EU State aid cases: is it time for reflection?

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EU State Aid: Questions

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- What is the basis of EU State aid investigations i.e. how are they able to challenge certain national tax law provisions as anti-competitive?
- If the national law did not have any definition of arm's length principle, how can the OECD's arm's length principle concept be applied against companies?
- Overall, what is the interaction between EU's State aid, OECD's and local/national law's understanding of 'arm's length principle'?

Basis for State Aid: Article 107 TFEU

A measure will be considered to be State aid if it satisfies the following cumulative criteria:

1. It must confer an economic advantage on the beneficiary (benefit);
2. It must be granted by a Member State or through State resources;
3. It must be a selective advantage (it must favor certain undertakings, the production of certain goods, or the provision of certain services);
4. There must be a (potential for) distortion of competition;
5. There must be an effect (or potential effect) on trade between Member States.

EU State Aid and Direct Taxes

Identifying State aid in the form of tax benefits causes considerable difficulty because – unlike direct aid by way of financial assistance – rather than the granting of an advantage in the shape of a state benefit, it consists of a dispensation from the disadvantage of taxation.

For tax law measures to be classified as State aid, it is first necessary to identify an advantage and then to determine that the advantage is granted selectively. For this purpose, the following three steps are indicated by the EU Commission to be applied:

- Identifying the ordinary or **normal tax system** applicable in the Member State concerned and demonstrate that the tax measure at issue is a derogation from that system
- Identify whether the **beneficiaries are treated differently** than the normal tax system applied to other undertakings in similar legal and factual situations
- Whether the difference in treatment (if any) is **justified** by the nature of the system.

EU State Aid and Tax Rulings

- Commission notice

The EU, in an attempt to clarify the broadened scope of Article 107(1), released a Commission Notice on the notion of State Aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, published on 19 July 2016. This document discusses (specifically under paragraphs 169 – 174) the case of tax rulings.

"To sum, tax rulings confer a selective advantage on their addressees in particular 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 'favourable' tax treatment compared with other taxpayers in a similar factual and legal situation.

This could, for instance, be the case where the tax authority accepts a transfer pricing arrangement which is not at arm's length because the methodology endorsed by that ruling produces an outcome that departs from a reliable approximation of a market-based outcome. The same applies if the ruling allows its addressee to use alternative, more indirect methods for calculating taxable profits, for example the use of fixed margins for a cost-plus or resale-minus method for determining an appropriate transfer pricing, while more direct ones are available."

EU State Aid and Tax Rulings

- Commission notice (continued)

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As most of the State Aid cases are challenged based on transfer pricing principle, the most difficult question to answer in respect of identifying 'state aid' under the said tax rulings is to assess what the normal tax system in a Member State was that was applied to all undertakings at large and whether it reflected the arm's length principle for their cross-border operations.

Under paragraphs 172 and 173 of the Commission Notice mentioned earlier, the Commission states that 'arm's length principle' is to be the guiding force in assessing tax measures/benefits granted to group companies and that OECD TP Guidelines are also to serve as a reference point in defining the arm's length principle, independently of whether a Member State has incorporated this principle into its national legal system and in what form.

Statutes of limitation

EU state aid has a **limitation** period of ten years for recovery.

Question: How does this compare to local statutes of limitation?

Political nature of arguments

- The cumulation of measures (e.g. CbCR, European wide filing of APAs, defining a European wide ALP) feeds the number of EU State aid cases.

- Local EU Member States report almost all tax policy proposals to the EU Commission, which with limited capacity cannot cope with the multitude of cases.

- How does this EU State aid tool rank vis-a-vis local implementation of ATAD measures, as well as the proper application and implementation of the MLI? Is there a need for traffic lights?

Key Takeaways

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The recent General Court decisions on Starbucks, Fiat and Apple have given green light to the European Commission to use both the **arm's length principle** and the **Authorized OECD Approach (AOA) on the attribution of profits to branches** as tools to assess whether State aid was given by a Member State.

- Is this the end of the OECD ALP as we know it? (e.g. Starbucks case in breakout room 1)
- Which of the arguments used by the European Commission are valid or not? + What is the difference between a tool of state aid analysis and a rule of law? (e.g. Apple case in breakout room 2)