CHAPTER 15

State Aid and Tax Rulings: Managing the Risk of Recovery

Chiara Francioso

15.1 Overview: The Commission's Inquiry on State Aid and Tax Rulings

The State aid framework is—together with the fundamental freedoms and the principle of non-discrimination—one of the tools to indirectly ensure a minimum standard of integration within the single market ("negative integration"). Its application has a great impact in the area of taxation, as the matters harmonized ("positive integration") by the Treaty on Functioning of the European Union (TFEU) do not include direct taxation.[1]

[1]The European Union currently lacks general competence to regulate the area of taxation and has no tax system. The Council must unanimously agree on tax proposals, under the special legislative procedure set forth in Art. 113 and 115 TFEU, which results in the possibility of national veto. The European Commission has recently proposed to move to qualified majority voting in EU tax policy (COM [2019] 8 final). *See* Tesauro, F. (2017). *Istituzioni di diritto tributario. Parte generale*. Milano: UTET, 82; Remeur, C. (2015). *Tax Policy in the EU: Issues and Challenge*. European Parliament Research Service, 1.

C. Francioso (✉)
School of Law, University of Milano-Bicocca, Milan, Italy
e-mail: c.francioso@campus.unimib.it

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Art. 108 TFEU reserves for the European Commission the power to keep under constant review all systems of aid existing in the Member States, with their cooperation.[2]

In order to curb harmful tax competition, in 1997 the Council of Economics and Finance Ministers (ECOFIN) adopted, on a proposal of the Commission, the Code of Conduct for business taxation. The States agreed on a non-binding instrument, but rather a political commitment to reexamine, amend or abolish their existing tax measures that constituted harmful tax competition ("rollback process") and refrain from introducing new ones in the future ("standstill process"). As a matching commitment to this political agreement, many Member States urged the Commission to reexamine its policy on fiscal State aid and to make full use of its powers under the Treaty rules in order to curb harmful tax competition[3]. This action resulted in the Commission Notice of 1998 on the application of State aid rules in the area of business taxation,[4] which aimed to link the provisions of the Treaty and related rules on State aid

Available at http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/549001/EPRS_IDA(2015)549001_EN.pdf. Since 1974, the Court of Justice of the European Union (CJEU) has clarified that the Commission's competence in the field of State aid control also covers the area of direct business taxation. ECJ, 2 July 1974, C-173/73, *Italy v. Commission*, para. 13: "The aim of Art. 92 is to prevent trade between Member States from being affected by benefits granted by the public authorities which, in various forms, distort or threaten competition by favoring certain undertakings or the production of certain goods. Accordingly, article 92 does not distinguish between the measures of State intervention concerned by reference to their causes or aims but defines them in relation to their effects. Consequently, the alleged fiscal nature or social aim of the measure in issue cannot suffice to shield it from the application of Article 92".

[2] In order to enhance the cooperation between the Member States and the Commission, the latter has recently adopted the Code of Best Practices for the conduct of State aid control procedures (C [2018] 4412 final). Available at http://ec.europa.eu/competition/state_aid/reform/best_practise/en.pdf.

[3] ECOFIN, *Code of Conduct for Business Taxation*, para. (J). Available at https://eur-lex.europa.eu/resource.html?uri=cellar:d2cdddef-e467-42d1-98c2-31b70e99641a.0008.02/DOC_2&format=PDF. *See* Monti, M. (1999). How State Aid Affects Tax Competition. *EC Tax Review*, *4*, 209.

[4] Commission notice on the application of the State aid rules to measures relating to direct business taxation (98/C 384/03) (1998) [hereinafter *1998 Commission Notice*]. Available at https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:1998:384:0003:0009:EN:PDF.

to the fight against harmful tax competition and provided guidance for the first time on discretionary administrative practices.[5]

Pursuant to Art. 107 TFEU, a measure is incompatible with the internal market if the following criteria are cumulatively met:

(a) it confers an advantage on the recipient;
(b) it is granted by a Member State or through State resources which can take a variety of forms (tax reliefs included);
(c) it is granted on a selective basis (i.e. favoring certain undertakings or industry sectors);
(d) it distorts or threatens to distort competition and is likely to affect trade between Member States.

The procedure followed by the Commission, to carry out this review, is typically structured in a preliminary phase possibly leading to a first decision of alleged State aid: by doing so, the Commission opens a formal investigation, inquiring the State and the company for information and possible justifications to the favorable tax treatment granted to the latter. This is followed by a second and final decision that may either confirm or dismiss the initial doubts expressed in the first. If the initial allegation of aid is confirmed, the decision will order the recovery of the unlawful favorable treatment granted by the Member State.[6] The latter must comply with the obligation of recovery within the deadline set in the Commission decision and, pursuant to Art. 16 Regulation 2015/1589, it must do so immediately and effectively.

Both parties can seek judicial remedy before the Union Courts: on the one hand, if the State concerned by the investigation does not comply within the prescribed time, the Commission (or any other interested

[5] *Ivi*., paras. 21–22.

[6] Art. 16 Regulation No. 2015/1589. The Treaties do not explicitly establish the obligation of recovery: instead, it has been inferred by the Union Courts' case law from Art. 108 TFEU (ex Art. 88 TEC) and later incorporated in the EU secondary law. *See* the first case, *ex multis*, ECJ, 12 July 1973, *Commission v. Germany*, C-70/72, para. 13. *See* also Commission Notice 2007/C 272/05 *Towards an effective implementation of Commission decisions ordering Member States to recover unlawful and incompatible State aid*, paras. 9-10 [hereinafter *Recovery Notice*]. Available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52007XC1115(01)&from=EN; Moreno González, S. (2017). *Tax rulings: intercambio de información y ayudas de Estado en el contexto post-BEPS*. Valencia: Tirant lo Blanch, 250.

State) may, by way of derogation from Arts. 258 and 259 TFEU, refer the matter directly to the Court of Justice (ECJ)[7]; on the other hand, the State, as well as the addressees of aids, can challenge the decision for annulment before the General Court (EGC).[8] The judgments of the General Court can be appealed to the Court of Justice.

In this context, in recent years we have witnessed the Commission taking a tougher line on State aid controls of fiscal nature, especially with regard to aids granted through the issuance of tax rulings.[9]

This course of action, however, should not be misinterpreted: not all tax rulings confer State aid on the taxpayer.[10] A tax ruling is a written statement, issued to the taxpayer by tax authorities, that interprets and applies the law to a specific set of facts.[11] Under the rule of law—the basis for the western legal tradition—advance rulings should not be meant to attract foreign investments, grant advantages not provided by

[7] Art. 108(2) TFEU. A case of this kind was brought before the Court as Ireland had failed to recover the State aid granted to Apple within four months following the notification of the decision (action brought on 5 December 2017, *Commission v. Ireland*, C-678/17): the case has been discontinued due to Ireland taking the measures necessary to comply with the obligations arising from the Commission's decision of recovery.

[8] Pursuant to Art. 278 TFEU, actions brought before the CJEU do not have suspensory effect. With regard to the obligation of recovery, the recovered amount can be placed in an escrow account, pending the outcome of the EU court procedures. The Court may, however, if it considers that circumstances so require, order to suspend the application of the contested act (Art. 278 TFEU).

[9] In June 2013, the Commission set up the Tax Planning Practices task force to follow up on public allegations of favorable tax treatment of certain companies voiced in the media and in national Parliaments. Since then, the task force has been reviewing the tax ruling practices of Member States from the perspective of State aid rules, identifying those not reflecting in a reliable manner what would result from the application of the ordinary tax rules. *See* State Aid Register. Available at http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html.

[10] De Broe, L. (2015). The State Aid Review against Aggressive Tax Planning: 'Always Look a Gift Horse in the Mouth'. *EC Tax Review*, *6*, 291; DG Competition, *Working Paper on State Aid and Tax Rulings*, Internal Working Paper—Background to the High Level Forum on State Aid of 3 June 2016, para. 5 [hereinafter *DG-Comp Working Paper*]. Available at http://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf.

