STATE AID POLICY AS A TOOL AGAINST HARMFUL TAX COMPETITION BETWEEN EU MEMBER STATES

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Abstract[*] [**]

The theme of this thesis is the relationship between harmful tax competition measures and prohibited fiscal State aid. The aim of this thesis is to present a targeted examination of the use of State aid rules against national tax measures, e.g. tax schemes and tax rulings, following the adoption of the EU Code of Conduct for Business Taxation in 1997.

The fiscal State aid decisions and judgments to be covered are divided in two parts. The first part includes certain Commission decisions and ECJ judgments of the (early) 2000s, which are labelled the "first wave". The second part consists of all the recent Commission decisions and investigations into tax schemes and individual tax rulings, most notably the *Apple*, *Fiat*, *Starbucks* and *Amazon* investigations, which are labelled the "second wave". The characteristics and common threads of each wave are set out, the similarities and differences between the two waves are dissected, and their nexus to the EU's fight against harmful tax competition is explored.

It is argued that an important factor connecting the two fiscal State aid waves is the link they share to the fight against harmful tax competition. It is also maintained that the first wave cases that were linked to this fight have substantially influenced State aid doctrine, and have also had the effect of rendering State aid rules a more effective tool against harmful tax competition by 'weakening' their major limitation, i.e. the selectivity requirement.

This trend could continue should the ECJ endorse the Commission's novel and creative approach in the second wave of fiscal State aid decisions, especially as regards its expansive interpretation of *Forum 187* and the advantage condition of Article 107 TFEU. It is, lastly, asserted that the Commission's novel approach is not legally sound.

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To my Parents and my Sister, for their unrelenting love and support.

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Introduction

Market integration has always been central to the activities of what is now the EU. The "common" market was expressed as a means to an end in the original Treaty, supplemented with effect from 1987 by the pursuit of an "internal market" and, since the entry into force of the Lisbon Treaty, Article 3 TEU commits the EU to the creation of such a market. To make sure the previously "common" market works as an "internal" one, the Treaty provides for, *inter alia,* four fundamental freedoms (free movement of goods, persons, services and capital), rigorous competition rules (Art. 101-109 TFEU), as well as harmonisation of national laws, insofar as disparities among them hinder the functioning of the internal market (e.g. Art. 114 TFEU). This is only natural, since there can be no common market without a common set of rules. An important part of the EU's competition regime is state aid policy, which is based on Articles 107-109 TFEU. Article 107 TFEU imposes a general ban, subject to certain exceptions, on '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, in so far as it affects trade between Member States'.

As Judge Forwood of the General Court had aptly noted, the global financial crisis provided 'an all too vivid reminder of the fact that state intervention is now a central feature of economic life in the European Union, and is likely to remain so for the foreseeable future.'[1] During that crisis, both crisis aid and "rescue and

[1] Judge Nicholas Forwood, 'Foreword to the Second Edition' in Bacon, European Union Law of State Aid, (2nd edition, OUP 2013), p. ix.

restructuring" aid proved essential to many areas of business life. These days, state aid is once again at the forefront, with billions of euros being cleared by the Commission to assist Member States in combating the coronavirus crisis. John Pocock famously asserted that 'politics is the form in which a society deals with unexpectedness'.[2] If his definition is correct, then state aid policy is certainly at the heart of EU politics.

Still, the TFEU provides little guidance when it comes to state aids. Naturally, this leaves the EU institutions with a lot of discretion, and they frequently have to take decisions with great political implications. State aid law affects fundamental political choices, such as 'the respective roles of the state and the market, the desirability or otherwise of competition between jurisdictions, the appropriate balance between market and non-market concerns etc.'[3] [4] With great power, however, comes great responsibility; thus, both the Commission and the Court have been the target of heavy criticism for their state aid rulings in the past. This is partly due to the fact that the constraints State aid rules impose on national governments are substantial, and the cost of compliance can be great.

In the field of taxation, these seemingly innocuous provisions have greatly limited the Member States' room for manoeuvre. For example, many tax

[2] Loïc Azoulai, Edwina Jaeger, Luuk van Middelaar, the Passage to Europe Trans. from Dutch by L. Waters (2014) 51 Common Market Law Review 311, 313.

[3] De Cecco, State Aid and the European Economic Constitution (Hart 2013), 1.

[4] On the constitutional significance of state aid law and its "functional" contribution to the preservation of the internal market, see, inter alia, Andrea Biondi, 'Some Reflections on the Notion of 'State Resources' in European Community State Aid Law' (2007) 30 Fordham International Law Journal 1426.

incentives granted by national governments have been found to be incompatible with articles 107-109 TFEU, and the Commission has frequently ordered their abolition.[5] This way, an EU Member State trying to maintain a preferential tax regime or protect a "tax haven" (e.g. UK and Gibraltar)[6] is likely to find that its practice contradicts its EU law obligations.

State aid rules can thus serve as a weapon in the hands of the Commission in order to combat harmful tax competition. The 'harmful tax competition' debate focuses on tax rules designed to attract foreign capital and other investments by offering conditions which are advantageous in relation to the conditions of the domestic taxpayer.[7] Harmful tax competition can lead to base erosion and fiscal degradation, forcing Member States to outbid each other with tax incentives in order to attract foreign investors, but in doing so sponging on each other's revenues. The result may be an EU-wide loss of tax revenue, which will benefit mainly those who were already very capable of looking after themselves (internationally mobile capital), at the cost of less mobile tax bases, like wages and pensions.[8] Consequently, when harmful tax competition thrives, financial capital drains elsewhere in search of a friendlier environment. In a market such as the

[5] See among others: Case C-88/03 Portugal v Commission EU:C:2006:511; Commission Decision 2003/755/EC of 17 February 2003, Belgian Coordination Centres, OJ L 282, 30.10.2003, p. 25; and Commission Decision 2006/940/EC of 19 July 2006 on State Aid C 3/2006, Luxembourg 1929 exempt holding companies, OJ L 366, 21.12.2006, p.47; Commission Decision of 21 October 2015 on State Aid which Luxembourg Granted to Fiat, Case SA.38375 (2014/C ex 2014/NN); and Commission Decision of 21 October 2015 on State Aid Implemented by the Netherlands to Starbucks, Case SA.38374 (2014/C ex 2014/NN).

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

[7] Wolfgang Schön, 'Taxation and State Aid in the European Union' [1999] CMLR 911, p. 918.

[8] B J M Terra and P J Wattel, European Tax Law (6th edn, Wolters Kluwer 2012), p. 6.

EU's internal market, where capital movements are in principle free, it is almost impossible to stop undertakings from looking after their interests in such a way. Thus, governments can be dragged into a race to the bottom, as they keep lowering their business-related taxes, to the detriment of their revenues.[9]

However, since most governments will not accept (some cannot accept due to large debts and deficits) such a decrease in their budget, the cost is rolled on the backs of less mobile tax subjects, like pensioners, state employees etc. As a matter of fact, by way of example, in the period between 1980 and 1997, the fiscal burden in Member States gradually shifted 'towards non-mobile factors of production, in particular labour, and away from more mobile factors of production, such as capital.' [10] Statistics show that the average tax rate on employed labour 'increased steadily during the period in question from 35% to 42%, while the corresponding rate for capital and self-employed labour fell from 42% to around 37%.'[11]

Consequently, tax competition does not only concern undertakings and states; it also affects – indirectly but very profoundly – everyone's lives, since everyone living in a country that is involved in this race to the bottom is likely to

[9] As to the existence of competition over corporate tax rates in particular cf. Michael Devereux, Ben Lockwood, Michela Redoano, 'Do countries compete over corporate tax rates?' (2008) 92 Journal of Public Economics 1210 et seq.

[10] Augusto Fantozzi, 'The Applicability of State Aid Rules to Tax Competition Measures: A Process of 'De Facto' Harmonisation in the Tax Field?' in: Wolfgang Schön (ed.), Tax Competition in Europe (Amsterdam, 2003), p. 123.

[11] ibid.

bear part of the cost. In a sense, totally free tax competition means less freedom for countries to set their own economic policies.[12]

It is certainly true that there is a big policy debate on the desirability of unrestricted tax competition. [13] Its desirability is largely based on whether its benefits outweigh its costs. These factors, however, are very hard to assess, as will be demonstrated in Chapter 1 (C). According to some, there is no such thing as harmful tax competition: competition can never be harmful! Thus, the very meaning of this concept is disputed.

Still, this policy debate will not be the focal point of my thesis *per se*. My interest lies in analyzing the legal context of this debate and in examining whether what the Commission seeks to achieve, i.e. the imposition of limits on harmful tax competition, is possible under state aid rules, or whether this leads to an illegitimate overextension of the rules' scope.

The theme of this thesis is the relationship of harmful tax competition measures and prohibited fiscal State aid. The aim of this thesis is to present a targeted examination of the use of State aid rules against national tax measures, e.g. tax schemes and tax rulings, following the adoption of the EU Code of Conduct for Business Taxation in 1997.[14]

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[12] N. Shaxson, Treasure Islands (Vintage 2012), p. 73.

[13] For a summary of the debate see B J M Terra and P J Wattel, supra n 7, p. 200.

[14] Council Conclusions of the ECOFIN Council Meeting on 1 Dec 1997 concerning taxation policy, O.J. of 6 Jan 1998, C 2/01.

The fiscal State aid decisions and judgments to be covered are divided in two parts. The first part includes certain Commission decisions and ECJ judgments of the (early) 2000s, which are labelled the "first wave". The second part consists of all the recent Commission decisions and investigations into tax schemes and individual tax rulings, most notably the *Apple*, *Fiat*, *Starbucks* and *Amazon* investigations, which are labelled the "second wave". The characteristics and common threads of each wave are set out, the similarities and differences between the two waves are dissected, and their nexus to the EU's fight against harmful tax competition is explored.

It is argued that an important factor connecting the two fiscal State aid waves is the link they share to the fight against harmful tax competition. It is also maintained that the first wave cases that were linked to this fight have substantially influenced State aid doctrine, through landmark judgments like *Forum 187*,[15] *Azores*[16] and *Gibraltar*.[17] This trend could continue should the ECJ endorse the Commission's novel and creative approach in the second wave of fiscal State aid decisions, especially as regards its expansive interpretation of *Forum 187*.

[15] Joined Cases C-182/03 & C-217/03 *Belgium and Forum 187 ASBL v Commission* EU:C:2006:416.

[16] Case C-88/03 *Portugal v Commission* EU:C:2006:511.

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

Furthermore, it is reasoned that, in the first wave, the decisions of the CJEU and the European Commission had the effect of rendering State aid rules a more effective tool against harmful tax competition by 'weakening' their major limitation, i.e. the selectivity requirement. It is, moreover, asserted that the evolution of selectivity in the ECJ's jurisprudence, especially in the landmark *Gibraltar* case, had the effect of making it particularly difficult for States to enact or preserve harmful tax measures.[18]

Finally, in relation to the second (and ongoing) fiscal aid wave, it is argued that it is now the expansive interpretation of the advantage condition that is having the same effect, i.e. is making State aid rules a more effective weapon against harmful tax competition. This is mainly due to the nexus the Commission has "identified" between the advantage condition and a (recently "discovered") EU Law arm's length principle (ALP), which, according to the Commission, has the effect of rendering advantageous every tax arrangement that departs from this ALP. It is argued that the Commission, by expansively interpreting the ECJ's *Forum 187* judgment, is attempting to widen the scope of the State aid prohibition, thus capturing tax measures and administrative practices which present potentially harmful tax competition elements. It is, lastly, asserted that the Commission's novel approach is not legally sound.

This topic is particularly intriguing due to its broad thematic implications, since it affects direct taxation, an area where Member State competence is the

[18] Giving shape to the scope of Article 107 TFEU in such a manner certainly went some way to "remedying" the Treaties' tight restrictions (limited competence and unanimity) on legislative competence on tax matters.

rule, and which traditionally lies at the core of State sovereignty. Moreover, the global financial crisis has made the fight against harmful tax competition and alleged "free-riders" more topical than ever; thus, fiscal aid investigations involving multinational giants (e.g. Apple, Amazon etc.) gained unprecedented media coverage. As former Competition Commissioner Almunia had emphatically stated in June 2014, when the second and ongoing fiscal State aid wave was launched, these State aid investigations are

> extremely important. Selective tax advantages to the benefit of multinationals seriously distort competition in the EU Single Market. Moreover, 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.[19]

Coming to the structure of this doctoral thesis, in Chapter 1 the debates surrounding tax sovereignty and harmful tax competition will be considered; moreover, the current state of EU Tax Law will be briefly set out, in order to illustrate the limited hard law tools the EU possesses to regulate Member States' tax incentives. In Chapter 2, both the early and recent OECD and EU initiatives against harmful tax competition will be examined, in order to provide the necessary context to the Commission's first and second fiscal State aid waves. Chapter 3 will then deal with the first fiscal State aid wave, launched by Competition Commissioner Mario Monti in the early 2000s. The most important cases will be scrutinised, their common threads will be explored and their contribution to the evolution of the selectivity condition will be identified. In Chapter 4 the ongoing, second, fiscal State aid wave will be dissected: the

[19] Commission Press Release, IP/14/190 (June 11 2014), available at <http://europa.eu/rapid/press-release_STATEMENT-14-190_en.htm> accessed 20 May 2020.

landmark cases will be analysed, their common elements will be identified and the Commission's controversial interpretation of the advantage condition will be challenged. Finally, the overt and covert facets of the link between both waves and the EU's fight against harmful tax competition will be unearthed in Chapter 5, thus demonstrating how the EU has diachronically employed its formidable State aid apparatus to achieve its - primarily soft law - goal of limiting harmful tax competition between Member States.

CHAPTER 1: Tax Sovereignty, EU Tax law and Harmful Tax Competition

'There are only two kinds of countries in Europe today – those that are small and know it, and those that are small and do not'

Paul-Henri Spaak, 1957

Coming from one of the most influential founding fathers of the EU and then NATO Secretary-General, this quote is worth pondering. In the aftermath of the terribly destructive Second World War, Europe was slowly starting to recover. It was becoming increasingly evident that the continent whose powers had dominated the largest part of the world was diminishing in significance. The incessant and inevitable rise of the USA to the West and the USSR to the east made collaboration imperative, if Europe was to play a role on the global stage.

If anything, this quote rings even truer today. The USSR may have collapsed, but Russia remains an important actor in world politics. As the economic centre of gravity slowly shifts further East, most notably in the direction of China, and the EU faces unprecedented internal challenges, including Brexit,[1] the relative economic and demographic "weight" of Europe is in free fall.

[1] On the desirability and likelihood of domestic state aid control in the UK post-Brexit, see Andrea Biondi, 'The House of Lords EU Internal Market Sub-Committee's Inquiry on Brexit: State Aid' (House of Lords, London, September 2017), esp. paras 17-20 & 24. See also Andrea Biondi and Andy Tarrant, 'EU State Aid law and British Assumptions: A Reality Check' (2017) Renewal: A journal of social democracy; and Andrea Biondi, 'Brexit and state aid control: 4 Quartets' (2018) Competition Law Journal 3.

Collaboration, thus, despite elevated euroscepticism levels, seems to remain a no-brainer.

However, every form of supranational collaboration, especially in the context of what is today the European Union, has repeatedly been pitted against the idea of State "sovereignty". This admittedly nebulous concept has been abused by politicians and academics alike; yet, it keeps rising from the dead, never disappearing from the public sphere.

Within the framework of this thesis, the concept of Member States' "tax sovereignty" or "fiscal sovereignty" is relevant, given that almost all Member States invoke it when accused of violating State aid rules or indulging in harmful tax competition.[2] Given that direct taxation is an area which in principle falls outside the Union's competence, Member States are quick to assert their sovereignty when they believe that the Commission or the ECJ have overstepped their mandate.

However, it is not immediately clear what the meaning of fiscal (or, for that matter, State) sovereignty is and whether it is a useful dispute resolution tool. Moreover, drawing the line between State sovereignty and EU competence, e.g. in tax matters, resembles a Sisyphean task. These two problems are exacerbated by the fact that States act in competition with each other, notably tax competition,

[2] In the words of Conor Quigley QC, as true today as when originally written, political movement in the direction of tax harmonisation on an EU level has been 'at a snail's pace, with some Member States making a point of fundamental principle out of their notions of tax sovereignty'; see Conor Quigley, 'General Taxation and State Aid' in Biondi, Eeckhout and Flynn (eds), The Law of State Aid in the European Union (OUP 2004) 207.

which leads to tensions both among Member States and between them and the EU. These tensions can, in turn, be exploited by multinational companies, thus giving rise to the risk of a race to the bottom that has led to the characterisation of certain types of tax competition as "harmful".

This chapter seeks to address all these important issues. In Part A, the concept of State sovereignty and tax sovereignty is explored in the context of the European legal order. In Part B, the status quo of EU Tax Law is briefly set out, through an analysis of the key parts of primary and secondary law. In Part C, the concept of harmful tax competition is examined from a political and economic perspective.

A) Tax sovereignty

Before deciphering Member States' tax sovereignty objections against tax-related EU action, it is useful to take a step back and briefly examine the idea of State sovereignty in general. An in-depth discussion of the concept of State sovereignty obviously falls outside the scope of this thesis. However, through a well-focused navigation of the relevant literature it will be demonstrated that most of the principal misunderstandings concerning the "core" and limits of tax sovereignty trace their origin back to a rather monolithic conception of State sovereignty. It will also be shown that tax sovereignty is not of a static nature[3] and that, in practice, tax sovereignty-related defences have not been successfully employed against EU action, even though they continue to be raised.

Traditionally, every account of sovereignty starts with the Treaty of Westphalia. This peace treaty, concluded in 1648, ended the Thirty Years' War, which was essentially a series of catastrophic wars waged in Central Europe between the Holy Roman Empire and Spain, both controlled by the Habsburg dynasty, on the one hand, and Denmark, the Dutch Republic, Sweden, France and smaller German States on the other. The end of the war is considered by many as a sort of "big bang" moment for the modern diplomatic and legal order, as well as for the principle of State sovereignty. It has been submitted that Westphalia 'formally recognized the concept of state sovereignty'[4] and also 'formally

[3] See also Tsilly Dagan, 'Tax Sovereignty in an Era of Tax Multilateralism' in Dennis Weber (ed.) EU Law and the Building of Global Supranational Tax Law (IBFD 2017) 42-44.

[4] Michael Sheehan, The Balance of Power: History and Theory (Routledge 1996) 38.

acknowledged a system of sovereign states.'[5] Moreover, it has been argued that it 'recognised a society of states based on the principle of territorial sovereignty'[6] and, more importantly for legal scholars, it set out principles that 'constitute the normative core of international law'.[7] In summary, the Westphalia Treaty is considered singularly important because it 'spelt out in full the terms on which the new international diplomatic order was to be based.'[8]

What exactly were those Westphalian principles and terms? They have been summarised in one word: sovereignty. What does it mean for a State to be sovereign? Can any State ever be fully sovereign? Does international cooperation erode its sovereignty? These are questions that need to be explored further because, even though the historical account summarized *supra* has now been persuasively challenged as will be seen below, its ideological and conceptual remnants survive and still inform the sovereignty debate.

According to the standard definition of sovereignty, a State is sovereign when it represents the ultimate authority (or supreme power)[9] within its territory and is free from outside interference. In other words, sovereignty

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[5] Hendrik Spruyt, The Sovereign State and Its Competitors (Princeton University Press 1994) 27.

[6] Graham Evans and Jeffrey Newnham, *The Dictionary of World Politics: A Reference Guide to Concepts, Ideas, and Institutions* (Simon & Schuster 1990) 420.

[7] Seyom Brown, *International Relations In A Changing Global System: Toward a Theory of the World Polity* (Westview Press 1992) 74.

[8] Frederick Parkinson, *The Philosophy of International Relations: A Study in the History of Thought* (Sage Publications 1977) 33.

[9] Samantha Besson, 'Sovereignty in Conflict' in Colin Warbrick and Stephen Tierney (eds) *Towards An 'International Legal Community'? The Sovereignty of States and The Sovereignty of International Law* (BICL 2006) 2.

'signifies the supremacy and inviolability of a state's institutions', [10] which translates into its "unboundedness" both from an internal and an external perspective.[11]

It is important to emphasise both aspects of this embryonic conception of sovereignty, namely in most cases at that time, of the sovereign monarch, i.e. both the right to function as the supreme ruler within certain geographic boundaries and, essentially, the "right to be left alone". [12] For instance, Dicey's classical definition of parliamentary sovereignty evidently only refers to the internal aspect of State sovereignty and designates the Parliament, as defined under the constitution, as the supreme ruler. Parliament has 'the right to make or unmake any law whatever' and 'no person or body is recognised by the law of England a having a right to override or set aside the legislation of Parliament.'[13] The UK's internal sovereignty is thus exercised, first and foremost, by the Parliament.

However, in an increasingly interdependent world facing problems that require transnational solutions, both the external and internal sovereignty of States is regularly put to the test. It has been insightfully remarked that the 'nation

[10] Thomas Gammeltoft-Hansen and Rebecca Adler-Nissen, 'An Introduction to Sovereignty Games' in Rebecca Adler-Nissen and Thomas Gammeltoft-Hansen (eds) *Sovereignty Games: Instrumentalizing State Sovereignty in Europe and Beyond* (Palgrave MacMillan 2008) 1, 3.

[11] Ole Espersen, Frederik Harhoff and Ole Spiermann, *Folkeret: De Internationale Retsforhold* (Ejlers 2003) 142.

[12] I borrowed this phrase from Mattias Kumm, 'Sovereignty and The Right to Be Left Alone: Subsidiarity, Justice-Sensitive Externalities, and the Proper Domain of the Consent Requirement in International Law' (2016) 79 Law & Contemporary Problems 239.

[13] Albert Venn Dicey, *Introduction to the Study of the Law of the Constitution* (9th edition, MacMillan 1939) 3-4.

state is no longer in a position to define its political priorities autonomously (as a "sovereign"), but is, instead, forced to coordinate them transnationally'.[14] This is the reason why so many forms of international cooperation have flourished throughout the 20th and 21st centuries. This inevitable "pooling" of sovereignty is no longer seen as a random Westphalian aberration but rather as 'a systemic feature of a globalized age.'[15]

States' inability to address vital problems on their own necessitates cooperation with other States. The terms of such collaborative relationships are prescribed by international law (or, for our purposes, by its sui generis branch called European law). The intrinsic limitations of sovereignty thus lead to the proliferation of international law; in turn, international (and EU) law then legitimise the exercise of State sovereignty. In this sense, international and EU law essentially seek 'to create the conditions and define the domain over which states can legitimately claim sovereignty'.[16] As regards the EU's competence, it is delineated by its creators, the Member States which, as "Masters of the Treaties", decide what the EU's mission and powers will be. This materialises through the amendments of the European Treaties, whose binding effect has its roots in the

[14] Christian Joerges and Christoph Schmid 'Towards Proceduralization of Private Law in the European Multi-Level System' in Arthur S. Hartkamp, Martijn W. Hesselink, Ewond Hondius, C Mak and Edgar Du Perron (eds), *Towards a European Civil Code* (4th edn, Kluwer 2010) 291.

[15] Thomas Gammeltoft-Hansen and Rebecca Adler-Nissen, 'An Introduction to Sovereignty Games' in Rebecca Adler-Nissen and Thomas Gammeltoft-Hansen (eds) *Sovereignty Games: Instrumentalizing State Sovereignty in Europe and Beyond* (Palgrave MacMillan 2008) 1, 2.

[16] Mattias Kumm, 'Sovereignty and The Right to Be Left Alone: Subsidiarity, Justice-Sensitive Externalities, and the Proper Domain of the Consent Requirement in International Law' (2016) 79 Law & Contemporary Problems 239, 244.

pacta sunt servanda rule of international law that provides them with 'normative validity'.[17]

Zooming in on the relationship between EU law and Member State sovereignty, the international and EU law line of thought is simple and easy to follow. In the celebrated words of the ICJ's predecessor, the Permanent Court of International Justice, there is no 'abandonment' of sovereignty when a State concludes a treaty by which it 'undertakes to perform or refrain from performing a particular act'. Such obligations simply place a voluntary 'restriction upon the exercise of the sovereign rights of the State, in the sense that it requires them to be exercised in a certain way.' In other words, the very 'right of entering into international engagements is an attribute of State sovereignty.' [18] As was eloquently put by the ECJ in its landmark *Van Gend en Loos* judgment, described as the Court's 'unique judicial contribution to the making of Europe',[19] the EU constitutes 'a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields'.[20] From the aforementioned perspective, therefore, both State sovereignty and EU competence are grounded on and legitimised by international law.

[17] Neil MacCormick, 'Democracy and Subsidiarity in the European Commonwealth' in Neil MacCormick *Questioning Sovereignty* (OUP 1999) 137, 140.

[18] *SS Wimbledon* (1923) PCIJ Series A No 1, at 25.

[19] G. Federico Mancini and David T. Keeling, 'Democracy and the European Court of Justice' (1994) 57 Modern Law Review 175, 183.

[20] Case 26/62 *Van Gend en Loos* EU:C:1963:1.

From a jurisprudential perspective, even though it has been admitted that 'the idea of sovereignty cannot just be wished away',[21] it has been persuasively argued that 'there is no compulsion to regard "sovereignty", or even hierarchical relationships of superordination and subordination, as necessary to our understanding of legal order in the complex interaction of overlapping legalities which characterises our contemporary Europe, especially within the European [Union].'[22] It is submitted that sovereignty, whether necessary or not, can surely breed divisiveness when it is portrayed as an opponent of EU competence, locked in a perennial zero-sum game where one's loss is the other's victory. Unfortunately, this manichaeistic understanding is occasionally advanced by national politicians, a relatively recent example being Boris Johnson's pro-Brexit manifesto of 2016, where he lamented the UK's 'loss of sovereignty' and warned that '[t]he more the EU does, the less room there is for national decision-making.'[23] Both on the political and the legal plane, sovereignty remains an 'essentially contestable concept'.[24]

What is not contestable, however, is the reality of transformation European States have undergone since the end of the Second World War. Large parts of what is traditionally considered the very essence of State sovereignty have been

[21] Neil Walker, *Sovereignty in Transition* (Hart 2003) vii.

[22] Neil MacCormick, 'Beyond the Sovereign State' (1993) 56 Modern Law Review 1, 10.

[23] Boris Johnson, 'Boris Johnson Exclusive: There Is Only One Way to Get The Change We Want-Vote to Leave the EU' *The Telegraph* (London, 16 March 2016).

[24] Samantha Besson, 'Sovereignty in Conflict' in Colin Warbrick and Stephen Tierney (eds) *Towards An 'International Legal Community'? The Sovereignty of States and The Sovereignty of International Law* (BICL 2006) 5. As has been aptly noted, 'sovereignty […] contains the seeds of its own essential contestability', see Jens Bartelson, 'The Concept of Sovereignty Revisited' (2006) 17 EJIL 463, 474.

partially transferred to supranational entities. Military "sovereignty" is coordinated by NATO, economic "sovereignty" by the WTO, and political, economic and, for some Member States, monetary "sovereignty" by the European Union. After the latter "pooling" of sovereignty took the leap of faith with the introduction of qualified majority voting (QMV) in the late 1980s, a question arose: had we reached the 'end of sovereignty'?[25]

Such questions reveal certain misconceptions regarding the nature and history of the concept of sovereignty. First, sovereignty is not absolute but relative – a State can be more or less sovereign. If it were not so, even the slightest dent to sovereignty, e.g. in the context of the WTO, would translate into its extinction. Secondly and most importantly, those who mourn the "death" or end of sovereignty have misunderstood its "life". As mentioned at the beginning of this subchapter, most sovereignty analyses start with the Treaty of Westphalia and then compare the modern situation, in the EU or elsewhere, to this Westphalian sovereignty "ideal". However, modern accounts of the treaty's actual effects have forcefully illustrated that 'the peace of Westphalia contributed little to the theory or practice of sovereignty'[26] and the claims connecting State sovereignty and Westphalia are a 'figment of imagination', a 'product of the nineteenth- and twentieth-century fixation on the concept of sovereignty'.[27] Moreover, on closer inspection of the Westphalian State system, it has been demonstrated that no State

[25] Joseph Camilleri and Jim Falk, *The End of Sovereignty?* (Edward Elgar 1992).
[26] Derek Croxton, 'The Peace of Westphalia of 1648 and the Origins of Sovereignty' (1999) 21 The International History Review 569, 584.

[27] Andreas Osiander, 'Sovereignty, International Relations, and the Westphalian Myth' (2001) 55 International Organization 251, 261 & 251 respectively.

possessed all aspects considered crucial for the existence of internal and external sovereignty; in other words, no State was "fully" sovereign, if such a status can ever be attained by a single State.[28] Consequently, the perceived threat of international, for our purposes EU, cooperation to this fictitious State sovereignty is really a threat to something that never really existed and can perhaps never exist. In reality, it is the resurgence of national sovereignty myths that now actually threatens European cooperation. No international organization, including the EU, has ever truly managed to fully escape the limitations of the Statist framework.[29] Therefore, we need to 'temper the claims that state sovereignty is being eroded because of globalization and Europeanization.'[30] As Walker has aptly remarked, sovereignty continues to survive as a 'single claim to the ultimate ordering power which constitutes and sustains the polity.'[31]

What the literature review has revealed is that, even though the content and contours of the concept of sovereignty cannot be pinned down with any accuracy, it is impossible to avoid referring to it since it 'continues to play a legally normative and politically substantive role without an adequate substitute.'[32] This is nowhere truer than in relation to tax sovereignty.

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[28] See Stephen Krasner, *Sovereignty: Organised Hypocrisy* (Princeton University Press 1999) 220.

[29] Robert O. Keohane, 'Hobbes's Dilemma and Institutional Change in World Politics: Sovereignty in International Society' in Hans-Henrik Holm and Georg Sørensen (eds) *Whose World Order: Uneven Globalisation and the End of the Cold War* (Westview Press 1995) 172.

[30] Thomas Gammeltoft-Hansen and Rebecca Adler-Nissen, 'An Introduction to Sovereignty Games' in Rebecca Adler-Nissen and Thomas Gammeltoft-Hansen (eds) *Sovereignty Games: Instrumentalizing State Sovereignty in Europe and Beyond* (Palgrave MacMillan 2008) 1, 6.
[31] Neil Walker, *Sovereignty in Transition* (Hart 2003) 8.

[32] Jack Hayward, 'National Governments, the European Council and Councils of Ministers: A Plurality of Sovereignties. Member State Sovereigns without an EU Sovereign' in Jack Hayward and Rüdiger Wurzel (eds) *European Disunion* (Palgrave MacMillan 2012) 65, 66.

Taxation has always been a crucial policy instrument for national governments. It can, inter alia, be used to redistribute wealth, encourage or discourage the production of certain goods and the provision of certain services, entice or deter investors, protect or undermine social cohesion. Like State sovereignty, tax sovereignty possesses both an internal and an external facet. The former mainly relates to levying taxes and pursuing a tax policy that serves its citizens' interests. The latter primarily concerns a State's right not to allow other States to interfere with its tax policy, but also its right to collaborate with other States on tax issues and coordinate the exercise of its tax sovereignty.

Zooming in on "internal" tax sovereignty, the right of a State to raise revenue through taxes is undoubtedly crucial to its existence. States need to levy taxes in order to ensure 'the continued operation and existence of a functioning government'.[33] Taxes are really a State's lifeblood. However, revenue-raising is not a goal in itself. States need to possess sufficient funds in order to be able to provide for their citizens: welfare, education and security come at a cost. The preservation of order in society and the provision of services to natural and legal persons within a State's territory are enabled by their "contribution" to the State's budget. This *quid pro quo*, which is necessary for a State's survival, lies at the very nucleus of State sovereignty. It has been rightly observed that the right to tax

[33] Diane Ring, 'Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereingty in Shaping Tax Cooperation' (2009) 9 Florida Tax Review 555, 560.

'forms one of the most intimate relationships between the sovereign and its subjects.'[34]

This intimate bond naturally gives rise to the "passive" aspect of external State sovereignty, namely States' hostility towards outside interference on tax matters. However, the "active", collaborative, facet of State sovereignty has been anything but dormant in the past one hundred years: a century 'of bilateral treaties evidences the longstanding need for something more than unilateral action in solving international tax problems.'[35] In a globalized world, where the advance of technology and the liberalization of trade have made global capital more mobile than ever, the completely independent exercise of fiscal sovereignty is illusory. In the minds of most policy makers, some form of transnational tax coordination is inevitable. One of the many reasons is because activities that are highly mobile from the perspective of a single State are much less mobile from the perspective of – for instance - the EU as a whole. It is accurately asserted that for a bloc of countries there is 'a considerable advantage to coordination on corporate tax rates' and that by 'acting collectively, countries should be able to extract more revenue'.[36]

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[34] George Melo, 'Taxation in the Global Arena: Preventing the Erosion of National Tax Bases or Impinging on Territorial Sovereingty?' (2003) 12 Pace International Law Review 183, 186.

[35] Diane Ring, 'What's At Stake in the Sovereignty Debate?: International Tax and the Nation-State' (2008) 49 Virginia Journal of International Law 155, 157. See also Michael Graetz, 'Taxing International Income: Inadequate Principles, Outdated Concepts and Unsatisfactory Policies' (2001) 26 Brooklyn Journal of International Law 1357.

[36] James Mirrlees, Stuart Adam, Tim Besley, Richard Blundell, Steve Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles and James Poterba, Tax by Design: the Mirrlees review (OUP 2011) 441.

Still, Member States have so far been reluctant to seriously coordinate their tax policies on an EU level. As will be seen in Chapter 1 (B), even though various fiscal trade barriers have been removed by way of negative harmonisation, the unanimity requirement has not allowed positive harmonisation to progress at an analogous rate. Very few pieces of secondary EU tax legislation have been adopted and, even those, have been, in a sense, ossified due to the difficulty of amending them by way of a new political bargain in a Union with an ever-increasing number of veto players.

The European Union is by no means a proper fiscal union, since the EU does not itself levy any direct taxes; only Member States levy direct taxes, based on their national tax laws. Tax revenue is collected by national tax authorities and does not (directly) reach the EU's coffers. Moreover, Member States set the criteria determining the scope of their tax laws, e.g. by applying the territoriality principle for the purpose of income taxation.[37] However, their broad fiscal autonomy does not translate into 'fiscal autarchy':[38] Member States have agreed to be bound by primary and secondary EU law and thus, as the ECJ famously proclaimed in *Schumacker*, 'the powers retained by the Member States must […] be exercised consistently with [EU] law'.[39]

Reconciling Member States broad tax sovereignty with their EU law commitments can at times be daunting. Member States are, in principle, free to

[37] Marjaana Helminen, EU Tax Law –Direct Taxation (IBFD 2015) section 1.2.1.
[38] Sjoerd Douma, Optimization of Tax Sovereignty and Free Movement (IBFD 2011), chapter 3.

[39] Case C-279/93 *Finanzamt Köln – Altstadt v Roland Schumacker* EU:C:1995:31, para 21.

determine the tax base and tax rate of their tax regimes, thus rendering tax disparities and, consequently, tax competition, a natural element of the European legal order. On the other hand, they are not allowed to adopt tax laws that infringe natural and legal persons' free movement rights, grant fiscal State aid to certain sectors (or companies) or violate secondary EU legislation, e.g. the Parent-Subsidiary Directive. Drawing the line between State sovereignty and EU competence is a delicate task in the area of direct taxation.

In a Union that represents perhaps the closest form of international cooperation short of a federal State, the pooling of tax sovereignty remains taboo. It is conceivable that Member States' trepidation can be explained by the fact that, 'having relinquished so many "traditional" sovereign powers, EU member states cling tenaciously to taxation as one of their core remaining powers.'[40] Whatever the reason may be, the fact remains that, even though the "Masters of the Treaties" decided to confer on the EU the power to regulate both direct and indirect taxation if all Member States could agree on the need for regulation, the latter rarely occurs. It has been fittingly opined that '[t]here is nothing worse for the Union than Member States signing up for initiatives they subsequently realise are too important to be dealt with in Brussels'.[41]

This position has not changed: unsurprisingly, for instance, tax sovereignty debates were not absent during the Brexit campaign, since the latter largely

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[40] Diane Ring, 'What's At Stake in the Sovereignty Debate?: International Tax and the Nation-State' [2008] 49 Virginia Journal of International Law 155, 200 fn 200.

[41] Anand Menon, *Europe: The State of the Union* (Atlantic Books 2008), 237.

focused on State sovereignty in general. Leave campaigners and political analysts asserted that the UK had lost control over some of its revenue-raising powers and the Lisbon Treaty had deprived it 'of a considerable element of tax sovereignty'.[42] Boris Johnson even accused the EU of preventing the UK from effectively cracking down on tax avoidance and properly taxing multinational companies.[43]

If legislative harmonisation of direct tax measures provokes stormy reactions, the prohibition of fiscal State aid has at times "incited" hurricanes. Whereas Member States possess a veto when it comes to harmonisation measures, they cannot prevent the Commission from using its exclusive competence to prohibit national tax measures that allegedly provide selective advantages. Apart from the lack of a veto, Member States are faced with a panoply of Commission prerogatives and are bound by burdensome procedural requirements. First, the rigorously enforced notification and standstill obligations generally deter most Member States from implementing tax measures whose compatibility with Article 107 TFEU is doubtful. Second, the Commission's power to issue injunctions against Member States, its practically unlimited discretion to approve aid measures and the onerous recovery obligation constitute a formidable weapon at the hands of the EU's competition watchdog. Finally, the high threshold for suspending the application of Commission decisions before the General Court, the limitations on third party rights and the substantial judicial

[42] Vanessa Houlder, 'Tax Sovereignty Issues in Brexit Debate Far From Clear-Cut' *Financial Times* (London, 29 May 2016).

[43] ibid.

delays result in the extra-legal accumulation of an important (strategic) "first-strike" advantage for the Commission.

With Member States feeling outgunned and possessing little legal options apart from lodging an action for annulment under Article 263 TFEU, the use of rhetoric during the protracted legal and PR battles is critical. By way of example, following the Commission's negative decision in the Apple case and the gigantic recovery order it imposed on Ireland, Irish Finance Minister Noonan stated that Ireland had to appeal the decision because, in his own words, it was necessary 'to defend the integrity of our tax system, to provide tax certainty to business and to challenge the encroachment of EU state aid rules into the sovereign member states competence of taxation.'[44] The language is familiar: tax sovereignty is used both as a legal shield against EU action and as a political accusation of illegitimate interference. Competition Commissioner Vestager responded in kind by stressing that the Commission is simply the EU's 'state aid controller' and not a tax authority, and it does 'not interfere with national prerogatives when it comes to taxation' since the latter is 'purely and solely [a competence of] the member state.'[45]

[44] Sean Farrell and Henry McDonald, 'Apple Ordered to Pay €13bn After EU Rules Ireland Broke State Aid Laws' *The Guardian* (London, 30 August 2016).

[45] RTÉ News, 'EU Competition Commissioner Says Deadline Has Passed for Apple to Lodge €13bn' *RTÉ* (Dublin, 31 January 2017).

