Commission is not a legislative body, yet it effectively is engaging in legislation, the prerogative of the Council together with Parliament. "Under [TFEU] Article [114], direct taxation is also subject to unanimity voting …, but its strong link to Member State sovereignty means that very few EU measures regulating direct taxation have been proposed."[297]

Notably, the DG TAXUD drafted anti-tax abuse legislation adopted by the Council.[298] The Commission should follow the TFEU Article 115 procedures.

Subsidiarity

The Commission's actions must adhere to the principle of subsidiarity articulated in Article 5 of the TEU. Subsidiarity in itself does not prevent the Commission's state aid investigations. It does suggest a prudential limit on the Commission's investigations. Sovereignty and subsidiarity together mean that states are normally free to act on tax

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[296] Joined Cases C 106/09P and C 107/09P, *Commission v Government of Gibraltar and United Kingdom* ECLI:EU:C:2011:215, Opinion of Judge Advocate General Jääskinen, Para. 134.

[297] Faulhauber, 181.

[298] Mason, "Tax Subsidy War," 12; Council Directive 2016/1164 of 12 July 2016.

matters, unless the aid is illegal.[299] EU member and non-member states have been cooperating as part of the OECD so deference to the principle of subsidiarity would seem appropriate.[300] This would avoid conflicting guidance as well as an inefficient allocation of resources.

Inefficiency

State aid cases are inefficient. The use of executive authority risks encroaching on direct tax authority member states. Nor is it clear that Commission possesses the tax expertise found in the DG TAXUD. While certainly the Commission can add tax experts to its staff, or borrow from DG TAXUD, is this an efficient use of resources? Is it a prudential exercise of power?

State aid cases risk disregarding the OECD's base erosion and profit shifting (BEPS) work. Further, while national tax authorities have detailed regulation and experience in transfer pricing, the EU does not.[301] The

> (l)ack of tax expertise in DG-Comp has already created problems. For example, it is unclear whether Commission staff appreciated the broader implications of developing a new arm's-length rule that would apply independently of domestic law. In addition to creating monumental uncertainty for multinational taxpayers and infuriating longtime OECD partners that openly questioned the competence of the Commission to apply international tax standards, the recent decisions seem to make it illegal for Member States to unilaterally adopt DG-Tax's star

[299] Éva Erdős and Beáta Gergely, "State Aids Connection with Tax Competition Regarding the Principle of Subsidiarity in the European Tax Law," *Curentul Juridic* 70, no. 3 (2017): 117.

[300] Mason, "Tax Subsidy War," 56.

[301] Eden and Byrnes, 29.

> legislative proposal. DG-Tax has been pushing the CCCTB [Common Consolidated Corporate Tax Base], major EU tax reform legislation that would require all the Member States to use formulary apportionment, rather than arm's length, to allocate income from cross-border transactions.[302]

APAs allow taxpayers and tax administrations certainty by avoiding disputes and double taxation.[303] Taxpayers may find these agreements overridden while EU Member states that have entered into bilateral tax agreements may find their efforts wasted if they are unable to honor these agreements."[304]

Resources play a role. The Commission may lack the resources to regulate economic policy.

> There is a danger that overextension of the State aid rules might result in all economic policy decisions of Member States being brought under the scrutiny of the Community authorities, without any distinction being made between direct interventions in the market and general measures to regulate economic activities it would also result in a substantial increase in the workload of the Community's supervisory authorities, the Commission and the Court.[305]

The scarcity of resources limits the Commission's ability to effectively monitor state aid and makes it difficult to predict what cases will draw attention, which "adds an

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[302] Mason, "Tax Subsidy War," 57.

[303] Liza Lovdahl Gormsen, "State Aid and Direct Taxation," *The Antitrust Bulletin* 62, no. 2 (2017): 360.

[304] Treasury White Paper, 23.

[305] Case C-237/04, *Enirisorse SpA v Sotacarbo SpA*, ECLI:EU:C:2006:21, Opinion of A.G. Maduro, para 45.

extra, very arbitrary facet to state aid control."[306] This will exacerbate Doleys's "dilemma of discretion."[307]

One commentator has noted the inherent tension between tax authorities and the Commission:

> So, arguments that would appear as natural to tax authorities because they raise the efficiency of a tax measure by focusing or targeting it or by simplifying its application, would be rejected by the Commission on the grounds that they make the measure selective and that they do not follow from the logic of the system. [308]

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[306] German Ministry of Finance, "A report of the Advisory Board to the Federal Ministry of Finance Tax benefits and EU state aid control: The problem of and approaches to resolving the conflict of jurisdiction with fiscal autonomy," (October 2017), 27, https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Ministry/Advisory_Board/2018-02-07-tax-benefits-and-eu-state-aid-control-Beitrag.html

[307] Nicolaides, "Fiscal State Aid in the EU," 375.

[308] Ibid., 375.

Chapter IX.

Conclusion

The prohibition on state aid has a long history, but the Commission's state aid cases raise hard legal and prudential questions. In response to the legal questions the Commission can argue that neither TFEU Article 107 nor the subsidiarity principle preclude the Commission's state aid enforcement activities. TFEU Article 107's silence as to a reference base gives the Commission scope to choose a reference base. Ultimately, courts will determine the whether the Commission has misapplied judicial precedent. The question becomes a prudential one. Should the "unelected Commission [have] the power, subject to judicial review, to strike down national laws passed under national democratic processes"[309] and "designed to capture voters' moral and political preferences?"[310] Should the Commission use its state aid powers expansively? Direct tax legislation follows a prescribed procedure under the TFEU.

The absence of Treaty guidance creates space for the Commission but uncertainty for nations and MNEs. The space is broad enough for the Commission to pursue its own policy. States, however, have a right to set their national tax policy. For Ireland, its tax policy has been instrumental in attracting foreign investment. State aid rules serve a valuable purpose and the Commission has a role to play. A balance must be struck between the rights of nation states and the Commission's authority.

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[309] Mason, "Tax Subsidy War," 42.

[310] Ibid., 43.

As a prudential matter, the Commission should exercise caution. Despite efforts to change the unanimity requirement, tax remains a competence of nation states subject to the fundamental freedoms. The Commission's policymaking in the area of traditional state deference raises sovereignty issues and disregards work done by the OECD. While the Commission acknowledged the OECD ALP, it applied the OECD's non-binding guidelines to states that have not adopted them or applied versions that postdated the tax rulings in question. This does not mean that state aid resulting from tax rulings should be exempted from EU scrutiny. Questions of tax avoidance, tax harmonization and the ability of multinational corporations to act as quasi-sovereign entities present legitimate concerns. But state aid rules developed by the Commission are not the appropriate mechanisms for dealing with these issues. Instead, legislation remains the prerogative of the Council, together with Parliament, in accord with legislative authority given by Member States.

Unfortunately, *Apple* may not be the ideal case to resolve the hard questions. The Commission's decision refers to the lack of economic analysis underpinning Apple's APA. As a sweetheart deal it is suspect under traditional state aid analysis without the need for the Commission's expansive state aid analysis. The case does suggest one possible reform. Removing the veil of secrecy surrounding APAs would minimize the possible of sweetheart deals.[311] Further, it is time for the Council and Parliament to step up to the plate and enact legislation. Not only would legislation comply with treaty requirements but it would prevent expansive policymaking by the unelected Commission and provide much needed certainty.

[311] Eden and Byrnes, 31.

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