[11] OECD, *Advance Ruling*, Glossary of Tax Terms. Available at http://www.oecd.org/ctp/glossaryoftaxterms.htm. *See* also Romano, C. (2002). *Advance Tax Rulings and Principles of Law Towards a European Tax Rulings System?* Amsterdam: IBFD, 78; Rogers-Glabush, J. (Ed.) (2015). *International Tax Glossary*. Amsterdam: IBFD, 11.

the law or to offer the taxpayers new tax avoidance tools.[12] Indeed, «one should be taxed by law, and not be untaxed by concession».[13] Given the complexity and heterogeneity of national tax legislations, rulings are a key instrument to provide the economic operators with the legal certainty needed to carry out structured transactions (as, for instance, the cross-border ones[14]) and to ensure consistency in the interpretation of tax provisions.[15] Besides, their use promotes cooperation between taxpayer and tax administration, making it easier for the first to comply with complex provisions and for the latter to perform its audit.[16] Therefore an indiscriminate restriction to the use of tax rulings or the excessive narrowing of their scope could affect the efficiency and simplicity of modern tax systems.

For these reasons, the Commission, as stated in its documents,[17] does not call into question the granting of tax rulings by the tax administrations of the Member States. Its scrutiny, pursuant to article 107 TFEU, is limited to those rulings that confer a selective advantage on

[12] Romano, C. (2001). Private Rulings Systems in EU Member States. A Comparative Survey. *European Taxation, 1*, 30. *See* also Lang, M. (2015). Tax Rulings and State Aid Law. *British Tax Review, 3*, 395; Van Eijsden, A. Killmann, B. Meussen, G. T. K. (2010). General Part. In M. Lang, P. Pistone, J. Schuch, & C. Staringer, (Eds.), *Procedural Rules in Tax Law in the Context of European Union and Domestic Law*. Alphen aan den Rijn: Kluwer Law International, 12.

[13] To borrow Walton J.'s eloquent expression in *Vestey v. Inland Revenue Commissioners* [1979] Ch. 177, 197. The judgment addresses the legal basis in the British tax system of the extra-statutory concessions, a practice that allowed the Inland Revenue to give taxpayers a reduction in tax liability to which they would not be entitled under the strict letter of the law. *See* Daly, S. (2017). The Life and Times of ESCs: A Defence? In P. Harris & D. De Cogan (Eds.), *Studies in the History of Tax Law: Volume 8* (pp. 169–194). Oxford: Hart Publishing.

[14] *See* De Broe, L., *supra* note 10, 291; *DG-Comp Working Paper*, *supra* note 10, para. 5; and Givati, Y. (2009). Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings. *Virginia Tax Review*, *29*, 137.

[15] *See* Romano, C., *supra* note 12, 22.

[16] Explanatory report on Legislative Decree No. 156/2015, 1. Available at http://www.governo.it/sites/governo.it/files/79296-10390.pdf. *See* McKee, M., Siladke, C. A., & Vossler, C.A. (2018). Behavioral Dynamics of Tax Compliance When Taxpayer Assistance Services Are Available. *International Tax and Public Finance, 3*, 722.

[17] *DG-Comp Working Paper*, *supra* note 10, para. 5; Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU (2016), para. 174 [hereinafter *2016 Commission Notice*]. Available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016XC0719(05)&from=EN.

the company by lowering the tax liability in the issuing State as compared to companies in a similar factual and legal situation. Dealing with discretionary administrative practices, 1998 Notice states that administrative rulings merely providing an interpretation of general rules do not give rise to a presumption of aid, while those departing from the general tax rules to the benefit of individual undertakings must be analyzed in detail.[18] Further guidance has been provided in the Commission Notice on the notion of State Aid released in 2016, according to which tax rulings confer a selective advantage on a company where: (a) the ruling misapplies national tax law and this results in a lower amount of tax; (b) the ruling is not available to undertakings in a similar legal and factual situation; or (c) the administration applies a more favorable tax treatment compared with other taxpayers in a similar factual and legal situation.[19] In this respect, the Commission claims that tax authorities apply a treatment of this kind, for instance, when accepting a transfer pricing arrangement which is not at arm's length because the methodology endorsed by the ruling produces an outcome that departs from a reliable approximation of a market-based outcome or if the ruling allows its addressee to use alternative, more indirect methods for calculating taxable profits (e.g. fixed margins for a cost-plus or resale-minus method for determining an appropriate transfer pricing), while direct ones are available.[20]

As well summarized by the State Aid Register,[21] since June 2014, the Commission has opened eleven formal investigations for alleged aid granted to well-known multinational groups by means of tax rulings offering a low level of taxation. These investigations have resulted in six final decisions of recovery of unlawful State aid granted by Luxembourg (to *Fiat*, *Amazon* and *ENGIE*), the Netherlands (to *Starbuck*), Ireland (to *Apple*) and Belgium (to 35 MNEs through the "excess profit

[18] However, in literature it has reasonably been argued that determining whether a tax ruling "*merely interprets*" or "*deviates from*" the normal application of a tax provision can be complicated in practice, especially considering the fact that rulings are used to provide certainty where the "*normal application*" of the law is not obvious. *See* De Broe, L., *supra* note 10, 291; Avi-Yonah, R. S., & Mazzoni, G. (2016). Apple State Aid Ruling: A Wrong Way to Enforce the Benefits Principle? *University of Michigan Law & Economics Research Paper Series*, Research Paper No. 16-024, 6. Available at SSRN: https://ssrn.com/abstract=2859996.

[19] *2016 Commission Notice*, *supra* note 17, para. 174.

[20] Ibid.

[21] http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html.

scheme"[22]). Further investigations are still ongoing toward the UK, for alleged aid to the MNEs benefitting from the "group financing exemption", the Netherlands, for tax rulings issued to *Inter IKEA*[23] and *Nike*, and Luxembourg, for the rulings granted to *Huhtamäki*. The Commission has also investigated on Gibraltar's ruling practice as a whole, assuming that it may constitute an aid scheme on grounds of a discretionary exercise of powers.[24] However the final decision of recovery concludes that the tax ruling practice as such does not constitute an aid scheme, while individual aids have been granted on the basis of five tax rulings.[25] Thus far, the only negative final decision concerns the Luxembourgish tax rulings issued to *McDonald's*: the Commission found that non-taxation of certain McDonald's profits in Luxembourg did not lead to illegal State aid, as it was in line with national tax laws and the Luxembourg-United States Double Taxation Treaty.[26]

The inquiry of the European Commission regarding tax rulings has been focusing, in particular, on advance pricing agreements (APAs), which endorse transfer pricing arrangements proposed by the taxpayer to determine the tax base of corporate groups, and on "confirmatory rulings", which confirm the application, or the non-application, of certain legislative provisions to a specific situation.[27] Moreover, the Commission's investigations target ruling systems that may constitute "aid schemes" under article 1(d) of Regulation No. 2015/1589, according to which an aid scheme is "any act on the basis of which, without further implementing measures being required, individual aid awards

[22]The EGC annulled the Commission decision which qualified the Belgian «excess profit» regime as State aid, stating that the Commission did not satisfy its burden to prove that the measure constituted a scheme. EGC, 14 February 2019, *Kingdom of Belgium v. Commission*, T-131/16.

[23]Commission, press release No. IP/17/5343. Available at http://europa.eu/rapid/press-release_IP-17-5343_en.htm.

[24]Commission Decision of 1 October 2014, *Case SA.34914 UK Gibraltar corporate tax regime* [hereinafter *Alleged Aid by Gibraltar*]. Available at http://ec.europa.eu/competition/state_aid/cases/250265/250265_1784365_398_2.pdf.