The conclusion to be drawn from such public face-offs is, once again,[46] that tax sovereignty is neither of a static nor of an objective nature; when it comes to State measures that could potentially qualify as State aid, there are no definitive lines that could resemble a "Rubicon" meant to signal inappropriate trespassing by the European Commission or Courts. In practical terms, a national tax measure only falls within the sacred area of national tax sovereignty as long as it has not been found to constitute State aid by the ECJ. This is because State aid measures are part of the Treaties' competition rules, which fall squarely within the EU's exclusive competence.[47] In practice, there are no clear 'external' limits to the scope of the EU's exclusive competence.[48] [49] As ECJ President Lenaerts put it many years ago, albeit in a different context, 'there simply is no nucleus of sovereignty that the Member States can invoke, as such, against the Community'.[50]

Through the preceding analysis it has become evident that the concept of Member States' tax sovereignty cannot be viewed in isolation or *in abstracto*. On the contrary, its definition goes hand-in-hand with the delineation of the

[46] I draw heavily, here, from my following article: Dimitrios Kyriazis, 'From Soft Law to Soft Law Through Hard Law: The Commission's Approach to the State Aid Assessment of Tax Rulings' (2016) 15 European State Aid Law Quarterly 428.

[47] Article 3 (1) (b) TFEU.

[48] Or, in fact, to any other kind of EU competence.

[49] The assertion that taxation on a macroeconomic level remains part of Member State sovereignty while it becomes prohibited State aid when it serves 'particularistic purposes' is a useful schema, which is unfortunately not helpful in practice: see Massimo Merola 'The Rebus of Selectivity in Fiscal Aid: A Nonconformist View On and Beyond Caselaw' (2016) 39 World Competition 533, 538.

[50] Koen Lenaerts, 'Constitutionalism and the Many Faces of Federalism' (1990) 38 The American Journal of Comparative Law 205, 220.

boundaries of EU Tax Law. It is to the status quo of EU Tax Law that the focus now turns.

B) EU Tax Law: Taxation and the European legal order

As has already been demonstrated *supra*, taxation is a crucial policy instrument for national governments. Following the global financial crisis, taxation has become an even more important tool, since, as has been aptly noted, '[c]oncern over the slow economic recovery in the European Union has meant that tax policy in European Member States has increasingly been used as an instrument to help promote economic growth.'[51] It is interesting to note that, according to the Commission's publicly available data, fiscal State aid in the form of tax exemptions is by far the most popular aid instrument used by Member States (more than 30% of the total amount of aid).[52]

This is why any EU intervention in this politically sensitive area is seen with suspicion and hesitation on the Member States' part. Tax policy-making still lies mainly with the Member States, who may delegate some of their taxation powers from central to regional level depending on their constitutional arrangements. The EU only plays a subsidiary role on taxes,[53] its aim being not to standardize the national tax systems, but simply to ensure that they are compatible with the aims of the Treaty.[54] Apart from this, it is correctly observed[55]

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[51] Richard Turner, Louise Harvey and Luc Cade, 'An insight into Europe – the IP Box debate' (*IP Copy*, 3 June 2014) <https://ipcopy.wordpress.com/2014/06/03/an-insight-into-europe-the-ip-box-debate/> accessed 9 April 2020.

[52] European Commission, 'State Aid Scoreboard 2016' <http://ec.europa.eu/eurostat/tgm_comp/refreshTableAction.do?tab=table&plugin=1&pcode=comp_ai_sa_02&language=en> accessed 9 April 2020.

[53] Note, however, its limited legislative competence, discussed directly infra.

[54] Christiana HJI Panayi, 'State Aid and Tax: The Third Way?' (2004) 32 Intertax 283

[55] B J M Terra and P J Wattel, supra n 7, p. 7.

that there exists 'no truly European tax, i.e. tax which is levied at EU level by an EU tax administration on the spending of which the European Parliament votes.' This way, tax integration at EU level can also be seen as an attack on the 'no taxation without representation' maxim, thus becoming even more contentious in an era of profound euroscepticism.

Consequently, it is not surprising that all tax matters that fall within the EU's legislative competence are decided by unanimity. Before, however, discussing the voting procedure on these issues, let us identify the TFEU articles that refer to taxation. These are: Articles 30 *et seq.* (ban on customs duties), Articles 110-113 (the so-called 'tax provisions' of the TFEU), 65(1) (free movement of capital), 173(3) (industry), 179(2) (Research & Development and Space), 191(2) and 192(2)(a) (Environment), and finally Articles 194(2) and 194(3) (Energy). In addition to these, Articles 114 (2) and 115 TFEU are also relevant.

From the above, only the creation of a customs union falls within the EU's *exclusive* competence (Article 3 (1) (a) TFEU). According to Article 2 (1) TFEU, when the Treaties 'confer on the Union exclusive competence in a specific area, only the Union may legislate and adopt legally binding acts, the Member States being able to do so themselves only if so empowered by the Union or for the implementation of Union acts'. The reason why this is an exclusive EU competence is obvious: a customs union presupposes a common customs tariff as regards third countries, and the elimination of all internal tariff hindrances. Both these tasks can

only be performed at the Union's level; after all, the customs union was one of the basic reasons for the Union's creation.

The remaining tax–related TFEU provisions affecting *intra*-EU cross-border trade, investment, employment etc. are closely linked to internal market-making, and are thus caught under the competence heading 'internal market' in Article 4 (2) (a) TFEU[56] - a *shared* competence. According to Art. 2 (2) TFEU, when the Treaties 'confer on the Union a competence shared with the Member States in a specific area, the Union and the Member States may legislate and adopt legally binding acts in that area. The Member States shall exercise their competence to the extent that the Union has not exercised its competence.' Thus, it seems that if the Union has exercised its competence in an area where the latter is shared with the Member States, the Member States are preempted from legislating.[57] The matter is now out of their hands, and all they can do is work through the Union in order to have it amended or altogether repealed.

However, one must not forget that state aid control, even when it directly affects fiscal measures, falls within the EU's exclusive competence (Art. 3 (1) (b) TFEU). Only the Commission and the CJEU (and national courts, of course) can decide whether a tax measure grants a selective advantage to certain undertakings, using state resources, distorting competition and affecting trade

[56] See also B J M Terra and P J Wattel, supra n 7, p. 9.

[57] However, the wording of Article 2 (2) TFEU is misleading. Member States are not preempted from acting in all cases of shared competence – see e.g. Articles 169 (4) and 193 TFEU on consumer protection and the environment respectively.

between Member States. The Commission is really the state aid 'queen'.[58] It is the first - and often the last - institution to decide upon an alleged aid measure's (in)compatibility with the internal market. The strict locus standi rules, as set by the case law on Article 263 TFEU, make it hard for any (legal) person to challenge the Commission's decisions in State aid cases, and thus the latter frequently has the final say, exercising its discretion as it sees fit, within the limits set by EU Courts.

Now, as regards the voting procedure on tax issues, things are relatively simple. Unanimity prevails everywhere, even in the most trivial matters (see e.g. Article 223 (2) *in fine* TFEU). Literally all tax-related initiatives and proposals are to be decided by unanimity (see e.g. Articles 113, 114 (2), 115, 192 (2) (a) and 194 (3) TFEU). This is not a coincidence, but a reflection of the aforementioned importance that Member States attach to their tax sovereignty.[59]

A crucial distinction in EU tax law is the one between indirect and direct taxes. In general, a direct tax is a tax that is directly paid to the government by the (legal) persons on whom it is imposed. Examples include income tax, corporation

[58] In the words of the ECJ in Case C-272/12 P *Ireland and Others v Commission* EU:C:2013:812, para 48 [emphasis added]: '[...] the intention of the [Lisbon] Treaty, in providing through Article [108 TFEU] for aid to be kept under constant review and monitored by the Commission, is that the finding that aid may be incompatible with the common market is to be arrived at, subject to review by the General Court and the Court of Justice, by means of an appropriate procedure which it is the Commission's responsibility to set in motion. Articles [107 TFEU] and [108 TFEU] thus reserve a central role for the Commission in determining whether aid is incompatible. The power conferred upon the Council in the area of State aid by the third subparagraph of Article [108 (2) TFEU] is exceptional in character, which means that it must necessarily be interpreted strictly.' See also Case C-111/10 Commission v Council EU:C:2013:785, paragraph 39.

[59] Over time, qualified majority voting and the ordinary legislative procedure have become the norm in EU lawmaking, but not for tax matters – tax remains "different".

tax, capital gains tax and inheritance tax. An indirect tax is a tax that is not paid to the government directly by the (legal) persons on whom it is imposed, but is collected by an intermediary (e.g. a retail store) from the person who bears the ultimate economic burden of the tax (e.g. a customer). Examples of indirect taxes include VAT, customs duties, excise duties etc.

The single most important tax provision is Article 113 TFEU, which provides the legal basis for the harmonisation of *indirect* tax legislation. Harmonisation of direct taxes, on the other hand, has no 'special' Treaty basis. Thus, the only legal bases that could be used to harmonise direct taxes are the general harmonisation provisions (Articles 114 and 115 TFEU). However, since Article 114 TFEU does not apply to fiscal provisions (see Art. 114 (2) TFEU), the EU is left with Article 115 should it wish to harmonise direct taxation. Contrary to Article 114, Article 115 can only be used to adopt Directives and requires unanimity; therefore, direct tax measures can only be harmonised under the same voting procedure as indirect tax measures (Article 113 TFEU). Apart from the unanimity requirement, the link to the 'establishment and the functioning of the internal market' is there in both provisions. Consequently, the measures adopted under these articles are compatible with the Treaty only to the extent that the disparities in national laws that they seek to eradicate obstruct the functioning of the internal market. [60]

[60] Still, challenges to a harmonisation measure adopted on the basis of Article 113 or 115 TFEU will be a lot fewer than those against an Article 114 measure, since Member States will have reached a carefully constructed political bargain.

Unsurprisingly, due to the unanimity rule, harmonisation of direct taxation measures has not been exhaustive. From the relatively few pieces of secondary legislation that have been adopted, three directives are noteworthy, especially since they play a prominent role in the taxation of multinational companies.

First, arguably the most important directive is the Parent-Subsidiary Directive, originally adopted in 1990.[61] The Directive's scope was extended in 2003,[62] it was recast, in the interests of clarity, in 2011,[63] and was amended again in 2015 to ensure that its provisions were not abused by taxpayers.[64] The Parent-Subsidiary Directive was enacted to address a simple problem: national tax provisions governing the relations between parent companies and their subsidiaries in different Member States varied significantly across the EU and they were generally less favourable than the rules applicable to purely internal situations. Naturally, this created distortions and obstructed the smooth functioning of the internal market. Thus, the directive's goal was to preclude national tax rules that disadvantaged cross-border company cooperation as compared to cooperation between domestic companies. In a nutshell, this is achieved through the exemption of profit distributions from withholding tax in

[61] Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [1990] OJ L225/6.

[62] Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2004] OJ L007/41.

[63] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2011] OJ L345/8.

[64] Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

the subsidiary's State of residence and the prevention of double taxation in the parent company's State of residence.

The second key directive adopted on the basis of Article 115 TFEU (then Article 94 TEC) is the Interest-Royalty Directive.[65] The objective of this directive will be familiar: the tax treatment of cross-border intra-EU payments of interest and royalties should be as seamless as they would be in a national context. This necessarily entails not only the abolition of double taxation but also the elimination of any 'burdensome administrative formalities', as explained in the directive's preamble. The directive, thus, requires that interest and royalty payments are tax-exempt in the source State, i.e. where they arise, and are only taxed once in the State of residence of the income recipient.[66] It should be noted that this is a minimum harmonisation measure, which allows Member States to apply more generous exemptions if they so choose.[67]

The final piece of secondary legislation to be examined is the Merger Directive. The directive was originally adopted in 1990,[68] its scope was extended

[65] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49.

[66] ibid, Article 1.

[67] ibid, Article 9.

[68] Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [1990] OJ L225/1.

in 2005[69] and it was eventually codified in 2009.[70] The goal of the Merger Directive, as set out, inter alia, in its preamble, is to remove national tax restrictions on cross-border corporate reorganisations in the EU. The provisions applying to reorganisations, e.g. mergers or asset transfers, falling within the scope of the directive should be tax neutral in order to encourage cross-border reorganisations in the internal market. To this end, for instance, the taxation of unrealised capital gains is prohibited.[71] The significance of this directive in competition law-related situations is self-evident.

Shifting our attention back to the Treaty, another interesting provision is that of Article 116 TFEU. This article allows qualified majority adoption of directives, when this is necessary in order to eliminate market distortions caused by disparities between national laws and administrative practices. Since no distinction is made, directives can be adopted even when the distortions are caused by disparities between national *tax* laws or the practices of national tax authorities. According to Article 117 TFEU, Member States planning to introduce measures which might create market distortions must consult the Commission, which shall recommend to the States concerned such measures as may be appropriate to avoid the distortion in question.

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[69] Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [2005] OJ L58/19.

[70] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L310/34.

[71] ibid, Article 4.

Even though Articles 116 and 117 TFEU seem – at first glance – to be of high significance, their almost non-existent place in academic literature can be easily explained. These provisions have had very little impact in the EU legal order: a handful of Commission recommendations have been issued, but no directives. [72] As has insightfully been remarked,[73] their role is in fact 'one of a safety valve, which enables the Union to handle market crises without being paralyzed by the unanimity rule of Articles 113 and 115 TFEU.' Still, it should be noted that former Commission President Juncker, appearing before the European Parliament's investigatory committee on money-laundering and tax evasion in May 2017, had vowed to use Article 116 TFEU in the future to counter tax-related distortions to competition.[74] This failed to materialise.

For completeness sake, it is worth mentioning that an alternative legal basis for the harmonisation of direct and indirect taxes could be Article 352 TFEU, which permits 'appropriate measures' to be taken unanimously by the Council 'if action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers.' However, given the

[72] Stephen Weatherill, 'Union Legislation Relating to the Free Movement of Goods' in Peter Oliver (ed.), Oliver on Free Movement of Goods in the European Union (5th edition, Hart, 2010), p. 447.

[73] B J M Terra and P J Wattel, supra n 7, p. 29.

[74] Sven Giegold, 'Juncker on tax avoidance: blind for the past, strong commitments for the future' (*Sven Giegold*, 30 May 2017) <http://www.sven-giegold.de/2017/juncker-on-tax-avoidance-blind-for-the-past-strong-commitments-for-the-future/> accessed 9 May 2020.

existence of Articles 113 and 115 TFEU, Article 352 TFEU has not been significant in the field of direct and indirect taxation.[75]

Moving on from fiscal State aid control and legislative harmonisation of national tax measures, the central feature of the EU's tax legal order has undoubtedly been the influence exercised by the fundamental freedoms. [76] Arguably, the vast amount of case law generated by ingenious litigants challenging national tax measures on the basis of internal market law has had the greatest impact on the design of national tax policy. Their effect has mostly been felt in the area of direct taxation.[77]

To begin with, in its celebrated *Avoir Fiscal* ruling,[78] the ECJ unequivocally affirmed that Member States' direct taxation measures need to comply with the fundamental freedom provisions. In this area of law, the prohibition of discrimination is undeniably the leitmotif.[79] Still, despite the wording of certain Treaty Articles, e.g. Articles 45 and 49 TFEU, which only seem to prohibit discriminatory treatment, it is established ECJ case law that restrictions on the

[75] For an example of an EU measure adopted on the basis of (the predecessor of) Article 352 TFEU which includes provisions on direct taxation, see Council Regulation 2137/85/EEC of 25 July 1985 on the European Economic Interest Grouping (EEIG) [2003] OJ L199/1.

[76] See Articles 34, 45, 49, 56 & 63 TFEU.

[77] Which is the area of taxation most relevant to this thesis, since it deals with corporate taxation, especially of multinational companies.

[78] Case 270/83 *Commission v France (Avoir Fiscal)* EU:C:1986:37.

[79] On the similarity of the free movement provisions' discrimination test and the state aid selectivity test, see Andrea Biondi 'Every family is the same, every family is different: state aid and free movement' (2017) European State Aid Law Quarterly 34, esp. section IV. See also some relevant comments in Andrea Biondi 'State aid, education and fiscal exemptions to the Catholic Church' (2017) Journal of European Competition Law and Practice 110.

four freedoms that do not amount to discrimination can also sometimes fall within their scope.[80]

The free movement provisions that are most relevant in relation to direct taxation are the freedom of establishment (Article 49 TFEU), the freedom to provide services (Article 56 TFEU) and the free movement of capital (Article 63 TFEU).[81] The extent to which these provisions have influenced national tax law and policy will now be briefly examined in turn, by way of certain characteristic examples.

The ECJ's interpretation of the freedom of establishment provisions (Articles 49-54 TFEU) has greatly enhanced the ability of individuals and companies to challenge Member States' tax codes. For instance, it has been held that a Member State cannot treat a parent company resident in its territory, but having subsidiaries in another Member State, less favourably than a parent company with subsidiaries in its own territory.[82] Such treatment constitutes a restriction on the freedom of establishment, since it discourages parent companies 'from creating, acquiring or maintaining a subsidiary in another Member State.'[83] Moreover, in principle, Articles 49-54 TFEU require that the

[80] See, e.g. Case C-55/94 *Gebhard* EU:C:1995:411 and Case C-118/96 *Safir* EU:C:1998:170.

[81] Of course, the other fundamental freedoms have also produced a certain amount of case law in relation to direct taxation. For the free movement of goods, see e.g. Case C-18/84 *Commission v France* EU:C:1985:175. For the free movement of workers, see e.g. Case C-302/98 *Sehrer* EU:C:2000:322 and Case C-512/13 *Sopora* EU:C:2015:108.

[82] Case C-347/04 *Rewe Zentralfinanz v Finanzamt Köln-Mitte* EU:C:2007:194.

[83] ibid, para 36.

permanent establishment of a company that operates in a different Member State must be treated in that State as beneficially as companies that are resident there.[84] Furthermore, the freedom of establishment, coupled with the free movement of capital, precludes national legislation that grants resident recipients of domestic-source dividends, but not of foreign-source dividends, a tax deduction.[85]

Two judgments on the freedom of establishment stand out, as they have inarguably left their mark on the obstreperous trajectory of the case law. In *Marks & Spencer*, the ECJ held that the aforementioned freedom does not preclude national tax rules that generally prevent a resident parent company from deducting, from its taxable profits, losses incurred in another Member State, even though they allow it to deduct losses incurred by a resident subsidiary.[86] Such difference in treatment can be justified by the need to safeguard the balanced allocation of taxing powers between Member States, as well as the need to prevent tax avoidance and the double use of tax losses.[87] In *Cadbury Schweppes*,[88] the Court delved deeper into the thorny issue of tax avoidance, by examining the EU law compatibility of controlled foreign corporation (CFC) regimes. In essence, CFC provisions are national tax rules that 'provide for a direct attribution of a foreign subsidiary's profit to the parent company if the foreign corporate entity derives

[84] Marjaana Helminen, EU Tax Law –Direct Taxation (IBFD 2015) section 2.2.5.2.1.

[85] Case C-446/04 *Test Claimants in the FII Group Litigation* EU:C:2006:774, para 112.

[86] Case C-446/03 *Marks & Spencer* EU:C:2005:763, para 59.

[87] ibid, paras 46-49.

[88] Case C-196/04 *Cadbury Schweppes* EU:C:2006:544.

"passive income" and is subject to low-tax or no tax in the foreign jurisdiction.'[89] The Court held that the UK's CFC rules amounted to a restriction on the freedom of establishment, since they dissuaded companies from establishing, acquiring or maintaining a subsidiary in a Member State with a low level of taxation.[90] Since companies have every right to establish themselves in another Member state with more favourable tax provisions,[91] such a restriction can only be justified if it concerns 'wholly artificial arrangements' aimed at circumventing Member States' tax laws.[92]

The above analysis has demonstrated that the freedom of establishment can truly "bite" in the area of direct taxation. The freedom to provide services, as set out in Articles 56 to 62 TFEU, is not equally potent, but still plays an important role. More specifically, the freedom to provide services allows service providers, whether individuals or companies, to offer their services in another Member State. Moreover, it prohibits any discriminatory treatment, as well as national rules that are 'liable to prohibit, impede or render less advantageous the activities of service providers from other Member States'.[93]

[89] I borrowed this succinct definition from Wolfgang Schön, 'Tax Legislation and the Notion of Fiscal Aid - A Review of Five Years of European Jurisprudence' (2015) Max Planck Institute for Tax Law and Public Finance Working Paper, p. 22.

[90] Case C-196/04 *Cadbury Schweppes* EU:C:2006:544, para 46.

[91] ibid, paras 36-37.

[92] ibid, paras 51 et seq.

[93] Case C-255/04 *Commission v France* EU:C:2006:401, para 37.

However, the freedom to provide services is subsidiary to the free movement of goods, capital and persons (Article 57 TFEU). In other words, it applies only when no other fundamental freedom is engaged.[94] As a result, case law on the interaction of direct taxation and the freedom to provide services is rather limited, but still not insignificant. For instance, in *Commission v Austria*[95] the Court ruled that a provision obliging real estate and investment funds to have a fiscal representative in Austria breached Articles 56-62 TFEU, since only Austrian credit institutions and Austrian chartered accountants could serve as fiscal representatives. Furthermore, in *Commission v Spain*,[96] the Court held that Spanish fiscal rules, which exempted winnings from lotteries of certain undertakings established in Spain but not elsewhere in the EU, violated the freedom to provide services. In general, Articles 56-62 TFEU mainly come into play in relation to the taxation of education and insurance services.[97]

Coming now to the final important internal market provision, the free movement of capital (Articles 63-66 and 75 TFEU), it is apposite to note at the outset that it has defined, to a great extent, the way Member States choose to tax, inter alia, cross-border investments, dividends and capital gains. Article 63 TFEU prohibits, in principle, all restrictions on the movement of capital between

[94] In practice, the case law is rather convoluted, with the applicability of each fundamental freedom being determined on an ad hoc basis. For some excellent examples, see Marjaana Helminen, EU Tax Law –Direct Taxation (IBFD 2015) section 2.2.8.2.

[95] Case C-387/10 *Commission v Austria* EU:C:2011:625.

[96] Case C-153/08 *Commission v Spain* EU:C:2009:618.

[97] See, respectively, Case C-136/00 *Danner* EU:C:2002:558 and Case C-56/09 *Zanotti* EU:C:2010:288.

Member States and between a Member State and a third country. The Court defines capital restrictions as all restrictions that are 'likely to discourage non-residents from making investments in a Member State or to discourage that Member State's residents to do so in other States'.[98] This broad formulation entails the prohibition of obstacles that, for example, do not result in a higher tax burden for non-residents, but simply impose an extra administrative burden that is deemed onerous.[99]

As briefly mentioned *supra*, the taxation of dividends and capital gains by Member States has been rigorously scrutinised by the ECJ on the basis of Article 63 TFEU. Finnish rules that subjected dividends of non-Finnish origin to less favourable treatment than Finnish-source dividends were found to restrict the free movement of capital, since investors residing in Finland were thus discouraged from purchasing shares in non-Finnish companies.[100] Moreover, in relation to capital gains taxation, the Court has repeatedly held that Article 63 TFEU precludes tax measures treating capital gains on foreign stock exchanges' shares less favourably than shares listed on the domestic stock exchange.[101]

It is difficult to overstate the significance of free movement law for national tax systems. It is interesting to observe, though, the interaction between the four

[98] Case C-370/05 *Festersen* EU:C:2007:59, para 24.

[99] See, e.g., Case C-267/09 *Commission v Portugal* EU:C:2011:273, para 37.

[100] Case C-319/02 *Manninen* EU:C:2004:484, paras 23-24.

[101] See, for instance, Case C-219/03 *Commission v Spain* EU:C:2004:785.

freedoms and the subject-matter of this thesis, namely EU State aid law. While the former mainly prohibit negative discrimination, i.e. discrimination against foreign (or non-resident) undertakings, the latter prohibits positive discrimination, i.e. the beneficial treatment of certain (usually domestic) undertakings. This formalistic distinction, however, conceals more than it reveals, since the two sets of provisions share important similarities and sometimes overlap. Their common goal is the establishment of an internal market where undistorted competition is ensured, while both prohibit, as a general rule, the differential treatment of undertakings in a comparable situation, without good reason. Although an in-depth analysis of their potential overlap falls outside the scope of this thesis,[102] it is important to highlight that the ECJ has insisted that the Commission cannot approve a State aid measure when this would result in the violation of other Treaty rules, most notably the fundamental freedom provisions.[103]

To conclude this subchapter on EU Tax Law, the key point to remember is that the operation of EU law has important implications for the domestic tax regimes of Member States. In fact, it is no longer possible to consider national tax rules without taking into consideration the effect EU law might have on them.[104]

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[102] For a more detailed examination see Melanie Staes, 'The Combined Application of the Fundamental Freedoms and the EU State Aid Rule: In Search of a Way out of the Maze' (2014) 42 Intertax 106; and Claire Micheau, 'European Union – Fundamental Freedoms and State Aid Rules Under EU Law: The Example of Taxation' (2012) 52 European Taxation 210.

[103] Case 74/76 *Iannelli & Volpi* EU:C:1977:51;see also Case C-169/08 *Presidente del Consiglio dei Ministri v Regione Sardegna* EU:C:2009:709.

[104] See, to the same effect, J. Tiley and G Loutzenhiser, Advanced Topics in Revenue Law (Hart Publishing, 2013), 477.

In a nutshell: the key thematic tension in this area of law is between (State) sovereignty and (EU) competence.

C) Harmful Tax Competition: The Debate

By way of introduction, one must endeavour to define the nebulous concept of 'tax competition'. Arguably, it can broadly be described as 'a process of uncooperative but interdependent setting of tax rates between jurisdictions that enjoy tax autonomy, in a bid for investments, other economically relevant activities, or mere profits.'[105] The 'harmful tax competition' debate focuses on tax rules designed to attract foreign capital and other investments by offering conditions which are advantageous in relation to the conditions of the domestic taxpayer.[106] As will be seen below, the adjective 'harmful' itself involves contested value judgments which give rise to different views on the very existence and desirability of this phenomenon.

Tax competition among EU Member States in general, and Eurozone States in particular, has moved high up the political agenda. For example, in 'Our manifesto for Europe',[107] drafted by the famous French economist Thomas Piketty and fourteen other French intellectuals in response to the German Glienicker group's proposals,[108] it was proposed that eurozone countries, starting with France and Germany, should share their corporate income tax (CIT).

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[105] Joachim Englisch and Anzhela Yevgenyeva, 'The 'Upgraded' Strategy Against Harmful Tax Practices Under the BEPS Action Plan' (2013) British Tax Review 620, 621.

[106] Wolfgang Schön, 'Taxation and State Aid in the European Union' [1999] CMLR 911, p. 918.

[107] Thomas Piketty & 14 others, 'Our Manifesto for Europe' *The Guardian* (London, 2 May 2014) http://www.theguardian.com/commentisfree/2014/may/02/manifesto-europe-radical-financial-democratic accessed 10 May 2020.

[108] Glienicker Gruppe, 'Towards a Euro Union' (Die ZEIT, 17 October 2013) <http://www.glienickergruppe.eu/english.html> accessed 2 May 2020.

Multinationals, they claimed, are taking advantage of the gaps and loopholes across the EU, treating states as marionettes and turning national sovereignty into a myth. According to their views, to fight against this 'tax optimisation', a sovereign European authority needs to be given the power to establish a common tax base that is as broad as possible and strictly regulated. Each country might then continue to set its own CIT rate on this common base, *with a minimum rate of around 20%,* and with an additional rate on the order of 10% to be levied at the 'federal' level. This minimum 20% tax rate that seems to be central in their proposal reflects their concern to limit tax competition among Eurozone states, and restrict it to a level that would still generate sufficient revenue for each state.

As mentioned in the introduction to this thesis, the premise underpinning the undesirability of harmful tax competition is that it can lead to base erosion and fiscal degradation, forcing Member States to outbid one another with tax incentives in order to attract foreign investors, thus limiting their revenues.[109] The problem is that not everyone agrees that tax competition can ever be harmful.[110] In fact, the whole process of defining a tax measure as harmful can be sabotaged by the fact that no general agreement exists on the extent to which tax competition is harmful or beneficial.[111] As is often the case, there are two – quite extreme - opposing views on the issue, and a more moderate one standing

[109] B J M Terra and P J Wattel, *European Tax Law* (6th edn, Wolters Kluwer 2012), p. 6.

[110] See, for instance, Tsilly Dagan, 'Tax Sovereignty in an Era of Tax Multilateralism' in Dennis Weber (ed.) EU Law and the Building of Global Supranational Tax Law (IBFD 2017) 45-47.

[111] Joachim Englisch and Anzhela Yevgenyeva, 'The 'Upgraded' Strategy Against Harmful Tax Practices Under the BEPS Action Plan' (2013) British Tax Review 620, 622.

somewhere in between. Proponents of the first view argue that tax competition is never harmful, while advocates of the second view believe it always is. The third view is however the most interesting one: tax competition may be harmful, and we need to decide when and what to do about it.

According to the first view, governments will abuse their power to levy taxes in order to please their voters. This will lead to an imposition of high tax rates so as to finance privileges for them and preserve an oversized public sector. This scenario is more likely to be the case with populist governments that endeavor to ensure their reelection through clientelism, but it can really occur with any government, since the majority of the electorate consists of everyday people and not multinational companies. As a result, governments are seen as an omnipotent modern-day Leviathan, whose unreasonable and impulsive taxing decisions need to be restrained. Tax competition, by taming this beast, cannot conceivably be harmful. On the contrary, it forms the chain that prevents it from devouring all healthy business activity for the sake of nourishing itself in the short term. Apart from this argument, there are other arguments in support of tax competition, which are also more relevant to state aid control. One such argument is that, if a state is forced to abolish a preferential tax regime because it is allegedly harmful, it might then decide to lower its tax rates in general, thus losing even more revenue.[112] A second pertinent argument is that countries or autonomous regions suffering from geographical disadvantages could legitimately choose to

[112] For instance, the fact that Ireland lowered its general corporation tax rate to 12.5% in 2004 was partly a result of the EU's efforts to force it to abandon its ring-fenced 10% rate for international financial operations.

rely on preferential tax regimes in order to compensate for the additional economic costs they need to bear.[113] A suitable real-life example here would be the *Azores* case,[114] where the Portuguese government argued, *inter alia,* that the tax reductions offered by these islands were compatible with the internal market because they helped offset the region's insularity and remoteness from the mainland. To sum it up, according to this view, tax competition is a justifiable and effective tool against many problems, and cannot therefore be considered 'harmful'.[115]

The second view naturally contradicts the first, and argues that tax competition is harmful for the exact same reason why proponents of the first view find it beneficial: it restricts the power of sovereign states. However, according to the second view, by forcing the state to lower its taxes in order to remain competitive, its revenue is reduced, and its capacity to provide public goods and promote welfare policies is limited. This way, the burden of financing these activities is shifted to relatively immobile sources, in particular labour, increasing the distortions that taxing these factors implies.[116] Thus, by making states yield to the vices of the economically potent few, an additional burden is placed on the

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[113] Joachim Englisch and Anzhela Yevgenyeva, 'The 'Upgraded' Strategy Against Harmful Tax Practices Under the BEPS Action Plan' (2013) British Tax Review 620, 624.

[114] Case C-88/03 *Portugal v Commission* [2006] EU:C:2006:511. For an analysis, see Chapter 4.

[115] For proponents of this view in general see, *inter alia,* G. Brennan and J.M. Buchanan, *The Power to Tax: Analytic Foundations of a Fiscal Constitution* (Cambridge, CUP, 1980); J. Edwards and M. Keen, 'Tax Competition and Leviathan' (1996) 40 European Economic Review 113; Keith Marsden, *Is Tax Competition Harmful?* (European Policy Forum, 1998); and P. Morriss and L. Moberg, 'Cartelizing Taxes: Understanding the OECD's Campaign Against 'Harmful Tax Competition'' (2013) Columbia Journal of Tax Law 1.

[116] Joachim Englisch and Anzhela Yevgenyeva, 'The 'Upgraded' Strategy Against Harmful Tax Practices Under the BEPS Action Plan' (2013) British Tax Review 620, 623.

shoulders of the many, who may consequently react and undermine the whole system. To sum it up, proponents of this view argue that tax competition is harmful to the interests of everyday people, renders sovereign states powerless, and causes democracies to pursue unpopular policies to their own detriment.[117]

It is evident that the proponents of both these theories do not only come up with a different conclusion; they also embark from different premises, and hold different views on the role of state sovereignty and states' 'benevolence'.[118] However, the analysis of this debate must stop here, since this is neither an economics nor a political science thesis. As will be seen now, the OECD and the EU subscribe to the third view, judging tax competition to be potentially harmful, and have thus taken steps to define and limit it.

In 1998 the OECD published a highly influential report entitled 'Harmful Tax Competition: An Emerging Global Issue'.[119] In this report, tax competition is described as being harmful in the case of special tax provisions and administrative practices with the principle of aggressively bidding for the tax base of other countries.[120] As has been aptly noted, the major problem of international tax

[117] For proponents of this view in general see, *inter alia,* R.S. Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State' (2000) Harvard Law Review 1573; D. Wilson and D.E. Wildasin, 'Capital Tax Competition: Bane or Boon' (2004) 88 Journal of Public Economics 1065; and D. Swank and D. Steinmo, 'The New Political Economy of Taxation in Advanced Capitalist Democracies' (2002) 46 American Journal of Political Science 642.

[118] See Rachel Griffith, James Hines, Peter Birch Sørensen, 'International Capital Taxation' in Stuart Adam, Tim Besley, Richard Blundell, Steve Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles and James Poterba (eds), *Dimensions of Tax Design: the Mirrlees review*, (OUP 2010) p. 935.

[119] *OECD, Harmful Tax Competition: An Emerging Global Issue (OECD Publications, 1998)*.

[120] ibid, para 29.

coordination was for the first time defined in terms of harmful tax competition with this report.[121]

To briefly go to the gist of the report, according to it a zero or low tax rate, the 'ring-fencing' practices, the lack of transparency and the absence of effective exchange of information were viewed as the 'key' factors in evaluating the 'harmfulness' of preferential tax regimes.[122] As will be seen in Chapter 2, following the OECD's 2013 BEPS Action Plan,[123] this list was supplemented with the requirement of 'substantial activity' (a similar criterion was included already in the 1998 OECD Report as an 'other', supplementing, factor) and with the incorporation of compulsory spontaneous exchange of rulings related to preferential tax regimes.[124]

These are important issues. As the OECD's Secretary-General Angel Gurría had emphasized, 'countries are under enormous pressure to provide competitive regulatory and tax environments to promote growth and prosperity' and there is increased recognition 'that acting together will reinforce rather than weaken each country's sovereign tax policies: countries have long accepted that they should set

[121] Claudio M. Radaelli & Ulrike S. Kraemer, The Rise and Fall of Governance's Legitimacy: The Case of International Direct Taxation (2005) (unpublished manuscript) 13, available at < https://eric.exeter.ac.uk/repository/bitstream/handle/10036/23834/RadaelliInformalGovernance.pdf > accessed 20 May 2014. The authors also assert that this was an exercise in political creativity rather than a case of usage of ideas developed by economists, thus echoing the debate reproduced *supra.*

[122] Ibid, 27.

[123] OECD, *Action Plan on Base Erosion and Profit Shifting (Action Plan)* (OECD Publishing, 2013).

[124] Joachim Englisch and Anzhela Yevgenyeva, 'The 'Upgraded' Strategy Against Harmful Tax Practices Under the BEPS Action Plan' (2013) British Tax Review 620, 636.

limits and that they should not engage in harmful tax practices.'[125] It is to these limits that the focus will now turn, through an examination, in Chapter 2, of the EU's and the OECD's initial, and more recent, initiatives against harmful tax practices and harmful tax competition.

[125] Angel Gurría, 'Taxation and Competition Policy' (European Competition Forum, Brussels, 11 February 2014) < http://www.oecd.org/about/secretary-general/taxation-and-competition-policy.htm> accessed 10 May 2020.

CHAPTER 2: The EU's and OECD's Initiatives Against Harmful Tax Competition

A) Introduction

More than two decades have passed since the adoption of the Code of Conduct and the publication of the OECD's 1998 'Harmful Tax Competition: An Emerging Global Issue' Report.[1] However, neither the EU's nor the OECD's willingness to eliminate harmful tax competition has faded. The Code of Conduct group is continuously assessing Member States' measures, while at the same time preferential tax regimes continue to be a significant issue for the OECD, as evidenced by their inclusion in 'Addressing Base Erosion and Profit Shifting' (BEPS Report),[2] the 'Action Plan on Base Erosion and Profit Shifting' (BEPS Action Plan)[3], and the Final BEPS Report on Action 5.[4]

In this chapter I will examine how the EU and the OECD have conducted their campaign against harmful tax competition by framing it as a collective action problem,[5] how their strategy has evolved through time and what conclusions can be drawn from it. The purpose of this chapter is to place the EU's state aid initiatives in their broader political context, so that the way in which state aid

[1] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998).

[2] OECD, '*Addressing Base Erosion and Profit Shifting'* (OECD Publishing, 2013).

[3] OECD, *Action Plan on Base Erosion and Profit Shifting (Action Plan*) (OECD Publishing, 2013).

[4] OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance* (OECD Publishing, 2015)

[5] See further on this Jason Sharman, *Havens in a Storm: The Struggle for Global Tax Regulation*, (Cornell University Press 2006), pp. 1-4.

rules interact with soft law instruments and EU legislative measures can become evident.

B) Early EU Action

Although the term "harmful tax competition" only emerged in EU discourse in the late 1990's,[6] the potential cross-border impact of national taxation was already an important issue in the EEC's early days.[7] In the so-called Neumark Report of 1962,[8] national experts from the (then six) Member States examined how national tax measures could affect the creation of the internal market. In discussing the general need to mitigate the factors distorting competition, the experts stressed the necessity of eliminating the fiscal and budgetary differences between Member States that could lead companies, capital and labour to choose a jurisdiction other than the one that is technically and objectively most appropriate.[9] Moreover, tax havens and discriminatory tax measures should, in their view, also be targeted, as they distort competition between Member States.

This early and somewhat amorphous European understanding of (potentially) harmful tax competition did not significantly change until the 1990's. It could be argued that the reason was that the creation of a "satisfactorily internal" market, i.e. a market with few trade barriers, proved to be a task more daunting and time-consuming than expected. Only when a satisfactory level of

[6] See *infra.*

[7] For a succinct overall summary of the evolution of the EU's strategy against harmful tax competition see Edoardo Traversa and Alessandra Flamini, 'Fighting Harmful Tax Competition Through EU State Aid Law: Will the Hardening of Soft Law Suffice?' ESTAL, 2015 (3) 323, 325.

[8] Comité Fiscal et Financier, 'Rapport du Comité Fiscal et Financier' (Neumark Report), Brussels 1962.