[25]Commission Decision of 19 December 2019, *Case SA.34914 UK Gibraltar corporate tax regime* [hereinafter *Aid by Gibraltar*]. Available at http://ec.europa.eu/competition/state_aid/cases/250265/250265_2042846_607_2.pdf.

[26]Commission, press release No. IP/18/5831. Available at http://europa.eu/rapid/press-release_IP-18-5831_en.htm.

[27] *DG-Comp Working Paper*, *supra* note 10, para. 7.

may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid, which is not linked to a specific project, may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount".[28]

It cannot be excluded that future State aid investigations will target favorable measures granted in the context of cooperative compliance. Such programs have been adopted in various member States[29] in order to promote a relationship between the taxpayer and the tax administration based on cooperation, transparency and disclosure "in exchange for certainty", rather than the traditional adversarial one.[30] In particular, the OECD has identified seven pillars on which cooperative compliance models are usually built: on the one side, the taxpayer is expected to grant transparency and disclosure; on the other side, commercial awareness, impartiality, proportionality, openness and responsiveness are expected from the tax administration. Moreover, the switch from a traditional control approach to a cooperative one is often

[28] Article 1(d) of Regulation No. 2015/1589. The case law of the Union Courts does not provide guidance on the interpretation of the definition of "aid scheme". In the final decision on Belgium's "excess profit scheme", the Commission notes, however, that the Union Courts have in the past accepted the Commission's qualification of tax measures sharing many characteristics with the contested schemes as aid schemes within the meaning of that provision. *See* Commission Decision of 11 January 2016, Case SA.37667 *Excess profit tax ruling system in Belgium*, para. 19. Available at http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_37667; ECJ, 22 June 2016, *Belgium and Forum 187 ASBL v. Commission*, joined cases C-182/03 and C-217/03; ECJ, 17 September 2009, *Commission v. Koninklijke FrieslandCampina*, C-519/07P. When targeting aid schemes, the Commission must preliminarily demonstrate that the contested set of measures falls within the scope of the aforementioned article 1(d) of Regulation No. 2015/1589. In particular, (i) the investigation must identify an act on the basis of which aid can be awarded, (ii) the act should not require any further implementing measures and (iii) should define the potential aid beneficiaries in a general and abstract manner.

[29] *See* Tropea, A. (2018). I profili giuridici dell'adempimento collaborativo. *Rivista trimestrale di diritto tributario*, *3–4*, 814; Szudoczky, R., & Majdanska, A. (2017). Designing Co-operative Compliance Programmes: Lessons from the EU State Aid Rules for Tax Administrations. *British Tax Review*, *2*, 208; Bronżewska, K. (2016). *Cooperative compliance: a new approach to managing taxpayer relations.* Amsterdam: IBFD, 93; OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*, OECD, Paris (2013). Available at https://read.oecd-ilibrary.org/taxation/co-operative-compliance-a-framework_9789264200852-en; and Id., *Study into the Role of Tax Intermediaries*, OECD, Paris (2008).

[30] Szudoczky, R., & Majdanska, A., *supra* note 29, 204.

the result of the development of a compliance risk management strategy,[31] which is supposed to benefit both parties in terms of lower administrative and compliance costs.

However the subjective scope of these programs raises concerns of incompatibility with the State aid framework, because, in most cases, they are available only to selected taxpayers (mainly large businesses). The suspicion is exacerbated by the fact that these regimes are designed in a way that may—directly or indirectly—lower the overall tax burden of the participants. Advantages may be represented by a reduction or waiver of the penalties on unpaid taxes or by postponements of taxes (that confer a cash flow to the benefit of the participants).[32]

15.2 The Risk of Recovery and the Protection of Legitimate Expectations: Open Issues Under Judicial Review

The legal issues arising from the investigations on fiscal aids granted by means of tax rulings are no small matter, with the protection of legitimate expectations being just one example.

The undue aids are to be recovered from the addressee of the tax ruling granting them, in order to restore the *ex ante* situation. Otherwise the undertaking benefitting from them would keep the advantage over its competitors and the obstacle (or potential harm) to competition between the Member States would not be removed.

However, from another perspective, it is the State that has failed to comply with the procedure laid down in Art. 108(3) TFEU. Accordingly, the Member States, prior to granting any measure in favor of certain undertakings, have to inform the Commission—in sufficient time to enable it to submit its comments—of any projected aid or plan to alter existing measures (notification obligation) and they shall not put their plans into effect until the procedure laid down in Art. 108(2) TFEU has resulted in a final decision (standstill clause).

[31] OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*, *supra* note 29, 29.

[32] Szudoczky, R., & Majdanska, A., *supra* note 29, 213. *See* also Bronżewska, K. (2016), *supra* note 29, 357, who addresses the risks related to the use of discretionary powers by the tax authorities within cooperative compliance programs.

A failure by the State results, therefore, in a financial burden that must be entirely borne by the undertaking. While this in the case in any scenario of aids' recovery, regardless of the ground (fiscal, commercial, labor, etc.) and nature of the aids, this circumstance appears to be particularly striking when the aids have been granted by means of tax rulings. Undue fiscal aids may, in principle, be harder to recover than aids of a different kind: in fact, the State aid framework has originally been designed for "positive" subsidies,[33] while the recovery of taxes that the State has renounced to impose ("negative" measure) requires a greater effort in terms of quantification and levy. What is making the economic operators even more uncomfortable is the circumstance that not only favorable measures were granted by a functional body of the State as the tax administration but also that such measures were confirmed in individual administrative acts (advance rulings, letter rulings, APAs, etc.) directly addressed to them.

In this respect, it has been argued that the retroactive recovery of unlawful State aids may de facto result in a situation in which undertakings, rather than turning to national tax authorities, will instead "seek guidance from the Commission prior to investment to get the required certainty, which is a shift in legal sovereignty".[34] The main counterargument to this clearly widespread perception is that Member States

[33]Maitrot De La Motte, A. (2017). Tax Recovery of the Illegal Fiscal State Aids: Tax Less to Tax More. *EC Tax Review*, *2*, *77*, after dealing with the procedural and technical difficulties of fiscal aids' recovery, seems to also question the constitutional grounds of the recovery in this field on the basis of the principle of "no taxation without representation". This objection, though clear and appealing, can be overcome considering that the State aid framework is provided by the TFEU, that all Member States have agreed on, thus yielding a portion of sovereignty. Therefore, it is true that taxation is usually covered in modern democracies by the rule of law, but the Commission's power to review all forms of aids, fiscal ones included, is fully compliant with it. As observed by Miladinovic, A., it is true that «Member States did not want to give up their sovereignty in direct tax matters […] nevertheless, the Member States need to respect EU principles and cannot use their tax sovereignty as an excuse to disregard the main rules, particularly the State aid prohibition». *See* Miladinovic, A. (2018). The State Aid Provisions of the TFEU in Tax Matters. In M. Lang, P. Pistone, J. Schuch, & C. Staringer (Eds.), *Introduction to European Tax Law on Direct Taxation* (pp. 109–110). Wien: Linde.

[34]Forrester, E. (2018). Is the State Aid Regime a Suitable Instrument to Be Used in the Fight Against Harmful Tax Competition? *EC Tax Review*, *27*, 33.

already have an upstream obligation to notify the Commission with projected aids and to comply with the standstill clause until their compatibility with the internal market is ascertained. The fact that in the cases at hand the MNEs involved had already received confirmation in the rulings issued by the tax authorities was not enough to rule out legal uncertainty. Indeed, the circumstance that favorable measures were not only granted by a functional body of the States but also confirmed in individual administrative rulings did not exempt the State from following the procedure laid down in Art. 108. However, it cannot be denied that the financial consequences of the infringement by the State are endured by companies that were supposed to be supported, which have to repay the aids with interest.[35]

For these reasons the MNEs involved have challenged the Commission decisions before the General Court (EGC),[36] invoking the principles of legal certainty and legitimate expectations, in order to rule out the order of recovery. The breach of general principles of Union law, together with the expiry of the limitation period[37] and the absolute impossibility, is one of the three situations that would exempt

[35] Maitrot De La Motte, A., *supra* note 33, 88, concludes that "at the end of the process, the offending State has been enriched and the 'aided' company has become poorer. It would be otherwise only if the Court of justice granted the possibility of incurring State responsibility".

[36] Action brought on 22 May 2018, *Amazon EU and Amazon.com v. Commission*, T-318/17, 7th and 8th plea in law; Action brought on 19 December 2016, *Apple Sales International and Apple Operations Europe v. Commission*, T-892/16, 11th plea in law; Action brought on 29 December 2015, *Fiat Chrysler Europe v. Commission*, T-759/15, 3rd and 4th plea in law. The Member States involved in the investigations are invoking the aforementioned principles as well. It may sound paradoxical the circumstance that they are opposing the Commission's orders to recover—and keep—the back taxes with interests. However Fregni, M. C. (2017) (Mercato unico digitale e tassazione: misure attuali e progetti di riforma. *Rivista di diritto finanziario e scienza delle finanze*, *LXXVI*(1), I, 74) notes that, on the one side, the recovered amounts would not be available as viable resources before the electorate, because, according to the EU rules, they would be allocated to lower the government debt; on the other hand, the States fear to lose their attractiveness for cross-border investments (as those performed by the MNEs involved in the pending cases). *See* action brought on 30 December 2015, *Luxembourg v. Commission*, T-755/15, 3rd plea in law; action brought on 9 November 2016, *Ireland v. Commission*, T-778/16, 7th plea in law; action brought on 14 December 2017, *Luxembourg v. Commission*, T-816/17, 5th plea in law.

[37] Ten years since the date, the aid was granted.

the Member States from the obligation of recovery (Art. 16-17 of Regulation No. 2015/1589).

The legal certainty and the legitimate expectations are two general principles of EU law. Despite being closely related to each other, their scope is slightly different.

The ECJ has defined the legal certainty as the principle "which requires that legal rules be clear and precise, and aim to ensure that situations and legal relations governed by Community law remain foreseeable".[38] If compared to the principle of legal expectations, the scope of legal certainty is wider, because it does not require a prior declaration of the EU institutions: in accordance with the case law of the Union Courts,[39] instead, citizens are protected by the principle of legitimate expectations when they reasonably trust in the maintenance or stability of a given legal situation created through an administrative or legislative act of the institutions, a reiterated legal practice or interpretation or even certain oral or written declarations.[40]

Although the tax authorities issuing the rulings may have created legal expectations at a domestic level with regard to the confirmed measures, the same is not obvious at the EU level. Indeed, since *Commission v. Germany*, the CJEU has held that "in view of the mandatory nature of the supervision of State aid by the Commission under Article 93 of the Treaty, undertakings to which an aid has been granted may not, in principle, entertain a legitimate expectation that the aid is lawful unless it has been granted in compliance with the procedure laid down in that article. A diligent businessman should normally be able to determine whether

[38] ECJ, 15 February 1996, C-63/93, *Duff and others*, para. 20. *See* also the EGC, 12 September 2007, T-348/03, *Friesland Foods v. Commission*, para. 125.

[39] *See*, *ex multis*, ECJ, 11 March 1987, *Van der Bergh en Jurgens BV v. Commission*, C-265/85, para. 45; Id., 12 November 1987, *Ferriere San Carlo s.p.a. v. Commission*, C-344/85, para. 13; *Id*., 12 November 1987, *Ferriere San Carlo s.p.a. v. Commission*, C-344/85, para. 13; Id., 26 June 1990, *Sofrimport v. Commission*, C-152/88, para. 22; *Id*., 15 April 1997, *Irish farmers Association and others v. Minister for Agricolture, Food and Forestry, Ireland y Attorney General*, C-22/94, para. 17; Id., 14 September 1995, *Lefebvre and others v. Commission*, C-571/93, paras. 73–74; and Id., 14 October 2010, *Nuova Agricast S.r.l. and Cofra S.r.l. v. Commission*, C-67/09, para. 71.

[40] Pastoriza, J. S. (2016). *The Recovery Obligation and the Protection of Legitimate Expectations: The Spanish Experience*. In I. Richelle, W. Schön, & E. Traversa (Eds.), *State aid Law and Business Taxation*. Berlin-Heidelberg: Springer, 254.

that procedure has been followed".[41] Besides, the extensive audit of the Commission on tax rulings may have been foreseen by the economic operators, based on the guidance provided by the Commission and the Code of Conduct Group, respectively in 1998[42] and 2010.[43] Therefore, it is unlikely that the principle of legitimate expectations will rule out the obligation of recovery, if the procedure of prior notification of the aid to the Commission (currently laid down in Art. 108 TFEU) has not been followed.[44]

Similarly, with regard to legal certainty, the CJEU settled case law provides that "so long as the Commission has not taken a decision approving aid and also so long as the period for bringing an action against such a decision has not expired, the recipient cannot be certain as to the lawfulness of the proposed aid which alone is capable of giving rise to a legitimate expectation on his part. It follows that the Commission did not infringe the principles of protection of legitimate expectations and legal certainty".[45]

Considering the unfavorable case law on the application of these general principles when the procedure *ex* Art. 108 TFEU has not been followed, it is essential to minimize the risk of recovery. The starting point to manage this risk is the identification of the most recurrent practices of tax arbitrage confirmed in the contested rulings and of the procedural flaws in their issuance. This identification allows to establish the measures to counter the risk of recovery for those undertakings that have been granted tax rulings in the past years by the tax authorities of the Member States.

[41] ECJ, 20 September 1990, *Commission v. Federal Republic of Germany*, C-5/89, para. 14; ECJ, 11 November 2004, *Demesa e Territorio Històrico de Alava v. Commission*, C-183/02 and C-187/02, para. 52; and EGC, 22 April 2016, *France v. Commission*, T-56/06 RENV II, para. 84.

[42] *1998 Commission Notice*, *supra* note 4, paras. 21–22.

[43] Code of Conduct Group, *Guidance on the identification of harmful tax rulings*, agreed on 22 November 2010, doc. 16766/10.

[44] *See* Falsitta, G. (2010). Recupero retroattivo degli 'aiuti di stato' e limiti della tutela dei principi di capacità contributiva e di affidamento [nota a Corte cost., ord. n. 36/2009]. *Rivista di diritto tributario*, *11*(II), 672. *Contra*, Forrester, E., *supra* note 34, 32; Giraud, A. (2008). A Study of the Notion of Legitimate Expectations in State Aid Recovery Proceedings: "Abandon All Hope, Ye Who Enter Here"? *Common Market Law Review*, *45*, 1426–1427.

[45] ECJ, 29 April 2004, *Commission v. Italy*, C-91/01, paras. 66–67.

15.3 Measures of Tax Arbitrage and Procedural Flaws in the Issuance of Rulings Identified by the Commission's Investigations

The following sections provide an overview of the recurrent measures of tax arbitrage and procedural flaws in the issuance of individual rulings outlined in the Commission's preliminary and final decisions (when available), in order to better comprehend what is the object of tax rulings likely to give rise to a State aid dispute.

The OECD defines tax arbitrage as the process of entering into tax motivated transactions, i.e. to obtain profit from the application of tax rules.[46] As will be further discussed, the Commission's investigations show that certain multinational groups, endorsed by tax authorities, have been exploiting the differences between national tax systems to substantially lower their overall tax burden, reaching, at times, the point of double non-taxation.