[9] Comité Fiscal et Financier, 'Rapport du Comité Fiscal et Financier' (Neumark Report), Brussels 1962, p.12.

integration had been attained did the Commission's focus once again turn to the importance of business taxation as a factor affecting the location of business within the Union and the intra-company allocation of profits, thus also possibly affecting the functioning of the internal market. In late 1990, a Committee was set up by the Commission in order to analyse all relevant questions in depth, the so-called Ruding Committee. In 1992, it presented its findings in a lengthy report.[10]

The Ruding Report contains various interesting findings and some rather audacious proposals. More specifically, the Committee found that there were substantial differences in the corporate tax systems of Member States, and "considerable variations" in their corporation tax rates and tax bases.[11] The data the Committee collected showed that differences in taxation affected companies investment and location decisions, especially in the financial services sector, thus causing distortions in competition.[12] The Committee warned that this could lead to a misallocation of resources within the Union and result in reduced productivity.[13] Although the Committee found no satisfactory way of quantifying this misallocation, the aforementioned data showed that the competition distortions and resulting efficiency losses could be extensive.[14] Moreover, surveys

[10] Ruding Committee, 'Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation', Brussels 1992.

[11] Ruding Committee, 'Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation', Brussels 1992, p. 9.

[12] Ruding Committee, 'Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation', Brussels 1992, p. 22.

[13] Ruding Committee, 'Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation', Brussels 1992, p. 22.

[14] Ruding Committee, 'Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation', Brussels 1992, p. 23.

conducted by the Committee showed that differences in taxation had a very significant impact on companies' financial and legal structures.[15] Still, in the end, the Committee did not reach an unambiguous verdict as regards the big picture, instead concluding that it "found no convincing evidence that independent action by national governments is likely to provoke unbridled tax competition among Member States and lead to a drastic and undesirable erosion of corporate tax revenues."[16] The words here have been chosen very carefully ("convincing", "unbridled", "drastic and undesirable") and the Committee's verdict is so qualified that it really leaves all possibilities open, especially when it goes on to note its concern about Member States' tendency to introduce special tax incentives for internationally mobile business.[17]

Its policy recommendations for dealing with the aforementioned concerns were quite bold. The Committee proposed the rigorous removal of discriminatory or distortive elements of national fiscal laws and urged Member States to be fully transparent with tax incentives granted to promote investment. More interestingly, it advocated for the adoption of an EU-wide minimum corporation tax rate at 30% and collective rules for a minimum tax base, in order for tax competition to operate within certain predetermined limits, thus ensuring any

[15] Ruding Committee, 'Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation', Brussels 1992, p. 23.

[16] Ruding Committee, 'Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation', Brussels 1992, p. 25.

[17] Ruding Committee, 'Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation', Brussels 1992, p. 26.

negative effects were both predictable and manageable.[18] Variations of all three proposals continue to be echoed by various institutions until today, a fact which highlights once again the lack of decisive action in areas where unanimity in Council prevails.

Four years after the publication of the Ruding Report, in March 1996, the Commission published an interesting document entitled "Taxation in the European Union".[19] It should be noted that at that time, the Commissioner in charge of Taxation was Mario Monti, who would go on to serve a second term as Competition Commissioner, thus also in charge of the application of (fiscal) state aid rules.

This document was formally a discussion paper for the informal meeting of ECOFIN Ministers in Verona in April 1996; its principal point was to highlight the main challenges for taxation policy in the EU and persuade Member States of the need for more coordination. In this document (hereafter the "Verona Report") we witness the official introduction into EU discourse of the concept that would later become "harmful tax competition". The Commission's paper mentions "unfair competition in the tax area" as a major potential cause of concern in relation to tax base erosion, which in turn leads to fiscal degradation and the destabilization of Member States' tax revenues.[20]

[18] Ruding Committee, 'Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation', Brussels 1992, p. 27-28.

[19] European Commission, 'Taxation in the European Union' SEC (96) 487 final.

[20] European Commission, 'Taxation in the European Union' SEC (96) 487 final, pp. 2-3.

This concept of unfair tax competition remains elusive, since it is not defined in the Verona Report: only its 'potential negative effects, particularly on tax revenues of Member States, on the efficient allocation of economic resources within the EU, and on competitiveness and employment'[21] were mentioned. The Commission is skeptical towards this brand of tax competition because its threat to the stability of tax revenues resulted, in its view, in the shift of the tax burden to less mobile tax bases (e.g. labour) as a means of compensating for the favourable treatment of more mobile tax bases.[22] When this happens, it generally means that Member States are forced to adopt unpopular measures, but also that their ability to structure their tax system as they see fit is restricted.[23] The Commission also implies that Member States' navel-gazing – as expressed by their "unfair" tax measures and their vetoes on common EU action – although appearing to shield national fiscal sovereignty from EU interference, actually resulted in a serious forfeiture of sovereignty to the markets.[24]

The Commission goes on to cite the Ruding Report as an authority for the "potentially dangerous effects of unfairly undermining taxation revenues of other countries."[25] What follows, however, is far more interesting (and relevant to this thesis), since the Commission proceeds to identify the areas that appear most

[21] European Commission, 'Taxation in the European Union' SEC (96) 487 final, p. 2.

[22] European Commission, 'Taxation in the European Union' SEC (96) 487 final, p. 4.

[23] European Commission, 'Taxation in the European Union' SEC (96) 487 final, p. 4.

[24] European Commission, 'Taxation in the European Union' SEC (96) 487 final, p. 10.

[25] European Commission, 'Taxation in the European Union' SEC (96) 487 final, p. 5.

problematic and susceptible to unfair tax competition. These are internationally mobile businesses and capital, with special treatment most frequently being reserved for international financial services, multinational group management, headquarters and treasury management.[26] In retrospect, one can easily discern the link between the Commission's soft law focus and its hard law initiatives, since it is precisely in these areas that Commissioner Monti, acting as Competition Commissioner, would later open the fiscal state aid investigations that marked the beginning of the first fiscal aid wave. [27] The Commission's consistency is praiseworthy, and its determination to unilaterally push forward when unanimous action seems improbable is crystal clear.

Another noteworthy element of the Verona Report is the Commission's acknowledgment[28] of the significance of the work that had already been carried out within the framework of the OECD, despite the fact that it had yet to produce concrete results. [29] The Commission further notes that the OECD's work had already pinned down certain elements that could help identify measures of unfair tax competition, i.e. what we would later call the "harmfulness criteria".[30] The Commission thus admits that the OECD led the way when it came to the identification of harmful tax measures in practice.

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[26] European Commission, 'Taxation in the European Union' SEC (96) 487 final, p. 5.

[27] Commission Press Release, IP/01/982 (July 11 2001), available at <http://europa.eu/rapid/press-release_IP-01-982_en.htm> accessed 10 April 2020.

[28] European Commission, 'Taxation in the European Union' SEC (96) 487 final, p. 5.

[29] The major OECD Report on harmful tax competition would be finalized in 1998.

[30] European Commission, 'Taxation in the European Union' SEC (96) 487 final, p. 5.

Finally, the similarities between the Commission's proposals in 1996 and its recent proposals are remarkable. The Commission, in the Verona Report, states that it wishes to improve the transparency of tax measures (today its similar wishes are reflected in the Tax Transparency Package), to ensure a more consistent and clearer application of the state aid prohibition to tax measures (this was reflected in the Commission's 1998 Fiscal Aid Notice,[31] its 2014 Draft Notice on the Notion of State Aid[32] and its 2016 Final Notice on the Notion of State Aid),[33] to promote closer administrative cooperation in the tax field (today this is reflected in the new provisions on the automatic exchange of tax rulings) and to improve Member States cooperation within the OECD (reflected in its warm reception of the BEPS Project).[34] The fact that the Commission's proposals two decades ago were almost identical to its proposals today serves as proof of the extremely slow-moving nature of EU tax policy in areas where Member States need to agree unanimously, like taxation. Out of the four aforementioned proposals, only work under state aid rules (where the Commission reigns supreme) and work in the context of the OECD (whose soft law nature provokes milder reactions) have reaped significant results. Member States would perhaps never have agreed to closer cooperation and transparency had it not been for the LuxLeaks scandal and the Commission's high-profile investigations into

[31] Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ 1998, C 384/03.

[32] European Commission, 'Draft Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU' (Communication) COM (2014) <http://ec.europa.eu/competition/consultations/2014_state_aid_notion/draft_guidance_en.pdf> accessed 11 April 2020.

[33] European Commission, 'Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU' COM (2016), hereafter "Final Notice".

[34] European Commission, 'Taxation in the European Union' SEC (96) 487 final, p. 13.

multinationals' tax arrangements, both of which caused public outcry and triggered demands for a more pugnacious stance against tax avoidance and aggressive tax planning.

Coming back to our narrative, the Commission's Verona Report was welcomed by Finance Ministers at their informal ECOFIN meeting in April 1996, and they agreed on the need to establish a High Level group that would further consider the issues the Commission had raised. Seven months after the publication of the Verona Report, the Commission followed up with a report entitled "Taxation in the European Union: Report on the Development of Tax Systems".[35] In that report, the Commission summarized the views expressed within the High Level Group that had been set up and, more importantly, once again shared its own proposals for a way forward.[36] The Commission reemphasized the dangers presented by various structural changes in taxation, e.g. the increase of tax rate on labour from 34.7% to 40.5% in 15 years, coupled with a contemporaneous decrease from 44.1% to 35.2% for capital, self-employed labour etc.[37] Although it conceded that there were many possible explanations for these changes, it noted that they could be owed to "the progressive erosion of certain fiscal bases" that could itself be "caused by excessive or harmful tax

[35] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final.

[36] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, p. 1b.

[37] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, p. 2.

competition".[38] It further stressed that "favourable tax regimes, particularly for internationally mobile activities, can cause economic misallocations and undermine other countries revenues."[39]

In this report, we witness an almost imperceptible shift in terminology, since the Commission also uses the adjective "harmful" alongside "unfair" to label the brand of tax competition that it scorns.[40] The adjective "harmful" would go on to dominate European discourse, starting with the Commission's 1997 package against harmful tax competition. This shift in terminology is perhaps part of the Commission's "manipulation" tactics, since fairness rarely strikes a chord with politicians; the threat of harm to their interests can be far more convincing.

Apart from this symbolic development, the Commission also addressed some very practical issues. Firstly, it noted that it was highly problematic that there was no common understanding of what constitutes a harmful tax measure.[41] It also stressed that it was being pressed to use state aid rules to eliminate harmful tax measures, that there was widespread support for cooperating with the OECD, and that there was a need to define acceptable and unacceptable Member State

[38] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, p. 2.

[39] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, p. 2.

[40] See, e.g. European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, pp. 5, 10, 12.

[41] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, p. 5.

conduct within the Union.[42] The Commission went on to suggest that it was imperative to create a group where Member States would exchange information on their taxation policies, so that better coordination could be achieved in the fight against harmful tax competition.[43] The Commission also proposed to proceed with various initiatives, mostly in relation to drafting a code of conduct, seeking agreement on what constitutes a harmful measure in an EU context,[44] and clarifying the scope of application of Article 107 TFEU to fiscal measures.[45]

The Commission's single most important soft law document in the 1990's was by far its proposed package to tackle harmful tax competition of October 1997.[46] Although it was formally a discussion paper for the October ECOFIN meeting, in fact it was much more: it was a policy instrument in which the Commission tabled a clearly-defined and ambitious proposal for a complete package to curtail harmful tax competition. The Commission's package sought to develop a common approach against harmful tax competition in order to combat its purported drawbacks, namely budget deficits, the overtaxation of labour, and the overall restriction of Member States' power to freely devise their tax policy.[47]

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[42] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, p. 5.

[43] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, p. 9.

[44] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, p. 10.

[45] European Commission, 'Taxation in the European Union: Report on the Development of Tax Systems' COM (96) 546 final, p. 11.

[46] European Commission, 'Towards Tax Coordination in the European Union: A Package to Tackle Harmful Tax Competition' COM (97) 495 final.

[47] European Commission, 'Towards Tax Coordination in the European Union: A Package to Tackle Harmful Tax Competition' COM (97) 495 final, paras 2-3.

The Commission stressed that the more integrated the internal market becomes through the EMU and the four freedoms, the larger the distorting effect of tax differences and their influence on economic decisions.[48] To avoid antagonism and conflict between Member States, and to better contribute to what must necessarily be a global response, the Commission urged Member States to achieve consensus and present a unified front to the world.[49]

What form would that front take? The form of a package of four measures proposed by the Commission. [50] For the purposes of this thesis, the most interesting measure is the first one, namely the adoption of a Code of Conduct for business taxation and a Commission communication on fiscal state aid. For the Commission, the Code of Conduct was "a key element of the package",[51] despite its non-binding nature. Still, the Commission is not naïve. First, it insisted on a strong political endorsement by the ECOFIN, in order for the latter to publicly signal its commitment to follow through.[52] It also reminded Member States of its "matching commitment" (i.e. gracefully veiled threat) to reexamine its fiscal state aid policy and to make full use of its powers in order to combat harmful tax competition by

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[48] European Commission, 'Towards Tax Coordination in the European Union: A Package to Tackle Harmful Tax Competition' COM (97) 495 final, para 7.

[49] European Commission, 'Towards Tax Coordination in the European Union: A Package to Tackle Harmful Tax Competition' COM (97) 495 final, para 11.

[50] European Commission, 'Towards Tax Coordination in the European Union: A Package to Tackle Harmful Tax Competition' COM (97) 495 final, para 13.

[51] European Commission, 'Towards Tax Coordination in the European Union: A Package to Tackle Harmful Tax Competition' COM (97) 495 final, para 14.

[52] European Commission, 'Towards Tax Coordination in the European Union: A Package to Tackle Harmful Tax Competition' COM (97) 495 final, para 16.

vigorously enforcing state aid rules. It also promised to publish a communication on the application of state aid rules to fiscal measures in order to ensure transparency and predictability.[53] In other words, what this means is that the Commission did not want to give Member States the benefit of the doubt; it would warn them of impending trouble using its soft law powers, wait for them to comply and then strike vigorously.

At the Commission's request, the Council adopted the Code of Conduct within just two months. Between the Commission's proposed package of October 1997 and the final adoption of the Code in December 1997, the Commission published a refined version of its package, in order to better pave the way for an agreement and accommodate Member States' concerns.[54] While some of them had insisted on more ambitious steps, others did not want to proceed at all.[55] However, the Commission considered that there was a real prospect of agreement on the package if all States were willing to compromise and seize the opportunity to put an end to a phenomenon that had, *inter alia*, led to unpopular raises in taxes on labour in almost all Member States.[56] The new refined package was very similar to the previous one, its central pillar being once again the adoption of the Code of Conduct, on the basis of which Member States would politically commit to

[53] European Commission, 'Towards Tax Coordination in the European Union: A Package to Tackle Harmful Tax Competition' COM (97) 495 final, para 17.

[54] European Commission, 'A Package to Tackle Harmful Tax Competition' COM (97) 564 final.

[55] European Commission, 'A Package to Tackle Harmful Tax Competition' COM (97) 564 final, p. 3.

[56] European Commission, 'A Package to Tackle Harmful Tax Competition' COM (97) 564 final, pp. 3-4.

"respect principles of fair competition and to refrain from tax measures that cause harmful competition."[57]

On December 1st 1997, the Code of Conduct for business taxation was finally adopted.[58] This Code, which was essentially a political agreement, signified the EU's determination in fighting against the problems the Commission had identified. The Council noted the need for coordinated action in order to reduce distortions in the internal market and help tax structures develop in a more employment-friendly way. It also acknowledged the positive effects of 'fair' competition, whilst noting that tax competition might also lead to tax measures with harmful effects.

The Code of Conduct covers business taxation and concerns measures which affect, actually or potentially, the location of business activity in the Union in a significant way. What is implied here is that, in order for a Member State measure to be harmful, it must play an important role in companies' decisions on their investment location.[59] These measures can be laws, regulations, or simply administrative practices. Still, this is just the general scope of the Code: not all these measures are necessarily harmful. To be caught by the Code, national measures must also provide for a significantly lower effective level of taxation,

[57] European Commission, 'A Package to Tackle Harmful Tax Competition' COM (97) 564 final, p. 4.

[58] Council Conclusions of the ECOFIN Council Meeting on 1 Dec 1997 concerning taxation policy, O.J. of 6 Jan 1998, C 2/01.

[59] Pinto, 'EU and OECD to Fight Harmful Tax Competition: Has the Right Path Been Undertaken?', (1998) Intertax, 386, 389.

including zero taxation, than those levels generally applicable in the Member State in question. Such measures are potentially harmful.

Although a low or zero tax rate is the necessary starting point for the evaluation of a tax measure, the final assessment of its harmfulness must take into account, *inter alia,* five important criteria. The first criterion is whether tax advantages are accorded only to non-residents or in respect of transactions carried out with non-residents. The second criterion is whether these advantages are ring-fenced from the domestic market, so as not to affect the national tax base. Thirdly, a further indication of a regime's harmfulness will be the grant of tax advantages even without any real economic activity and substantial economic presence within the Member State granting them. The penultimate criterion concerns whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD. Finally, the lack of transparency, which includes cases where legal provisions are relaxed at administrative level in a non-transparent way, also "betrays" a regime's harmfulness.

After its – rather laconic – description of the characteristics of harmful tax measures, the Code goes on to define Member States' obligations in relation to them. Firstly, Member States share a standstill obligation: they commit themselves not to introduce new tax measures which are harmful under the

Code's criteria.[60] Secondly and more importantly, Member States share a rollback obligation: they commit themselves to assess their existing tax measures that may fall under the Code, and dismantle or amend them as necessary.[61] Furthermore, Member States are bound to inform each other of existing and proposed tax measures which may fall within the Code's scope, in accordance with the principles of transparency and openness. In particular, they are called upon to provide at the request of another Member State information on any tax measure which appears relevant to the Code.[62]

The procedure and the timing to fulfill the above tasks are also set in the Code. A group of representatives of the Member States and the European Commission referred to as the 'Code of Conduct Group' (hereinafter 'Primarolo Group') was established.[63] Its main duties were to assess the tax measures that may fall within the scope of the Code and oversee the provision of information on those measures. The Group also committed to regular reporting to the Council on the measures assessed.[64]

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[60] Council Conclusions of the ECOFIN Council Meeting on 1 Dec 1997 concerning taxation policy, O.J. of 6 Jan 1998, C 2/01.

[61] Council Conclusions of the ECOFIN Council Meeting on 1 Dec 1997 concerning taxation policy, O.J. of 6 Jan 1998, C 2/01, para D.

[62] Council Conclusions of the ECOFIN Council Meeting on 1 Dec 1997 concerning taxation policy, O.J. of 6 Jan 1998, C 2/01, para E.

[63] Pinto, 'EU and OECD to Fight Harmful Tax Competition: Has the Right Path Been Undertaken?', (1998) Intertax, 386, 406.

[64] Council Conclusions of the ECOFIN Council Meeting on 1 Dec 1997 concerning taxation policy, O.J. of 6 Jan 1998, C 2/01, para H.

Following two interim reports, the Primarolo Group published its final report on November 23rd 1999.[65] This report laid out the results of the Group's work on the evaluation of 271 measures, 66 of which were found to be harmful. It is interesting to note that crucial preparatory material, more specifically an initial list of potentially harmful national measures, had been provided to the Group by the Commission.[66] Although that list was only a starting point and obviously non-exhaustive, the Commission's contribution to the Group's workings is noteworthy and by no means negligible: it literally gave the Group a lot of food for thought, and it was around the Commission's initial list that most of the discussion would revolve. A further – rather illuminating – piece of information is that the Group, after some deliberation, came to the conclusion that a literal interpretation of the Code's curtly phrased criteria would be of little or no significance, and thus agreed to engage in a wider interpretation.[67] This thorny issue, i.e. the Code's interpretation, remains topical: for instance, in December 2015 the ECOFIN invited the Group to further clarify the Code's criteria and produce guidance notes on their interpretation and application.[68]

[65] Council of the European Union, 'Report from the Code of Conduct Group (Business Taxation)' (Report) SN 4901/99.

[66] Council of the European Union, 'Report from the Code of Conduct Group (Business Taxation)' (Report) SN 4901/99, para 8. In paragraph I of the Code of Conduct, the Council had invited the Commission "to assist the group in carrying out the necessary preparatory work for its meetings and to facilitate the provision of information and the review process."

[67] Council of the European Union, 'Report from the Code of Conduct Group (Business Taxation)' (Report) SN 4901/99, para 14.

[68] See conclusions 12-14 here: Council of the EU Press Release, 908/15 (December 8 2015), available at <http://www.consilium.europa.eu/en/press/press-releases/2015/12/08-ecofin-conclusions-business-taxation/> accessed 10 April 2020.

The Primarolo Report was put back into the spotlight in 2015 by an unexpected development that stirred the waters. A large additional part of the Primarolo Report that had been kept secret was published,[69] more specifically a report, prepared for the European Commission by UK law firm Simmons & Simmons, which described and analysed Member States' administrative practices in the area of taxation.[70] The Annex to this secret report was also published, and it contains the responses of Member States to the report's principal findings.

Contrary to its content, the existence of this report was no secret, since in paragraph 26 of the Primarolo Report it was made clear that "[t]he Commission appointed consultants to undertake a comparative study across Member States of administrative practices in taxation. Member States presented a number of comments on that study."[71] Still, its belated publication did come as a surprise, since its content is quite revealing.

To begin with, the Commission asked the contractor (the report's drafter, i.e. Simmons & Simmons) to provide a comparative analysis of "those aspects of the administrative practices that may have an influence on the location of business

[69] See Theo Keijzer, 'Why a 1999 EU study was kept a secret till now: France made tax deals outside the law' (Kluwer International Tax Blog, 1 November 2015) <http://kluwertaxblog.com/2015/11/01/why-a-1999-eu-study-was-kept-a-secret-till-now-france-made-tax-deals-outside-the-law/> accessed 10 April 2020.

[70] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999.

[71] Council of the European Union, 'Report from the Code of Conduct Group (Business Taxation)' (Report) SN 4901/99, para 26.

activity in the European [Union]."[72] This refers to Code's first and most important harmfulness condition, namely that a measure affects, or may affect, the location of business activity in the EU. The information that the contractor was asked to collect in this context was rather detailed, covering the scope and degree of administrative discretion in business taxation in all Member States. The part, however, that is mostly related to the Commission's investigations in the second fiscal aid wave is where the contractor is asked to report on the "practical procedures used for determining transfer prices for controlled transactions in relation to intra-group service activities and financial services." [73] More specifically, it is asked to describe how, in practice, tax administrations verify whether transfer prices are at arm's length, what transfer pricing methods they use, how these are chosen, and what administrative flexibility is available in the application of formal or informal APAs.[74] The relevance of these questions to the Commission's concerns about multinationals APAs is self-evident.

The report's general conclusion, as set out in the executive summary, is that the degree of the administration's discretion and the various administrative practices vary considerably within the Union. Certain Member States'[75] fiscal laws

[72] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, Annex.

[73] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, Annex (B) (2).

[74] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, Annex (B) (2).

[75] Italy, Greece, Finland, Denmark, Sweden, Germany and, to an extent, Austria.

were found to allow little administrative discretion or contain no significant administrative practices likely to lure business. The fiscal laws of Ireland, Portugal, Spain and the UK provided more flexibility, but their administrative practices were not considered likely to attract international capital, when viewed in isolation from related statutory incentives. This caveat is key, since in many state aid cases (e.g. in the Apple case that concerns an Irish Advance Opinion) the State will be arguing that its tax ruling or opinion merely applied the law to the facts, in the sense that if its fiscal law is not found to constitute an incompatible aid scheme, the rulings based on it cannot possibly amount to individual state aid either. In the report's third category of States we find the "usual suspects", namely Belgium, the Netherlands and Luxembourg, with the surprising addition of France. The rules of these Member States are found to allow the negotiation of favourable tax treatment on a case by case basis.[76] This discretion is even more generous in France and Belgium, where the ability to strike a favourable tax deal has the least firm basis on statutory provisions,[77] with France being the only Member State where taxpayers had obtained special tax treatment that was not even provided for in French law, after negotiating directly with the government.[78]

[76] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, para 9.5.

[77] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, para 9.5.

[78] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, para 6.2 (A).

As regards the thorny issue of transfer pricing, the report describes the way in which national tax authorities determine transfer prices and whether these deviate from OECD Transfer Pricing Guidelines: the results varied markedly among Member States. In many cases, Member States accepted transfer prices that were inconsistent with arm's length pricing,[79] e.g. Belgium, France and the Netherlands applied the cost-plus method in a way that benefited taxpayers.[80] However, the report explains that a deviation from the OECD's interpretation of the arm's length principle (ALP) is not a *per se* indication that the administrative practices affect the location of business.[81] Finally, it is interesting to note the correlation found to exist between the possibility of direct government intervention in tax negotiations[82] with the presence of a practice likely to affect the location of business.

The Commission is probably the institution to blame for the report's non-publication until now. It is the Commission that had commissioned the study and must surely have been aware of its content; still, it opened no investigations into the overgenerous individual tax rulings that the secret report brought to its

[79] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, para 10.1.

[80] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, para 6 (2) (c) and executive summary.

[81] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, para 10.4. It is worth comparing this view to the Commission's approach in its opening decisions of the second fiscal aid wave, where it concluded that a deviation from the ALP was a *per se* sufficient indicator that a selective advantage had been conferred.

[82] For example, in France and Luxembourg, see Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, para 7.4.

attention. Why did the Commission instead choose to focus on tax schemes in the early 2000s? Did it follow a deliberate strategy of wishing to appear objective and consistent by targeting States and not companies, or had it not at that time developed a legal theory allowing it to link individual tax rulings and their deviation from the arm's length principle to Article 107 TFEU? One can only speculate, but it is worth noting that the ECJ case (*Forum 187*)[83] on which the Commission has built its legal case in its recent probes had not been decided at that time; in fact, it was decided seven years (2006) after the Primarolo Report and its secret sub-report had been drafted, at a time when the first fiscal aid wave had slowly been dying out.

In retrospect, the importance of this report cannot be overstated. It provides great insights into the behind-the-scenes workings of Member States and sheds light on what is now at the epicentre of the Commission's attention, namely individual tax arrangements instead of more generally applicable tax schemes. It also proves that the Commission was aware of the fact that certain Member States, e.g. Belgium and the Netherlands, did not adhere to the arm's length principle when determining transfer prices.[84] Had this report been published in 1999, perhaps we would have had no second fiscal aid wave: the tax arrangements of multinational giants like Apple, whose initial tax ruling dated from 1991, would probably have attracted regulatory scrutiny following public outcry, and the

[83] Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 v. Commission* [2006] EU:C:2006:416.

[84] Simmons & Simmons, 'Administrative Practices in Taxation: A report prepared for the European Commission on Administrative Practices in Taxation likely to affect the location of business in the European Union', London 1999, para 6 (2) (c).

European courts, when seized, would have prevented the current doctrinal uncertainty.

Returning now to the Commission's soft law instruments, apart from its major contribution with the Fiscal Aid Notice of 1998,[85] the Commission assumed a rather passive stance while allowing its hard law initiatives, i.e. its state aid investigations, to do the heavy lifting. Only two of its communications in the 2000s are worth noting.

The first communication is its Communication on Preventing and Combating Corporate and Financial Malpractice, published in 2004.[86] In this communication, the Commission revealed its strategy for reducing the risk of financial and corporate malpractice through coordinated action in the areas financial services, company law, accounting, tax, supervision and enforcement.[87] In the area of taxation, the Commission's proposals revolved around transparency and information exchange, the development of EU-wide definitions of tax fraud and avoidance, the interaction and mutual assistance between national tax authorities and, most ambitiously at the time, a common company identification number for tax purposes.[88] More specifically, as regards information exchange, the Commission proposed possible amendments to the Mutual Assistance

[85] See *infra.*

[86] European Commission, 'Communication on Preventing and Combating Corporate and Financial Malpractice' COM (2004) 611 final.

[87] Commission Press Release, IP/04/1164 (September 30 2004), available at <http://europa.eu/rapid/press-release_IP-04-1164_en.htm?locale=en> accessed 10 April 2020.

[88] Commission Press Release, IP/04/1164 (September 30 2004), available at <http://europa.eu/rapid/press-release_IP-04-1164_en.htm?locale=en> accessed 10 April 2020.

Directive and highlighted the importance of the OECD's work on improving access to bank information for tax purposes. It also suggested that joint investigations in direct tax matters between Member States, coupled with demands for greater transparency when dealing with well-known tax havens, were the way forward.

The second important communication came in 2009, namely the Commission's Communication on Promoting Good Governance in Tax Matters.[89] In this communication, the Commission sought to identify actions that Member States should take in order to promote transparency, exchange of information and fair tax competition, i.e. what the Commission and the ECOFIN[90] called "good governance" in the tax area.[91] The Commission acknowledged that one of globalization's major drawbacks was the free flow of capital to unregulated and opaque tax havens that facilitate tax avoidance, thus putting national budgets under severe strain.[92] This is why the Commission insisted on promoting good governance on as broad a geographical basis as possible, and assumed that, if tax governance is improved within the EU, then third countries would be persuaded to follow suit.[93]

[89] European Commission, 'Promoting Good Governance in Tax Matters' COM (2009) 201 final.

[90] European Commission, 'Promoting Good Governance in Tax Matters' COM (2009) 201 final, p. 5.

[91] Commission Press Release, IP/09/650 (April 28 2009), available at <http://europa.eu/rapid/press-release_IP-09-650_en.htm?locale=en > accessed 10 April 2020.

[92] European Commission, 'Promoting Good Governance in Tax Matters' COM (2009) 201 final, p. 4.

[93] European Commission, 'Promoting Good Governance in Tax Matters' COM (2009) 201 final, p. 13.

The Commission's emphasis on the need for global – not just European – coordination in tax matters clearly echoes the OECD's approach. In fact, the Commission admits that its proposals reflect many of the principles driving the OECD's work against harmful tax practices.[94] One major similarity lies in the fact that the OECD first endeavors to identify and eliminate harmful tax practices in its Member countries and then tries to export its principles to non-OECD states by obtaining political commitments for genuine cooperation in tax matters.[95]

Despite their similarities, the differences between both the *modus operandi* and the particular needs of the EU and the OECD are numerous. That is why the Commission, in the communication's juiciest part, tables its very own proposals for strengthening good tax governance in the EU and abroad. For the purposes of this thesis, five of the Commission's twenty-three proposals appear to be noteworthy.[96] First, the Commission insists that national tax measures should continue to be rigorously assessed under the Code of Conduct for business taxation, with particular emphasis being given to the Code's procedural requirements, namely the rollback and standstill obligations. As regards EU-level agreements with third countries, the Commission appears keen to ensure that third countries commit to establish a tax environment that is as close as possible to the pillars underpinning the EU's (limited) common standards. In this context, it stresses that such agreements should include provisions that are similar to state

[94] European Commission, 'Promoting Good Governance in Tax Matters' COM (2009) 201 final, p. 6.

[95] European Commission, 'Promoting Good Governance in Tax Matters' COM (2009) 201 final, pp. 6-7.

[96] European Commission, 'Promoting Good Governance in Tax Matters' COM (2009) 201 final, pp. 9-13.

aid provisions, rules ensuring transparency and exchange of information, as well as provisions stipulating a coherent policy against harmful tax practices. Finally, the Commission is shrewdly advocating for a greater degree of coordination within the UN, the G20 and the OECD in dealings with uncooperative tax havens, in order to secure more leverage. It is precisely to the OECD's significant initiatives against harmful tax competition that the focus now turns.

C) Early OECD Action

The OECD has been at the forefront of the fight against harmful tax competition since the 1990s. In May 1996, OECD Ministers urged the organization to "develop measures to counter the distorting effects of harmful tax competition on investment and financing decision and the consequences for national tax bases, and report back in 1998."[97] The G7 group of countries endorsed the decision in 1996, urging the OECD to "vigorously pursue its work in this field".[98] Taking advantage of the strong political momentum of the era, in January 1998 the OECD adopted its landmark report entitled "Harmful Tax Competition: An Emerging Global Issue" (hereafter "the Report"),[99] a report that was pivotal in alerting national governments and the general public of tax competition's increasingly detrimental consequences, while also stimulating academic interest into this topic.

The Report is structured in three parts. First, the nature of tax competition as a global phenomenon is recognized, and globalisation's effect on national fiscal laws is accounted for. Second, certain characteristics that serve to identify harmful tax practices, i.e. tax havens and harmful preferential tax regimes, are set out. Third, various recommendations for countering these phenomena are tabled.

[97] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 1.

[98] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 2.

[99] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998).

To begin with, the OECD explicitly endorses the distinction underlying its entire project, namely that preferential tax regimes can be divided into acceptable and harmful tax regimes.[100] It is also quick to accuse the latter of eroding national tax bases, distorting trade and investment decisions and undermining tax systems' fairness.[101] The negative cross-border effects of harmful tax regimes necessitate cross-border coordination: the problem is naturally framed as a collective action problem[102] since no unilateral solution is conceivable to a problem that is "inherently multilateral".[103] This is the reason why the OECD sought to involve as many countries as possible – including non-OECD countries – in the dialogue leading up to the Report:[104] the larger the coalition of States presenting a united front, the greater the effectiveness of any proposed solutions.[105]

In addition to the above conceptual observations, the OECD is quick to recognize the EU's work on harmful tax competition. Although both organisations commenced work at roughly the same time in early 1996, the EU was the first to produce a complete package of measures in 1997 (as analysed *supra*). The OECD notes that the scope and the operation of the Code of Conduct differs from its own

[100] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 4.

[101] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 4.

[102] See Jason Sharman, *Havens in a Storm: The Struggle for Global Tax Regulation*, (Cornell University Press 2006), pp. 1-4.

[103] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 4.

[104] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 13.

[105] Given that there would be fewer "harmfulness-friendly" jurisdictions that businesses can flee to.

Guidelines, but still stresses that the two initiatives are "mutually reinforcing" and "broadly compatible", in particular as regards the harmfulness criteria.[106] The close collaboration of the EU and the OECD, as witnessed today, clearly has its roots in their early joint efforts to curb harmful tax competition.

For the OECD, it is mainly the ever-advancing wave of globalization and technology, coupled with the removal of non-tax obstacles to international trade, that has forced countries to continuously improve their fiscal regimes in order to attract highly mobile capital.[107] Interestingly enough, the report also draws attention to the increasing struggle between multinational companies for dominance on the global stage.[108] This fierce inter-company competition also results in global tax competition between States that wish to lure companies into relocating to an even better fiscal "climate" than the one enjoyed by their competitors.

Whatever its primary cause may be, unlimited global tax competition between States can lead, according to the Report, to numerous undesirable consequences. Patterns of trade and investment are distorted, tax revenues plummet, and the tax burden is shifted to less mobile production factors like labour.[109] Investors in tax havens manage to benefit from their home state's

[106] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 18.

[107] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 21.

[108] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 22.

[109] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 23.

infrastructure and overall public spending without financing it through their own taxes, thus essentially becoming free riders.[110] Still, the OECD acknowledges[111] what one could call the "relativity" of harmfulness, i.e. that a regime can have consequences that are harmful to one state but very beneficial to another. In other words, there really is no objective measure of a regime's harmfulness; at best this is a majoritarian decision, dictated by the perception certain states have about what would best promote global welfare. Still, rather paradoxically, according to the OECD the effects of certain regimes can be so negative that the measures amount to "poaching" other countries' tax bases, thus rendering them doubtlessly harmful.[112] More specifically, this applies to fiscal laws that reduce the effective tax rate on income from mobile activities well below the tax rates in other countries.[113]

The Report does not, however, stop at a general and abstract definition of what a harmful tax regime is. Instead, it provides detailed guidance to assist governments in identifying harmful tax regimes.[114] The necessary starting point for determining a measure's harmfulness is that it allows for no or low effective taxation of relevant income.[115] This reminds us, although it is not exactly the same,

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[110] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 24.

[111] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 27.

[112] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), paras 29-31.

[113] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 30.

[114] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 38. The Report also describes the characteristics of tax havens, i.e. countries with no or nominal taxes, but this category is not particularly relevant for the purposes of this thesis.

[115] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), paras 46 and 59.

of the second gateway condition of the EU Code of Conduct, namely that a tax measure must provide for a significantly lower level of taxation, including zero taxation, than the level generally applicable in the Member State in question. Apart from this initial criterion of no or low effective taxation, the OECD highlights three more criteria that it considers key in assessing a regime's harmful nature. More specifically, the questions that need to be asked are whether the regime is "ring-fenced", whether its operation is non-transparent, and whether the relevant jurisdiction engages in effective information exchange with other countries.[116] These need to be discussed in a bit more detail, along with some other secondary conditions whose fulfillment can serve to reinforce the initial impression of harmfulness. Finally, once a regime is found to be potentially harmful, its economic effects need to be evaluated in order to reach a safe conclusion.[117]

Starting with the four key factors, the condition of no or low effective taxation is the strongest initial indication of a regime's harmfulness. The regime's "ring-fencing" is a second indication of its harmfulness, since the artificial separation from the domestic economy shows that the government wishes to protect its own market from its regime's harmful effects, so that the latter can only erode foreign tax bases.[118] The fact that the country implementing the regime bears little or none of the financial burden of its legislation can further attest to

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[116] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 59.

[117] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 59.

[118] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 62.

the legislation's harmfulness.[119] It should be kept in mind that ring-fencing can take many forms, for instance provisions that restrict preferential treatment to non-residents or deny beneficiaries access to the domestic market.[120]

A regime's lack of transparency is the third key indicator of its harmfulness. A regime will be deemed to be intransparent if e.g. the tax administration does not clearly set out the conditions for the regime's applicability and does not disclose its details to other countries' tax officials.[121] The reason why opaque regimes usually have particularly harmful effects is that they are much more likely to lead to secret tax deals that favour the select few, thus resulting in unequal treatment of taxpayers in similar circumstances.[122] The emphasis the OECD places on this kind of preferential treatment reminds one of the selectivity test in state aid law, where the differential treatment of undertakings that are in a comparable factual and legal situation to others leads to a finding of *prima facie* selectivity. The analogy becomes even more interesting when one compares the OECD's focus on administrative practices with the Commission's perennial worries about administrative discretion that is exercised selectively, worries that erupted into the high-profile investigations of the recent fiscal aid wave. More specifically, the OECD very accurately pinpoints the most harmful practices that opacity gives birth to, for instance favourable advance tax rulings deviating from statutory

[119] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 62.

[120] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 62.

[121] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 63.

[122] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 63.

provisions and purposefully lax tax audits to companies the government wishes to favour.[123] The Advance Pricing Agreements (APAs) currently under state aid scrutiny, and the unwillingness of Member States to even reveal the identity of the alleged beneficiaries,[124] serve to once again illustrate how often fiscal state aid law[125] overlaps with OECD soft law.[126]

The fourth factor identified by the OECD as a key indicator of a regime's harmfulness is the lack of effective exchange of information. Strict secrecy laws,[127] generous interpretations of "business secrets" or simply a lack of administrative cooperation with other countries hints at a regime's harmfulness.[128] The same holds true for the absence of an annual general audit requirement for companies, the absence of a public register of shareholders etc.[129] This unwillingness to cooperate with other jurisdictions is not only an indication that the relevant regime might be harmful to their interests, but it can also result in their inability

[123] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 63.

[124] Luxembourg only revealed that "FFT" stood for "Fiat Finance & Trade" after the Commission issued an information injunction.

[125] For the Commission's view see paras 170-171 and 174-177 in European Commission, 'Draft Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU' (Communication) COM (2014) <http://ec.europa.eu/competition/consultations/2014_state_aid_notion/draft_guidance_en.pdf> accessed 10 April 2020.

[126] Arguably also with the EU Code of Conduct; see *infra* Chapter 4 on the second fiscal wave for a tentative harmfulness assessment of the measures under state aid scrutiny.

[127] Secrecy laws is also one of the "other" factors cited by the OECD in para 75 of its Report.

[128] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 64.

[129] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 67.

to properly tax companies in their own jurisdiction due to lack of information in relation to their foreign activities.

Apart from the aforementioned four key factors, the Report sets out eight other (secondary) factors that help reinforce the initial conclusion as to the regime's harmfulness. Three of these supplementary factors are particularly noteworthy. First, a regime can allow the artificial definition and reduction of the tax base. For instance, it can allow for the deduction of costs that were never incurred, or go beyond the scope of instruments aimed at avoiding table taxation, in a way that results in double non-taxation.[130] Moreover, a tax authority's failure to adhere to international transfer pricing principles, for example by deviating from the OECD's Transfer Pricing Guidelines, can have harmful effects, when such failure results in the favourable tax assessment of a multinational subsidiary. The Report cites examples[131] of harmfulness which sound very familiar, since they echo many of the Commission's similar concerns in its recent probes, for instance the grant of APAs that do not reflect arm's length prices, the negotiation of relevant transfer pricing benchmarks with taxpayers etc.[132] Finally, a further secondary harmfulness indicator is that a regime encourages purely tax-driven operations or arrangements, in the sense that benefits are granted to taxpayers whose operations involve no substantial activities.[133]

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[130] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 69. This can be compared to the Commission's relevant concerns in the Belgian Excess Profit Tax Rulings case.

[131] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 71.

[132] See, e.g. the Commission's allegation in SA.38373 (2014/C) Alleged aid to Apple [2014] OJ C 3606 final, para 58.

[133] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 79.

After the examination of the aforementioned legal conditions, the OECD also advocates for an assessment of the measures' economic effects before a conclusive decision on their harmfulness is taken. In this context, three questions must be answered in order to ascertain the regime's "character":[134] a) does the tax regime simply shift activity from country to country without creating significant new activity? b) is the regime the main motivation for the choice of location? and c) is the presence and level of activities in the host country commensurate with the amount of investment or income? An affirmative answer to one or more of these questions serves to show that a measure that has, in a sense, been found to be *prima facie* harmful, is conclusively harmful.

Following this quite detailed – especially when compared to the Code of Conduct – description of the criteria for harmfulness, the Report concludes with various recommendations for combating harmful tax competition. Its recommendations are split into three categories, i.e. recommendations concerning domestic legislation, recommendations concerning tax treaties and recommendations for intensification of international cooperation. Still, it is clear that for the OECD it is the last category of recommendations that can really make a difference if implemented. The reason is that a single country is disinclined to take unilateral action against harmful tax competition if it is not certain that its neighbours will follow suit, since it is afraid of losing investment and "bleeding" tax revenues. From a broader point of view, such unilateral action simply leads to

[134] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), paras 80-84.

a relocation of mobile tax activities drawn by harmful tax regimes from one jurisdiction to the next. In the OECD's poetic words, "individual actions do not completely solve the problem; they may merely displace it." [135] Harmful tax competition is always a collective action problem in the eyes of the OECD.

A quick glance at the recommendations' substance reveals many interesting ideas. More specifically, one recommendation - that is of particular relevance today - is for countries that grant advance tax decisions to publish the conditions for obtaining such decisions. This is because the opacity of a tax ruling regime can result in unequal treatment of taxpayers.[136] Another recommendation that is of particular relevance (but not restricted) to countries granting advance tax decisions or assessments is that they strictly follow the OECD's Transfer Pricing Guidelines and do not deviate from them in a way that amounts to harmful tax competition.[137] Moreover, the OECD urges countries to intensify information exchange concerning transactions in tax havens or under harmful tax regimes, including individual tax rulings,[138] and to also review bank secrecy laws impeding access to necessary tax data.[139]Furthermore, the OECD committed to prepare a list of jurisdictions that could be classified as tax havens based on the report's

[135] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 138.

[136] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), paras 108-109.

[137] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 111.

[138] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), paras 114-116.

[139] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 112.

criteria.[140] Finally, it provided a set of guidelines for OECD countries to identify and eliminate the harmful features of their regimes.

In 2000, the OECD published a report documenting the progress that had been made in identifying and eliminating harmful tax practices.[141] In that report, it summarized the results achieved in three areas, namely in the identification of potentially harmful regimes and tax haven jurisdictions based on the previous report's criteria, and in the work that had taken place between the OECD and non-member countries.[142] In the area of harmful preferential regimes, the OECD Committee on Fiscal Affairs had endorsed the development of guidance on the application of the previous report's harmfulness criteria to regimes found to be potentially harmful.[143] The Forum on Harmful Tax Practices, a subsidiary body of the Committee, promised to develop these guidance notes in order to help OECD countries determine whether their *prima facie* harmful regimes are conclusively harmful and how they can be amended.[144] Still, the OECD had in the meantime proceeded with its own assessment by identifying forty-seven potentially harmful

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[140] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publications, 1998), para 149-151.

[141] OECD, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices* (OECD Publications, 2000).

[142] OECD, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices* (OECD Publications, 2000), p. 6.

[143] OECD, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices* (OECD Publications, 2000), p. 6.

[144] OECD, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices* (OECD Publications, 2000), p. 6.

tax regimes.[145] However, it made it clear that its evaluation was "dynamic", in the sense that it would be regularly updated and subject to change (for better or worse).[146] This way the member countries were reminded that the organization was ever-vigilant. The report concluded with a detailed list of defensive measures that OECD countries could, in coordination with each other, take against uncooperative tax havens, a thinly veiled threat to the latter that illustrates the organisation's practical spirit.[147]

In its 2004 Progress Report,[148] the OECD sought to document the most recent results of its continuous push for further elimination of harmful tax regimes. Following the previous report, every OECD country was asked to self-assess its regimes that had been found to be potentially harmful, as well as any new regimes that it had introduced in the meantime.[149] After this had taken place, a peer review process ensued, with each member country assessing the harmfulness of the others' measures. [150] The Progress Report presents the results

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[145] OECD, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices* (OECD Publications, 2000), pp. 12-14.

[146] OECD, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices* (OECD Publications, 2000), p. 20.

[147] OECD, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs: Progress in Identifying and Eliminating Harmful Tax Practices* (OECD Publications, 2000), pp. 24-26.

[148] OECD, *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (OECD Publications, 2004).

[149] OECD, *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (OECD Publications, 2004),p.6.

[150] OECD, *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (OECD Publications, 2004),p.6.

of these assessments in a very helpful table, which shows that almost all of the measures that were previously found to be potentially harmful were either abolished, amended or found to be non-harmful after further examination[151] - an impressive feat. Still, some measures were amended not because of OECD pressure but because they had also been targeted by the Commission under state aid provisions, most notably the Luxembourg 1929 Holding Companies regime.[152]

Having examined the OECD's work products very closely in Part 3, let us now take a step back. The OECD's early - i.e. before the launch of the BEPS Project - work on harmful tax competition has been relatively successful. Data from the 1990's and early 2000's shows that corporate tax *revenues* in OECD countries did not decline, while corporate tax revenues of non-OECD countries did decline during the same period.[153] However, corporate tax *rates* declined in both developed and developing countries.[154] Developed countries managed to avoid the losing tax revenue by broadening their tax base,[155] but in developing countries the decline in corporate tax rates resulted in an enormous 20% decline in

[151] OECD, *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report* (OECD Publications, 2004),pp. 7-9.

[152] OECD, *The OECD's Project on Harmful Tax Practices: 2006 Update on Progress in Member Countries* (OECD Publications, 2006), p. 4 fn 7.

[153] Reuven S. Avi-Yonah, 'The OECD Harmful Tax Competition Report: A Tenth Anniversary Retrospective' Brook. (2009) 3 J. Int'l L. 783, 783-784.

[154] Michael Keen and Alejandro Simone, 'Is Tax Competition Harming Developing Countries More Than Developed?' (2004) 34 Tax Notes International 1317.

[155] Rachel Griffith and Alexander Klemm, 'What has been the Tax Competition Experience of the Last 20 Years?' (2004) 34 Tax Notes International 1299

corporate tax revenues.[156] A large part of this decline is attributed[157] to the proliferation of tax incentives for multinational companies, thus demonstrating the insidious way in which harmful tax competition can undermine countries' revenues. The "pleasant" takeaway, however, is that there is no data showing that harmful tax competition had a negative effect on OECD countries during the aforementioned period, i.e. when the OECD had started promoting a coordinated response to this phenomenon. In fact, corporate tax revenues in OECD countries had been unusually stable from 1975 until at least 2006, despite a reduction in corporate tax rates.[158] This shows that the tax revenues of OECD countries have largely escaped the generally deleterious effects of harmful tax competition, and one could reasonably assume that the OECD's work in this field played a meaningful role.[159] Apart from the above, another example of effective OECD action was the way in which it managed to persuade countries to commit to offering effective information exchange in the early 2000's. Although in 2000 the OECD published a list with thirty-five jurisdictions that would be classified as "uncooperative tax havens", countries' eagerness to avoid being stigmatized led to a list of only three jurisdictions in 2008.

[156] Michael Keen and Alejandro Simone, 'Is Tax Competition Harming Developing Countries More Than Developed?' (2004) 34 Tax Notes International 1317, 1318 fn 49.

[157] Michael Keen and Alejandro Simone, 'Is Tax Competition Harming Developing Countries More Than Developed?' (2004) 34 Tax Notes International 1317, 1318-1321.

[158] Reuven S. Avi-Yonah, 'The OECD Harmful Tax Competition Report: A Tenth Anniversary Retrospective' Brook. (2009) 3 J. Int'l L. 783, 791.

[159] Reuven S. Avi-Yonah, 'The OECD Harmful Tax Competition Report: A Tenth Anniversary Retrospective' Brook. (2009) 3 J. Int'l L. 783, 791.

Of course, the above achievements, although substantial, are far from a complete victory over tax havens or harmful tax regimes. Progress has been made, but the campaign against harmful tax competition has not wholly fulfilled its goals. Harmful tax measures still exist within the EU and the OECD, and new such measures continue to be introduced: in a way, the fight seems inherently never-ending, at least until radical coordinated action is taken. This is the reason why one of the most important actions of the OECD's celebrated BEPS Project, Action 5, examines the most effective ways of countering harmful tax practices, as analysed in Part 4 *infra*.

D) Recent OECD Action

The early 2010s resembled the late 1990s, in that there was increased momentum, both on the part of the EU and the OECD, to resume and intensify the battle against harmful tax competition. However, it was now the OECD's turn to be the first to produce a package of proposals. In February 2013, the OECD published its landmark 'Base Erosion and Profit Shifting' (BEPS) Report,[160] which identified harmful tax practices as one of the causes of tax base erosion and profit shifting. The OECD also published a "BEPS Action Plan"[161] where one of the main actions branded as essential to combat BEPS was the need to 'counter harmful tax practices more effectively, taking into account transparency and substance',[162] namely BEPS Action 5.

In September 2014, the OECD published an interim report on Action 5,[163] while in October 2015 it released its Final BEPS Report on Action 5, entitled "Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance".[164] In this part, all these OECD initiatives against harmful tax practices and competition will be examined in depth, and in Part 5

[160] OECD, *Addressing Base Erosion and Profit Shifting* (OECD Publications, 2013).

[161] OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publications, 2013).

[162] ibid, p. 18.

[163] OECD, *Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance* (OECD Publications, 2014).

[164] OECD, *Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance, Action 5 – 2015 Final Report* (OECD Publications, 2015).

infra it will become evident that they set the scene for the avalanche of corresponding post-2013 EU law developments.[165] [166]

The birth of the OECD's BEPS project can be traced back to the Los Cabos G20 summit in June 2012 in Mexico. The leaders of the world's twenty major economies, in their joint concluding declaration, *inter alia* stressed 'the need to prevent base erosion and profit shifting'.[167] The die had been cast. The G20 – a group representing approximately 85% of the gross world product, 80% of world trade and two thirds of the world's population – had indicated its willingness to support initiatives against base erosion and profit shifting (BEPS).

Moreover, the G20 asked the OECD to produce a relevant report before the G20's February 2013 meeting in Moscow. Action on the part of the OECD proved to be swift and decisive. In February 2013, the OECD's BEPS Report was published. In it, base erosion was presented as 'a serious risk to tax revenues, tax sovereignty and tax fairness for OECD member countries and non-members alike.'[168] One of the "key pressure areas" identified was the 'availability of harmful preferential

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[165] Certain authors rightly stress that the BEPS strategy 'has its own specific features, which could […] end up, in certain cases, being harmful to the EU itself. See Edoardo Traversa and Allessandra Flamini, 'The Impact of BEPS on the Fight Against Harmful Tax Practices: Risks…and Opportunities for the EU' (2015) British Tax Review 396, 397. See also Wolfgang Schön and Philip Baker, 'The BEPS Action Plan in the light of EU law' (2015) British Tax Review 277.

[166] On the interesting – but not directly relevant here – question of whether the US and the EU are locked into some version of transatlantic competition due to the US stance towards BEPS see Reuven Avi-Yonah and Gianluca Mazzoni, 'BEPS, ATAP, and the New Tax Dialogue: ¿A Transatlantic Competition?' (2018) 46 Intertax 885.

[167] OCED, 'G20 Leaders Declaration' (June 19 2012), available at <http://www.oecd.org/g20/summits/los-cabos/2012-0619-loscabos.pdf> accessed 2 February 2020, point 48.

[168] OECD, *Addressing Base Erosion and Profit Shifting* (OECD Publications, 2013), 5.

regimes',[169] a problem requiring a 'holistic' and 'comprehensive' approach, which should be 'globally supported' and whose solution should rely on an in-depth analysis of all important parameters.[170] The report made it clear that the success of the fight against BEPS depended on the active participation of national governments and stressed that the need to take action was urgent.

Coming to the section of the BEPS report that is most relevant to the subject-matter of this thesis, the OECD reminded stakeholders that it had been reviewing member countries' preferential tax regimes for years, based on its seminal 1998 Report, while the work of its Forum on Harmful Tax Practices (FHTP) had led to the abolition or modification of more than forty potentially harmful tax regimes.[171] Moreover, it highlighted the fact that, since late 2010, its focus had been the review of regimes applying to 'globally mobile activities, such as financial and other service activities, including the provision of intangibles.'[172] Moving forward, the report foreshadowed the general direction that the ensuing BEPS Action Plan would take on this issue, clarifying that the end goal was to find 'solutions to counter harmful regimes more effectively, taking into account factors such as transparency and substance.'[173]

[169] ibid, 6.

[170] ibid, 7-8.

[171] ibid, 83.

[172] ibid, 85.

[173] ibid, 10.

True to its promise, when the OECD published its long-awaited Action Plan in June 2013, Action 5 bore the title included in the quotation marks immediately *supra*.[174] The reasons why preferential regimes remained a key concern if BEPS was to be properly addressed were repeated once more. Without effective control over such regimes, a race to the bottom would 'ultimately drive applicable tax rates on certain mobile sources of income to zero for all countries.'[175] This would occur whether states desired it or not. In other words, without coordinating the exercise of their sovereign taxation rights, their tax sovereignty would diminish. The theme is familiar; as seen in chapter 1, the concept of sovereignty is tricky, and the leitmotif in this area will usually be the emphasis on how pooling sovereignty actually enhances it.

Coming back to the text of the 2013 BEPS Action Plan on Action 5, the "revamp" of the organisation's work against harmful tax practices was based on two pillars. First, increasing transparency, since the opacity of most preferential tax regimes rendered their effective review virtually impossible, and generally reinforced their perception of being harmful.[176] Transparency, in this context, included 'the compulsory spontaneous exchange of rulings related to preferential regimes'.[177] The second pillar was the requirement of "substantial activity" before any undertaking benefited from a preferential regime. No further guidance on

[174] OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publications, 2013), 18.

[175] ibid, 17.

[176] See earlier in this chapter how the lack of transparency influences a measure's harmfulness assessment, both according to the OECD 1998 and the EU's Code of Conduct criteria.

[177] OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publications, 2013), 18.

how these two pillars would actually translate into concrete proposals was provided in the action plan, since the latter more or less amounted to an ambitious sketch, which member countries would need to endorse and support before it could evolve into something more tangible.

The official G20 endorsement did not take long. In September 2013, i.e. two months after the publication of the OECD's Action Plan, the G20 leaders met in Saint Petersburg. In their joint declaration after the end of the summit, the leaders of the world's largest economies emphasised that cross-border tax evasion and avoidance undermine public finances and people's trust in the fairness of the tax system.[178] This was even more imperative in an era of 'severe fiscal consolidation and social hardship'; therefore, the G20 leaders firmly stressed that '[t]ax avoidance, harmful practices and aggressive tax planning have to be tackled.'[179] They then went on to 'fully endorse the ambitious and comprehensive [BEPS] Action Plan', going as far as to christen it the 'G20/OECD BEPS project' and encourage all interested countries to participate.[180] Finally, the leaders promised to take all necessary steps, individually and collectively, in order to tackle BEPS, in the way presented in the Action Plan's 15 relevant Actions.[181]

[178] G20 Leaders Declaration, (September 6 2013), available at <https://www.mofa.go.jp/files/000013928.pdf> accessed 2 February 2020, p 4.

[179] ibid, 12.

[180] ibid.

[181] ibid, 12-13.

The OECD promptly delivered some interim results on Action 5 (Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance). On September 16th 2014, the OECD released several deliverables on seven of the fifteen action points outlined in the 2013 Action Plan, one of which was an interim report on Action 5 (hereafter 'interim report').[182] The report essentially reflected the consensus, as of July 2014, of 44 countries (including all OECD members, OECD accession countries and G20 countries).[183] That consensus, which would be refined through further discussion, was endorsed by G20 Finance Ministers at their meeting held in late September 2014 in Cairns, Australia.

In the context of Action 5, the OECD had tasked its Forum on Harmful Tax Practices (hereafter FHTP) with delivering three outputs. These were a review of member countries' preferential regimes, a strategy to expand participation to non-OECD member countries and a consideration of revisions or additions to the existing framework.[184] The interim report only discussed the first output, since the second and third outputs' due delivery dates were in late 2015.

Concerning the subject-matter of the first output, i.e. the review of existing preferential regimes, the focus was two-fold.[185] First, the FHTP placed renewed

[182] OECD, *Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance* (OECD Publications, 2014).

[183] ibid, 3 & 13.

[184] ibid, 9.

[185] ibid.

emphasis on the elaboration of a methodology to define what the "substantial activity" requirement should mean in practice when assessing a regime's harmfulness, especially intellectual property regimes. Second, the FHTP produced work on ways in which regimes' transparency could be improved, especially through the compulsory spontaneous exchange of rulings related to preferential regimes. [186] Although a framework on improving transparency was actually agreed on by all participants, a conclusive solution on the substantial activity requirement had not been reached at the time of publication of the interim report.[187] In essence, as will become evident, the discussion in the report mainly revolved around IP regimes and tax rulings.[188] The reader need not be reminded that most of the EU Commission's state aid investigations post-2014 concerned tax rulings, and many also involved the calculation of a royalty or another IP-related issue.

Let us pause for a minute and connect the landmark 1998 OECD Report on the emergence of harmful tax competition as a global issue to the OECD's 2014 interim report under scrutiny. The importance of not allowing internationally mobile capital to drive down tax rates had only grown in the sixteen years separating the reports, as globalization and technological innovation enhanced cross-border capital mobility.[189] Thus, the shift of the tax burden to less mobile

[186] ibid.

[187] ibid, 10.

[188] ibid, 4.

[189] ibid, 13.

tax bases, such as labour, had experienced a corresponding increase. The OECD's theoretical justification – the initiative's underpinnings – remained unchanged: its Action Plan all about shielding 'effective fiscal sovereignty' from multinationals' corrosive influence, even though tax harmonisation was (explicitly) not an OECD goal,[190] clearly falling outside the organisation's mandate.

While the justifications underlying the "demonization" of harmful tax regimes were similar, the emphasis of the OECD (and its FHTP) post-BEPS was on refining, clarifying, and in practice redefining the criteria based on which a state measure's harmfulness is assessed. As the reader will recall from the detailed analysis undertaken in the immediately preceding section, i.e. Chapter 2 (3) of this thesis, the 1998 Report employed twelve factors enabling the FHTP to discern a regime's "character", namely four key factors and eight "other", complementary factors. For the purposes of this section, two of these factors are relevant, i.e. a tax regime's lack of transparency (3rd "key" factor) and the encouragement of purely artificial arrangements involving no substantial activities (8th "other" factor). In a nutshell, the quintessence of Action 5, i.e. of the OECD's post-BEPS revamp of its fight against harmful tax practices, was the redefinition and elaboration of the transparency and substantial activity requirements (hence the explicit mention of "transparency and substance" in the very title of Action 5). It is, thus, no surprise that the OECD's 2014 interim report on Action 5 also revolved around these two pillars.

[190] ibid, 14.

As regards the substantial activity requirement, the 1998 Report discussed how 'many harmful preferential tax regimes are designed in a way that allows taxpayers to derive benefits from the regime while engaging in operations that are purely tax-driven and involve no substantial activities'.[191] However, detailed guidance as regards this criterion was missing in 1998, which is understandable given that it was not one of the key factors identified in the report.

This vacuum was filled by the 2014 interim report, signaling the elevation of the substantial activity requirement to a key factor when assessing a regime's potential harmfulness. Pinning down the precise content of this requirement proved to be a conundrum. The Forum decided to start by devising a test that would make sense in the context of IP regimes, both because existing intangible regimes had not previously been reviewed and because income from intangibles is particularly mobile and is frequently used to minimise corporate tax liability.[192] However, at the time of publication of the interim report (September 2014), member countries had been unable to reach consensus on the most suitable approach to demanding substantial activities in an IP regime.[193] Without going into too much detail, three approaches were considered by the FHTP, namely the value creation approach, the transfer pricing approach and the nexus approach.[194]

[191] ibid, 27.

[192] ibid, 28.

[193] ibid.

[194] ibid, 28-29.

Only the nexus approach will be analysed here, since the FHTP ended up focusing on that approach, and the ensuing debates concerned the details of its application.[195] In accordance with the nexus approach, an IP regime will not be harmful if the tax benefits it provides are 'conditional on the extent of R&D activities of taxpayers' receiving said benefits.[196] In essence, this approach links tax benefits to actually incurred IP expenditures, so that only companies involved in R&D activities avail themselves of the tax reductions. In other words, expenditures 'act as a proxy for substantial activities.'[197] The end result is that the 'proportion of income that may benefit from an IP tax regime is the same proportion as that between qualifying expenditures and overall expenditures.'[198] The taxpayer is, consequently, only allowed to benefit from a preferential rate on IP-related income to the extent that the latter was generated by qualifying expenditures. The report goes on to explain how the nexus approach would work in practice, while reiterating that agreement had not yet been reached on the type of nexus approach that would preferable as a harmfulness condition.[199]

Once an approach was agreed on, it would first be applied to member countries' IP regimes.[200] Lastly, the substantial activity requirement would need

[195] For a more detailed analysis of the three approaches, see António Carlos dos Santos, 'What Is Substantial Economic Activity for Tax Purposes in the Context of the European Union and the OECD Initiatives Against Harmful Tax Competition?' (2015) 3 EC Tax Review 166, 171 et seq.

[196] ibid, 29.

[197] ibid.

[198] ibid.

[199] ibid, 29-35.

[200] For more on, inter alia, how the OECD refers to the nexus rule 'as a proxy for economic allegiance' see Ana Paula Dourado, 'In Search of an International Tax System in a Post-BEPS Tax Competition Setting' (2019) 47 Intertax 2.

to eventually be rediscussed and perhaps articulated differently by the FHTP, so that it can be used to review all preferential regimes, apart from IP regimes.[201]

The interim report's focus then shifts to transparency, which has been a key harmfulness factor since 1998. The importance of transparency in the context of harmfulness is self-evident: without the details of a regime or its application being publicly available, States can easily confer advantages on specific taxpayers, while it is harder for other countries to take defensive measures.

The interim report identified two types of opacity. First, a regime might be opaque in the way in which it is designed and administered. Second, national provisions might promote secrecy or hinder the effective exchange of information.[202] It is noted that 'transparency is often relevant in connection with rulings';[203] this is the reason why Action 5 of the BEPS project explicitly referred to compulsory spontaneous exchange of information on rulings related to preferential regimes. This means that the exchange of relevant information must happen on the issuing state's own initiative and is obligatory.[204]

Following the aforementioned guidelines, the FHTP committed to two deliverables: developing a framework for compulsory spontaneous information

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[201] ibid, 63.

[202] ibid, 35.

[203] ibid.

[204] ibid, 36.

exchange on rulings and applying said framework to member and associate countries' preferential regimes.[205] The FHTP "promised" to begin applying the framework almost immediately: countries had until the end of 2014 to begin taking steps in the appropriate direction, while continued lack of the necessary legal framework would result in the new, elaborated transparency factor being triggered.[206]

The work of the OECD on Action 5, as presented in its September 2014 interim report, was endorsed by the G20 Finance Ministers and Central Bank Governors at their meeting in Cairns in late September 2014. In their declaration, they stressed their commitment 'to a global response to cross-border tax avoidance' and welcomed 'the significant progress achieved towards the completion of [the] two-year G20/OECD Based Erosion and Profit Shifting (BEPS) Action Plan'.[207] In his report to the G20 Leaders, OECD Secretary-General Angel Gurria highlighted how the 2014 deliverables demonstrated 'strong progress towards the commitment of leaders to reform the international tax rules.'[208] These actions, including Action 5 obviously, would in the OECD's view 'bring substantial benefits to both developed and developing countries' by restoring the coherence of the international corporate tax system, improving transparency and

[205] ibid.

[206] ibid, 49.

[207] G20 Information Centre, 'Communiqué - Meeting of G20 Finance Ministers and Central Bank Governors' (2014), available at <http://www.g20.utoronto.ca/2014/2014-0921-finance.html> accessed 2 February 2020, para 8.

[208] OECD Secretary-General Report to G20 Leaders, (November 2014), available at <https://www.oecd.org/tax/transparency/OECD-secretary-general-report-tax-matters-brisbane-november-2014.pdf> accessed 2 February 2020, 7.

realigning taxation with economic activity.[209] He then went on to make a somewhat impassioned plea to G20 leaders, by reminding them how their 'committed leadership' is required to 'successfully complete the OECD/G20 BEPS Project' and present 'a holistic package' by the end of 2015.[210]

The goal was achieved on time, and part of the package delivered included the Final Report on Action 5. However, before perusing it, we need to briefly mention the key agreement that allowed the Action 5 Report to be finalised. As the reader will recall, in the interim report of 2014 no consensus existed on the adoption of a nexus approach, since there was disagreement among the stakeholders. The deadlock was broken on February 6th 2015, when the OECD's headquarters emitted white smoke and tax lawyers the world around cried "habemus nexus"! On that date, the OECD announced that an agreement had been reached on a modified nexus approach for IP regimes.[211] In a nutshell, the UK and Germany put forward a proposal which was eventually endorsed by all OECD and G20 countries. This proposal, hereafter called "the agreed approach", built on the nexus approach as presented earlier in this chapter, with some amendments being made in order for all stakeholders to give their blessing. For instance, it was agreed that it would be possible to increase qualifying expenditures by 30% in some instances.[212] Countries employing IP regimes that were inconsistent with

[209] ibid.

[210] ibid.

[211] OECD, *Action 5: Agreement on Modified Nexus Approach for IP Regimes* (OECD Publications, 2015).

[212] For a snapshot of the agreement, please see OECD, *Explanatory Paper - Agreement on Modified Nexus Approach for IP Regimes* (OECD Publications, 2015).

the new "agreed approach" would need to disallow new entrants from June 30th 2016 onwards and the entire scheme would need to be abolished five years after that date. Still, the OECD acknowledged that even though the deadlock on this critical issue had been broken, more work was needed before detailed guidance could be developed in time for its inclusion into the Final Action 5 Report.

The final Report on Action 5 was published on October 5th 2015.[213] This is now the cornerstone of the OECD's work on Harmful Tax Practices and is on a par, as a matter of significance, with the 1998 Report that first tackled harmful tax competition and brought this debate into the new millennium. The final Action 5 Report "absorbed" and consolidated all previous BEPS work on this subject[214] and superseded the 2014 interim report.[215] It is, therefore, a "master document" of sorts within the framework of the OECD's campaign against harmful tax practices/competition.[216]

The pillars remained the same in the final report as they had been since 2013: the substantial activity requirement (read, mainly, "nexus approach") and need for transparency (read "exchange of tax rulings' information") dominated the discussion. An interesting add-on was the conclusion of the review of 43

[213] OECD, *Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance, Action 5 – 2015 Final Report* (OECD Publications, 2015).

[214] ibid, 3.

[215] ibid, 9.

[216] See also the comments of Irene Burgers, 'Tax Incentives, Global Tax Fairness and the Development of Tax Law in Developed and Developing Countries: A Multi-Way Flow of Concepts' in Dennis Weber (ed.) EU Law and the Building of Global Supranational Tax Law (IBFD 2017) 61-69.

preferential regimes, 16 of which were IP regimes, and the publication of the findings. As we will see, they were far from promising.

Starting with the substantial activity requirement, the final report confirmed that it had been elevated in importance and was on an equal footing with the four pre-existing key criteria harmfulness criteria of the 1998 report.[217] In the context of IP regimes, the modified nexus approach (i.e. the "agreed approach") was considered the best way forward. This is because it was concluded that it struck the appropriate balance between the various conflicting interest and rights, e.g. the freedom of a country to promote research and development and the potential of IP income to raise base-eroding concerns.[218] The gist of the nexus approach remained the same, namely the availability of tax benefits being conditional on the extent of relevant R&D activities. However, more detailed guidance on the application of the nexus approach was naturally provided in the final report, for instance on qualifying taxpayers and expenditures, IP assets etc. The report then provided some examples on how the approach would be applied to real-life examples. Finally, as regards grandfathering, the report strictly repeated that no new entrants would be permitted to harmful IP regimes post-June 2016.[219]

[217] OECD, *Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance, Action 5 – 2015 Final Report* (OECD Publications, 2015), 23.

[218] ibid, 24.

[219] ibid, 34.

Moving on to the substantial activity requirement in the context of non-IP regimes, the OECD admitted that their variety is such that only a category-by-category analysis would be practical; no clear common threads existed, as in the case of IP regimes. The categories covered were many, including holding company regimes, headquarters regimes, financing/leasing/banking regimes.[220] It is worth noting that all such regimes have been targeted by the Commission in its two fiscal aid waves, as will be shown in Chapters 3 and 4 of this thesis. Despite the differences among the aforementioned categories, the overarching principle for non-IP regimes remained the same as in the nexus approach for IP regimes: they 'would only be found to meet the substantial activity requirement if they also granted benefits only to […] taxpayers [which] undertook the core income generating activities required to produce the type of business income covered by the preferential regime.'[221] Thus, when applied to such regimes, the substantial activity requirement should 'also establish a link between the income qualifying for benefits and the core activities necessary to earn the income.'[222] However, determining which activities are necessary, in that sense, ultimately depends on the type of the regime, i.e. it is a category-by-category issue, on which the report offers detailed guidance.

Moving on to the second priority of the final report, viz. the improvement of transparency, it is worth once again remembering that this subject is, in a sense,

[220] ibid, 43.

[221] ibid, 37.

[222] ibid.

perennially topical. Ruling regimes and their alleged opacity have been in the OECD's crosshairs since its 1998 Report.[223] This is because ruling regimes can enhance administrative discretion and promote secrecy when it comes to attracting internationally mobile capital.

For these reasons, the OECD asked its Forum on Harmful Tax Practices to take the work on transparency forward in three directions. First, the development of a framework for compulsory spontaneous information exchange on rulings. This had already been mentioned in relation to the 2014 interim report, but the framework was modified in the lead-up to the publication of the final report.[224] Second, the FHTP considered whether transparency can be further improved and perceived more broadly. [225] Third, the Forum developed a "best practices" framework for the 'design and operation' of ruling regimes.[226] The framework was constructed with the aim of balancing BEPS-related concerns and the avoidance of unnecessary administrative burdens.[227]

Delving deeper into the actual framework itself, the report deals with several issues, including, inter alia, which rulings are covered by the obligation, what kind of information is subject to exchange and other practical

[223] ibid, 46.

[224] ibid, 45.

[225] ibid.

[226] ibid, 46.

[227] ibid.

implementation issues.[228] Going into a great amount of detail here would be impossible, but it is worth quoting some of the report's dicta, especially those relating to the definition of a ruling and the issuing process, since such issues frequently arise in practice, and are not infrequently found in the Commission's state aid investigations.

To begin with, rulings are defined as 'any advice, information or undertaking provided by a tax authority to a specific taxpayer or group of taxpayers concerning their tax situation and on which they are entitled to rely.'[229] It is evident that this definition is strikingly broad, but the obligation to exchange only applies to taxpayer-specific rulings. As regards the more specific subcategory of advance tax rulings, they are 'specific to an individual taxpayer and provide a determination of the tax consequences of a proposed transaction on which the particular taxpayer is entitled to rely.'[230] This also includes informal rulings. Furthermore, advance pricing arrangements (APAs), whose relevance will become apparent in the context of the analysis of the Commission's recent state aid investigations, are arrangements that determine 'in advance of controlled transactions, an appropriate set of criteria […] for the determination of the transfer pricing for those transactions over a fixed period of time.'[231] APAs are differentiated from other categories of rulings by reason of two attributes peculiar

[228] ibid, 47.

[229] ibid.

[230] ibid.

[231] ibid, 48.

to them: factual assumptions made by the taxpayers must be rigorously verified and continuous monitoring of their ongoing validity needs to take place.[232]

Proceeding to the final report's recommendations on best practices and the process of granting rulings, several important pieces of "advice" are worth keeping in mind. First, the rules and procedures for issuing rulings need to be identified in advance and published; they have to remain within the limits of the law (and acceptable administrative discretion); they need to be issued in writing; at least two officials need to be involved in the decision; and they need to be issued only for a fixed period of time and be subject to review before being extended.[233] Again, as we will see in Chapter 4 of this thesis, many EU Member States, according to the Commission's accusations, did not fully comply with these conditions.

The last substantive part of the final 2015 report on Action 5 concerned the review of countries' potentially harmful regimes. IP regimes were assessed in light of the newly elaborated substantial activity factor, viz. the modified nexus approach.[234] On the contrary, non-IP regimes had only been assessed in light of the old criteria by the drafting of the report, and they were either found not to be harmful or were amended. As regards IP regimes, none of the sixteen regimes was found to comply with the nexus approach, a finding reflecting the fact that this

[232] ibid.

[233] ibid, 56-57.

[234] ibid, 61.

approach was new and the regimes had been designed earlier in time.[235] Countries with such regimes were asked to amend them or face the consequences.

The report concluded by foreshadowing the OECD's next steps in the fight against harmful tax practices/competition.[236] The review and monitoring of regimes would continue, third countries would be asked to participate and revisions or additions to the harmfulness criteria would be considered.[237] The last step was by far the most interesting one. In essence, the OECD warned member countries that, following the refinement (in truth, redefinition) of two of the harmfulness criteria (substance and transparency), two more factors could be ripe for "elaboration". These were the fifth factor set out in the 1998 report, i.e. the artificial definition of the tax base, and the key "ring-fencing" factor of the 1998 report, applying where a regime implicitly or explicitly excludes resident taxpayers from benefiting or prevents the beneficiaries from operating in the domestic market.[238] With that parting shot, the OECD's cornerstone was firmly set on the international stage: BEPS Action 5 was complete.

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[235] ibid, 63.

[236] Whether the OECD succeeded in providing clearer guidance on whether some regimes "alter" tax competition is up for debate; see Professor Pistone's views in Laura Allevi and Chiara Celesti, '10th GREIT Annual Conference' (2016) 44 Intertax 70, 89.

[237] OECD, *Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance, Action 5 – 2015 Final Report* (OECD Publications, 2015), 67.

[238] ibid, 69.

The now completed BEPS package was strongly endorsed by G20 leaders in their Antalya summit in November 2015.[239] The G20's leadership reiterated that '[w]idespread and consistent implementation' was critical if the project was to be effective, and urged countries to participate.[240] It was stressed that progress was being made in order to enhance tax systems' transparency, and all relevant prior commitments made by aforesaid leaders were reaffirmed.[241]

The BEPS project having been completed, including Action 5 on Harmful Tax Practices, the OECD's focus shifted to the crucial next step, i.e. its actual implementation. In February 2016, the OECD published a report by its Secretary-General to the G20 Finance Ministers.[242] In that report, Secretary-General Gurria called the delivery of the BEPS package 'a high-point in the OECD-G20 partnership to deliver an important and impactful progress on critical international tax issues', noting that moving into the implementation phase heralded 'an exciting new era'.[243] The report concerned the latter's progress, as well as the development of an 'inclusive framework with the involvement of interested non-G20 countries and jurisdictions on an equal footing'.[244] As regards the implementation of BEPS,

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[239] For arguments on how 'the BEPS project represents no topical or substantive innovation' apart from its elements 'relating to participation, scope and form of application' see Pablo A. Hernández González-Barreda, 'Historical Analysis of the BEPS Action Plan: Old Acquaintances, New Friends and the Need for a New Approach' (2018) 46 Intertax 278, 279 & 292 respectively.

[240] G20 Leaders' Communiqué, Antalya Summit (November 16 2015), available at <https://www.mofa.go.jp/files/000111117.pdf > accessed 2 February 2020, para 15.

[241] ibid.

[242] OECD Secretary-General Report to G20 Leaders, (February 2016), available at <https://www.oecd.org/g20/topics/taxation/oecd-secretary-general-tax-report-g20-finance-ministers-february-2016.PDF> accessed 2 February 2020.

[243] ibid, 10.

[244] ibid, 5.

the Secretary-General dithyrambically stated that it had already begun, and thus the 'BEPS package, delivered under the G20's leadership, [was] already becoming reality.'[245] By the time of the report, i.e. late February 2016, many countries had implemented several BEPS measures, including for instance transfer pricing rules' updates and country-by-country reporting. Most importantly, the EU had, in January 2016, launched its Anti-Tax Avoidance Package, aimed at the smooth implementation of BEPS across EU Member States.[246] As regards the aforementioned inclusive framework, it is noteworthy that it would primarily focus on the review of the implementation of four BEPS minimum standards, one of which concerns harmful tax practices, the leitmotif of this doctoral thesis.[247] Clearly, the fight against harmful tax practices and competition maintains its place at the top of the OECD's international tax agenda.

In February 2017, the OECD published its peer review documents on Action 5.[248] Every one of the four BEPS minimum standards is subject to peer review, and Action 5 is no exception, its peer review being undertaken by the Forum on Harmful Tax Practices.[249] The review mentions both aspects of Action 5, namely the harmfulness of preferential tax regimes and the tax rulings' transparency framework,[250] but only focuses on the latter. The peer review

[245] ibid, 8.