15.3.1 Transfer Mispricing

Since most of the contested rulings are APAs, the Commission's review revolves around the transfer pricing arrangements to determine the corporate group entities' taxable profits. In particular, this assessment is crucial to establish whether the aid has been selectively granted to the undertaking in question. In fact, the Commission claims that, in the case of an individual aid measure, the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective, without it being necessary to analyze the selectivity of the measure according to the three-step selectivity analysis devised by the Court of Justice for State aid schemes (1. identification of the appropriate reference framework; 2. assessment of a deviation from that reference system, in so far as the measure differentiates between operators who, in the light of the objective pursued by that system, are in a comparable factual and legal situation; 3. assessment of the justification in light of the nature or

[46] OECD, *Arbitrage, Tax*, Glossary of Tax Terms. Available at http://www.oecd.org/ctp/glossaryoftaxterms.htm. *See* also Avi-Yonah, R. S. (2007). Tax Competition, Tax Arbitrage and the International Tax Regime. *Bulletin for International Taxation*, *61*(4), 137.

general scheme of the system).[47] Therefore, the Commission considers the selectivity requirement to be met,[48] if it succeeds in demonstrating that an individual ruling confers an economic advantage on its addressee by endorsing a transfer pricing arrangement that produces an outcome departing from a reliable approximation of a market-based outcome, resulting in an undue reduction of the tax base. This might be the case when the transfer pricing arrangement confirmed by means of the APA is not at arm's length because the methodology endorsed by the ruling produces an outcome that departs from a reliable approximation of a market-based outcome or if the ruling allows its addressee to use alternative, more indirect methods for calculating taxable profits, while direct ones are available.

In order to assess the advantage in cases involving transfer pricing methods, the Commission has taken as guidance the Transfer Pricing Guidelines adopted by the OECD in 2010 and, most recently,[49] those released in 2017. This circumstance is likely to raise an even stronger criticism by the concerned Member States and MNEs with regard to legal certainty and the protection of legitimate expectations, as the Commission seems to be retroactively enforcing non-binding guidance.[50]

[47] *See* Ismer, R., & Piotrwki, S. (2015). The Selectivity of Tax Measures: A Tale of Two Consistencies. *Intertax*, *43*, 559.

[48] However the Commission usually develops a subsidiary line of reasoning by examining the individual tax rulings against the aforementioned three-step selectivity test to demonstrate that it is also selective under that analysis.

[49] Commission Decision of 4 October 2017, Case SA.38944 *Aid to Amazon* [hereinafter *Aid to Amazon*], rec. 249. Available at http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38944.

[50] *See* Action brought on 22 May 2018, *Amazon EU and Amazon.com v. Commission*, T-318/17: "Eighth plea in law, alleging that the decision violates the principles of legal certainty, retroactivity, and non-discrimination, and an essential procedural requirement because it assesses the validity of the 2003 ATC by reference to post-dating OECD Guidelines. The decision retroactively and discriminatorily applies, and improperly holds the applicants and Luxembourg to, standards in the 2017 OECD Guidelines on transfer pricing first issued after the Commission opened the procedure under Article 108(2) TFEU, and long after the adoption of the 2003 ATC". *See* also action brought on 14 December 2017, *Luxembourg v. Commission*, T-816/17, 5th plea in law: "the recovery of the aid is incompatible with the principle of legal certainty, taking into account the good faith of the Grand Duchy of Luxembourg in the application of transfer pricing and the fact that the new transfer pricing approach applied by the Commission in the contested decision could not have been foreseen".

In its negative decisions the Commission has found that the prices endorsed by the APAs for certain inter-company transactions did not comply with the "arm's length principle" (ALP), according to which "[Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly" (Article 9(1) of the OECD Model Tax Convention on Income and on Capital).[51] However, it must be noted that the Commission stressed in both the 2016 Notice[52] and the *Apple* final decision[53] that it does not directly apply the OECD's guidelines, even though it may have reference. Nonetheless, it underlined repeatedly that "if a transfer pricing arrangement complies with the guidance provided by the OECD Transfer Pricing Guidelines, […] a tax ruling endorsing that arrangement is unlikely to give rise to state aid".[54]

The main findings of the Commission relate to the appropriateness of the methods used in the APAs to determine the arm's length prices of intragroup transactions.

For instance, in *Fiat*, the Commission questioned the appropriateness of the method—proposed by Fiat Finance and Trade's tax advisor and accepted by Luxembourgish tax authorities—to estimate the company's remuneration for its activities (mainly financial services, such as intercompany loans): in the transfer pricing analysis, an indirect method had

[51] For an in-depth analysis on the application of the ALP by the Commission, *see* Mason, R. (2017). Tax Rulings as State Aid—Part 4: Whose Arm's-Length Standard? *Tax Notes*, *155*(7), Virginia Law and Economics Research Paper No. 2017-19. Available at https://ssrn.com/abstract=2990603; Wattel, P. J. (2016). Stateless Income, State Aid and the (Which?) Arm's Length Principle. *Intertax*, *44*, 791; and Boccaccio, M. (2017). L'evoluzione della politica della Commissione su aiuti di Stato e ruling fiscali. *Rivista di diritto finanziario e scienza delle finanze*, *LXXVI*(2), I, 224.

[52] *2016 Commission Notice*, *supra* note 17, para. 173.

[53] Commission Decision of 30 August 2016, Case SA.38373 *Aid to Apple*, rec. 255 [hereinafter *Aid to Apple*]. Available at http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38373.

[54] *2016 Commission Notice*, *supra* note 17, para. 173; *DG-Comp Working Paper*, *supra* note 10, para. 18. *See* Thomson, A., & Hardwick, E. (2017). The European Commission's Application of the State Aid Rules to Tax: Where Are We Now? *Journal of Taxation of Investments*, 45.

been used, the transactional net margin method, while the Commission, pursuant to the case law[55] and the OECD guidelines,[56] regards direct methods as preferable. In particular, the most appropriate method in this case would have been the uncontrolled price method that should be preferred in cases where comparable transactions can be observed on the market, as those identified by the Commission decision.[57]

Conversely, in *Amazon*, the Commission found the uncontrolled price method to be inappropriate, rejecting the comparability of agreements that the group considered sufficiently established by the U.S. Tax Court to value intangibles such as payments to contribute to the costs of developing the intellectual property. Instead, the Commission claims the transactional net margin method should apply.[58] It is interesting to note how the Commission replies to the argument of Luxembourg and Amazon that, because transfer pricing is not an exact science, the assessment by the Commission of the transfer pricing arrangement endorsed by the contested tax ruling should necessarily be limited. The Commission recalls that the approximate nature of transfer pricing has to be viewed in the light of its objective: "The objective of transfer pricing is to find a reasonable estimate of an arm's length outcome on the basis of reliable information. The pursuit of that objective would be impossible if the approximate nature of the transfer pricing analysis could be invoked to justify a transfer pricing arrangement producing an outcome that departs from a reliable approximation of a market-based outcome. Similarly, Luxembourg's argument that the Commission, in undertaking such an assessment, improperly replaces the Luxembourg tax administration in the interpretation of national tax law, if accepted, would remove fiscal measures in general and transfer pricing rulings in particular from the scrutiny of the State aid rules".[59]

The Commission's line of reasoning on transfer pricing is currently under judicial review, as the States and the MNEs involved claim that the

[55] *See* ECJ, 22 June 2016, *Belgium and Forum 187 ASBL v. Commission*, joined cases C-182/03 and C-217/03, para. 95.

[56] OECD (2010), *Transfer Pricing Guidelines*, para. B.2.3.

[57] Commission Decision of 21 October 2015, Case SA.38375 *Aid to Fiat*, rec. 132. Available at http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38375.

[58] *Aid to Amazon*, *supra* note 49, rec. 542.