[246] ibid.

[247] ibid, 9.

[248] OECD, *BEPS Action 5 on Harmful Tax Practices: Transparency Framework Peer Review Document* (OECD Publications, 2017).

[249] ibid, 7.

[250] ibid, 9.

evaluates the implementation of this minimum standard against certain agreed criteria: the peer review document of February 2017 set out the terms of reference and the methodology the FHTP would follow.[251]

More specifically, the terms of reference for the conduct of the peer reviews of the Action 5 transparency framework concern the information gathering process, the compulsory spontaneous exchange of information on tax rulings, the confidentiality of relevant information and the collection of statistical data by national authorities.[252] As regards the methodology and the relevant timeline, suffice it to note that the final 2015 BEPS report mandated an annual review of jurisdictions' compliance with the transparency framework, starting in 2017.[253] This annual review will be provided, in the form of a report, to the inclusive framework by the FHTP, and the inclusive framework may produce a progress report for publication, not including the questionnaire responses from peers or from the reviewed jurisdiction, which should remain confidential.[254]

The inclusive framework published the first progress report on Action 5 and preferential regimes in November 2017.[255] By way of reminder, the OECD, by creating the inclusive framework shortly after the release of the final 2015

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[251] ibid, 7.

[252] ibid, 11.

[253] ibid, 16.

[254] ibid, 20.

[255] OECD, *Harmful Tax Practices: 2017 Progress Report on Preferential Regimes* (OECD Publications, 2017).

reports, placed 'all interested and committed countries and jurisdictions on an equal footing in the Committee on Fiscal Affairs and all its subsidiary bodies.'[256] The FHTP operates under the auspices of the inclusive framework and reviews compliance with the BEPS Action 5 minimum standard. The goal of the November 2017 progress report was to present the results of FHTP's review of 164 preferential regimes, i.e. its conclusions on their "harmfulness" under the Action 5 criteria (ringfencing, substantial activities etc…).[257] The OECD's conclusion was that the 'standard on harmful tax practices is now a truly global standard' and that the 'outcomes of the work on Action 5 have tangible impacts on tax planning.'[258] Without going into too much detail, the progress report presented the FHTP's updated assessment of regimes reviewed in the 2015 BEPS Final Action 5 report, but also its assessment of new regimes introduced after October 2015.[259] Finally, it included the OECD–prescribed timelines for implementing the nexus approach, its guidance on closing off/grandfathering harmful regimes and its approach to the assessment of the "substantial activities requirement" in relation to non-IP regimes, e.g. holding company or shipping regimes.[260]

In February 2018, the Inclusive Framework approved certain updates to the FHTP's results for preferential regime reviews, signaling its unremitting

[256] ibid, 3-4.

[257] ibid, 11.

[258] ibid, 9.

[259] ibid, 15 et seq.

[260] ibid, Annexes A, B & D.

determination to closely monitor this field.[261] In May 2018, further updated results on the same topic were released by the Inclusive Framework, bringing the total of assessed regimes to 175 regimes in over 50 jurisdictions.[262] However, the most important development came in November 2018, when the OECD announced its move to strengthen the level-playing field in relation to zero tax jurisdictions.[263] After striking an optimistic tone by stating that international efforts to curb harmful tax practices were 'having a tangible impact worldwide', it admitted that 'it is essential to ensure that business activity does not simply relocate to a zero tax jurisdiction in order to avoid the substance requirements.'[264] This would trigger second thoughts in all jurisdictions that chose to comply with BEPS and suddenly see mobile capital relocate to zero tax jurisdictions. To prevent such developments and the consequent unravelling of the BEPS project, the OECD vowed to 'ensure that substantial activities [are] performed in respect of the same types of mobile business activities, regardless of whether they take place in a preferential regime or in a no or only nominal tax jurisdiction', in the words of Saint Amans, director of the OECD Centre for Tax Policy and Administration.[265]

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[261] OECD Press Release, (February 8 2018), available at <http://www.oecd.org/tax/beps/oecd-announces-further-developments-in-beps-implementation-february-2018.htm>, accessed 10 March 2020.

[262] OECD Press Release, (May 17 2018), available at <http://www.oecd.org/tax/beps/oecd-releases-decisions-on-11-preferential-regimes-of-beps-inclusive-framework-members.htm>, accessed 10 March 2020.

[263] OECD Press Release, (November 15 2018), available at <http://www.oecd.org/tax/beps/oecd-releases-latest-results-on-preferential-regimes-and-moves-to-strengthen-the-level-playing-field-with-zero-tax-jurisdictions.htm>, accessed 10 March 2020.

[264] ibid.

[265] ibid.

The OECD's press release was accompanied by a 20-page long report which elaborated on the background to this issue and the appropriate way forward.[266] More specifically, the initial 1998 OECD report on harmful tax competition had collectively referred to certain no or only nominal tax jurisdictions and harmful preferential regimes as "harmful tax practices",[267] even though the two are clearly distinct.[268] Moreover, it transpires that, since 2001, the FHTP had in practice not used the substantial activities criterion to assess the harmfulness of preferential regimes and had also not focused much on no or only nominal tax jurisdictions.[269] This meant that, in practice, before the launch of the BEPS project, the substantial activities requirement was not 'a decisive factor for identifying and eliminating, harmful tax practices' i.e. neither preferential regimes nor no tax jurisdictions.[270] For preferential regimes, as we have already examined in great detail, this all changed with BEPS and, inter alia, the nexus approach. What the report of November 2018 thus sought to achieve was to address this potential incoherence and clarify how the substantial activities would also apply to no or only nominal tax jurisdictions. Those are defined as jurisdictions that do not impose a corporate income tax or simply impose a nominal tax to avoid the OECD's requirements.[271]

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[266] OECD, *Resumption of Application of Substantial Activities Factor to No or Only Nominal Tax Jurisdictions* (OECD Publications, 2018).

[267] On the similarly nebulous concept of aggressive tax planning see José Manuel Calderón Carrero and Alberto Quintas Seara, 'The Concept of 'Aggressive Tax Planning' Launched by the OECD and the EU Commission in the BEPS Era: Redefining the Border Between Legitimate and Illegitimate Tax Planning' (2016) 44 Intertax 206, 209 et seq.

[268] ibid, 9.

[269] ibid, 10.

[270] ibid.

[271] ibid, 11.

The report then goes on to provide detailed guidance, which divided activities into activities earning non-IP income and activities for the exploitation of IP assets, but further analysis of this guidance falls outside the scope of this thesis.[272]

In its final press release for 2018, the OECD announced that transparency on tax rulings had increased significantly and that the peer review process had proven to be effective, with 60% of recommendations issued having been successfully addressed in the time span of just one year.[273] The OECD's work in this area is still ongoing.

[272] ibid, 11 et seq.

[273] OECD Press Release, (December 13 2018), available at <http://www.oecd.org/tax/beps/transparency-on-tax-rulings-significantly-increased-according-to-oecd-peer-reviews-on-beps-action-5-minimum-standard.htm>, accessed 10 March 2020.

E) Recent EU Action

On June 27th 2012, just ten days after the G20 Los Cabos meeting, which in the previous section of this chapter was singled out as the beginning of the OECD's campaign that culminated with BEPS, the European Commission released a Communication on 'concrete ways to reinforce the fight against tax fraud and tax evasion'.[274] In this Communication, the Commission stressed how tax fraud and evasion were hindering Member States' ability to raise tax revenue and design their own fiscal/economic policy, even though the ongoing crisis had rendered the conduct of fiscal policy more crucial than ever.[275] The Commission, however, went further, by framing the issue as not just one of tax revenue, but also of fairness. During turbulent times 'honest taxpayers should not suffer additional tax increases to make up for revenue losses incurred due to tax fraudsters and evaders.'[276] Moreover, globalization and technological advancements had made Member States' tax authorities more independent and reinforced the need for joint action.[277]

Still, the Commission cautioned that cross-border cooperation between tax authorities could only be effective if there was 'mutual trust and solidarity

[274] European Commission, 'Communication from the Commission to the European Parliament and the Council: On Concrete Ways to Reinforce the Fight Against Tax Fraud and Tax Evasion Including in Relation to Third Countries' COM (2012) 351 final.

[275] ibid, 2.

[276] ibid, 3.

[277] ibid.

between Member States.'[278] [279] This would enable them to take collective action to address tax fraud and evasion. Some concrete steps were sketched out by the Commission, e.g. the strengthening of existing legal instruments and the enhancement of information exchange. This, as will be seen in the pages that follow, would prove to be an accurate foreshadowing of EU law developments in the tax arena. Being encouraged by the European Council, the Commission promised to identify concrete actions to fight tax fraud and evasion, and agreed to publish a relevant Action Plan before the end of 2012.[280]

This promise was not broken. In fact, the Commission "over-delivered". On December 6th 2012, it published two tax –related soft-law instruments, viz. an Action Plan to strengthen the fight against tax fraud and tax evasion[281] and a recommendation on aggressive tax planning.[282]

Starting with the Action Plan, the Commission presented the initiatives it had already taken since June 2012 and the ones it was planning for the future. This

[278] ibid, 6.

[279] It is worth noting that "mutual trust" is very much a "favourite" phrase of the EU Court of Justice; see e.g. Case C-327/18 PPU EU:C:2018:733 and Opinion 1/17 CETA EU:C:2019:341, para 128. Emphasis on mutual trust is obviously a preoccupation of the ECJ's President too; see several of his published articles, e.g. Koen Lenaerts, 'Upholding the Rule of Law through Judicial Dialogue' (2019) 38 Yearbook of European Law 3.

[280] European Commission, 'Communication from the Commission to the European Parliament and the Council: On Concrete Ways to Reinforce the Fight Against Tax Fraud and Tax Evasion Including in Relation to Third Countries' COM (2012) 351 final, 12-13.

[281] European Commission, 'Communication from the Commission to the European Parliament and the Council: An Action Plan to Strengthen the Fight Against Tax Fraud and Tax Evasion' COM (2012) 722 final.

[282] European Commission, 'Recommendation of 6.12.2012 on Aggressive Tax Planning' COM (2012) 8806 final.

plan, in the Commission's own words, represented 'a general contribution to the wider international debate on taxation and [was] aimed at assisting the G20 and the G8 in its ongoing work in this field'.[283] Member States and stakeholders were consulted on the contents of the Action Plan, and their strong preference was to prioritise ongoing legislative initiatives and ameliorate the use of existing instruments. Due to the cross-border dimension of tax fraud and evasion, administrative cooperation was identified as a 'key objective of the Commission's strategy in this area.'[284] More specifically, the Action Plan mentioned Council Directive 2011/16/EU of February 2011 on administrative cooperation in the field of taxation[285] and discussed how Member States should fully and effectively implement it by engaging in enhanced exchange of information. As regards the future, the Commission presented several new initiatives, most notably a recommendation on aggressive tax planning (which will be briefly analysed *infra*) and, crucially, 'improvements in the area of harmful business taxation and related areas'.[286]

Zooming in on the Commission's recommendations in relation to harmful tax competition, the guardian of the Treaties was vocal in highlighting 'the urgent

[283] European Commission, 'Communication from the Commission to the European Parliament and the Council: An Action Plan to Strengthen the Fight Against Tax Fraud and Tax Evasion' COM (2012) 722 final, 15.

[284] ibid, 3.

[285] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC (OJ L 64 of 11.3.2011, p. 1).

[286] European Commission, 'Communication from the Commission to the European Parliament and the Council: An Action Plan to Strengthen the Fight Against Tax Fraud and Tax Evasion' COM (2012) 722 final, 7.

need for a new impetus to be given to the work that is currently discussed in the context of the Code of Conduct for business taxation'.[287] The Commission did not hold back in its assessment of the Primarolo Group's functioning. It noted how 'making progress and achieving tangible results in the Code of Conduct Group […] ha[d] become increasingly difficult.'[288] Furthermore, the Commission in effect asked Member States to start acting in a way that furthered the Group's original goals, or else it would be forced to propose legislative solutions, e.g. in relation to hybrid mismatches. Still, contrary to the stance it would come to adopt three years later in its 2015 Transparency package, the Commission did not recommend a review of the Code's harmfulness criteria, nor did it make any concrete proposals as regards the group's inner workings. Finally, on the future initiatives' front, the ones most relevant to the subject-matter of this thesis were the proposals to revise the Parent-Subsidiary Directive, to review anti-abuse provisions in EU legislation and, of course, to promote automatic information exchange. More on these three ideas later on in this section.

Let us now take a quick look at the Commission's recommendation on aggressive tax planning, which was also published on December 6th 2012.[289] The recommendation is only five pages long, but it is an important statement of intent. The timing was not accidental. In the midst of the financial and economic crisis, with Member States overtaxing their citizens, some corporations seemed to

[287] ibid.

[288] ibid.

[289] European Commission, 'Recommendation of 6.12.2012 on Aggressive Tax Planning' COM (2012) 8806 final.

engage in a form of tax planning considered to be … excessive, thus being labelled "aggressive tax planning". The Commission defined this concept as tax planning which consists in 'taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability.'[290] One of its major downsides is that it can lead to the double non-taxation of income, with Member States being unable to unilaterally combat this. The Commission then drew a link to the proper functioning of the internal market, warning that the latter necessitates a common general approach to aggressive tax planning by all EU States.

The recommendation then encouraged its addressees to ensure that the double tax conventions they had signed only exempt income that is actually taxed elsewhere, and prompted them to insert a catch-all anti-abuse rule in their domestic tax laws, in order to 'counteract aggressive tax planning practices which fall outside the scope of their specific anti-avoidance rules'.[291] As will be seen in this section, both recommendations were taken seriously. However, this soft law document was important because of its symbolism: a gradual tightening of the screw by the European Commission, a decreasing tolerance for tax planning, and perhaps a sense of exasperation at the slow-moving state of EU tax affairs, which would perhaps lead the Union's competition watchdog to the decision to dust off its state aid weapons.

[290] ibid, 2.

[291] ibid, 4.

Before jumping straight into the cataclysmic legislative developments post-2015, it is worth perusing the ECOFIN conclusions of December 2013, i.e. one year after the aforementioned Commission soft law documents. In its conclusions, the Council asked the Code of Conduct Group to analyse the Code's "substantial activities" criterion, which was at the time also being assessed by the OECD in the context of the BEPS project, and which later morphed into the modified nexus approach for IP regimes. Secondly, the Council invited the Group to review all patent boxes in the EU before the end of 2014, against the background of OECD BEPS developments. In other words, already in late 2013, the Member States themselves, not just the Commission, had realised the need for coordinated action in the global tax arena.

However, the initiative that marked a break with the past and heralded the new era of EU tax law-making, in which we still find ourselves today, was the Commission's tax transparency package of early 2015. The Commission announced the launch of this initiative in a press release on February 18th 2015,[292] where it reminded Europeans that President Juncker had made the fight against tax evasion and avoidance 'a top political priority' of his Commission.[293] The College of Commissioners had agreed that it was necessary to ensure that companies are taxed where they perform the activities generating profits and are prevented from engaging in aggressive tax planning to avoid paying their fair share. Tax transparency was thus deemed indispensable. In the words of

[292] Commission Press Release, IP/15/4436 (February 18 2015), available at <http://europa.eu/rapid/press-release_IP-15-4436_en.htm> accessed 30 March 2020.

[293] ibid.

Commission Vice President Dombrovskis, to achieve a 'deeper and fairer internal market' it is imperative 'to establish greater tax transparency and ensure fairer tax competition'.[294] The words of Commisioner Moscovici were even more poetic: 'Abusive tax practices and harmful tax regimes breed in the shadows; transparency and co-operation are their natural foes.'[295]

After announcing that it would publish its tax transparency package in March 2015, the Commission also foreshadowed what would follow soon thereafter, with a second tax package on fair and efficient corporate taxation being planned for June 2015, which would, inter alia, take into account the OECD's BEPS project. Before moving on to the transparency package *per se*, it is worth noting that in the same press release where all the above dicta are to be found, the Commission mentioned its then ongoing fiscal state aid investigations against Ireland, Luxembourg, Belgium and the Netherlands. It is, therefore, obvious, that for the Commission its legislative and executive "hats" are readily interchangeable, and that the use of its exclusive state aid competence serves goals similar to the "packages" it chooses to put forward: positive and negative integration as seen at their best!

The Commission released its tax transparency package on March 18 2015.[296] As will be seen as this subchapter progresses, with this package we enter

[294] ibid.

[295] ibid.

[296] European Commission, 'Communication from the Commission to the European Parliament and the Council on Tax Transparency to Fight Tax Evasion and Avoidance' COM (2015) 135 final.

a new era in relation to legislative EU tax measures, an era when the EU is more active, more vocal and more ambitious. The Commission's language and "tone" reflect its belief that the time for action was right and that the indignation of EU citizens would prevent even the most recalcitrant Member States from vetoing key pieces of legislation. Reality proved to be slightly more complicated.

In its tax transparency communication, the Commission set the scene by justifying why EU action was necessary. Multinationals' aggressive tax planning techniques undermine 'fair' burden-sharing, 'fair' competition between companies and 'fair' tax competition between Member States. In one sentence, the adjective 'fair' appears thrice. The concept of fairness lies at the core of the Commission's *modus communicandi* and is frequently found in Commissioners' speeches, including Commissioner Vestager's.

Fairness can only be restored when aggressive tax planning is suppressed, and tax transparency is the…panacea. The Commission was optimistic that its goal was achievable and that there was 'unprecedented momentum behind the battle against tax evasion and avoidance' which had been 'fuelled largely by the public demand for fair taxation in difficult times.'[297] This was also the reason why the EU contributed to the OECD/G20 BEPS project, but Member States needed something more than just soft law. National tax administrations lacked the necessary information about 'the impact of other countries' tax regimes and practices on their own tax systems.'[298] Relying on scandals such as LuxLeaks was certainly not

[297] ibid, 2.

[298] ibid, 4.

a viable way of safeguarding fair tax competition. Finally, the EU could not play an active role in the global tax arena if it could not put its own house in order: credibility was also a consideration. Before presenting the six sets of transparency measures proposed by the Commission, it is apposite to stress that the Commission's fiscal state aid investigations into tax rulings were explicitly flagged as yet another transparency-related campaign.[299]

The first and most important of the six measures put forward by the Commission was a proposal for the automatic exchange of information on cross-border tax rulings. This would entail an obligation for national tax authorities to share information on tax rulings issued by them with all other EU States at regular intervals. For this purpose, the Directive on Administrative Cooperation would need to be amended. The second proposal concerned the repeal of the Savings Tax Directive in order to avoid its overlap with the much broader Administrative Cooperation Directive. The third initiative aimed at evaluating more ambitious steps, such as obliging multinationals to, for instance, commit to country-by-country reporting of tax-related information. The fourth proposal of the tax transparency package goes to the heart of the theme of this thesis, with the Commission proposing changes to the modus operandi of the Code of Conduct Group, so that it can more effectively assess Member States' potentially harmful tax regimes. The Commission considered the Code's criteria inadequate when reviewing modern tax incentives such as patent boxes (the regimes for which the OECD came up with the modified nexus approach).

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[299] ibid.

The two final recommendations of the transparency package were slightly more general: the Commission needed to work with Eurostat and the Member States to quantify the tax gap, as well as with the G20/OECD to globally promote tax transparency. The seven-page-long communication concluded with a call to action: the Commission would present further initiatives in June 2015, but in the meantime asked the Council to adopt its transparency-related legislative proposals 'as a matter of high political priority.'[300]

The Commission's second and more comprehensive step towards the reform of corporate taxation in the EU was indeed released on June 17th 2015. Its title? An Action Plan for 'Fair' (our leitmotif) and 'Efficient' corporate taxation in the EU. Its aim? To fundamentally reform corporate taxation in the EU.'[301] In the more eloquent words of Commissioner Moscovici, the Commission 'laid the foundation for a new approach to corporate taxation in the EU' which Member States should build on.[302] The initiatives in this package expanded on the Tax Transparency package but also echoed the OECD's ongoing work on BEPS. As will become manifest, the Commission's strategy is to take bolder and bolder steps, increasing the ambition and detail of its proposals incrementally.

[300] ibid, 7.

[301] Commission Press Release, IP/15/5188 (June 17 2015), available at <http://europa.eu/rapid/press-release_IP-15-5188_en.htm> accessed 30 March 2020.

[302] ibid.

In its Action Plan for a fair and efficient corporate tax system in the EU,[303] before setting out the five key areas for action, the Commission provided some historical and economic context to its proposals. First, the Commission observed that corporate tax rules were no longer fit for purpose in a globalised and digital world, having largely been conceived in the aftermath of the First World War. Such obsolete rules allow multinationals to minimise their tax burden, thus causing 'public discontent', and this 'perceived lack of fairness threatens the social contract between governments and their citizens'.[304] Apart from fairness,[305] the lack of EU-wide tax coordination creates obstacles in the single market and on occasion leads to double taxation of the same income. The co-existence of 28 different tax systems in one integrated market also results in fierce tax competition between Member States, pushing tax rates lower.[306] EU States are, in essence, stuck between Scylla and Charybdis: they want their tax systems to be fair and stable enough to fund their basic functions, but they also wish to attract international capital. We, therefore, re-arrive at a common theme: the Commission does not mind "fair", legitimate, reasonable intra-EU tax competition, but its odious counterpart is becoming intolerable. As the Commission put it in the

[303] European Commission, 'Communication from the Commission to the European Parliament and the Council: A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action' COM (2015) 302 final.

[304] ibid, 2.

[305] In the Staff Working Document accompanying the Action Plan, it is stated that '[e]vidence from behavioural economics shows that fairness is an important determinant of tax morale' and that preferential treatment of some taxpayers 'might deteriorate the willingness to contribute to public revenues via taxes in general'. See European Commission, 'Commission Staff Working Document: Corporate Income Taxation in the European Union' COM (2015) 121 final, 5 fn 9.

[306] European Commission, 'Communication from the Commission to the European Parliament and the Council: A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action' COM (2015) 302 final, 4.

Action Plan: '[t]he legitimacy of tax competition is weakening, if such competition is abused for corporate tax avoidance, fragments the single market and prevents fair and efficient taxation.'[307]

In the Commission's view, the EU's timeworn way of ensuring fair tax competition within its borders, while also disallowing harmful tax competition, was found to literally be so…1990s. The non-binding Code of Conduct lacks teeth and its criteria have been outpaced by international tax developments; in other words, it had reached its limits.[308] With these considerations in mind, the Commission published its Action Plan in a communication that builds on its March 2018 tax transparency package but was more comprehensive and, crucially, would 'be the basis for Commission work on corporate tax policy over the next years.'[309]

Moving on to the Commission's five substantive proposals to meet the objectives of fair and efficient taxation, the first one was an "old friend", namely the Common Consolidated Corporate Tax Base (CCCTB).[310] The CCCTB was hailed 'an extremely effective tool' for meeting the aforementioned objectives, especially in tackling profit shifting and corporate tax abuse in the EU.[311] However, the

[307] ibid, 5.

[308] ibid, 3.

[309] ibid, 15.

[310] Academics had already noted how BEPS concerns had 'become a strong underlying spirit' for CCCTB-related work in 2014; see Shuchien Chen, 'CCCTB – Proposal on a Common Consolidated Corporate Tax Base for discussion at the Working Party on Tax Questions' Highlights & Insights in European Taxation (2015) 23, 47.

[311] ibid, 7.

Commission had learned its lesson after its relevant 2011 proposal failed to make progress. The CCCTB would not be adopted in one piece but gradually, and its application would be compulsory, at least to multinational companies.[312]

The second proposal regarded ensuring effective taxation where profits are generated. This required coordination on many fronts, including the modification of the Code of Conduct, the streamlining of the EU's transfer pricing framework and possibly the CCCTB. As regards the Code of Conduct, the Primarolo Group had already agreed in 2014 to adopt the OECD's modified nexus approach when assessing the harmfulness of IP regimes such as patent boxes.[313] The collaboration between Paris (OECD) and Brussels (EU Commission) emerges as one of the constants in the tax reform landscape.

The third proposal of the Action Plan regarded additional measures such as enabling cross border loss offset and the improvement of double taxation dispute resolution mechanisms. In its fourth proposal, the Commission aimed at directly building on its tax transparency package and adopting more transparency-related measures.[314] For instance, in an outbreak of public relations

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[312] Parts of the professional community were less optimistic about the CCCTB, questioning, inter alia, whether it would 'materially curb tax competition in Europe' since differences in tax rates would persist even after the CCCTB: Isabel Verlinden and Pieter Deré, 'The European Commission Action Plan for a Fair and Efficient Tax System in the European Union: What Should be Expected?' (2015) International Transfer Pricing Journal 343, 346.

[313] ibid, 10. Academics at the time also argued that '[a] new interpretation of the third criterion of the Code of Conduct […] is crucial', see António Carlos dos Santos, 'What Is Substantial Economic Activity for Tax Purposes in the Context of the European Union and the OECD Initiatives Against Harmful Tax Competition?' (2015) 3 EC Tax Review 166, 172.

[314] It has been argued that 'transparency cannot be seen as an objective in itself' since e.g. unlimited transparency 'has its drawbacks.' See Edoardo Traversa and Allessandra Flamini, 'The Impact of

blitzkrieg, the Commission had published an EU-wide list of third country non-cooperative tax jurisdictions, and stood ready to coordinate possible counter-measures. Again, we observe a European Commission that does not hesitate to seize the initiative and can ruffle feathers and become pugnacious when necessary. The fifth and final proposal concerned further coordination on e.g. tax audits and also, once again, the reform of the Primarolo Group's working methods.[315]

In its concluding remarks, the Commission urged the upcoming Council presidencies to make progress on its proposals and Member States to overcome their differences since it was 'time to move forward.'[316]

It is imperative, at this point, to recall that the European Commission was not alone in its campaign for a better and fairer tax system. Even though the Council of the EU, where national governments are represented, was not wholly endorsive of all Commission initiatives, the latter found a key ally in the third corner of the EU's power triangle: the European Parliament. The representatives of Europe's citizens threw their weight behind the Commission's crusade and used their democratic legitimacy to push for more transparency and more decisive action.

BEPS on the Fight Against Harmful Tax Practices: Risks…and Opportunities for the EU' [2015] British Tax Review 396, 399 et seq.

[315] European Commission, 'Communication from the Commission to the European Parliament and the Council: A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action' COM (2015) 302 final, 14.

[316] ibid, 15.

Obviously, the European Parliament showed its support mainly by agreeing to adopt certain key legislative measures, including the directive on information exchange and other measures that will be analysed further *infra*. Still, these initiatives were led by the Commission, given that the latter proposes legislation in the EU. Therefore, the adoption of legislative measures does not allow us to "hear" the Parliament's distinct "voice" in this debate. However, its relevant resolutions and reports offer key insights and thus deserve to be examined in depth.

Some background information is essential here. On November 5th 2014, the International Consortium of Investigative Journalists (ICIJ) released 28.000 pages of confidential documents describing more than 500 private tax deals between Luxembourg and approximately 300 multinational corporations between 2002 and 2010. The uproar caused was of gigantic magnitude, with all major media outlets picking the story up and closely following it for months on end.

Three months later, on February 12th 2015, came the first interesting reaction by the European Parliament, with its decision to set up a special committee on tax rulings and other measures similar in nature or effect (hereafter the "TAXE Committee"). The TAXE Committee published its final report in November 2015, which was endorsed by the Parliament in its resolution of

November 2015.[317] The insights this report offers on the Parliament's position on key tax issues are invaluable.

First, simply perusing the sources the TAXE Committee cited at the beginning of its report is telling. Some illustrative, by no means exhaustive, examples are the following: the LuxLeaks revelations, the OECD's 1998 Harmful Tax Competition Report, the OECD's BEPS project, the work of the Code of Conduct Group, the State Aid Procedural Regulation, the Commission's 2015 tax initiatives (e.g. the Tax Transparency package), and the outcome of the various G20 summits. The sources are diverse but they share a common thread, namely they all lend support to a dynamic response on the part of the EU.

The report stresses that the LuxLeaks scandal simply exposed an array of harmful tax practices that were widespread within Europe and beyond, but that it is unacceptable to have to rely on the courage of whistleblowers to receive that kind of information.[318] It then went on to make an intriguing remark, which will perhaps be picked up by an industrious law-maker or a "creative" panel of ECJ judges in the future: tax competition does exist between Member States, but the latter are bound by the principle of sincere cooperation (Art. 4 TEU) and should 'fully apply the principle of sincere cooperation in matter of tax competition'.[319] It remains to be seen what this might mean in practical terms.

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[317] European Parliament, 'Resolution of 25 November 2015 on Tax Rulings and Other Measures Similar in Nature or Effect' (2015/2066 (INI)).

[318] ibid, paras B-D.

[319] ibid, para L.

The TAXE Committee proceeded to note that international tax rules reflect the consensus at the dawn of the previous century and have not kept pace with the evolution of the business environment.[320] In the context of the EU, this had led to base erosion, profit shifting and a race to the bottom, meaning that the result is a 'negative-sum game for all national budgets taken together',[321] a practice lamented as a 'de facto beggar-thy-neighbour' policy in tax matters, which was contrary to the very foundations of the European project'.[322] These are strong and unequivocal statements; the European Parliament confessed that, in its view, 'fiscal policy and competition policy should be seen as two sides of the same coin in the internal market'.[323]

The report becomes even more blunt: the Parliamentary Committee, having had regard to the fiscal state aid investigations initiated by the Commission, for instance against Apple, Fiat and Starbucks, underlined 'the fact that some harmful tax practices may fall within the scope of tax-related state aid rules'.[324] State aid rules and sanctions 'are useful as a means of addressing the most abusive and distortive harmful tax practices'[325] and, therefore, the Parliament encouraged the Commission to 'make full use of its powers under EU

[320] ibid, para 1.

[321] ibid, para 5.

[322] ibid, para 14.

[323] ibid, para 15.

[324] ibid, para 60.

[325] ibid, para 51.

competition rules to tackle harmful tax practices and to sanction Member States and companies found to be involved in such practices'.[326]

Real politik seems to be the Parliament's "expertise", and it is not afraid to be even more pugnacious and ambitious than the European Commission, by inviting the latter, for instance, to 'enhance strategic synergies between the activities of the (reformed) Code of Conduct Group and the Commission's enforcement' of fiscal state aid rules.[327] In other words, the Commission is encouraged to utilise a hard law tool (state aid rules) to achieve a soft law goal (fight harmful tax competition). The theme of this thesis thus keeps reappearing, i.e. the crucial question of how much the definition of state aid can and should be stretched, if at all, to accommodate a specific policy goal.

In the report's conclusions, the critique of the Committee against both Member States and the Commission is scathing. In its view, and (as always) without prejudice to the outcome of the (then still ongoing) investigations, Member States had violated Article 107 TFEU and the principle of sincere cooperation.[328] The Commission, on the other hand, had not fulfilled its role as guardian of the Treaties, had breached Article 108 TFEU by not launching state aid investigations in the past, and had not fully cooperated with the Committee when asked to disclose certain documents requested.[329]

[326] ibid, para 130.

[327] ibid, para 133.

[328] ibid, para 86.

[329] ibid, paras 86-87.

The European Parliament then proceeded to call on EU Heads of State and EU institutions to take urgent action to put an end to harmful tax competition, since this situation 'can no longer be tolerated'.[330] On the subject-matter of the Code of Conduct for business taxation and the relevant group, the Parliament asked for their reform, given that it had 'proved to be of questionable value'.[331] Moreover, it boldly asserted that the Group's legitimacy would 'benefit from increased transparency and accountability'[332] and therefore proposed that the wider public be granted more information on the work of the Group.[333] The Commission concluded with a veiled threat: the veto possessed by EU States with regard to tax legislation leads to inertia, and thus the Commission should not refrain from using Article 116 TFEU to break the deadlock, should Member States not move towards more cooperative solutions.[334]

It is clear that the European Parliament rapidly became heavily invested in the fight against tax avoidance and harmful tax competition. The political "soil" here is fertile, and every "victory" against an allegedly tax-avoiding multinational company is bound to increase EU citizens "fondness" towards the Union and

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[330] ibid, paras 91-92.

[331] ibid, para 124.

[332] For some excellent insights into the inner workings of the Code of Conduct Group, see Martijn F. Nouwen, 'The European Code of Conduct Group Becomes Increasingly Important in the Fight Against Tax Avoidance: More Openness and Transparency is Necessary' (2017) 45 Intertax 138.

[333] European Parliament, 'Resolution of 25 November 2015 on Tax Rulings and Other Measures Similar in Nature or Effect' (2015/2066 (INI)), paras 125 & 128.

[334] ibid, para 172.

highlight the latter's important role. But where did Member States stand on this debate in late 2015? Were they as proactive and cooperative as the Commission and the Parliament desired?

On paper, this was indeed the case. The ECOFIN conclusions of December 2015 reveal national governments' receptiveness to ambitious solutions.[335] In relation to the Code of Conduct for business taxation, the requested "reform" was translated as a "strengthening" of the Code. More specifically, the Council of Finance Ministers invited the group to develop general guidance to prevent tax avoidance, base erosion and profit shifting (BEPS).[336] Furthermore, the Group was asked to help the EU implement the OECD's BEPS project conclusions, clarify the third criterion of the Code (substantive activities requirement) on the basis of Action 5 (modified nexus approach etc.) and make its six-monthly reports available to the public, even though the actual deliberations would remain confidential.[337]

On corporate taxation and the BEPS project, the ECOFIN stressed that unfair tax competition could affect the functioning of the single market and complimented the EU for being a 'pioneer' by fully implementing OECD BEPS

[335] Council of the European Union, 'Outcome of the 3435th Council Meeting: Economic and Financial Affairs' PRESSE 78 PR CO 70.

[336] Council Press Release, 908/15 (December 8 2015), available at <https://www.consilium.europa.eu/en/meetings/ecofin/2015/12/08/> accessed 28 April 2020.

[337] ibid.

conclusions on Action 5 (harmful tax practices).[338] The Council also stressed that directives and not regulations were preferable when implementing BEPS and invited the Code of Conduct group to review the Code's fourth criterion concerning transfer pricing and align it with the relevant BEPS actions.[339]

Finally, on cross-border tax rulings and the Commission's tax transparency package, the Council adopted the relevant amendment to the Administrative Cooperation Directive and acquiesced to the automatic exchange of information, with a start date of January 1st 2017.[340] As 2015 drew to a close, all three EU lawmakers were in sync, at least in relation ot the desirability of the goals: tax avoidance and harmful tax competition in the EU had finally found worthy adversaries.

The Commission was dancing to the same tune in early 2016, when it unveiled its third, and possibly most significant, tax package. On January 28th 2016, the Commission presented what became known as the "Anti Tax Avoidance Package" (ATAP), i.e. a series of proposals aiming at a coordinated EU-wide response to corporate tax avoidance, following the guidance developed by the OECD in its BEPS project. The Commission called the ATAP a 'new chapter in its campaign for fair, efficient and growth-friendly taxation in the EU' and stressed

338 Council Press Release, 910/15 (December 8 2015), available at <https://www.consilium.europa.eu/en/press/press-releases/2015/12/08/ecofin-conclusions-corporate-taxation/pdf> accessed 28 April 2020.

339 ibid.

340 Council Press Release, 905/15 (December 8 2015), available at <https://www.consilium.europa.eu/en/press/press-releases/2015/12/08/ecofin-cross-broder-tax-ruling/pdf> accessed 28 April 2020.

that it revolved around three core pillars, all of which will sound familiar.[341] First, companies should pay tax where they make their profits, i.e. effective taxation in the EU is necessary. Second, tax transparency needs to be boosted: tax ruling-related transparency alone will not suffice. Third, since tax avoidance and harmful tax competition are global problems, the EU must make sure its international partners follow its steps, or else it risks being outflanked by countries facilitating aggressive tax planning.

Again, a certain theme re-emerges. The Commission is making small steps, building on its two previous packages, always connecting the dots between its initiatives and gradually increasing the pressure on Member States. The turn of the screw in EU tax affairs becomes swifter post-2015.

The Commission's actual communication on the Anti-Tax Avoidance Package was only nine pages long, yet full of ideas and proposals for both soft and hard law measures.[342] In the Commission's view, Member States understood that if they wanted a stronger single market, then taxation could not be left aside.[343] This meant that aggressive tax planning needed to be addressed, and thus a common approach at EU level on anti-tax avoidance measures was mandated.[344]

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[341] Commission Press Release, IP/16/159 (January 28 2016), available at <http://europa.eu/rapid/press-release_IP-16-159_en.htm> accessed 30 April 2020.

[342] European Commission, 'Communication from the Commission to the European Parliament and the Council: Anti-Tax Avoidance Package: Next Steps Towards Delivering Effective Taxation and Greater Transparency in the EU' COM (2016) 23 final.

[343] ibid.

[344] The ATA package was accompanied by a useful and informative study containing lots of relevant data, entitled 'Study on Structures of Aggressive Tax Planning and Indicators'. Both the study and some illuminating comments by one of its authors can be found here: Jacob Bundgaard,

In the Commission's words, it was 'no time for business as usual': it was imperative to have political ambition and legal certainty.[345]

One of the reasons justifying and explaining the Commission's renewed momentum in early 2016 was that its "partner in crime", i.e. the OECD, had concluded and published its work on BEPS in October 2015. Some Member States were, consequently, ready to implement the BEPS proposals, but doing so in an uncoordinated manner would endanger the single market.[346] This is why the Commission seized the opportunity to create its own Anti-Tax Avoidance packaged, which complemented and reinforced the OECD's BEPS project.[347] It is telling that the ATA package was characterised as 'an interesting exercise in interpreting the G20/OECD BEPS ideals, because it is a regional implementation of the BEPS holistic approach, which is much more consistent with the BEPS spirit, than the unilateral measures that have been taken by some EU Member States.'[348] Obviously, the main difference between the OECD and the EU is that the latter can adopt legally binding measures.

'Understanding the EU Anti-Tax Avoidance Package – Study on Structures of Aggressive Tax Planning and Indicators' (Kluwer International Tax Blog, 23 February 2016) <http://kluwertaxblog.com/2016/02/23/understanding-the-eu-anti-tax-avoidance-package-study-on-structures-of-aggressive-tax-planning-and-indicators/> accessed 30 April 2020.

[345] European Commission, 'Communication from the Commission to the European Parliament and the Council: Anti-Tax Avoidance Package: Next Steps Towards Delivering Effective Taxation and Greater Transparency in the EU' COM (2016) 23 final, 3.

[346] Ibid, 4.

[347] Commission Fact Sheet, MEMO/16/160 (January 28 2016), available at <http://europa.eu/rapid/press-release_MEMO-16-160_en.htm> accessed 28 April 2020.

[348] Ana Paula Dourado, 'The EU Anti Tax Avoidance Package: Moving Ahead of BEPS?' (2016) 44 Intertax 440.