[59] *Ivi*, rec. 404–405.

decisions are in breach of Art. 296 (2) TFEU and Art. 41(2)(c) of the Charter of Fundamental Rights of the EU, as the Commission failed to explain how it derived the arm's length principle from EU law, "or even what the principle is".[60]

In this respect, it has been argued that the ALP may be used as a benchmark, or as part of the reference framework to determine whether the measure is selective,[61] only when it is included in the domestic tax system.[62] While in most of the States involved in the investigations, the ALP is embedded in the domestic law, the reasoning of the Commission may be questioned when no transfer pricing rules exist or when they do not implement the ALP. That being the case of Ireland (up to 2010), the Commission's reasoning is apparently weak. It is indeed difficult to claim that the tax administration derogated from the normal tax system, when the principle in question is not part of it.[63] However, the counter-argument could be that the ALP forms part of the international tax regime included in customary international law, thus affecting the Irish tax system as well. In fact, it cannot be denied that the principle has achieved an internationally recognized status, given that it has been applied for decades in most tax treaties to the matter of transfer pricing and is the guiding principle in the OECD soft law.[64] This theory

[60] Action for annulment brought on 29 December 2015, *Fiat Chrysler Finance Europe v. Commission*, T-759/15.

[61] *See* Cachia, F. (2017). Analyzing the European Commission's Final Decisions on Apple, Starbucks, Amazon and Fiat Finance & Trade. *EC Tax Review*, *1*, 33; Ismer, R., & Piotrwki, S., *supra* note 47, 559.

[62] Ibid.

[63] Action for annulment brought on 9 November 2016, *Ireland v. Commission*, T-778/16, second plea in law: "The Commission also wrongly claims that the Opinions were selective. The Commission's reference system wrongly ignores the distinction between resident and non-resident companies. The Commission attempts to re-write the Irish corporation tax rules so that, in respect of Opinions, the Revenue Commissioners should have applied the Commission's version of the arm's length principle ('ALP'). This principle is not part of EU law or the relevant Irish law in relation to branch profit attribution, and the Commission's claim is inconsistent with Member State sovereignty in the area of direct taxation".

[64] Avi-Yonah, R. S., *supra* note 46, 137; Lepard, B. D. (1999). Is the United States Obligated to Drive on the Right? A Multidisciplinary Inquiry Into the Normative Authority of Contemporary International Law Using the Arm's Length Standard as a Case Study. *Duke Journal of Comparative & International Law*, *43*, 57–58.

has been debated at length, opposed by those[65] who claim that there is no international tax regime providing principles that are inherent every domestic system and that each country is therefore free to pursue its own tax interest. It will be interesting to see if and how the Union Courts will engage in this debate, when addressing the mentioned plea.

15.3.2 Mismatches in the Classification of Entities

Following the assessment on transfer pricing arrangements, the Commission verifies whether the profit allocation endorsed in the rulings lowered the tax liability of the entities based in the concerned Member State as compared to the liability of undertakings in a similar legal and factual situation.

In *Amazon* and *Apple* the Commission found that, due to a difference in the Member States and US tax rules on entities' characterization or residence, these corporate groups shifted their profits to EU-based group entities that were neither liable to pay taxes in the EU nor in the US.

For instance, in *Amazon*,[66] the Commission found that Amazon EU, a Luxembourg-based corporation that recorded the profits from all European sales, paid an "exaggerated" royalty to LuxSCS, a limited liability partnership also based in that State, but transparent for Luxembourg tax purposes. While the royalty was deducted from the tax base of Amazon EU in Luxembourg, the profits shifted to LuxSCS were supposedly to be taxed at the level of the US partners, provided that, according to the contested ruling, LuxSCS did not have any permanent establishment in Luxembourg. However, the US partners deferred taxation indefinitely[67] by regarding LuxSCS as a separate corporate entity resident in Luxembourg. Indeed, pursuant to US "Check-the-box" regulation, US MNEs may choose to treat, for US tax purposes, certain CFCs either as partnerships (fiscally transparent) or as corporations (fiscally nontransparent). In the latter case, the profits attributed to the

[65] Cachia, F., *supra* note 61, 34; Vann, R. J. (1998). International Aspects of Income Tax. In V. Thurony (Ed.), *Tax Law and Drafting* (vol. 2, 718). The Hague: Kluwer Law International.

[66] Ibid.

[67] Commission Decision of 7 October 2014, *Case SA.38944 Alleged Aid to Amazon*, note 21, 8 [hereinafter *Alleged Aid to Amazon*]. Available at http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38944.

entity are disregarded, as if they belonged to a separate corporate entity resident in the foreign country, and taxation in the US is deferred indefinitely, so long as none of the said profits are repatriated to the US.[68]

In *Apple*, the mismatch related to the residency Apple Sales International (ASI) and Apple operations Europe (AOE), Irish incorporated entities that are fully owned by the Apple group and ultimately controlled by the US parent (Apple Inc.). Most of the profits generated by sales of Apple products in the EU were recorded by ASI's head office; ASI and AOE, as remuneration for the rights to use Apple's IP to sell and manufacture outside America, made yearly payments to Apple in the US to fund research and development.[69] These payments were deducted from the profits recorded in Ireland.[70] The group tax base was further reduced as a result of ASI's head office being "stateless" for tax residency purposes. In fact, although ASI and AOE did not have any taxable presence in any other tax jurisdiction beside Ireland during the time that the contested rulings were in force, the Irish Revenue, in application of Section 23A TCA 97, considered them to be managed and controlled in the US.[71]

The US Senate Subcommittee on Investigation in 2013 released a bipartisan memorandum[72] and held a hearing showing how Apple had "established and directed tens of billions of dollars to at least two Irish affiliates, while claiming neither is a tax resident of any jurisdiction, including its primary offshore holding company, Apple Operations International (AOI), and its primary intellectual property rights recipient, Apple Sales International (ASI). AOI, which has no employees, has no physical presence, is managed and controlled in the United States, and received $30 billion of income between 2009 and 2012, has paid no

[68] *Aid to Amazon*, *supra* note 49, rec. 155, note 119.

[69] Commission, press release No. IP/16/2923. Available at http://europa.eu/rapid/press-release_IP-16-2923_en.htm.

[70] Ibid.

[71] *Aid to Apple*, *supra* note 53, rec. 51–52.

[72] US Senate Subcommittee on Investigation, *Offshore Profit Shifting & Apple*, Memorandum (21 May 2013), 5. *See* also https://www.revenue.ie/en/companies-and-charities/corporation-tax-for-companies/corporation-tax/company-residency-rules.aspx; Furthermore, the Memorandum released by the Subcommittee offered recommendations to strengthen US transfer pricing rules and reform the so-called "check-the-box" and "look-through" loopholes that enable multinationals to shield offshore income from US taxes.

corporate income tax to any national government for the past five years". It further explained that this was made possible "since Ireland bases tax jurisdiction over companies that are managed and controlled in Ireland, and the US bases tax residency on where a company is incorporated".[73] As a result, Apple exploited the gap between the two, shifting the profits to their subsidiaries that enjoyed double non-taxation.

15.3.3 Procedural Flaws

With regard to the procedure governing the national ruling systems, the Commission's investigations have identified discretionary administrative practices of the tax authorities when confirming the profit allocation.

In *Apple*, the Commission found that the tax base in the first ruling was "negotiated rather than substantiated by reference to comparable transactions"[74] and that "the authorities did not seem to have had the intention of establishing a profit allocation based on transfer pricing",[75] as the profits of the branch of AOE were calculated "on the basis of actual costs without this choice being reasoned in any way". Moreover, the Irish Revenue did not provide the Commission with any transfer pricing report (which is a common manner by which a transfer pricing proposal is made to tax authorities) to support the calculation at hand.[76] Discretion—increasing the risk of negotiation—is one of the main circumstances that led the Commission to qualify the profit allocation to ASI and AOE as a selective advantage.[77] In this respect, according to the ECJ case law, negotiation alone does not suffice in determining the selective nature of an advantageous measure[78]: it is weighted—among other factors—as a circumstance indicative of selectivity. The Union

[73] US Senate Subcommittee on Investigation, *Activities Report of the Permanent Subcommittee on Investigations for the 113th Congress*, Memorandum (December 2014).

[74] Commission Decision of 11 June 2014, *Case SA.38373 Alleged aid to Apple*, rec. 58 [hereinafter *Alleged aid to Apple*]. Available at http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38373.

[75] Ibid.

[76] *Ivi*, rec. 59.

[77] *Aid to Apple*, *supra* note 53, rec. 150: the «favourable position selectively granted to the two undertakings [is considered to be] based on the discretion of Irish Revenue which went beyond the simple management of tax revenue by reference to objective criteria».

[78] ECJ, 4 June 2015, C-15/14, *European Commission v. MOL Magyar Olaj-es Gazipiari Nyrt*, para. 66.

Courts are thus called to establish whether the national legislation confers a margin of assessment on national authorities with regard to the detailed rules for the application of the measure and, if so, whether such discretion is limited by objective criteria related to the tax system[79] or it is so broad that it can lead to the grant of an advantage in favour of a specific economic operator[80] (for instance, taking into consideration criteria unrelated to the tax system, such us maintaining employment).[81] Additionally, the Commission pointed out that the 1991 ruling, whose duration was much longer than the usual length of APAs concluded by other Member States, remained in force too long to ensure reliable results: "Even if the initial agreement was considered to correspond to an arm's length profit allocation, *quod non*, the open-ended duration of the 1991 ruling's validity calls into question the appropriateness of the method agreed between Irish Revenue and Apple to arrive to that allocation in the latter years of the ruling's application, given the possible changes to the economic environment and required remuneration levels".[82]

Similarly, in *Amazon*, the contested ruling remained in force more than ten years without any revision.[83]

Besides the investigations performed by the Commission, the hundreds of tax rulings issued by Luxembourgish tax authorities and made public in 2014 by The International Consortium of Investigative Journalists (the so-called "LuxLeaks" scandal) also provide food for thought. Omri Marian[84] has analyzed an original dataset, generated from a hand-coded sample of 172 of the leaked advance tax agreements, finding, *inter alia*, that (strikingly) "Sixty-eight of the ATAs, about 40% of the ATAs for which data are available, were approved the same day of the submission. Eleven of the ATAs, 11.22% of the ATAs for which data

[79] ECJ, 18 July 2013, C-6/12, *P Oy*, para. 27.

[80] ECJ, 4 June 2015, C-15/14, *European Commission v. MOL Magyar Olaj-es Gazipiari Nyrt*, para. 65.

[81] ECJ, 18 July 2013, C-6/12, *P Oy*, para. 27.

[82] *Ivi*, rec. 65.

[83] *Alleged aid to Amazon*, *supra* note 67, rec. 76. *Aid to Amazon*, *supra* note 49, rec. 306 and 325.

[84] Marian, O. (2017), The State Administration of International Tax Avoidance. *Harvard Business Law Review, 7*, 201; UC Irvine School of Law Research Paper No. 2015-95.

are available, were approved the same day that the taxpayer apparently first engaged LACD [*Administration des Contributions Directes*]".[85] One might think that the issuing office was so well structured and efficient that the assessment was performed in such a short time. Instead, responsible for the whole process was a single administrator, which further exacerbates the suspicion that, in many instances, the Luxembourgish tax administration did not give substantive consideration to the contents of the submission.[86]

15.4 Managing the Risk of Recovery: A Matter of Tax Governance and EU Policy

As shown in the previous sections, the contested measures endorsed in the tax rulings and certain procedural flaws in their issuance appear to be rather recurrent.

For instance, more than once the Commission has noted that the issuance of the rulings was not based on a transfer pricing report[87] or that the remuneration confirmed therein was not consistent with the relevant case law and soft law nor compliant with the ALP.

A recurrent measure indicative of tax arbitrage is represented by the "inflated" royalties paid (and thus deducted) by the EU-based entities to other EU-based entities that were transparent for tax purposes: due to a mismatch in the classification of the latter (transparent/nontransparent) between the Member States and the US, where the partners of such entities reside, these profits were "disregarded" for tax purposes in the US as well, remaining largely untaxed.

As far as the administrative practices are concerned, the investigations have shown that the tax authorities have sometimes enjoyed discretion when establishing the profit allocation. In *Apple*, the Commission found that the tax base in the first ruling was "negotiated rather than substantiated by reference to comparable transactions".[88] In addition, despite the evolving market conditions, some of the contested rulings remained in force even 10 or 15 years without undergoing any revision.

[85] *Ivi*, 220.

[86] *Ivi*, 217.

[87] *Alleged aid to Apple*, *supra* note 74, rec. 58; *Aid to Amazon*, *supra* note 49, rec. 63.

[88] *Alleged aid to Apple*, *supra* note 74, rec. 58.

The study carried out by Omri Marian on a sample of tax rulings issued by Luxembourgish tax authorities and made public in the so-called "LuxLeaks" scandal has shown that a large number of those rulings were approved the same day of the submission or the same day as the taxpayer apparently first engaged the tax administration. Similarly, in *Amazon*, the Commission pointed out that the contested ruling was granted within eleven working days from the receipt of the first letter constituting the ruling request.[89]

The undertakings that have been granted a ruling by the tax authorities of the Member States in the past (or are in the process of obtaining one) should thus beware of the following circumstances:

- inadequate evidence in support of the ruling request (e.g. lack of transfer pricing report);
- lack of compliance with the relevant EU provisions, Union Court's case law, OECD guidelines, resulting in a derogation from the general domestic tax rules (i.e. application of a more favorable tax treatment compared with other taxpayers in a similar factual and legal situation);
- issuance of a kind of tax ruling that is not available to undertakings in a similar legal and factual situation;
- non-compliance by the State with the procedure laid down in Art. 108 TFEU (lack of notification or violation of the standstill requirement);
- excessive duration of the ruling without undergoing any revision;
- ruling granted within a short time frame after the submission of the request.

Taking into account the high risk of investigation (and potential recovery of unlawful State aids),[90] in these cases it is worth considering the possibility of asking for a revision of the ruling. It is true that the revision

[89] *Aid to Amazon*, *supra* note 49, rec. 272.

[90] This a case in point for tax risk, which can be defined as the chance of undergoing a tax assessment—in the form of a State aid investigation—combined with the subsequent amount of revenue losses. *See* Marino, G. (2018). *La* Corporate Tax Governance *quale nuovo approccio culturale nei rapporti tra Fisco e contribuente*, in *Corporate Tax Governance*. Milano: Egea editore, 4; Valente, P., (2017). *Tax governance e tax risk management*. Milanofiori-Assago: Wolters Kluwer, 91. In the cases at hand, due to the extensive media coverage, the tax risk involves a high risk to reputation as well that can result in the so-called "tax shaming" or even in boycotts. *See* Barford, V., & Holt, G., (2013, May 21).

is not sufficient to rule out the risk of recovery (*an debeatur*) for the years in which the ruling has been operating. However, it would lower the *quantum* exposed to such risk, in an evolving framework where the automatic exchange of information and the country by country reporting (respectively focusing on the issuance of cross-border rulings and on the amount of revenue collected in any jurisdiction in which the MNE operates) make it easier than ever to cross-reference the data of each taxpayer doing a cross-border business.[91]

The risk of recovery of incompatible or unlawful State aids is also a matter of EU policy. As anticipated in the previous sections and well pointed out by Alexandre Maitrot de la Motte, "the main weakness of the State aid rules is that even if it is the State that violates European law by not notifying a project of aids, by granting them without authorization or by maintaining them contrary to a Commission decision, the

Google, Amazon, Starbucks: The rise of "tax shaming". *BBC News Magazine*. Available at https://www.bbc.com/news/magazine-20560359.