Using its clout, the European Commission asked Member States to ensure that companies pay taxes where their profit-generating activities take place, something that the Code of Conduct Group could also be used to monitor.[349] Member States were also asked to go further than the OECD in certain areas.[350] To persuade them, the Commission used its CCCTB proposal as an overhanging sword of Damocles, an overly ambitious, yet in its view feasible, future goal, in comparison to which all its other proposals were not so audacious or onerous to implement.[351]

The Commission also decided to double down on transparency. Its proposal on the automatic exchange of information on cross-border tax rulings had been adopted very swiftly, but it was not sufficient: tax authorities should also share information on how much tax a company pays and on what profits, on a country-by-country basis, following the relevant BEPS recommendations.[352] [353]

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[349] Given the links between the ATA package and the fight against harmful tax competition, it is important to note that it is not clear whether the ATA Directive would help relieve the tension causes by tax competition between Member States. See Anzhela Cédelle, 'The EU Anti-Tax Avoidance Directive: A UK Perspective' British Tax Review (2016) 490, 495 et seq.

[350] In a sense, this is because '[s]olidarity through European tax legislation would present a counterpart to economic interdependence.' See Jukka Snell and Jussi Jaakkola, 'Economic Mobility and Fiscal Federalism: Taxation and European Responses in a Changing Constitutional Context' (2016) 22 European Law Journal 772, 790.

[351] European Commission, 'Communication from the Commission to the European Parliament and the Council: Anti-Tax Avoidance Package: Next Steps Towards Delivering Effective Taxation and Greater Transparency in the EU' COM (2016) 23 final, 6.

[352] ibid, 7.

[353] For a critical comment on the ATAD, see Guglielmo Ginevra, 'The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU Level' (2017) 45 Intertax 120, 137: 'it does not seem that the Directive has accomplished [...] all of the three main objectives advocated in the preamble and in the [relevant Communication]'.

In a nutshell, the Anti-Tax Avoidance Package represented a 'pragmatic approach' and contained two hard-law initiatives, namely a proposal for an Anti-Tax Avoidance Directive and a proposal on country-by-country reporting.[354] Both were adopted by the Council very swiftly, in under four months, signaling a change of pace in EU tax policies.[355] [356]

By July 2016, both Directives having been adopted,[357] the Commission was back to the drawing board, sketching out yet more tax-related ideas. On July 5th 2016, it set out the next steps in its campaign against tax avoidance, its resolve having been strengthened by the Panama Papers leaks of April 2016. These revelations had exposed how secret accounts could be used to hide income and assets offshore, 'often for tax evasion and other illicit purposes.'[358] To stop this, in the Commission's view, it was necessary to identify the ultimate beneficiary behind every company, trust and fund, but this sort of information was not readily

[354] European Commission, 'Communication from the Commission to the European Parliament and the Council: Anti-Tax Avoidance Package: Next Steps Towards Delivering Effective Taxation and Greater Transparency in the EU' COM (2016) 23 final, 8.

[355] Anzhela Cédelle, 'The EU Anti-Tax Avoidance Directive: A UK Perspective' British Tax Review (2016) 490, 506.

[356] Although this swift adoption was in itself very positive, the reception that the ATA package received was sometimes lukewarm. See, for some thoughts on how the misapplication of the ATAD's anti-abuse rule could lead to the violation of state aid rules, Sjoerd Douma and Alexia Kardachaki, 'The Impact of European Union Law on the Possibilities of European Union Member States to Adapt International Tax Rules to the Business Models of Multinational Enterprises' (2016) 44 Intertax 746, 753. See also the criticism of Nick Shaxson, 'Europe's Anti Tax Avoidance Package: Adding Fuel to the Fire?' (Tax Justice Network, January 29 2016) < https://www.taxjustice.net/2016/01/29/europes-anti-tax-avoidance-package-adding-fuel-to-the-fire/> accessed 29 April 2020.

[357] Council Directive (EU) 2016/881 of 25 May 2016, OJ L 146, pp. 8-22; Council Directive (EU) 2016/1164 of 12 July 2016, OJ L 193, pp. 1-14.

[358] Commission Press Release, IP/16/2354 (July 5 2016), available at < http://europa.eu/rapid/press-release_IP-16-2354_en.htm> accessed 30 April 2020.

available to Member States' tax authorities throughout the Union.[359] Therefore, the solution was to amend the Administrative Cooperation Directive, in order to give tax authorities access to national anti-money laundering information, particularly beneficial ownership and due diligence information.[360]

Three more interesting initiatives were unveiled by the Commission on that date, although they were at a nascent state. First, oversight over tax advisors' work had to be improved, since the LuxLeaks and Panama scandals had revealed the crucial role these firms had played in facilitating tax evasion. Second, whistleblowers bringing such scandals to light had to be adequately protected, since they act at great personal cost to serve the public interest. Finally, an EU "black list" of uncooperative tax jurisdictions would be put together by early 2017.

One day after the Commission released the aforementioned press release, the European Parliament published the second report of the TAXE Committee (TAXE 2 Report).[361] It was equally, if not more, critical of the Member States' and the Commission's (in)actions, as it had been in its 2015 report, and called for an overhaul of the Code of Conduct Group's working methods. The Parliament did not mince its words and, at several points, its tone was outright damnatory. For instance, it notes that 'the criteria for identifying harmful measures are outdated

[359] ibid.

[360] The Directive was adopted in 2018: Council Directive (EU) 2018/822 of 25 May 2018, OJ L 139, pp. 1-13.

[361] European Parliament, 'Resolution of 6 July 2016 on Tax Rulings and Other Measures Similar in Nature or Effect' (2016/2038 (INI)).

and the unanimity principle […] ha[d] not proven effective'.[362] Moreover, it accused several Member States of 'opposing a necessary reform' of the Primarolo Group and 'deplored' the fact that the Commission claimed to have "lost" many of the internal documents relating to the remit of the Primarolo Group.[363] It observed a 'pattern of systematic obstruction by some Member States to achieving any progress on fighting tax avoidance' and essentially called on the Commission to bypass the unanimity requirement by proposing legislation under Articles 116 or 352 TFEU to reform the Primarolo Group.[364]

The Commission did not take Parliament's advice, probably because of the backlash such a move would face from EU States eager to preserve their vetoes. Still, in October 2016, it broke new ground when it finally tabled a re-launched proposal for a Common Consolidated Corporate Tax Base (CCCTB).[365] Given the resistance its 2011 CCCTB proposal had faced in Council, having never been adopted, the Commission put forward a two-step approach: first a common corporate tax base (CCCTB) would be agreed on, and then the rules on the cross-border consolidation of profits and losses (CCCTB) would be adopted.

The CCCTB has been the European Commission's holy grail in the tax area for years now. It is a goal whose achievement has been elusive, due to its

[362] ibid, para 52.

[363] ibid, paras 52, 48 & AP.

[364] ibid, paras 53 & 55.

[365] Commission Press Release, IP/16/3471 (October 25 2016), available at <http://europa.eu/rapid/press-release_IP-16-3471_en.htm> accessed 30 April 2020.

remarkably far-reaching scope. If it were to be adopted, companies would file one tax return for all EU activities; offset profits in one Member State against losses in another; mismatches, transfer pricing and preferential regimes would be eliminated.[366] An Commission-designed fiscal dreamland of sorts would, in a few words, materialise. However, such a bold step forward requires unanimous support and the perceived cost in terms of tax sovereignty continues to appear steep.

The CCCTB proposal meant that 2016 came to an end on an ambitious note, and on January 1st 2017 the directive on the automatic exchange of information on tax rulings entered into force. The productive period of legislative initiatives post-2015 had started to reap fruit; yet the Commission's appetite for change remained insatiate. A Second Anti-Tax Avoidance Directive was adopted in May 2017, amending and complementing the first Directive by closing loopholes regarding hybrid mismatches with third countries.[367] Moreover, the Commission proposed new transparency rules for intermediaries, including tax advisors, that design and promote aggressive tax planning schemes for their clients, and its proposal was adopted in May 2018.[368] [369] In September 2017, the Commission

[366] ibid.

[367] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries OJ L 144, pp. 1-11.

[368] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU OJ L 139, pp. 1-13.

[369] For a very interesting comment on the Commission's 2017 proposal see Paulina Szotek, 'Is the EU Council about to confirm the existence of an EU at arm's length principle?' (Kluwer Tax Blog, July 6 2017) available at < http://kluwertaxblog.com/2017/07/06/council-confirm-existence-eu-arms-length-principle/> accessed 1 May 2020.

launched yet another tax initiative, aiming at the fair and efficient taxation of the digital economy.[370]

The following year started off on the same foot. The European Commission moved from highlighting the key issues and problems of digital companies' taxation to putting forward concrete proposals. On March 21st 2018, the Commission announced it was proposing new measures to ensure the "fair" taxation of digital business activities, measures that would make the EU a "global leader" in designing modern tax laws.[371] Fairness is an obstinate leitmotif: it is the purported aim of almost all Commission initiatives in relation to taxation, the opposite of "harmful" tax competition and "aggressive tax planning", activities in which Member States and companies seem to engage. Global leadership is also another goal, since the EU is generally trying to adopt standard-setting rules in many areas, e.g. data and environmental protection. This bard of "regulatory innovation" is a clearly stated aim in the tax arena as well, even though the unanimity requirement and the healthy rivalry with the OECD makes it more difficult to achieve in practice.

The reason why the Commission deemed it necessary to propose legislation on digital taxation was that, despite the fact that digital companies' dominance has increased dramatically in the past decade, with their revenues and

[370] European Commission, 'Communication from the Commission to the European Parliament and the Council: A Fair and Efficient Tax System in the European Union for the Digital Single Market' COM (2017) 547 final.

[371] Commission Press Release, IP/18/2041 (March 21 2018), available at <http://europa.eu/rapid/press-release_IP-18-2041_en.htm> accessed 30 April 2020.

profits ballooning, they have an average effective tax rate half of that of the traditional economy in the EU.[372] In its Communication, the Commission stressed that '[f]aced with rising inequalities and perception of a lack of social justice, EU citizens are calling for Member States and the Commission to take action to improve the fairness of tax systems.'[373] Besides, '[f]rom the start of its mandate, [the] Commission made it a priority to improve the fairness and efficiency of EU tax systems.'[374] This cannot be accomplished if Member States pursue unilateral solutions to the taxation of digital companies, since that would create 'a legal minefield and tax uncertainty for business.'[375]

Against this background, the Commission proposed two measures. The first had a more mid-term to long-term objective: a directive forcing business to pay tax on profits in Member States where they have a significant digital presence, even if they do not have a physical presence there.[376] The second measure was meant to appease EU States and halt any aggressive unilateral "cash-grabbing" initiatives: an interim digital services tax at EU level. Crucially, and unlike the first measure, this would be a 3% tax on gross annual revenues in the EU, and not a tax on profits.[377] The Commission considered that the combination of these two

[372] ibid.

[373] European Commission, 'Communication from the Commission to the European Parliament and the Council: Time to Establish a Modern, Fair and Efficient Taxation Standard for the Digital Economy' COM (2018)146 final,3.

[374] ibid.

[375] Commission Press Release, IP/18/2041 (March 21 2018), available at < http://europa.eu/rapid/press-release_IP-18-2041_en.htm> accessed 30 April 2020.

[376] European Commission, 'Communication from the Commission to the European Parliament and the Council: Time to Establish a Modern, Fair and Efficient Taxation Standard for the Digital Economy' COM (2018)146 final,6.

[377] ibid, 9.

measures would provide 'a comprehensive structural solution to the question of taxation of the digital economy within the EU'.[378]

That was not the Commission's final say on taxation on that date: the 21st of March was an unusually productive date for the Commission in this respect. More specifically, it published a communication summarising that state of play of its diverse efforts to tackle tax avoidance, in an effort to facilitate compliance with the various different – yet related – requirements.[379]

The March flurry of activity was completed with the release of a report on aggressive tax planning indicators.[380] The objective of that report, essentially a study, was to 'provide economic evidence of the relevance of aggressive tax planning (ATP) structures for all EU Member States.'[381] In other words, the aim was to 'complement the existing legal evidence base and theoretical considerations about ATP in the EU Member States with economic substance' and to examine which national tax rules are actually being used in such planning practices.[382] The report is rather long and detailed, but the ATP structures that it analysed were grouped into three categories, viz. ATP via interest payments, ATP

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[378] ibid.

[379] European Commission, 'Communication from the Commission: On New Requirements Against Tax Avoidance in EU Legislation Governing in particular Financing and Investment Operations' C (2018) 1756 final.

[380] European Commission, 'Taxation Papers, Working Paper No 71 – 2017: Aggressive Tax Planning Indicators, Final Report' https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_papers_71_atp_.pdf accessed 20 April 2020.

[381] ibid, 8.
[382] ibid, 22.

via royalty payments and ATP via "strategic" transfer pricing.[383] Although taxation papers, such as the one being discussed, do not necessarily represent the official views of the European Commission, the report constitutes an interesting read for anyone wishing to comprehend the Commission's general method of identifying "suspicious" national tax laws and loopholes, a set of skills that was certainly put to use in the fiscal state aid investigations launched post-2014 by the EU's competition watchdog.

An important legislative development followed in May: the so-called Tax Intermediaries Directive became law,[384] i.e. the directive introducing mandatory disclosure obligations on tax intermediaries and taxpayers in relation to certain cross-border tax planning schemes. Having witnessed the key role played by tax advisors in the LuxLeaks scandal and in the tax rulings' cases, the EU considered it imperative to increase transparency at an early tax planning stage.

Later in 2018, the Commission's Directorate-General for the Taxation and Customs Union (DG TAXUD) published a report of the EU's Joint Transfer Pricing Forum entitled 'A Coordinated Approach to Transfer Pricing Controls Within the EU'.[385] The report's objective was to 'establish a coordinated approach to transfer pricing controls within the EU', so as to enhance the functioning of the internal

[383] ibid, 8.

[384] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive (EU) 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements OJ L 139, 5.6.2018 p. 1.

[385] European Commission, 'EU Joint Transfer Pricing Forum: A Coordinated Approach to Transfer Pricing Controls within the EU' DOC: JTPF/0132018/EN.

market and avoid both double taxation and double non-taxation.[386] It was recognised that it is not always in Member States' interests to collaborate in the transfer pricing field, since an upward adjustment in one jurisdiction will usually be followed by a corresponding downward adjustment in another jurisdictions.[387] Still, collaboration is inevitable to prevent double taxation, a duty imposed on Member States by EU law.[388]

The view of the Joint Transfer Pricing Forum was that the existing EU legal framework, complemented with voluntary collaboration between national tax administrations, was sufficient to reach a satisfactory level of administrative cooperation in transfer pricing matters.[389] The report's conclusion was that coordinated transfer pricing controls present many advantages 'in overcoming the risk of diverging assessments between stakeholders when applying transfer pricing in accordance with the arm's length principle.'[390] It is impossible to miss the Commission's focus on the importance of the arm's length principle, both in its soft law documents such as the report *supra*, and in its hard law "adventures", i.e. its insistence on the existence of an EU law ALP in its fiscal state aid investigations.

[386] ibid, 2.

[387] ibid, 7.

[388] See Council Directive (EU) 2017/852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union OJ L 265, 14.10.2017 pp. 1-14.

[389] European Commission, 'EU Joint Transfer Pricing Forum: A Coordinated Approach to Transfer Pricing Controls within the EU' DOC: JTPF/0132018/EN, 7-8.

[390] ibid, 14.

On January 1st 2019, while the rest of the world was welcoming the new year, the European Commission was (also) welcoming the entry into force of the Anti-Tax Avoidance Directive (ATAD).[391] As discussed earlier in this chapter, the purpose of this OECD-inspired directive was to prevent profits from being 'siphoned out of the EU where they go untaxed.'[392] The primary mechanisms were the controlled foreign company rules, the interest limitation rules and the general anti-abuse rule, ATAD's entry into force represented an important step in the EU's fight against tax avoidance, and has helped bolster the EU's image as a global leader 'in terms of the political and economic approach to corporate taxation.'[393]

Rather than basking in the glory of old achievements, the Commission in mid-January 2019 decide to tackle the biggest question in EU tax policy: will Member States ever agree to move from unanimity to qualified majority voting (QMV)? The Commission kick-started the relevant debate by calling for the use of the Treaties' passerelle clause (Article 48 (7) TEU) to establish a 'progressive and targeted transition to qualified majority voting […] in certain areas of shared EU taxation policy'.[394] This would mean that Member States would be able to 'reach quicker, more effective and more democratic compromises on taxation matters', receiving input from the European Parliament and 'increasing accountability'.[395]

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[391] Commission Press Release, IP/18/6853 (December 30 2018), available at <http://europa.eu/rapid/press-release_IP-18-6853_en.htm> accessed 30 April 2020.

[392] ibid.

[393] ibid.

[394] Commission Press Release, IP/19/225 (January 15 2019), available at <http://europa.eu/rapid/press-release_IP-19-225_en.htm> accessed 30 April 2020.

[395] ibid.

Commissioner Moscovici, when announcing the launch of the debate, did not mince his words, even though he acknowledged how delicate the issues were. More specifically, he noted that '[t]he unanimity rule in taxation increasingly appears as politically anachronistic, legally problematic and economically counterproductive' so, despite the issue being 'sensitive', the relevant discussion had to take place.[396] Although some academics hailed this as a 'remarkable' proposal,[397] others were more cautious, stressing the importance of the existing 'mistrust between Member States engaged in tax competition.'[398] Whether the Commission's boldest and grandest proposal will gain traction remains to be seen.

The Commission's tax team was not the only one hard at work in early 2019. After appointing a new Chair, the Code of Conduct Group started reviewing the potentially harmful tax measures notified by Member States in 2019 and late 2018. Its remit has become broader than ever, including, inter alia, anti-abuse measures and transparency (information exchange) in the area of transfer pricing.[399] The work of the Primarolo group remains as topical as ever, with academics lamenting that 'the digital and dematerialised economies have fostered

[396] ibid.

[397] Henk Van Arendonk, '2019: A Landmark Year For European Cooperation, or Maybe Not?!' (2019) EC Tax Review 68, 69.

[398] Edoardo Traversa, 'Ongoing Tax Reforms at the EU Level: Why Trust Matters' (2019) 47 Intertax 244.

[399] Council Press Release, (February 5 2019), available at <https://www.consilium.europa.eu/en/press/press-releases/2019/02/05/code-of-conduct-on-business-taxation-new-chair-of-the-council-working-group/> accessed 28 April 2020.

harmful tax competition among states, and the latter has in turn incentivized aggressive tax planning.'[400]

A recent addition to its workload have been its recommendations to the ECOFIN Council on the content of the EU's black tax list, i.e. the EU list of non-cooperative jurisdictions for tax purposes. The most recent update of the list took place on March 12th 2019. The Commission conceived the idea underpinning the list in order to tackle tax abuse and unfair tax competition between the narrow border of the EU. After Member States agreed to its adoption in December 2019, the Commission assessed almost 100 countries and blacklisted fifteen, while over 100 harmful regimes were eliminated.[401] The list has therefore been branded 'a true European success' with a 'resounding effect on tax transparency and fairness worldwide'.[402]

The European Parliament, in its final TAXE 3 Report, published in late March 2019, acknowledged the importance of the commitments received in the context of the EU listing process, but regretted the 'opaque nature of the negotiations regarding the [process]' and called on Member States to ensure transparency in future revisions to the list.[403] Among other recommendations, the

[400] Ana Paula Dourado, 'In Search of an International Tax System in a Post-BEPS Tax Competition Setting' (2019) 47 Intertax 2, 5.

[401] Commission Press Release, IP/19/1606 (March 12 2019), available at < http://europa.eu/rapid/press-release_IP-19-1606_en.htm> accessed 30 April 2020.

[402] ibid.

[403] European Parliament, 'Resolution of 26 March 2019 on Financial Crimes, Tax Evasion and Tax Avoidance' (2018/2121 (INI)), paras 411-412.

Parliament re-emphasised the need to update the mandate of the Code of Conduct group[404] and to bring it under 'a framework which enables democratic control or supervision', since the Group 'addresses matters beyond the assessment of harmful EU tax practices'.[405] Finally, the Commission's ambitious launch of an offensive against the unanimity requirement in tax matters was, unsurprisingly, warmly endorsed by the European Parliament, given that it would, if successful, increase its prominence in a field where it lacks real clout.[406] Work on these issues in still ongoing.

[404] It has therefore rightly been noted by academics that 'it would be an illusion to think that the topic of harmful tax competition can be removed from the political agenda.' See Cees Peters, 'Tax Policy Convergence and EU Fiscal State Aid Control: In Search of Rationality' (2019) EC Tax Review 6, 7.

[405] European Parliament, 'Resolution of 26 March 2019 on Financial Crimes, Tax Evasion and Tax Avoidance' (2018/2121 (INI)), para 417.

[406] ibid, para 427.

CHAPTER 3: The First Fiscal State Aid Wave: Background and Common Threads

In this chapter we will examine how the Commission started using state aid law as a tool against harmful tax competition in the early 2000s. In Part A of this chapter the Commission's practice will be scrutinised, mainly by focusing on five key Commission decisions and presenting their factual and legal background, in order to demonstrate how effective state aid policy can be in this context. In Part B, the decisions' common threads will be identified and assessed. Finally, in Part C of this chapter, the landmark *Gibraltar* case will be used to argue that the evolution of the selectivity condition has had the effect of making it extremely difficult for Member States to enact or preserve harmful tax measures.

Introduction

As already discussed in Chapter 2, the Code of Conduct, on which EU Member States agreed in late 1997, made clear mention of the possible application of state aid rules to harmful tax practices. More specifically, the Council acknowledged that, in drafting the Code, it took into account the Commission's undertaking on fiscal state aid. Moreover, the Council noted that tax measures covered by the Code of Conduct could also fall within the scope of the Treaty's state aid rules, and that the Commission had committed itself to their strict application, taking into account the negative effects of aid brought to light in the application of the Code. Lastly, it 'warned' that the Commission would in fact examine tax arrangements and propose national legislation on a case-by-case basis, thus ensuring that the state aid prohibition was applied consistently and equally to all States.

The Commission didn't disappoint. Firstly, in late 1998, true to its commitment, the Commission set out in detail its approach to the control of fiscal state aid by publishing the Notice on the application of state aid rules to direct taxation measures. [1] Secondly, following the instructions of Competition Commissioner Mario Monti, the Commission's services scrutinised the most important cases identified by the Code of Conduct (or 'Primarolo') group, in order to observe the Commission's undertaking regarding its fight against harmful tax competition. To this end, on July 11 2001, the Commission initiated fifteen state aid procedures in relation to special corporation taxation regimes in twelve Member States. These measures were mainly related to special tax advantages granted to multinational groups of companies, and to companies active in the insurance and financial sectors.[2] In eleven of these procedures, concerning eight Member States, the Commission decided to open formal state aid investigations,[3] with the purpose of determining whether the regimes in question amounted to illegal operating aid. These investigations generated a lot of litigation, the most important of which is analysed below, along with more recent cases.

[1] Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ 1998, C 384/03. For a brief analysis of this Notice, see Chapter 2 Part C.

[2] Mario Monti, 'EU Policy Towards Fiscal State Aid' (Seminar on State Aid and Tax, Netherlands, 22 January 2002) < http://europa.eu/rapid/press-release_SPEECH-02-15_en.htm?locale=en > accessed 20 May 2014, p. 4.

[3] These Member States were: Germany, Spain, France, Ireland, Luxembourg, The Netherlands, Finland and the UK. For more details see Commission Press Release, IP/01/982 (July 11 2001), available at <http://europa.eu/rapid/press-release_IP-01-982_en.htm> accessed 20 May 2014.

However, before going to the individual cases, it is important to take a look at the broader picture, and remember how state aid rules can be applicable in the first place. The classic paradigm of a state aid measure is one that grants selective advantages to domestic undertakings, helping them improve their standing in the internal market. On the contrary, the classic paradigm of a harmful measure is a measure that offers advantages to foreign economic agents, in order to attract them to the 'poaching' state. At first, this appears to be odd, since no domestic undertakings seem to be involved. However, the 'poaching' state seeks to strengthen its own economy, and in the end it is a domestic business - e.g. the domestic subsidiary of a foreign company - which benefits from the tax incentive offered at the expense of the tax revenue of the other Member State.[4] Thus, state aid law is applicable in this context, provided that all the state aid conditions are fulfilled.

In June 2014, Algirdas Šemeta, then Commissioner for Taxation, stressed that

> fair tax competition is essential for the integrity of the Single Market, for the fiscal sustainability of our Member States, and for a level-playing field between our businesses. Our social and economic model relies on it, so we must do all we can to defend it.[5]

The importance, for the Commission, of the fight against harmful ('unfair') tax competition is manifest. The spotlight now turns to its initial state aid actions

[4] Wolfgang Schön, 'Taxation and State Aid in the European Union' [1999] CMLR 911, p. 934-935.

[5] Commission Press Release, IP/14/663 (June 11 2014), available at <http://europa.eu/rapid/press-release_IP-14-663_en.htm> accessed 20 June 2014.

against it, and the then reactions of Member States and the European Court of Justice.

A) Factual and Legal Background

As mentioned *supra*, the significance, for the Commission, of the fight against harmful ("unfair") tax competition is evident. The focus now needs to turn to its initial state aid actions against it, and the then reactions of Member States and the European Court of Justice.

1. Belgian coordination centres

A coordination centre is an undertaking which belongs to a multinational group and provides services to other undertakings within this group. The Belgian tax regime for coordination centres had first come under scrutiny in 1984, when the Commission had decided to raise no objections.[6] However, true to its pledge in the Fiscal Aid Notice, and after the Primarolo Group classified the scheme as being harmful,[7] the Commission reexamined it and proposed that Belgium amend it. Following its refusal, the Commission opened a formal investigation procedure which resulted in a negative decision for Belgium. Still, the need to respect the recipients' legitimate expectations prevented the Commission from ordering the recovery of the aid. Instead of recovery, it ordered Belgium to phase out the scheme by late 2010 and not to renew the coordination centre status of such undertakings. As will be seen, the dispute finally reached the ECJ. Although it

[6] Commission Press Release, IP/03/242 (February 18 2003), available at <http://europa.eu/rapid/press-release_IP-03-242_en.htm#file.tmp_Ref_1> accessed 20 June 2014.

[7] Council of the European Union, 'Report from the Code of Conduct Group (Business Taxation)' (Report) SN 4901/99, pp. 30-31.

upheld the core of the Commission's decision, the ECJ partially annulled it as to its part that did not allow a transitional period for certain coordination centres.

The problem with this scheme was that any company fulfilling its criteria[8] could obtain coordination status through a renewable ten-year license. This meant, *inter alia,* that its taxable income would be determined according to the cost plus method. This is a transfer pricing method used to determine whether the conditions of controlled transactions are consistent with the arm's length principle,[9] and thus whether the taxable income is comparable to that which would have been obtained if the transactions had been carried out on a fully commercial basis between independent undertakings.[10] Although this method is not contrary to state aid rules *per se*, its practical application in this case gave rise to state aid.[11]

More specifically, according to the Primarolo Report, Belgian coordination centres were liable to corporate income tax at the normal rate (then 40.17%), but - instead of the actual profits as shown in their financial statements - only on a notional tax base determined as a percentage of certain operating costs incurred

[8] Commission Decision 2003/755/EC of 17 February 2003, Belgian Coordination Centres, OJ L 282, 30.10.2003, p. 25, para 13.

[9] See *OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Publications, 2010)*, paras 2.39-2.55.

[10] Paul Green, 'Coordination centres: the end of an era? Not quite ...' in Linsey Mc Callum & Nicola Pesaresi (eds), *Competition Policy Newsletter Number 2*, (European Commission 2003), 23.

[11] Commission Press Release, IP/03/242 (February 18 2003), available at <http://europa.eu/rapid/press-release_IP-03-242_en.htm#file.tmp_Ref_1> accessed 20 June 2014.

by them.[12] Belgium systematically used a mark-up rate of 8% without verifying whether it reflected economic reality. Moreover, significant operating costs were excluded, while these centres enjoyed additional tax advantages.[13] On the whole, this scheme reduced the centres' taxable profits and thus granted them a competitive advantage.

As regards the scheme's selective nature, the Commission in its decision noted that it resulted from the compulsory criteria which the centres and the groups to which they belonged needed to satisfy in order to benefit from the scheme. These criteria included, *inter alia,* the size and multinational character of the group (subsidiaries in at least four countries), and the nature of the activities carried out by it.[14] Furthermore, the Commission maintained that these criteria were not justified by the nature and or general structure of the scheme. There was no inherent reason why firms having subsidiaries in e.g. three countries could not perform activities in their head office and thus also benefit from the scheme.[15] The ECJ concurred, asserting that the scheme derogated from the ordinary Belgian tax regime, was restricted to groups with specific characteristics and was not shown to be justified by the Belgian authorities.[16] The Court's judgment marked the end

[12] Council of the European Union, 'Report from the Code of Conduct Group (Business Taxation)' (Report) SN 4901/99, p. 31.

[13] Commission Press Release, IP/03/242 (February 18 2003), available at <http://europa.eu/rapid/press-release_IP-03-242_en.htm#file.tmp_Ref_1> accessed 20 June 2014.

[14] Commission Decision 2003/755/EC of 17 February 2003, Belgian Coordination Centres, OJ L 282, 30.10.2003, p. 25, para 104.

[15] ibid, para 112.

[16] Joined Cases C-182/03 & C-217/03, *Belgium and Forum 187 ASBL v Commission* [2006] ECR I-5479, paras 119-126. This judgment's importance in the second – and ongoing – wave of fiscal

of a very successful (for Belgium) tax scheme: more than 200 multinational groups had established coordination centres in Belgium, through which dozens of billions of euros were channeled each year.[17]

2. The Dutch IFA scheme

The Dutch International Financing Activities (IFA) scheme, along with the Belgian coordination centres, were by far the most economically significant cases that the Commission examined in the early 2000s. The Belgian initiative had proven so successful in attracting major international corporations that other Member States decided to implement similar tax schemes in order to remain competitive, and the Netherlands was one of them.[18]

The scheme was initially adopted by the Dutch government in 1996. Under its provisions, multinational companies which were active in more than four countries or two continents could place up to 80% of their foreign-source financial profits in a tax-free reserve for up to 10 years. The scheme's beneficiaries, should they then decide to release funds from the reserve, could do so tax-free or at a reduced tax rate if they agreed to use them for certain objectives encouraged by

state aid cases cannot be overstated. See Chapter 4B of this thesis for an extensive analysis of all relevant issues.

[17] Paul Green, 'Coordination centres: the end of an era? Not quite ...' in Linsey Mc Callum & Nicola Pesaresi (eds), *Competition Policy Newsletter Number 2*, (European Commission 2003), 23.

[18] ibid, 23-24.

the scheme. Lastly, beneficiaries could also decide to put an end to the reserve, by releasing the funds at a reduced rate of 10% instead of the normal 34.5%.[19]

The scheme was found to be harmful under the Code of Conduct,[20] and the Commission opened a formal investigation procedure in July 2001. This resulted in a negative decision in 2003,[21] since the Commission found that the scheme constituted aid that had been granted in violation of Article 108 (3), and was furthermore incompatible with the internal market. More specifically, it decided that the tax exemption granted to profits placed in the reserves, along with the reduced tax rate applicable to funds released from them, constituted an advantage.[22]

The Commission then went on to demonstrate that this advantage was also selective. In relation to this assessment, it pointed out that the scheme was solely targeted at the financing activities of internationally active groups operating in at least four countries or on two continents, and only some of their transactions were eligible.[23] Furthermore, only financing operations which could be conducted independently from the Netherlands were eligible, and financial activities for

[19] Commission Press Release, IP/03/242 (February 18 2003), available at <http://europa.eu/rapid/press-release_IP-03-242_en.htm#file.tmp_Ref_1> accessed 20 June 2014.

[20] Council of the European Union, 'Report from the Code of Conduct Group (Business Taxation)' (Report) SN 4901/99, p. 65.

[21] Commission Decision 2003/515/EC of 17 February 2003, Netherlands International Financing Activities, OJ L 180, 18.07.2003, p. 52.

[22] ibid, paras 79-83.

[23] ibid, para 87.

Netherlands-based entities should be limited to 10% of total activities. These criteria confirmed the expressed aim of the Dutch authorities to reserve the scheme for internationally active groups whose financial centre was in the Netherlands, but which conducted financing activities chiefly focused on the group's entities abroad. As such, the measure was selective, if only because it did not apply to groups which were mainly based on Dutch territory or to multinationals with operations in fewer than four countries or two continents.[24]

The Commission also went on to reject the government's claim that the measure was justified by the nature or general scheme of the Dutch tax system. In this connection it noted that even if the reserve itself was justified by an accounting and a financial perspective, limiting it to certain categories of undertakings was not. Groups active in only three countries or on one continent were, in the Commission's view, no less exposed to the risks associated with international financing activities. Finally, the scheme's express aim was to encourage large multinationals to transfer their financing activities back to the Netherlands. This was an economic aim, not inherent in the taxation system, and thus not able to prevent the measure's classification as selective.[25]

Because of the previous positive Commission decision on the Belgian coordination centres in 1984 and the similarities of the two schemes, the beneficiaries of the Dutch IFA measure had legitimate expectations that the

[24] ibid, para 88.

[25] ibid, paras 93-95.

scheme did not constitute illegal aid at the time of its implementation. Therefore the Commission did not request recovery of the aid granted, but ordered it to phase it out by late 2010.[26] The Commission's decision marked the end of yet another successful harmful tax regime: eligible companies had placed dozens of billions in the tax-free reserves provided for by it.[27]

3. The Irish IFI scheme

The Irish Foreign Income scheme consisted of two separate measures: one for foreign dividends, the other for foreign branches' profits. According to the Commission's description of the Irish tax system, double taxation relief is normally given to companies via the credit system, under which Irish tax on doubly taxed income is reduced by the foreign tax incurred on that income. The tax credit can generally not exceed the amount of tax due in Ireland on that foreign income or gains.[28] However, under the Foreign Income scheme, relief was instead provided by exempting the foreign source income or gains from Irish corporation tax.[29]

The exemption for foreign dividends was introduced in 1988, under which dividends received by an Irish resident company from its foreign subsidiaries

[26] Pierpaolo Rossi-Maccanico, 'Commentary of State Aid Review of Multinational Tax Regimes' (2007) 6 European State Aid Law Quarterly 25, 33.

[27] Paul Green, 'Coordination centres: the end of an era? Not quite ...' in Linsey Mc Callum & Nicola Pesaresi (eds), *Competition Policy Newsletter Number 2*, (European Commission 2003), 23.

[28] Commission Decision 2003/601/EC of 17 February 2003, Ireland Foreign Income, OJ L 204, 13.08.2003, p. 51, para 6.

[29] ibid.

were exempted from corporation tax where those dividends were applied to an investment plan in Ireland.[30] In order to qualify for the exemption, a company had to submit an investment plan describing the investment proposed.[31] The Irish authorities could then classify the company as a 'qualifying company' if they were satisfied that the plan was directed at the creation of 'substantial new employment' in Ireland, and that the investment would not only be made but would also create jobs. This measure was found to be harmful under the Code of Conduct in 1999,[32] and the Commission went on to adopt a negative decision in 2003.

The Commission's selectivity analysis was extremely concise, taking up just one short paragraph. The impressive ease with which the Commission ticks the selectivity box is characteristic of many of its harmful fiscal aid decisions. However, being aware that this will usually be the major hurdle it will need to overcome in order to engage the state aid rules in any given case, the Commission is not afraid to sometimes delve into a more detailed selectivity assessment, as will be seen in the *Luxembourg* and *Gibraltar* cases *infra*. In the present case, the Commission simply stated that the beneficiaries of the measure were only the companies that had obtained an exemption certificate pursuant to the law's conditions, and that these conditions were 'very restrictive'.[33]

[30] ibid, para 7.

[31] ibid, para 11.

[32] Primarolo Report, p. 179.

[33] Commission Decision 2003/601/EC of 17 February 2003, Ireland Foreign Income, OJ L 204, 13.08.2003, p. 51, para 38.

Despite its incompatibility findings, the Commission concluded that, because of the similarities between this scheme and the Belgian coordination centres' scheme, the beneficiaries had legitimate reasons to believe that they did not fall foul of State aid rules. Accordingly, no reimbursement of the advantages that might have been received was sought.[34]

4. Luxembourg 1929 Holding companies

The 1929 holding companies scheme was enacted in 1929 in order to attract companies exclusively engaged in the management of shareholdings in other companies. According to the Primarolo Group's detailed description of the scheme, the 1929 holding companies were Luxembourg resident companies whose exclusive purpose was the acquisition of participations in other Luxembourg or foreign companies, and the management and development of these participations.[35]

Such companies were not allowed to pursue any commercial activity of their own, nor to do business with the public or accept any commissions, fees or similar remuneration.[36] They were, however, entitled to great tax benefits, since they were only subject to capital contribution tax at a rate of 1% and subscription

[34] Commission Press Release, IP/03/242 (February 18 2003), available at <http://europa.eu/rapid/press-release_IP-03-242_en.htm#file.tmp_Ref_1> accessed 20 June 2014.

[35] Primarolo Report, p. 47.

[36] ibid.

duty at a rate of 0.2% of the paid up value of the shares. Moreover, they were not subject to any other taxes, at a time when the normal corporate tax rate, including municipal business tax, was approximately 37.45%.[37] This measure was found to be harmful under the Code of Conduct in 1999, and the Commission went on to adopt a negative decision in 2006.[38]

The Commission's selectivity analysis was unusually extensive, taking up twelve paragraphs.[39] Luxembourg had cleverly argued that the scheme was not selective because 'all undertakings in comparable situations, i.e. those carrying on exclusively the activities of managing and maximising the value of participations held in controlled companies and of receiving income derived from those activities' could benefit from it.[40] The Commission did not agree that this was the suitable point of reference. It considered that what should be taken into consideration for comparison purposes were 'companies receiving *income comparable* to that of exempt 1929 holding companies.'[41] It then noted that, among these companies, only the exempt 1929 holding companies were completely exempted from tax on all the income they received, irrespective of any tax already borne upstream on their income by companies in which they held a participation.[42]

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[37] ibid.

[38] Commission Decision 2006/940/EC of 19 July 2006 on State Aid C 3/2006, Luxembourg 1929 exempt holding companies, OJ L 366, 21.12.2006, p.47.

[39] ibid, paras 72-83.

[40] Ibid, para 72.

[41] Ibid, para 73 [emphasis added].

[42] Ibid.

After these findings, the Commission inevitably concluded that such an exemption scheme was selective since it favoured certain undertakings carrying on exclusively certain activities among the various comparable undertakings.[43] The importance of defining the relevant reference framework is evident; in fact, in this case it was decisive. Had Luxembourg's suggested framework been accepted, the measure would not even have been *prima facie* selective. After concluding that it actually was *prima facie* selective, the Commission went on to find that Luxembourg had not managed to show that the measure was justified by the internal logic of the tax system, since its only aim was to place the limited number of beneficiaries at an advantage compared with their competitors.[44]

Because of the long and uninterrupted application of the scheme since 1929, its beneficiaries had legitimate expectations that the status quo would not change from one day to the next, a change that could also seriously damage the Duchy's employment and economic growth.[45] Therefore, the Commission did not demand that the regime be immediately abolished, but granted a transitional period for existing beneficiaries, ending in late 2010.[46] The Commission's decision marked the end of a very successful harmful tax regime: 13.000 exempt 1929

[43] ibid, para 74.

[44] ibid, paras 75 & 82.

[45] ibid, paras 110-112.

[46] ibid, para 113.

holding companies were active in Luxembourg at the time of the decision, contributing greatly to the Duchy's attractiveness as a global financial centre.[47]

5. Gibraltar Corporation Tax Reform

In August 2002 the UK notified the Commission of Gibraltar's plan to implement a general corporation tax reform. Interestingly enough, the stated aim of the new regime was to replace the Qualifying and Exempt Companies schemes which had been found to involve incompatible state aid, and to deliver compliance with the EU Code of Conduct and 1998 OECD Report on harmful tax competition.[48] The reform introduced three taxes applicable to all Gibraltar companies, namely a payroll tax, a business property occupation tax (BPOT), and a registration fee. Liability to the first two taxes was capped at 15% of profits.

After receiving the notification, the Commission opened a formal investigation procedure which resulted in a negative decision. The Commission's assessment was devastating: the reform was "infected" with all kinds of selective advantages. To begin with, it was materially selective in three ways. First, it favoured companies which made no profit. Secondly, the 15% cap favoured companies which had profits that were low in relation to their number of employees and size of premises. Thirdly, the payroll tax and the BPOT favoured offshore companies, since these companies usually have no employees and don't

[47] ibid, para 112.

[48] Commission Decision 2005/261/EC of 30 March 2004, Gibraltar Corporation Tax Reform, OJ L 85, 02.4.2005, p. 1, para 5.

occupy any business premises. Moreover, the tax reform was found to be regionally selective because it resulted in a lower level of taxation for Gibraltar companies in comparison to UK companies outside Gibraltar.

Both the UK and Gibraltar sought to annul the decision, and their wish was granted by the General Court in late 2008.[49] The General Court held that the Commission had not followed the correct method in examining material selectivity, and had deviated from both its Fiscal Aid Notice and the Courts' case law. It noted that the Commission had not identified Gibraltar's common or normal tax regime, and that it had failed to determine whether the various taxation criteria were capable of constituting the 'normal' tax regime in their own right.[50] The Commission's defeat was complete when its finding on regional selectivity was also quashed, since the General Court decided that the three *Azores* criteria were fulfilled in Gibraltar's case.[51]

Both Spain and the Commission lodged appeals before the ECJ. Advocate General Jääskinen proposed that they be rejected, but the ECJ found that the General Court had committed an error of law as regards its dicta on the selective nature of the advantages accruing to offshore companies. Criticizing the lower court's formalistic approach, it held that a functional approach to selectivity led to the conclusion that the purposeful adoption of the taxation criteria achieved the

[49] Case T-211/04, *Gibraltar v Commission* [2008] ECR II-3745.

[50] ibid, paras 170-173.

[51] ibid, paras 114-116.

same result as the derogation that the GC was passionately looking for. *De facto* material selectivity was thus found to exist, and the ECJ did not need to examine the scheme's regional selectivity.

The ECJ's selectivity analysis is highly innovative and interesting, and will be analysed in Part C *infra*, where it will be argued that it has made it particularly difficult for states to indulge in harmful tax competition. However, before discussing selectivity, the decisions' common threads will be identified and assessed, since, apart from their link to harmful tax competition, they also share other interesting similarities.

B) Common Threads

For the purposes of this thesis, the most important common thread binding the cases of the first fiscal state aid wave is, doubtlessly, their link to the EU's fight against harmful tax competition. Following the publication of the Primarolo Report and the identification of sixty-six tax regimes as falling under the definition of a "harmful tax measure", Competition Commissioner Mario Monti initiated several fiscal state aid investigations into certain of these measures, as already mentioned in this chapter's introduction. This common thread, however, i.e. the purported connection of both the first and second fiscal aid waves to harmful tax competition, constitutes one of the main arguments of this thesis and is thus carefully analysed and substantiated in the final chapter of this thesis (Chapter 5).

Certain other intriguing similarities between the cases of the first wave exist, however, and they merit careful examination here. These similarities become more patent when juxtaposed with the cases of the second wave, which are discussed in the next chapter. For this reason, some parallels will already be drawn in this section.

To begin with, the main similarity shared by the cases of the wave of the early 2000s is that they concerned tax regimes, i.e. (in state aid jargon) aid schemes. None of the cases of that wave was about individual tax rulings or any other other form of individual fiscal state aid. As a consequence, no specific company was targeted and there was no need for the alleged aid beneficiaries to be "named and shamed" in press releases or other public fora. This is obviously

inextricably linked to the fact that the means mostly used by Member States during that era to engage in harmful tax competition were harmful *regimes* and not individual aid measures. Another reason is that it was easier and more convenient for the Commission to go after these more manifest infringements of the Code of Conduct than to endeavour to uncover secret tax deals between States and individual companies. Finally, tax regimes that constituted both prohibited fiscal state aid and harmful tax competition measures were (very reasonably) a priority for the Commission, since their distortive effect on both inter-company and inter-State competition was rather severe.

This initial similarity, namely the Commission's focus on aid schemes rather than individual aid measures, leads us to the identification of the second common thread, viz. the importance of the selectivity condition (and the relevant justification) in concluding that the measures fell within the ambit of Article 107 TFEU. Since the tax regimes under scrutiny benefitted certain companies sharing specific characteristics, e.g. offshore companies or multinationals' coordination centres, the Commission needed to justify why these measures were selective, pursuant to the three-step selectivity analysis and the *Adria Wien* comparability/derogation test. As will be seen in Part C of this chapter, where selectivity is more thoroughly considered, the Commission's selectivity analysis was not particularly detailed; at times it could even be characterised as perfunctory. Still, the litigation that ensued before the EU's Courts led to a series of landmark ECJ judgments that transformed our understanding of selectivity.[52]

[52] Especially the *Gibraltar* case; see Part C of this chapter.

A third common element that can very easily be identified is how strikingly laconic all the Commission decisions were. Despite their consequential nature, the decisions of the first wave were approximately fifteen pages long on average, with some decisions only covering nine pages, [53] despite including the States' arguments and the measures' description alongside the state aid analysis per se. This is in line with the general trend during the early 2000s, when the Commission's decisions were not particularly long, but it still needs to be noted for two reasons. One, this speaks volumes about the perceived standards of fiscal state aid analysis, which the Commission did not consider to be high, and about the relevant justifications' rigour (or lack thereof). Second, it can be sharply contrasted with the length of the decisions of the second wave, that were more than ten times longer, frequently exceeding one hundred pages in length. In the fifteen years separating the two waves, a century had passed in terms of fiscal state aid case law, and our understanding of the limits of Article 107 TFEU, albeit always elusive, was more complete.

The fourth common thread which can be spotted is that, in the cases of the first fiscal state aid wave, the recovery of state aid was, as a general rule, not ordered. The reason cited by the Commission, for regimes that were not found to be existing aid, was the protection of beneficiaries' legitimate expectations, mainly due to the fact that most regimes shared similarities with the Belgian coordination centres regime, which the Commission had in effect "cleared" in the 1980s. The

[53] Commission Decision 2003/438/EC of 16 October 2002 on State aid C 50/2001, Luxembourg Finance Companies, OJ L 153, 20.6.2003, p. 40; Commission Decision 2003/501/EC of 16 October 2002 on State aid C 49/2001, Luxembourg Coordination centres, OJ L 170, 9.7.2003, p. 20.

"legalistic" reasons underpinning the non-imposition of a recovery obligation were clear, and were firmly based on ECJ case law and the Procedural Regulation, as acknowledged by the Commission in its relevant decisions. However, there are extra-legal reasons behind such a decision, both political and strategic, which are not only worth mentioning, but also keeping in mind when we take stock of the Commission's more pugnacious approach to recovery in the second fiscal wave.

First, one reason militating against recovery was that the Commission was not interested in "punishing" Member States or beneficiaries for past transgressions. Rather, the goal was to change the status quo prospectively, i.e. to "convince" Member States that they should alter their approach to tax incentives. Most of the regimes under scrutiny were fairly long-standing and well-established, so the recovery of aid would cause massive disruption. Their future abolition was sufficient, since Member States needed the time to adjust their overall fiscal models and find state aid-compliant ways of attracting international capital. The recovery of aid, apart from the insurmountable legal obstacles it faced, was thus not *stricto sensu* necessary: the message had been sent, and the message was that the Code of Conduct did, to a large extent, have teeth. Should Member States consider it too…soft a form of soft law, the Union's state aid apparatus would come to its rescue.

Finally, in relation to recovery, a concluding remark is apposite. The reason why the Commission considered it legally problematic to order the recovery of aid was, in essence, that it acknowledged it had changed its own approach to the assessment of this kind of measures. It had originally cleared the Belgian

coordination centres regime in the 1980s, but at the dawn of the 21st century it had "refined" its views and reached a different conclusion. The commission openly admitted this and refrained from adopting a more combative stance. This is worlds apart from the Commission's approach in the second state aid wave, where it asserted that there is nothing new under the sun and that its controversial claim regarding the existence of an arm's length principle in primary EU law is not novel. It is no wonder that the Commission had thus ordered the recovery of aid in all cases where the latter had been found to exist, with the recovery amounts sometimes reaching dizzying heights.[54]

Given that we have now raised the issue of the EU law ALP, it is worth discussing another thread binding the cases of the first wave. Although most of them concerned tax regimes favouring multinational companies and dealing with intra-group transaction, the Commission did not invoke any general principle of EU state aid law encompassing the ALP, let alone a general principle of equality in taxation from which the ALP emanates.[55]

A final common thread that could, perhaps, be spotted is that the cases of the first wave had few repercussions outside the EU. In a sense, the first wave was more about the EU "tidying up" its house, rather than championing an international approach to taxation. The intra-EU beggar-thy-neighbour policy had

[54] In Chapter 4 of this thesis the Commission's second wave cases will be discussed and the author will endeavour to show that the Commission's legal approach is not persuasive.

[55] The question of what exactly the Commission and the ECJ decided in the Belgian coordination centres saga will be analysed in Chapter 4 of this thesis, where it will be argued, inter alia, that they did not support the existence of an EU Law ALP but, at most, referred to the OECD's soft law ALP because it was part of the national (Belgian) legal counterfactual.

exceeded tolerable limits and the Commission took decisive action to eliminate the most "odious" forms of harmful tax competition, thus sending a clear signal to all Member States. Therefore, the first fiscal state aid wave appears to be more "internal" than the second fiscal state aid wave, where the involvement of high-profile American multinationals led to a transatlantic spat between the EU and the US.

Having examined the common threads between the cases of the first wave, it is now appropriate to focus on the Commission's selectivity analysis as presented in these cases, and on the broader doctrinal significance thereof.

C) Selectivity and harmful tax competition

As stated in the introduction, one of the aims of this thesis is to show that state aid policy is a necessary tool in the EU's fight against harmful tax competition, albeit not always a sufficient or even suitable one.

Without the support of the state aid rules, the Code of Conduct would lack the teeth it desperately needed. Before the energetic efforts of Commissioner Monti proved successful in tackling harmful tax practices that also infringed Article 107, academics were adamant that the Code had 'not passed its test as an effective tool against unfair competition practices.' [56] It was the strict application of the Treaty's rules that forced Member States in 2003 to agree to rollback the measures found to be harmful by the Primarolo Group in its 1999 Report.[57]

Still, despite their effectiveness, state aid rules cannot eradicate all harmful tax measures. One reason lies in their inherent limitation, enshrined in the Treaty's wording: the selectivity condition. Harmful tax measures that apply to all undertakings in a state will be considered general measures, and escape the Commission's state aid scrutiny. This was the case, for instance, with Malta's 'International Trading Companies' and 'Companies with Foreign Income'

[56] See e.g. Wolfgang Schön, 'Taxation and State Aid in the European Union' [1999] CMLR 911, p. 936.

[57] Commission Press Release, IP/03/242 (February 18 2003), available at <http://europa.eu/rapid/press-release_IP-03-242_en.htm#file.tmp_Ref_1> accessed 20 May 2019.

scheme.[58] In such cases Article 107 TFEU reaches its limits – its scope will not suffice.

However, let us now move the focus to the second argument presented in this chapter's introduction. The decisions of the CJEU and the European Commission have had the effect of making state aid rules more effective by weakening their impediment, i.e. the selectivity condition. I will argue that the evolution of the selectivity condition in the ECJ's jurisprudence, and especially in the landmark *Gibraltar* case, has had the effect of making it extremely difficult for states to enact or preserve harmful tax measures.[59] I will also go a step further and argue that the ECJ was legitimized to interpret selectivity in such a way, and that, in casu, it cannot be accused of a kind of judicial activism that tramples Member States' fiscal sovereignty.[60]

I will use the *Gibraltar* judgment to prove this point because the four documents related to it - the Commission decision, the General Court ruling, AG Jääskinen opinion, and the ECJ's judgment - demonstrate the broad thematic tensions more vividly than any other previous case.[61] I will also argue that the

[58] Commission, 'Tax Incentives in favour of 'international Trading Companies' and 'Companies with Foreign Income' ' COM (2006) 810 final.

[59] Giving shape to the scope of Article 107 TFEU in such a manner certainly went some way to "remedying" the Treaties' tight restrictions (limited competence and unanimity) on legislative competence on tax matters.

[60] For a masterful and incisive analysis of, inter alia, the *Gibraltar* ruling, see Conor Quigley, 'Direct Taxation and State Aid: Recent Developments Concerning the Notion of Selectivity' [2012] 40 Intertax 112.

[61] Even though the Gibraltar tax reform of 2002 was not actually found to be harmful by the Code of Conduct Group: see ECOFIN Conclusions of 3 June 2003.

other seminal selectivity case of the past decade, namely the *Azores* case, essentially paved the way for the Gibraltar judgment. In effect, these two decisions make it more difficult for Member States to indulge in harmful tax competition, through either regionally or materially selective schemes. Intentionally or not, the Court gave a clear signal that state aid rules are an effective net for harmful tax competition practices, even the cleverly designed ones.[62]

1. The Commission's Decision

The spark that lit up the entire *Gibraltar* saga started in late March 2004. The Commission adopted a negative decision in relation to Gibraltar's proposed tax reform, declaring it incompatible with the internal market. The analysis here will focus on the third prong of the Commission's finding on material selectivity, since it is the only one that survived the ECJ's scrutiny and decided the final outcome.

The Commission, in essence, considered the reform materially selective because the BPOT and the payroll tax inherently favoured offshore companies, which tend to have no physical presence in Gibraltar.[63] The rationale behind its conclusion was based on a combination of two factors. The first was that the two taxes applied in the absence of a general system of taxation of company profits; in fact, they replaced such a system.[64] The second was the peculiar nature of

[62] Please note here that my argument only refers to the effects of Commission and ECJ decisions, and not to the intentions of the people (lawyers, judges etc.) taking these decisions.

[63] Commission Decision 2005/261/EC of 30 March 2004, Gibraltar Corporation Tax Reform, OJ L 85, 02.4.2005, p. 1, para 150.

[64] ibid, para 143.

Gibraltar's economy, i.e. the existence of a large offshore sector with no real presence in Gibraltar. The combination of these two factors had the effect of turning what at first seemed like a *de jure* general measure to a *de facto* selective one, favouring offshore companies with no employees or property.[65] The fact that corporate taxation was exclusively based on these two factors, and that the two taxes were not added on top of a general profit tax but replaced it, precluded the reform from being a general measure.[66] General measures, as defined in paragraph 13 of the Fiscal Aid Notice, are only those 'effectively open to all firms on an equal access' that are 'not de facto reduced in scope through [...] factors that restrict their practical effect'. The effect of the reform was, in the Commission's view, the preservation of the offshore companies' privileged position of zero taxation.[67]

The Commission then went on to support its views with hard data, which showed that most Gibraltar companies had no income and thus paid no tax at all, while almost 90% of companies with income would remain exempt from tax under the reform's provisions.[68] This data proved, in the Commission's view, that although the formal distinction between offshore and onshore companies would have been abolished, the regime would remain inherently selective in the former's

[65] ibid.

[66] ibid.

[67] ibid, para 150.

[68] ibid, Table 1.

favour.[69] The analysis of the system as a whole led the Commission to the conclusion that it was materially selective.

2. The General Court's judgment

The General Court disagreed with the Commission's conclusion.[70] As regards the third prong of the latter's material selectivity analysis, the Court noted that it was vitiated by an error of law. The 'anchor' for the Court's attack against the Commission's decision was paragraph 16 of the Fiscal Aid Notice, which until then reflected the orthodox approach to tax measures' selectivity.

This paragraph states that 'the main criterion in applying Article [107 (1) TFEU] to a tax measure is [...] that the measure provides in favour of certain undertakings in the Member States an exception to the application of the tax system. The common system applicable should thus first be determined.' If the Commission deviated from this approach, it would 'go beyond the limits of [its] review' and 'assume the role of the Member State with regard to determination of that State's tax system and the common or 'normal' regime under it'.[71] In the Court's opinion, the Commission did not adhere to these principles, neither in general nor as regards the assessment of the payroll tax and the BPOT.

[69] ibid, para 148.

[70] Case T-211/04, *Gibraltar v Commission* EU:T:2008:595.

[71] ibid, para 145.

More specifically, the Commission did not follow any stage of the analysis relating to the determination of selectivity, failing, first, to identify and examine the common or 'normal' tax regime from which those two taxes might derogate and, second, to demonstrate that they constituted derogations. This also made it impossible to assess any justification for the alleged derogations on the basis of the nature or general scheme of the tax system.[72]

In the Court's view, the Commission did not successfully rebut the argument that the requirement that a company must make a profit is inherent in the logic of a system of taxation based on staff numbers and the use of occupied land, since it corresponds to a fundamental objective of that system, namely that of not taxing companies that are not profitable.[73] The 'hybrid' and 'inherently selective' etiquettes that the Commission put on the tax reform would not suffice, especially in the absence of a harmonised standard relating to what constitutes the 'common' or 'normal' regime under a national tax system.[74]

Any further argument by the Commission was doomed to fail since it had not observed the three-stage test laid out in its Notice. Any deviation from this test automatically led it beyond the limits of its power of review, and its decision was annulled in its entirety.[75] It is evident that the Court was very focused on the form

[72] ibid, para 173.

[73] ibid, para 177.

[74] ibid, para 179.

[75] ibid, paras 185-189.

of the test and dismissed all arguments pointing to the aims behind the reform and - most importantly – to its effects. The triumph of clever design was complete, albeit short-lived.

3. The ECJ judgment, its effects, and the Azores prelude

Advocate General Jääskinen in his opinion warned that if the appeals against the General Court's (hereinafter 'GC') ruling were successful, this would amount to a 'methodological revolution'.[76] Still, on November 15 2011, a revolution took place in the otherwise quiet Duchy of Luxembourg. It was not bloody, but it was certainly controversial.

In what is arguably the most important selectivity-related ruling[77] of the past decade, the ECJ decided that the GC's finding that no selective advantages accrued to offshore companies under the proposed reform was vitiated by an error of law.[78] The ECJ started off by repeating one of its most famous dicta: Article 107 'does not distinguish between measures of State intervention by reference to their causes or their aims but defines them in relation to their effects, and thus independently of the techniques used.'[79]

[76] Joined Cases C-106/09P and C-107/09P, *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] EU:C:2011:732, Opinion of AG Jääskinen, para 202.

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

[78] ibid, para 86.

[79] ibid, para 87.

It then went on to find the GC's approach was not consonant with this principle, since it was based solely on a regard for the regulatory technique used by the proposed tax reform. This did not allow the effects of the tax measure in question to be considered, and excluded from the outset any possibility that the lack of tax liability for offshore companies could be classified as a selective advantage.[80]

The ECJ asserted that its previous case law did not make the classification of a tax system as selective 'conditional upon that system being designed in such a way that undertakings which might enjoy a selective advantage are, in general, liable to the same tax burden as other undertakings but benefit from derogating provisions'.[81] Had this been the case, tax measures would only fall within the ambit of Article 107 if they were designed in accordance with a certain regulatory technique. The consequence of this would be that national tax rules would 'fall from the outset outside the scope of control of State aid merely because they were adopted under a different regulatory technique, although they produce the same effects in law and/or in fact.'[82] This was the case with the proposed tax reform, which achieved the same result as a derogation 'by adjusting and combining the tax rules in such a way that their very application result[ed] in a different tax burden for different undertakings.'[83]

[80] ibid, para 88.

[81] ibid, para 91.

[82] ibid, para 92.

[83] ibid, para 93.

The ECJ went on to stress that the GC would have discerned the measure's selective nature if it had assessed it as a whole. The two bases of assessment and the cap on profits, even though generally applicable *per se*, became *de facto* selective when combined, because they discriminated 'between companies which [were] in a comparable situation with regard to the objective of the proposed tax reform, namely to introduce a general system of taxation for all companies established in Gibraltar.'[84] Offshore companies were exempted from taxation *ab initio*, since they had no physical presence in Gibraltar.[85]

The Court then went on to add an important dictum to its previous case law, which had established that 'a different tax burden resulting from the application of a 'general' tax regime is not sufficient on its own to establish the selectivity of taxation for the purposes of Article [107 (1) TFEU].' [86] More specifically, the Court asserted that, in order to be selective, the application criteria of a tax measure must not only result in a different tax burden, but also 'be such as to characterise the recipient undertakings, by virtue of the properties which are specific to them, as a privileged category'.[87] Offshore companies were, due to their lack of physical presence, characterized as such under the reform,

[84] ibid, para 101.

[85] ibid, para 102.

[86] ibid, para 103.

[87] ibid, para 104.

making the latter *de facto* materially selective. The ECJ therefore annulled the GC's judgment[88] and found that the proposed reform amounted to state aid.

It is evident that the ECJ extended the scope of the selectivity condition by introducing 'privileged category' cases, where non-differential provisions, leading to different tax burdens, can be considered selective. It also set the only example we have of such 'privileged undertakings' for now, namely offshore companies. The implications for the fight against harmful tax competition are immense. After this ruling, state aid rules have become a much more effective weapon in this fight, and Member States' cannot safely hide behind intelligently designed measures.

As one author put it, the

> hard law prohibition of state aids has […] achieved with the Gibraltar judgment an equivalent level of protection of free competition in this area to the one that, before such judgment, only the soft law approach could reach through 'voluntary' compliance. From this perspective, the Gibraltar judgment starts the completion of a cycle that had its soft start with the project on harmful tax competition in the 1990s.[89]

The judgment truly amounts to 'a red card to any form of selective tax competition, with the Court declaring that it has its eyes wide open to this phenomenon and that will use every (and any!) weapon in its arsenal.'[90]

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[88] ibid, para 109.

[89] Pasquale Pistone, 'Smart Tax Competition and the Geographical Boundaries of Taxing Jurisdictions: Countering Selective Advantages Amidst Disparities' (2012) 40 Intertax 85, 87.

[90] Cristina Romariz, 'Revisiting Material Selectivity in EU State Aid Law – Or 'The Ghost of Yet-To-Come'' [2014] EStAL 39, 45.

In my view, the *Gibraltar* judgment did not come out of the blue. Unexpectedly enough, I think that the *Azores* ruling bore the seed of Gibraltar in it. This at first sounds peculiar since, crudely speaking, the latter is a state-friendly case, while the former is the exact opposite. Still, the *Azores* judgment was the first to land a major blow on the Commission's Fiscal Aid Notice, by disputing its assumption that only one 'common' or 'normal' tax regime can exist in a Member State. More specifically, it showed that more than one regime can legitimately coexist in parallel. Thus, a derogation is not sufficient to conclude that a certain regime is *prima facie* selective. The *Azores* contribution here lies in the fact that the Fiscal Aid Notice was no longer to be revered as good law in its entirety. By challenging the (now repealed) Notice's content, and thus making an amendment of paragraphs 16 and 17 necessary, the *Azores* ruling opened the door for further challenges.

The *Gibraltar* attack to the rule/derogation approach of the Notice came from the opposite direction: the finding of a 'classic' derogation is not always necessary. A measure can be selective even if neither a common system nor a derogation from it can be identified, as long as its effects are equivalent to a derogation. This was the *coup de grâce* for the Fiscal Aid Notice, which has now been replaced by the 2016 Final Notice on the Notion of Aid.

Apart from bearing the seed of *Gibraltar*, the *Azores* judgment's fiscal autonomy requirement was sufficiently strict to make it very difficult for infra-state bodies to indulge in harmful tax competition, since they ran the risk of impoverishing themselves due to the prohibition of any support from the local

government. Although it did allay some constitutional fears, the *Azores* judgment was not really a gift to the Member States. In fact, it might have actually been a Greek gift. According to the General Court, Gibraltar satisfied the three *Azores* criteria, and had the ECJ examined this aspect, it would almost certainly have concurred. If the Gibraltar tax reform were a harmful tax measure that had to be eliminated, regional selectivity would not do the trick; a reinvention of the Court's material selectivity case law was necessary. The three autonomy criteria were fashioned in a way that Gibraltar could satisfy them, and thus any blow to its reform could only come from an extension of the concept of material selectivity.

To conclude, the cases of the first fiscal state aid wave shared various similarities, other than their contribution to the EU's fight against harmful tax competition. They were the first cases where the Commission illustrated the potential of Article 107 TFEU in relation to harmful tax measures falling under the Code of Conduct on business taxation. However, they were not the Commission's last word. As will be seen in the next chapter, after a period of relative tranquility, the Commission opened a series of investigations into potentially harmful tax measures, mainly focusing on tax rulings and other types of tax arrangements put in place by multinational companies and accepted by Member States.

CHAPTER 4: The Second Fiscal State Aid Wave: Facts, Legal Assessment, and Common Threads

Introduction

In this chapter, the ongoing wave of fiscal State aid investigations is examined in depth.[1] Part A contains a detailed analysis of the factual and legal background of the three published Commission decisions in the investigations in the *Fiat*, *Starbucks* and *Belgian Excess Profit Ruling* cases. These three cases have been chosen because they are the only ones that had been decided by the EU's General Court at the time of writing. They were also the first ones to be concluded by the European Commission in late 2015 and early 2016. Interestingly enough, they concern both individual aid (*Fiat* & *Starbucks*) and (allegedly) aid schemes (*Belgian Excess Profit*), with all the corresponding differences as regards their selectivity analysis that this entails. In Part B1, the decisions' common threads are

[1] The Commission's approach, both in general and in connection with particular cases, has already been discussed in the academic literature. The purpose of this chapter is to place this discussion in a broader context, while at the same time analysing the similarities of the cases in detail, especially as regards their shared nexus to harmful tax competition and the Commission's "doctrinal pillars". As for the existing literature, see, most notably: Conor Quigley, *European State Aid Law and policy*, (3rd edn, Hart Publishing 2015), p. 107; Pierpaolo Rossi-Maccanico, 'Fiscal State Aids, Tax Base Erosion and Profit Shifting' (2015) 2 EC Tax Review 63; Anna Gunn and Joris Luts, 'Tax Rulings, APAs and State Aid: Legal Issues' (2015) 2 EC Tax Review 119; Raymond Luja, 'Will the EU's State Aid Regime Survive BEPS?' (2015) 3 British Tax Review 379; Michael Lang, 'Tax Rulings and State Aid Law' (2015) 3 British Tax Review 391; Wolfgang Schön, 'Tax Legislation and the Notion of Fiscal Aid - A Review of Five Years of European Jurisprudence' (2015) Max Planck Institute for Tax Law and Public Finance Working Paper; Richard Lyal, 'Transfer Pricing Rules and State Aid' (2015) 38 Fordham International Law Journal 1017; Dimitrios Kyriazis, 'Luxembourg, Amazon, and the State Aid Connection' (State Aid Hub Blog, 22nd January 2015) <http://stateaidhub.eu/blogs/stateaid/post/1205> accessed 30 June 2019; Shafi U Khan Niazi, 'An Account of recent activity of the European Commission on applying state aid rules to income taxes: In retrospect and prospect' (2016) Monash Business School Working Paper No. 2016-03-01 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2740269> accessed 28 August 2019; Liza Lovdahl Gormsen, 'EU State Aid Law and Transfer Pricing: A Critical Introduction to a New Saga' (2016) Journal of European Competition Law & Practice; Dimitrios A Kyriazis, 'From Soft Law to Soft Law Through Hard Law: The Commission's Approach to the State Aid Assessment of Tax Rulings' (2016) 15(3) EStAL 428 and Conor Quigley QC, 'Tax Rulings and State Aid' (2016) Tax Journal 8.

identified and assessed. Particular emphasis is placed on the Commission's creative way of linking Article 107 TFEU to the arm's length principle. In Part B2, the General Court's judgments in the *Fiat* and *Starbucks* cases are examined.

The birth of the unfolding string of high profile investigations can be traced back to June 11th 2014, when the Commission decided to open three in-depth investigations into tax rulings issued by Ireland, Luxembourg and the Netherlands in relation to Apple, Fiat and Starbucks respectively.[2] On October 7th 2014, the Commission announced that it would also be examining whether the tax treatment of Amazon by Luxembourg was in line with EU state aid rules,[3] while in February 2015 it opened an investigation into the Belgian Excess Profit Tax Ruling System. [4] Finally, in December 2015 the Commission targeted the tax arrangements of McDonald's in Luxembourg[5] and in September 2016 it revealed that it would be scrutinizing the tax ruling Engie had received from Luxembourg.[6]

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[2] SA.38373 (2014/C) Alleged aid to Apple [2014] OJ C 3606 final, hereafter 'Apple Opening Decision'; SA.38375 (2014/C) Alleged aid to FFT [2014] OJ C 3627 final, hereafter 'Fiat Opening Decision'; SA.38374 (2014/C) Alleged aid to Starbucks [2014] OJ C 3626 final, hereafter 'Starbucks Opening Decision'. See also Commission Press Release, IP/14/663 (June 11 2014), available at <http://europa.eu/rapid/press-release_IP-14-663_en.htm> accessed 20 August 2019.

[3] SA.38944 (2014/C) Alleged aid to Amazon by way of a tax ruling [2014] OJ C 7156 final, hereafter 'Starbucks Opening Decision'. See also Commission Press Release, IP/14/1105 (October 7 2014), available at <http://europa.eu/rapid/press-release_IP-14-1105_en.htm?locale=en>accessed 20 August 2019.

[4] SA.37667 (2015/C) Belgium - Excess profit tax ruling system in Belgium – Art. 185§2 b) CIR92 [2015] OJ C 563 final, hereafter 'Belgian Excess Profit Opening Decision'. See also Commission Press Release, IP/15/4080 (February 3 2015), available at <http://europa.eu/rapid/press-release_IP-15-4080_en.htm> accessed 20 August 2019.

[5] SA.38945 (2015/C) Alleged aid to McDonald's [2016] OJ C 8343 final, hereafter 'McDonald's Opening Decision'. See also Commission Press Release, IP/15/6221 (December 3 2015), available at <http://europa.eu/rapid/press-release_IP-15-6221_en.htm > accessed 20 August 2019.

[6] Commission Press Release, IP/16/3085 (September 19 2016), available at <http://europa.eu/rapid/press-release_IP-16-3085_en.htm> accessed 20 September 2019.

More investigations have since been opened and most have already been concluded, including most notably the *Fiat*,[7] *Starbucks*,[8] *Belgian Excess Profit*[9] and *Apple*[10] investigations, all with the adoption of negative decisions. These decisions are the spearhead of the clampdown on "sweetheart" tax deals between Member States and big multinationals that former Competition Commissioner Almunia had in 2014 promised would ensure that they pay "their fair share of taxes".[11]

The Commission claims that up to a trillion euros in taxes are lost each year due to tax evasion and tax avoidance,[12] including aggressive tax planning by multinational corporations.[13] Within the EU, the European Parliamentary Research Service estimates that EUR 50-70 billions are lost to corporate tax avoidance each year.[14] In a crisis-hit European Union, such statements have attracted the attention of both the media and the public, thus forcing policy-makers to take action. Unsurprisingly, the Commission is not the only institution

[7] Commission Decision of 21 October 2015 on State Aid which Luxembourg Granted to Fiat, Case SA.38375 (2014/C ex 2014/NN), hereafter "Fiat".

[8] Commission Decision of 21 October 2015 on State Aid Implemented by the Netherlands to Starbucks, Case SA.38374 (2014/C ex 2014/NN), hereafter "Starbucks".

[9] Commission Decision of 11 January 2016 on the Excess Profit Exemption State Aid Scheme Implemented by Belgium, Case SA.37667 (2015/C) (ex 2015/NN), hereafter "Belgian Excess Profit".

[10] Commission Decision of 30 August 2016, Case SA.38373 (2014/C), hereafter "Apple Decision".

[11] Commission Press Release, IP/14/663 (June 11 2014), available at <http://europa.eu/rapid/press-release_IP-14-663_en.htm> accessed 20 June 2019.

[12] Two fundamentally different concepts, of course.

[13] European Parliament, 'Tax rulings: are member states unfairly helping multinationals to pay less tax?' (European Parliament News, 17th February 2015) <http://www.europarl.europa.eu/news/en/news-room/content/20150216STO24403/html/Tax-rulings-are-member-states-unfairly-helping-multinationals-to-pay-less-tax. > accessed 20 September 2019.

[14] European Commission, 'EU Competition Policy in Action' COM (2016), 12.

to become involved. On February 12th 2015, the European Parliament decided to conduct its own inquiry into tax rulings by setting up a special committee of 45 members. But what are tax rulings, and why have they attracted such vigorous State aid scrutiny?

Tax rulings, in essence, are "comfort letters" by tax authorities, giving a certain undertaking advance certainty on how its corporate tax bill will be calculated. As the Commission has kept stressing,[15] tax rulings are not problematic *per se*. Its initial legal approach, as encapsulated in its Draft Notice on the Notion of State Aid in early 2014, i.e. before the ongoing probes were launched, was rather rudimentary and clearly echoed[16] the Commission's original view from 1998: [17] rulings that merely interpret the tax provisions without deviating from relevant case law and administrative practice do not give rise to state aid. However, a ruling that 'departs from the general tax rules and benefits individual undertakings leads in principle to a presumption of State aid and must be analysed in detail.'[18]

[15] See, for example, Commission Press Release, IP/14/1105 (October 7 2014), available at <http://europa.eu/rapid/press-release_IP-14-1105_en.htm?locale=en>accessed 20 August 2019.

[16] For a masterful summary and analysis of the most important fiscal State aid judgments adopted before the publication of the Draft Notice see Conor Quigley, 'Direct Taxation and State Aid: Recent Developments Concerning the Notion of Selectivity' [2012] 40 Intertax 112.

[17] See Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ 1998, C 384/03, hereafter "1998 Fiscal Aid Notice", para 22.

[18] European Commission, 'Draft Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU' COM (2014), hereafter "Draft Notice", para 171.

As will be illustrated in Parts A and B of this chapter *infra*, the Commission's approach to the State aid assessment of tax rulings has changed since 2014, and is now much more creative (and convoluted). Interestingly enough, this novel approach, as set out in the *Fiat*, *Starbucks* and *Belgian Excess Profit* decisions, has now also been incorporated in the Commission's long-awaited Notice on the Notion of State Aid, intended to be its final (and authoritative) say on the definition of State aid.[19] However, as will be shown in Part B *infra*, the argumentative line underpinning this newly-presented position is far from bulletproof; in fact, to a certain extent, it is not as legally sound as the Commission claims.

Tax rulings can, in theory, benefit a particular company in numerous ways, one of which is by validating transfer pricing agreements, also known as advanced pricing agreements (APAs). An APA is a contract between a tax authority and a taxpayer stipulating the pricing method the latter will apply to its affiliated-company transactions when calculating its taxes. If this method is not agreed, or if it is misapplied, then a multinational can manipulate the prices of transactions between its subsidiaries, thus moving profits to low (or no) tax jurisdictions. In order to combat this form of tax avoidance, the most popular standard for setting commercial conditions between related companies is the "arm's length principle", as defined in Article 9 of the OECD Model Tax Convention, which requires that they do not differ from conditions between unrelated companies. Moreover, the OECD Transfer Pricing Guidelines provide five different

[19] European Commission, 'Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU' COM (2016), hereafter "Final Notice", paras 169-174.

methods of applying the arm's length principle to intra-group transactions. Both these documents are important because the Commission has retained them[20] as "guidance",[21] thus giving these soft law instruments a hard edge.[22]

Still, this is not the final soft law "complication" that the Commission's initiatives have highlighted. As will be shown in Chapter 5 of this thesis, these cases present potentially harmful tax competition elements, as the latter are defined in the EU Code of Conduct.[23] This finding serves to show that, for various reasons - including the unanimity requirement for tax-related legislation - the Commission remains undaunted in its use of the formidable state aid arsenal against harmful tax competition measures and practices.

[20] Conor Quigley, *European State Aid Law and policy*, (3rd edn, Hart Publishing 2015), p. 108 aptly notes that the Commission is using them as a "reference document".

[21] *Final Notice*, para 173.

[22] I have borrowed part of my analysis here from: Dimitrios Kyriazis, 'The Apple State Aid Investigation: Fiscal State Aid At Its Best' (European Law Blog, 15 October 2014) <http://europeanlawblog.eu/?p=2565> accessed 11 May 2019.

[23] Council Conclusions of the ECOFIN Council Meeting on 1 Dec 1997 concerning taxation policy, O.J. of 6 Jan 1998, C 2/01.

A) The Starbucks, Fiat and Belgian decisions: Factual and legal assessment

1. Starbucks and the Netherlands

On June 11th 2014, the European Commission notified the Netherlands of its decision[24] to open a State aid investigation in relation to the tax treatment of a member of the Starbucks corporate group by the Dutch tax authorities. After approximately 16 months, on October 21st 2015, the in-depth investigation was concluded with the adoption of a negative decision,[25] ordering the Netherlands to recover €20-€30 million from the alleged State aid beneficiary.[26]

1.1. The Starbucks Group

The Starbucks Group is composed of the mother company, Starbucks Corporation, and all the companies controlled by it. The Group is headquartered in Seattle, USA, and mainly operates as a roaster, marketer and retailer of specialty coffee. The Group's corporate structure, to the extent that it has been disclosed by the Commission in its decisions,[27] is fairly complex, but at the same time rather beautiful from a tax advisor's perspective.[28]

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[24] SA.38374 (2014/C) Alleged aid to Starbucks [2014] OJ C 3626 final, hereafter 'Starbucks Opening Decision".

[25] Commission Decision of 21 October 2015 on State Aid Implemented by the Netherlands to Starbucks, Case SA.38374 (2014/C ex 2014/NN), hereafter "Starbucks".

[26] Commission Press Release, IP/15/5880 (October 21 2015), available at <http://europa.eu/rapid/press-release_IP-15-5880_en.htm> accessed 20 August 2016.

[27] At many points in its final decision, the Commission refers the reader to its opening decision for more details, see e.g. *Starbucks*, para 38 fn 10.

[28] *Starbucks Opening Decision*, pp. 8-9, especially figure 1 on p. 9 that showcases this peculiar corporate mosaic.