[91]The EU has been promoting a transparency policy, which requires national tax authorities to implement the automatic exchange of information on advance cross-border rulings and advance pricing arrangements. In particular, the Council adopted the Directives (EU) 2015/2376 and (EU) 2016/881 as regards mandatory automatic exchange of information in the field of taxation and country-by-country reporting. The first imposes to exchange information with a receiving administration, in respect of a cross-border ruling, within three months after its issuance (Art. 8a(5)(a) Directive (EU) 2015/2376). The latter extends the scope of the automatic exchange of information to the country-by-country reports, in which MNEs should provide annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax and income tax paid and accrued. MNE groups should also report the number of their employees, stated capital, accumulated earnings and tangible assets in each tax jurisdiction. Finally, they should identify each entity within the group doing business in a particular tax jurisdiction and provide an indication of the business activities in which each entity engages. *See* OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5—2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD, Paris (2015). Available at http://dx.doi.org/10.1787/9789264241190-en; Id., *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13—2015 Final Report*, OECD, Paris (2015). Available at http://dx.doi.org/10.1787/9789264241480-en. *See* also Seer, D. R., & Wilms, A. L., (2016), Tax Transparency in the European Union Regarding Country by Country Reporting (BEPS Action 13). *EC Tax Review*, *5–6*, 325; Joint transfer pricing forum, *Statistics on APAs in the EU at the End of 2017*, JTPF/007b/2018/EN, meeting of 24 October 2018. Available at https://ec.europa.eu/taxation_customs/sites/taxation/files/statistics_on_advance_pricing_agreements_2017_en.pdf.

financial consequences are endured by companies that were supposed to be supported. They indeed have to repay them with interest. At the end of the process, the offending State has been enriched and the 'aided' company has become poorer".[92]

The Commission, based on the ECJ case law,[93] has often reminded the States and the economic operators that the recovery of unlawful and incompatible aids is not a penalty, but rather the logical consequence of the finding that it is unlawful.[94] However, even if the recovery is aimed at enforcing the EU policy on State aid by restoring the *ex ante* equilibrium, it results in the mentioned paradox. For this reason, the EU Institutions, starting from the Commission, should consider adopting a deterrent policy similar to that implemented by Art. 260(3) TFEU in case of failure by the national Parliaments to fully transpose a legislative Directive. This innovation, introduced in the Treaty of Lisbon, allows the Commission to propose financial penalties even when referring a case for the first time to the ECJ under Article 258 TFEU. In the field of the State aid review, a provision of this kind may incentivize the Member States to fully comply with the procedure laid down in Art. 108. At the same time, it would increase the effectiveness and immediateness of the recovery,[95] ensuring that the level-playing field in the internal market is maintained.

While the recovery of illegal or unlawful aids is correctly not considered as a penalty, a penalty would indeed be appropriate, in parallel, to counter the "beggar thy neighbor" behavior shown by the States in some of the cases at hand. This occurs, for instance, when a Member State sets up special schemes or adopts certain administrative practices which involve lower levels of taxation than generally apply in the State in question and are targeted to non-residents,[96] generating an unfair and harmful tax competition.

[92] Maitrot De La Motte, A., *supra* note 33, 88.

[93] ECJ, 17 June 1999, *Belgium v. Commission*, C-75/97, para. 65.

[94] Recovery Notice, *supra* note 6, para. 13.

[95] *Ivi*, para. 3.

[96] *See* Monti, M., *supra* note 3, 208. Marian, O., *supra* note 84, 203, defines this behavior, with specific reference to the course of action of the Luxembourgish tax administration, as "arbitrage manufacturing [,] a process in which, in return for a fee, a jurisdiction issues a regulatory instrument to a taxpayer who resides outside the jurisdiction, in respect of an investment located outside the jurisdiction. The regulatory instrument is designed to

Finally, the identification at the EU level of the recommended structure of the tax offices issuing the rulings (even by means of soft law) may improve the substantial, i.e. assessment of the ruling requests, granting adequate scrutiny and ruling out the single-administrator problem,[97] seen in the LuxLeaks scandal. In this respect, in 2016 the Code of Conduct Group has released guidelines on the conditions and rules for the issuance of tax rulings,[98] promoting standard requirements for the national ruling systems. Among these best practices, the Member States have agreed on the recommended organization of the offices that assess the ruling requests: at least two officials should be involved in the decision to grant a ruling or a two-level review should be performed. Higher caution is advisable in cases where the applicable rules and administrative procedures explicitly refer to discretion or the exercise of judgment by one of the relevant officials.[99]

15.5 Final Observations

The Commission's inquiry on State aids granted by means of tax rulings has raised complex legal issues, especially with regard to the legal certainty and the protection of legitimate expectations. Instead of increasing the degree of legal certainty—which is the usual expectation of taxpayers requesting a tax ruling—the cases at hand have resulted in a burdensome situation for the MNEs involved, perilous also for those undertakings that have been granted rulings in the past or that are seeking to obtain one by the tax authorities of the Member States. This is due to the fact that, while it is the State that has failed to comply with the notification

synthetically generate differences between the tax laws of the jurisdictions of source and residence. The taxpayer can then take advantage of the manufactured differences, and eliminate most of its tax liability on the profitable activity", suggesting that, while current efforts to counter tax avoidance are aimed at curtailing aggressive taxpayer behavior, such efforts should focus instead and also on certain rogue practices adopted by national tax authorities.

[97] Marian, O., *supra* note 84, 217.

[98] Code of Conduct Group, *Guidance on the conditions and rules for the issuance of tax rulings—standard requirements for good practice by Member States*, agreed on November 2016, doc. 14750/16.

[99] Ibid.

and standstill requirements, the financial risk of the recovery is entirely borne by the undertaking that was supposed to be supported.

The circumstances that raise a concern of incompatibility with the State aid rules are both substantial and procedural, as the Commission sees deficiencies in process as indicating potential problems with substance.[100] Taxpayers who have been issued a ruling in the past years should consider opting for a revision if they had not provided a transfer pricing report or if the remuneration confirmed therein was not consistent with the relevant EU provisions and OECD soft law nor compliant with the ALP. Moreover, we have witnessed the Commission taking a tough line against tax rulings endorsing an allocation of profits and/or of IP rights that resulted in a mismatch in the classification of EU-based entities (addresses of "inflated royalties) whose profits were "disregarded" for tax purposes both in the US and in the EU, remaining largely untaxed. Similarly, those undertakings doing a cross-border business that are in the process of obtaining a ruling should avoid incurring in similar situations. As far as administrative practices are concerned, red flags are raised especially by the non-compliance of the Member State with the procedure laid down in Art. 108 TFEU (lack of notification and/or violation of the standstill requirement), as well as by the excessive duration of the ruling without undergoing any revision or by the timing of certain tax administration that have issued tax rulings after few working days from the submission of the request.

However, in the present contribution it has been argued that the management of the risk of recovery should not be limited to the exclusive domain of the enterprises. Considering the limited chances of success of the pleas regarding the breach of legitimate expectations and of legal certainty before the Union Courts, it is worth considering the adoption of a deterrent policy similar to that implemented by Art. 260(3) TFEU in case of failure by the national Parliaments to fully transpose a legislative Directive. This innovation would allow the Commission to propose financial penalties even when referring a case for the first time to the ECJ under Article 258 TFEU, increasing the effectiveness and immediateness of the recovery, while preventing the Member States from granting derogatory rulings without notifying the Commission.

[100] Thomson, A., & Hardwick, E., *supra* note 54, 48.

In the meanwhile, the Member States' tax authorities should assess the taxpayers' ruling requests in light of the relevant domestic and international tax regulations and case law and the offices issuing the tax rulings should be structured in a way that ensures a thorough scrutiny, leaving no room for discretion.

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