Starbucks Corporation holds all shares in Starbucks Coffee International Inc., which in turn wholly (100%) owns two other US companies, namely SCI Europe I and SCI Europe II. These three companies are the partners of a so-called "closed" Dutch limited partnership, which the Commission chose to call CV1 based on its Dutch name. CV1, along with SCI Europe I and SCI Europe II, are the partners of another Dutch partnership of the same type, called CV2 by the Commission. CV2 owns the vast majority of shares (>95%) of Alki LP, a UK limited partnership. I implore the reader to be patient, because with Alki we are approaching the heart of the matter. Alki LP owns Starbucks Coffee EMEA BV (hereafter 'SCBV'), which in turn owns Starbucks Manufacturing EMEA BV (hereafter 'SMBV'). The latter, SMBV, is the protagonist of this investigation and the alleged aid beneficiary.

Before proceeding to examine SMBV's tax ruling and APA, it is helpful to briefly comment on the functions of Alki, SCBV and SMBV. Alki holds all IP for the Europe, Middle East and Africa region (EMEA region).[29] SCBV is the group's head office for the EMEA region. It holds certain Starbucks trademarks, the Starbucks shop format, *et alia*, in licence of its shareholder Alki, thus paying Alki a royalty.[30] SMBV, the alleged beneficiary, is a coffee-roasting house of great commercial significance to the group, since it is the only such Starbucks facility outside the USA. SMBV is supplied with green coffee beans by a Swiss subsidiary of the Starbucks group, which buys beans for the benefit of the whole "family".[31] SMBV

[29] ibid, para 27.

[30] ibid, para 22.

[31] ibid, para 23.

allegedly does not carry out sales activities itself. Most importantly, SMBV also licenses IP from Alki, in return for which it pays Alki (its owner's owner) a royalty.

Alki, as mentioned above, is controlled by CV2, which is in turn "controlled" by CV1, both partnerships being transparent under Dutch tax law. CVs are not taxed themselves but their participants, according to their share in the CV.[32] Alki LP, a UK limited partnership very similar to a Dutch CV, is also tax transparent under Dutch law. Consequently, a royalty payment from SMBV to Alki is considered a direct payment to the Starbucks group's US companies from a Dutch law perspective.[33]

1.2. The SMBV APA

In April 2008, the Dutch tax authorities concluded two APAs with SCBV and SMBV. Solely the SMBV APA was investigated by the Commission. However, the Commission made it clear in its opening decision that, once its SMBV investigation resulted in a final decision, it could scrutinize the SCBV APA as well, since its economic rationality 'is not straightforward'.[34] No such move has been reported yet.

[32] ibid, para 28.

[33] ibid.

[34] ibid, p. 39.

The SMBV APA is based on a transfer pricing report prepared by Starbucks' tax advisor, which was made available to the Commission. This report forms an integral part of the SMBV APA,[35] and its soundness is thus crucial to the latter's assessment. The transfer pricing method employed by the tax advisor – and accepted by the Netherlands – is the Transactional Net Margin Method (TNMM). According to the OECD Guidelines, the TNMM is based on comparisons of net profit indicators, e.g. the ratio of profit weighed to costs, between independent and related companies. This is done in order to estimate the profits that the company under scrutiny would have realized had it solely dealt with independent companies. To this item a mark-up is applied, which is considered "arm's length" to estimate the amount of taxable profit.[36]

When applying the TNMM in the SMBV APA, the tax advisor considered the relevant base for the net profit indicator to be the costs of the services rendered by SMBV.[37] SMBV's remuneration amounted to a figure which the Commission would not fully disclose, but was somewhere between 9% and 12% (mark-up rate) of the relevant cost base.[38] However, and this is important, this mark-up was not calculated on the basis of the whole SMBV cost base, but only on the costs for which SMBV performed a "a value added role."[39] What does this mean in practice? When is value added? In general, this occurs when a company takes a generic

[35] ibid, para 32.

[36] ibid, para 15.

[37] ibid, para 41.

[38] ibid, para 31.

[39] ibid, para 42.

product that does not greatly differ from competitors' products and adds a characteristic that gives it a greater sense of value.[40]

In the SMBV APA, this meant that certain costs were excluded from the costs on the basis of which SMBV's remuneration was calculated. More specifically, *inter alia,* the costs of green coffee beans, certain logistics and distribution costs and the royalty payments to Alki were excluded from the cost base. As regards the latter, the Dutch tax authorities further accepted that the level of the royalty payment to Alki would be determined as the difference between SMBV's operating profit and its aforementioned remuneration. Furthermore, this (very substantial) royalty payment would be fully tax deductible.[41]

It is obvious that this arrangement, which the Dutch authorities approved via the SMBV tax ruling,[42] greatly reduced SMBV's corporate tax bill. This was because SMBV's remuneration, and thus profits, were "tied" to its cost base, and the tax ruling accepted the smaller cost base that SMBV's tax advisor had proposed, while allowing the remaining operating profits to be shifted to Alki, which was liable to corporate tax neither in the UK nor the Netherlands.

[40] ibid, p. 13 fn 24.

[41] *Starbucks*, para 44.

[42] For more details on the Dutch tax regime and how the OECD's ALP has been applied in practice since 2002, see Bram Vos, 'State Aid, Taxation & Transfer Pricing: Illegal Fiscal State Aid Granted to Starbucks?' (2018) 2 EC Tax Review 113, 116.

1.3. The Commission's State aid focus

Following its approach in the opening decision, the Commission, in its State aid assessment of the SMBV tax ruling, is quick to demonstrate that all the State aid conditions can effortlessly be shown to be fulfilled, apart from the conferral of a 'selective advantage'.[43] The Commission's emphasis is unmistakably portrayed by the length of its respective analyses, with the first three State aid conditions occupying one page in total, while the selective advantage section runs for almost forty-two pages. This is no surprise, since the Commission's assertions regarding these two conditions, i.e. "advantage" and "selectivity", are the most controversial features of all its final decisions.

Despite the fact that the Commission's analysis in relation to the "selective advantage" is rather lengthy, the vast majority of this analysis is dedicated to transfer pricing comment and observations. Thus, the part that encapsulates the Commission's fiscal State aid argumentation on the existence of a selective advantage can be summarized quite succinctly once its misleading "surroundings" are carefully disregarded.

The Commission embarks on its analysis by invoking the long-established three-step selectivity test that the Court has applied in fiscal State aid cases. First, the reference system needs to be identified. Second, a derogation from this reference system must be found to exist, i.e. it needs to be shown that the alleged

[43] The problematic bundling of these two separate conditions is discussed at Part B.1.1 *infra.*

aid measure differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. Third, if the Member State cannot prove that this *prima facie* selective measure is justified by the nature or general scheme of the reference system, then it is found to be conclusively selective.

Starting off from the first step, the Commission identified the reference system to be the Dutch corporate tax system, whose objective is the taxation of profits of all companies subject to tax in the Netherlands.[44] The taxable profits of standalone and integrated companies are determined differently: the former can take their accounting profits as a starting point since these are dictated by the market, while the latter cannot, since these profits are the result of controlled transactions between companies belonging to the same corporate group. [45] However, this difference, in the Commission's view, does not affect the objective of the Dutch corporate tax system, since the latter's aim is to tax the profits of both integrated and standalone companies without distinction. [46] Thus, these two groups of companies are in a similar factual and legal situation in light of the objective pursued by the Dutch tax system.[47]

[44] *Starbucks*, para 232.

[45] *Starbucks*, para 235.

[46] It is noteworthy that the arm's length principle has been incorporated in Dutch tax law by Article 8b of the Dutch Corporate Income Tax Act 1969, while there is also a pertinent Transfer Pricing Decree; see *Starbucks Opening Decision*, para 31.

[47] *Starbucks*, para 236.

Having concluded [48] that the reference system is the general Dutch corporate tax system, the Commission swiftly jumps to the second step of the selectivity test. This step is crucial since, if the Commission successfully shows that a derogation exists, the burden of proof is reversed and it falls on the Netherlands to prove that the derogation is justified by the nature or general scheme of the reference system. In trying to prove that the SMBV APA derogated from the general Dutch corporate tax system, the Commission uses various shortcuts. First, it links the advantage to the selectivity condition and only focuses on proving that an advantage has been conferred. The Commission's basis is its assertion that 'whether a tax measure constitutes a derogation from the reference system will generally coincide with the identification of the advantage granted to the beneficiary under that measure.'[49] To back this up, the Commission relies on the ECJ's recent ruling in *MOL*, where the Court stated that, in cases of individual aid, 'the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective'.[50] As will be shown in Part B.1.1 of this chapter, the Commission's interpretation of *MOL* is misguided.

In any case, having established the link between the two conditions, the only step left for the Commission is to demonstrate that the SMBV APA conferred an advantage on SMBV. If this is the case, then this advantage will also be selective according to its aforementioned reasoning. How does the Commission endeavour

[48] *Starbucks*, para 251.

[49] *Starbucks*, para 253.

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

to show that an advantage was conferred on SMBV? It relies on the judgment that has in the past two years emerged as its very own "holy grail", namely *Forum 187*.[51] According to the Commission's interpretation of this 2006 ruling, the ECJ held that

> a reduction in the taxable base 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 accounting profits as a basis to determine their taxable base.[52]

Furthermore, in the Commission's view, the ECJ in *Forum 187* 'endorsed the arm's length principle as the benchmark for establishing whether a group company receives an advantage for the purposes of Article 107(1) of the Treaty as a result of a tax measure that determines its transfer pricing and thus its taxable base.' Moreover, this ALP benchmark endorsed by the Court in 2006 was not the widely-accepted OECD version of the arm's length principle, but a standalone ALP that is derived directly from EU law. More specifically, this EU law ALP 'is a general principle of equal treatment in taxation falling within the application of Article 107(1) of the Treaty, which binds the Member States' independently of whether they have incorporated it into their national legal orders.[53] As will be shown in Part B.1.3 of this chapter, the Commission's (creative) interpretation of *Forum 187* is erroneous.

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[51] Joined Cases C-182/03 & C-217/03 *Belgium and Forum 187 ASBL v Commission* EU:C:2006:416.

[52] *Starbucks*, para 258.

[53] *Starbucks*, para 264.

Having established all the aforementioned links, the Commission's task becomes very simple: the only point it needs to prove is that the SMBV APA (and the transfer pricing report that accompanied it) depart from this newly-presented EU law ALP.[54] If they do, and if this departure leads to a reduction of SMBV's tax liability in comparison to similar non-integrated companies, then an advantage is conferred on SMBV (*Forum 187*) and this advantage is presumably selective (*MOL*). Thus, the second step of the selectivity exercise is complete and the ball has left the Commission's court. Now, it is up to the Netherlands to prove that…it is not an elephant. This is the Commission's State aid reasoning in a nutshell; its most problematic aspects are critically assessed in Part B of this chapter.

Coming back to the structure of the Starbucks decision, once the Commission sets out its argumentative line, it goes on to scrutinize the SMBV APA for its compliance with the EU law ALP, using the OECD's soft law instruments as "guidance". This constitutes the lengthiest and most technical part of its decision.[55] From this point on, the decision exits the realm of EU State aid law and enters that of transfer pricing; tax advisors and accountants are therefore better placed to contradict the Commission's assertions than State aid lawyers. These assertions will thus not be described in great detail, but will instead be presented as succinctly as possible.

[54] *Starbucks*, para 267.

[55] *Starbucks*, paras 268-416.

1.4. Compliance with the arm's length principle?

In its opening decision, the Commission had expressed three doubts regarding the compliance of SMBV's APA with the ALP. First, it had questioned whether the Dutch authorities rightly accepted the classification of SMBV as a low-risk toll manufacturer. Why was this classification important, and why is it suspicious? The reason is that the rationale behind excluding several costs from SMBV's cost base, thus reducing its remuneration, is exactly that SMBV operates as a toll manufacturer.[56] Therefore, by challenging this classification, the Commission questioned the rationale underpinning SMBV's low remuneration and low tax bill.[57] Second, the Commission entertained doubts in relation to two adjustments made by SMBV's tax advisor when determining the appropriate arm's length profitability for its client, these adjustments having been accepted by the Netherlands.[58] The Commission's third and final objection was related to the royalties paid by SMBV to Alki LP. More specifically, since these royalties depended on the difference between SMBV's accounting pre-tax profit and SMBV's remuneration as established in the APA,[59] this meant that they did not reflect the value of the IP in question.

[56] *Starbucks Opening Decision*, para 80.

[57] In its final decision the Commission in fact concluded that SMBV was incorrectly classified as a low-risk manufacturer: see *Starbucks,* para 381.

[58] *Starbucks Opening Decision*, para 47.

[59] ibid, para 115.

In its final decision, after better examining the SMBV APA, the Commission raised four (even more detailed) objections to the methodological choices underpinning its transfer pricing report. According to the Commission, the validation, by the Dutch authorities, of the SMBV tax ruling that incorporated these misguided choices, directly resulted 'in a taxable profit for SMBV that cannot be regarded to constitute a reliable approximation of a market-based outcome', [60] thus violating the ALP and conferring an advantage on SMBV. Let us briefly describe the Commission's objections in turn.

Firstly, in the Commission's view, the transfer pricing report accompanying the SMBV APA, failed to identify or properly assess SMBV's controlled and uncontrolled transactions.[61] More specifically, the tax authorities did not properly examine whether the royalty payment from SMBV to Alki was at arm's length. A proper transfer pricing analysis, based on comparable transactions between independent undertakings, would have indicated that no royalty should have been paid to Alki at all.[62] Secondly, the transfer pricing report failed to examine whether the price paid by SMBV to the Swiss Starbucks subsidiary for green coffee beans was compliant with the ALP. Moreover, no 'market-based justification' existed for the sharp increase in their price from 2011 onwards, which led to a diminution of SMBV's profits.[63] Thirdly, the report did not

[60] *Starbucks*, para 271.

[61] *Starbucks*, para 272.

[62] *Starbucks*, para 272.

[63] *Starbucks*, para 272.

analyse the complexity of the functions of all group companies before concluding that SMBV was the least complex party and thus the 'tested party' for transfer pricing purposes.[64] Finally, the tax advisor's report misidentified SMBV's main functions to be remunerated and inappropriately sought to estimate its remuneration on the basis of its operating expenses. [65]

These four objections led the Commission to the conclusion that the SMBV APA departed from a proper application of the arm's length principle and resulted in a reduced tax bill for SMBV, thus conferring a selective advantage on it.[66]

1.5. General Comments

The Starbucks probe was slightly different from the other probes in relation to the Member State's cooperation and the level of detail in the transfer pricing analysis. More specifically, the Dutch authorities were relatively cooperative throughout the investigation and disclosed all necessary documents rapidly and (almost) completely - a stark contrast with Luxembourg. Moreover, when the Commission requested information on Starbucks that the Netherlands did not possess, it allowed the Commission to contact Starbucks directly, [67] thus giving it the

[64] *Starbucks*, para 273.

[65] *Starbucks*, para 274.

[66] *Starbucks*, para 415-416.

[67] *Starbucks*, paras 12-20. The Commission also went on to contact four competitors of Starbucks in order to request market information on their business model and their value creating activities so as to enable it to better assess the SMBV APA.

opportunity to use its recently acquired powers under Regulation 734/2013 for the first time.[68]

As opposed to other probes, the SMBV APA was accompanied by a transfer pricing report from a tax advisor, which was shared with the Commission. This could explain why the latter had to mount a very technical challenge against the APA, and why both its opening and its final decisions were longer than those in the other cases. In its very own press release, the Commission had admitted that the Netherlands usually carries out thorough assessments based on comprehensive information that the taxpayer is required to provide and that it did not therefore 'expect to encounter systematic irregularities in [Dutch] tax rulings'.[69]

Finally, the Starbucks decision is also important because of its political significance. The former First Vice President of the Commission, Mr Timmermans, was possibly facing a conflict of interest. Ironically enough, due to his former role as the Dutch Foreign Affairs Minister, the decision opening the SMBV investigation had been addressed to him…[70]

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[68] Commission Press Release, IP/15/5880 (October 21 2015), available at <http://europa.eu/rapid/press-release_IP-15-5880_en.htm> accessed 20 August 2019.

[69] Commission Press Release, IP/14/663 (June 11 2014), available at <http://europa.eu/rapid/press-release_IP-14-663_en.htm> accessed 20 August 2019.

[70] The Netherlands' reputation had previously taken another blow by the revelation that the Dutch former Competition Commissioner Neelie Kroes was the director of an offshore company based in the Bahamas tax haven, which she did not declare while she served as Competition Commissioner; see Nikolaj Nielsen, 'Ex-EU commissioner Kroes held offshore firm' *EuObserver* (Brussels, 22 September 2016) <https://euobserver.com/institutional/135190> accessed 24 September 2019.

1.6. The General Court Judgment

In its much anticipated *Starbucks* judgment, handed down on September 24th 2019, the General Court annulled the Commission's 2015 decision, where it had found that the Netherlands had granted Starbucks (SMBV) illegal and incompatible fiscal state aid.[71] Should one only read the Court's concluding remarks, where it emphatically stated that the Commission had not 'managed, by any of the lines of reasoning set out in the contested decision, to demonstrate to a requisite legal standard the existence of an advantage within the meaning of Article 107 TFEU',[72] they would think the Commission suffered a humiliating defeat.

However, they would only be focusing on part of the story. The Commission, for the reasons that will now be presented, did lose the Starbucks case; its decision was quashed. Despite the negative conclusion, the Commission managed to secure an important doctrinal victory. Its controversial assertions linking Article 107 TFEU to an arm's length principle were indirectly (though not wholly) endorsed by the General Court. In other words, its *in principle* victory overshadowed its *ad hoc* defeat.[73]

[71] Case T-760/15 and T-636/16 *Kingdom of the Netherlands and Others v European Commission (Starbucks)* EU:T:2019:669.

[72] ibid, para 561.

[73] Dimitrios Kyriazis, 'Playing Chess Like Commissioner Vestager' (European Law Blog, 12 November 2019) <https://europeanlawblog.eu/2019/11/12/playing-chess-like-commissioner-vestager/> accessed 20 January 2020.

These issues will be carefully dissected in Part B2 of this chapter, since the General Court's dicta on the arm's length principle (ALP) were identical in both its *Starbucks* and *Fiat* judgments. This section will focus on succinctly summarising the reasons underlying the Commission's ad hoc defeat in the *Starbucks* case. As will become immediately evident, it was the Commission's failure to persuasively demonstrate that the Netherlands had deviated from the substantive and procedural standards of the ALP that actually cost it the case.

To begin with, the General Court deserves to be praised for its highly detailed and meticulous transfer pricing analysis, which was almost of the standard of a specialist tax court.[74] More specifically, the Seventh Chamber of the General Court, sitting in extended composition, went through all six lines of the Commission's principal reasoning, as well as its subsidiary reasoning, and concluded that none of them was sufficient to prove that the alleged aid measure had conferred an advantage in favour of Starbucks. The Commission's reasoning and the Court's objections will now be discussed.

Firstly, the Commission was wrong to find that the absence of a separate analysis of the royalty in the SMBV APA showed that the latter was not in conformity with the ALP.[75] Secondly, the Commission was wrong to find to find

[74] Jérôme Monsenego, 'Some observations on Starbucks, Fiat, and their potential impact on future amendments to the arm's length principle' (Kluwer International Tax Blog, 28 September 2019) <http://kluwertaxblog.com/2019/09/28/some-observations-on-starbucks-fiat-and-their-potential-impact-on-future-amendments-to-the-arms-length-principle/> accessed 20 November 2019.

[75] Case T-760/15 and T-636/16 *Kingdom of the Netherlands and Others v European Commission (Starbucks)* EU:T:2019:669, para 205.

that the mere choice of the TNMM transfer pricing method, as opposed to the CUP method, was enough to prove that an advantage had been conferred on Starbucks.[76] Thirdly and fourthly, as the royalty paid by SMBV to Alki for the use of Starbucks roasting IP, the court found that the Commission had failed to demonstrate that SMBV did not have to pay a royalty,[77] or that the amount of the royalty should have been zero.[78]

Moving on, the Court stated that the Commission's findings on the price of green coffee beans purchased by SMBV were both irrelevant, being outside the scope of the 2008 SMBV APA, and insufficient to prove the conferral of an advantage.[79] Finally, the reliance, by the Commission, on evidence that had not been available to Starbucks and the Netherlands when concluding the 2008 APA, was judged to be impermissible.[80]

Having identified several "holes" in the Commission's reasoning, the Court's conclusion was inevitable: the Union's state aid watchdog had not managed to demonstrate the existence of an economic advantage within the meaning of Article 107 TFEU.[81]

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[76] ibid, para 216.

[77] ibid, para 265.

[78] ibid, paras 346 & 359 & 373. See also the transfer pricing analysis of Professor Byrnes in William Byrnes, 'William Byrnes' Starbucks State Aid Commentary: Boiling Down to the Essence of the Residual' (Kluwer International Tax Blog, 25 September 2019) <http://kluwertaxblog.com/2019/09/25/william-byrnes-starbucks-state-aid-commentary-boiling-down-to-the-essence-of-the-residual/> accessed 20 November 2019.

[79] ibid, para 391.

[80] ibid, para 251.

[81] ibid, para 261.

2. Fiat and Luxembourg[82]

In late September 2014, the Commission published its decision to open an in-depth State aid investigation in relation to the tax treatment of Fiat Finance and Trade (FFT) by Luxembourg.[83] This investigation was opened on the same day as the Apple and Starbucks investigations. Although the facts naturally differ, the legal issues at stake are similar to those in the Starbucks case. However, the Fiat investigation has proven to be particularly tempestuous, since the Commission had to issue an information injunction against Luxembourg in order to get the information it needed to launch its probe. On October 21st 2015, the in-depth investigation was finally concluded with the adoption of a negative decision,[84] ordering Luxembourg to recover €20 - €30 million from the alleged State aid beneficiary.[85]

[82] This section draws upon my blog post on the Fiat opening decision: Dimitrios Kyriazis,'Driving In the Wrong Direction? The Opening Decision in Fiat' (State Aid Hub Blog, 28 November 2014) <http://stateaidhub.eu/blogs/stateaid/post/803> accessed 11 May 2019.

[83] SA.38375 (2014/C) Alleged aid to FFT [2014] OJ C 3627 final, herafter 'Fiat Opening Decision".

[84] Commission Decision of 21 October 2015 on State Aid which Luxembourg Granted to Fiat, Case SA.38375 (2014/C ex 2014/NN), hereafter "Fiat".

[85] Commission Press Release, IP/15/5880 (October 21 2015), available at <http://europa.eu/rapid/press-release_IP-15-5880_en.htm> accessed 20 August 2019.

2.1. FFT and the Fiat Group

FFT is a member of the Fiat Group. This group is composed of Fiat S.p.A., incorporated in Italy, and all the companies Fiat S.p.A. controls.[86] Fiat S.p.A. wholly owns FFT, in a direct (40%) and indirect (60%) manner. Within the Fiat Group, all funding, corporate finance, bank relationships, foreign exchange and interest rate risk management, cash pooling, money market operations etc. are performed by treasury companies. FFT provides treasury services and financing to the Fiat group companies based (mainly) in Europe (excluding Italy), and also manages several cash pool structures for them.[87] In plain English, Fiat subsidiaries across Europe both lend to and borrow from FTT large amounts of capital, amongst other things.[88]

2.2. The FFT APA

In September 2012, the Luxembourgish tax authorities issued a tax ruling approving FFT's transfer pricing arrangements, since they found that FFT's remuneration complied with the arm's length principle. The FFT APA (binding for five years) stated that[89]

> [t]he transfer pricing study determines an *appropriate* remuneration on the capital at risk and the capital aimed at remunerating the functions performed by the company of EUR 2.542 million *on which a range of +/- 10% is envisaged.*

[86] *Fiat Opening Decision*, para 20.

[87] ibid, para 21.

[88] For more details on FFT see *Fiat*, paras 34-51.

[89] *Fiat Opening Decision*, para 37, emphasis added.

FFT relied on an OECD transfer pricing method to calculate its remuneration. More specifically, it relied on the transactional net margin method (TNMM), the method also used in the Starbucks APA. According to this method, in order to examine whether a taxpayer's remuneration complies with the arm's length principle, one compares a specific net profit indicator (e.g. return on assets) that the taxpayer realises from a controlled transaction to the same indicator in a comparable internal or external transaction. In the FFT APA, equity was chosen as the net profit indicator, and the approximated arm's length rate of return on equity was estimated through the CAPM financial model.[90]

Most importantly, the Commission outlined four steps for estimating FFT's remuneration: 1) estimation of the capital at risk (in application of the Basel II criteria); 2) identification of the capital used to perform the functions and to support the financial investments; 3) estimation of the expected return of capital by using the CAPM to remunerate the capital at risk and identification of the return to reward the capital used to perform the functions; and 4) estimation of the overall profitability to be left to FFT to remunerate the functions performed and the risks borne by FFT. [91]

[90] ibid, para 38.

[91] ibid, para 48; Fiat, para 58.

2.3. The Commission's State aid focus

Following its approach in the opening decision, the Commission, in its State aid assessment of the FFT tax ruling, is quick to demonstrate that all the State aid conditions can effortlessly be shown to be fulfilled, apart from the conferral of a 'selective advantage'.[92] The Commission's emphasis is once again unmistakably portrayed by the length of its respective analyses, with the first three State aid conditions occupying one page in total, while the selective advantage section runs for almost thirty-five pages. This is no surprise, since the Commission's assertions regarding these two conditions, i.e. "advantage" and "selectivity", are the most controversial features of all its final decisions and thus merit a lengthier analysis.

The Commission embarks on its analysis by invoking the long-established three-step selectivity test that the Court has applied in fiscal State aid cases. First, the reference system needs to be identified. Second, a derogation from this reference system must be found to exist, i.e. it needs to be shown that the alleged aid measure differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. Third, if the Member State cannot prove that this *prima facie* selective measure is justified by the nature or general scheme of the reference system, then it is found to be conclusively selective.

[92] *Fiat*, paras 185-190. The problematic bundling of these two separate conditions is discussed at Part B.1.1 *infra.*

Starting off from the first step, the Commission identified the reference system to be the general Luxembourg corporate tax system, whose objective is the taxation of profits of all companies subject to tax in Luxembourg.[93] The taxable profits of standalone and integrated companies are determined differently: the former can take their accounting profits as a starting point since these are dictated by the market, while the latter cannot, since these profits are the result of controlled transactions between companies belonging to the same corporate group.[94] However, this difference, in the Commission's view, does not affect the objective of Luxembourg's corporate tax system, since the latter's aim is to tax the profits of both integrated and standalone companies without distinction.[95] Thus, these two groups of companies are in a similar factual and legal situation in light of the objective pursued by Luxembourg's tax system.[96]

Having concluded[97] that the reference system is the general Luxembourg corporate tax system, the Commission swiftly jumps to the second step of the selectivity test. This step is crucial since, if the Commission successfully shows that a derogation exists, the burden of proof is reversed and it falls on Luxembourg to prove that the derogation is justified by the nature or general scheme of the reference system. In trying to prove that the FFT APA derogated from the general corporate tax system, the Commission uses various shortcuts, e.g. it links the

[93] *Fiat*, para 194.

[94] ibid, para 197.

[95] ibid, para 198.

[96] ibid, para 199.

[97] ibid, para 215.

advantage to the selectivity condition and only focuses on proving that an advantage has been conferred. The Commission's "doctrinal shortcuts" through the erroneous interpretation of *MOL* and *Forum 187* are identical to those described in section 1.3 *supra* in relation to the Starbucks decisions; they are thus not repeated in detail here.

Having established all these links, the Commission's task becomes very simple: the only point it needs to prove is that the FFT APA departs from the newly-minted EU law ALP.[98] If it does, and if this departure leads to a reduction of FFT's tax liability in comparison to similar non-integrated companies, then an advantage is conferred on FFT (*Forum 187*) and this advantage is presumably selective (*MOL*). Thus, the second step of the selectivity exercise is complete and the ball has left the Commission's court. Now, it is up to Luxembourg to prove that the measure was justified by the nature or general scheme of the reference system. This is the Commission's State aid reasoning in a nutshell; its most problematic aspects are critically assessed in Part B of this chapter.

Coming back to the structure of the FFT decision, once the Commission has set out its argumentative line, it goes on to scrutinize the FFT APA for its compliance with the EU law ALP, using the OECD's soft law instruments as "guidance". Just like in *Starbucks*, this constitutes the lengthiest and most technical part of its decision.[99] Once again, from this point on, the decision departs from the

[98] *Fiat*, para 231.

[99] ibid, paras 232-347.

realm of EU State aid law and enters that of transfer pricing; tax advisors and accountants are therefore better placed to contradict the Commission's assertions than State aid lawyers. These assertions will thus not be described in great detail, but will instead be presented as succinctly as possible.

2.4. Compliance with the arm's length principle?

In its opening decision, the Commission had expressed three doubts regarding the compliance of FFT's APA with the ALP. Firstly, the APA set FFT's tax base at 2.542 million euros - give or take 10%. This meant that its tax base was virtually fixed for the duration of the tax ruling and could only range somewhere between 2.288 and 2.796 million euros. Thus, even if FFT's activities doubled, there seemed to be no provisions in the tax ruling guaranteeing that its tax assessment would adjust accordingly.[100] Secondly, the OECD method used, the TNMM, was found to be *in concreto* inappropriate, as the use of the comparable uncontrolled price (CUP) method would have been preferable. Third, as regards the use of the CAPM financial model to estimate the relevant equity returns, the Commission claimed that the two components determining FFT's remuneration on the basis of the CAPM, i.e. the amount of capital remunerated and the level of remuneration applied to that capital amount, were set at too low a level.[101]

In its final decision, after better examining the FFT APA, the Commission decided to only focus on the third concern it had initially voiced, which, however,

[100] *Fiat Opening Decision*, para 64.

[101] *Fiat*, para 133.

gave rise to more objections to the methodological choices underpinning the APA's transfer pricing report. According to the Commission, Luxembourg's tax authorities, by validating the FFT tax ruling that incorporated these misguided choices, directly conferred 'a selective advantage on FFT for the purposes of Article 107(1) of the TFEU by deviating from the arm's length principle'.[102] Let us briefly describe the Commission's eventual objections in turn.

At first, the Commission acknowledged that its initial conclusion, in the opening decision, that the FFT APA provided for a fixed tax base, was misguided. Following some clarifications from Luxembourg, the Commission thus arrived at the conclusion that its first objection was not well-founded.[103] Moreover, it accepted that the transfer pricing method employed by FFT, i.e. the TNMM, was after all an appropriate choice due to the peculiarities of FFT's function within the Fiat group.[104] However, the pleasantries stopped here as the Commission went on to contest almost all of the FFT APA's parameters, assumptions and conclusions. Its objections revolved around two issues: the amount of FFT's capital for which it should have been remunerated and the appropriate level of that remuneration. More specifically, as regards the former, the Commission took issue with the use of FFT's hypothetical regulatory capital as profit level indicator,[105] the inconsistent application of the Basel II framework to calculate that capital,[106] and

[102] ibid, para 240.

[103] ibid, para 233.

[104] ibid, para 247.

[105] ibid, para 248-266.

[106] ibid, para 267-276.

the allegedly inappropriate deductions that FFT applied to that capital.[107] As regards the latter, the Commission asserted that the way in which FFT's tax advisor arrived at the proposed level of return on capital was inappropriate; the reasons given here were highly technical, including *inter alia* the selection of comparable companies.[108]

These objections led the Commission to the conclusion that the FFT APA departed from a proper application of the arm's length principle and resulted in a reduced tax bill for FFT, thus conferring a selective advantage on it.[109]

2.5. General Comments

Two interesting observations can be made about the Fiat investigation. First, it presented one peculiarity that tested the Commission's powers under the Procedural Regulation. More specifically, Luxembourg refused to disclose the alleged beneficiary's (FFT) full identity, and the Commission decided to issue an information injunction in order to force Luxembourg to do so.[110] Luxembourg challenged, *inter alia,* this injunction before the EU's judiciary, but then dropped

[107] ibid, para 277-291.

[108] ibid, para 292-301.

[109] ibid, para 339-340.

[110] Commission Press Release, IP/14/309 (March 24 2014), available at <http://europa.eu/rapid/press-release_IP-14-309_en.htm> accessed 10 May 2019.

the challenge in light of the Commission's decision to review the practices of all Member States with regard to tax rulings.[111]

Secondly, it needs to be remembered that the Commission's then President, Mr Juncker, faced a very severe conflict of interest. In 2003, when he was still Luxembourg's Prime Minister, Mr Juncker had boasted of his success in luring multinational companies like Fiat to Luxembourg. More specifically, in relation to e.g. Amazon, whose Luxembourg tax rulings are also under Commission investigation, he was quoted saying that Amazon's establishment in Luxembourg was the result of

> "a correct tax policy, of a correct infrastructure policy, but also the result of tough negotiations with the top management of the groups. They took place in America, they took place here at home, and I did not lead them alone."[112]

With the Commission increasingly targeting Luxembourgish tax rulings that look more like tax deals with the government than fair interpretations of the law, such statements seem to have helped neither Luxembourg nor the head of the EU's State aid watchdog.

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[111] Luxembourg Finance Ministry Press Release (December 18 2014), available at <http://www.mf.public.lu/actualites/2014/12/lux_rulings_181214/index.html> accessed 10 May 2019.

[112] Alex Barker, Vanessa Houlder and George Parker, 'Netherlands accused of subsidising Starbucks tax bill' *Financial Times* (London, 13 November 2014), <https://www.ft.com/content/f064f922-6b56-11e4-9337-00144feabdc0> accessed 17 September 2019.

2.6. The General Court Judgment[113]

As already discussed *supra* in Part 2.6 of this chapter, on September 24th 2019 the General Court annulled the Commission's decision in the *Starbucks* case. However, on the exact same date, the Court also handed down its judgment in the *Fiat* case, where the Commission scored an important victory: its 2015 decision against Luxembourg and Fiat was upheld.[114]

The most important doctrinal part of this judgment is almost identical to the corresponding part of the *Starbucks* judgment and concerns the Court's assessment of the controversial Commission assertions linking Article 107 TFEU to an arm's length principle. One might assume that, since the Commission's decision was not annulled in the *Fiat* case, its reasoning was fully and unreservedly upheld. As will be shown in Part B2 of this chapter, this is not entirely accurate.

This section will solely focus on succinctly summarising the reasons underlying the Commission's ad hoc victory in the *Fiat* case; the reasons of principle and doctrine can be found in Part B2 of this chapter.

To begin with, similarly to its *Starbucks* judgment, the General Court needs to once again be lauded for its painstakingly detailed transfer pricing analysis.

[113] General Court of the EU Press Release, 118/19 (September 24 2019), available at <https://curia.europa.eu/jcms/upload/docs/application/pdf/2019-09/cp190118en.pdf> accessed 20 December 2019.

[114] Case T-755/15 and T-759/15 *Luxembourg v European Commission (Fiat)* EU:T:2019:670.

Given the many pleas put forward by both Luxembourg and Fiat, the Seventh Chamber of the General Court, once again sitting in extended composition, had to carefully examine and rebut the various accusations raised against the validity of the Commission's decision. Indeed, all five pleas raised were meticulously examined and dismissed by the Court; they will now be presented in turn.

Firstly, the applicants had accused the Commission of engaging in tax harmonisation in disguise.[115] The reader will be familiar with this type of argument. Member States have, at least since the early 1970s, been invoking their tax sovereignty as a sort of "shield" against fiscal state aid scrutiny. The Court's reply will surely ring a (monotonous) bell: the Commission is merely exercising the state aid powers vested in it by the EU Treaties and Member States, when adopting tax measures, need to respect, inter alia, the four fundamental freedoms and the state aid provisions.[116] In other words, simply invoking tax sovereignty will not suffice; as argued in Chapters 1 and 4.B(1) of this thesis, the key question will always be whether the EU has exceeded its competence by reviewing measures it had no right to review. However, this merely leads us to the next question which is: did the Fiat tax ruling amount to state aid? Every answer has to be provided within the context of the EU Treaties, in this case Article 107 TFEU. An external "brake" to the Commission's powers will not be accepted by the EU's courts.

[115] ibid, paras 100-117.

[116] ibid.

The Court thus naturally rejected the first half of the first please and moved on to the very "juicy" second half, which concerned the existence of an arm's length principle in EU State aid law.[117] As already mentioned, this plea, which was eventually rejected by the Court, will be dissected in Part B2 of this chapter *infra*.

Moving on to the second plea,[118] the Court, according to its own press release, 'examined whether the Commission was right to find that the methodology for calculating FFT's remuneration, as endorsed by the tax ruling at issue, did not enable an arm's length remuneration to be obtained and whether this resulted in a reduction of FFT's taxable profit.'[119] After undertaking a highly technical and detailed analysis, the Court concluded that the Commission had correctly considered that the *Fiat* tax ruling had endorsed a methodology that was not ALP-compliant and reduced Fiat's tax burden.[120] The second plea was, consequently, rejected.

The applicants' third plea brought us back to the heart of state aid doctrine, since it concerned the selectivity of the alleged aid measure. More specifically, it related to the selective character of the advantage which the General Court accepted as having been conferred on Fiat. First, the Court confirmed that the *MOL*

[117] ibid, paras 126-187.

[118] ibid, paras 188-286.

[119] General Court of the EU Press Release, 118/19 (September 24 2019), available at <https://curia.europa.eu/jcms/upload/docs/application/pdf/2019-09/cp190118en.pdf> accessed 20 December 2019.

[120] Case T-755/15 and T-759/15 *Luxembourg v European Commission (Fiat)* EU:T:2019:670, para 286.

selectivity presumption was applicable in the case of the alleged aid measure, since Fiat's tax ruling constituted individual aid, within the meaning of Article 1 (c) of Regulation 2015/1589. [121] In any event, the Court noted that the Commission had concluded that the tax ruling was also selective if one were to follow the traditional three-step selectivity analysis for fiscal aid measures. [122] Thus, the Court rejected the applicants' third plea as well. The fact that the Court did not seriously examine[123] whether standalone and integrated companies are comparable will be analysed in Part B2 of this chapter, together with the Court's ALP-related arguments.

Coming to the applicants' fourth (and penultimate) plea, it was argued that the Commission had not proven that the tax ruling had led to a restriction (sic) of competition, either actual or potential. Surprisingly enough, the Court devoted thirty paragraphs to this plea; [124] unsurprisingly, it rejected it, as it almost invariably does, given the very low threshold of this state aid condition, in the way it has been developed in ECJ case law.

The applicants, in their fifth and final plea, had argued that the recovery order breached the principle of legal certainty and infringed their rights of

[121] ibid, paras 328 et seq, especially paras 355 & 359.

[122] ibid, paras 360-367.

[123] See, in the same vein, Jérôme Monsenego, 'Some observations on Starbucks, Fiat, and their potential impact on future amendments to the arm's length principle' (Kluwer International Tax Blog, 28 September 2019) <http://kluwertaxblog.com/2019/09/28/some-observations-on-starbucks-fiat-and-their-potential-impact-on-future-amendments-to-the-arms-length-principle/> accessed 20 November 2019.

[124] ibid, paras 368-398.

defence, an argument that was also eventually shot down by the General Court as being unfounded.[125]

Having rejected all pleas put forward by Luxembourg and Fiat, the General Court decided to uphold the Commission's *Fiat* decision, thus granting it its first victory at the judicial stage of the second fiscal state aid wave, a victory so doctrinally significant that it easily counterweighted its defeat in the *Belgian Excess Profit* and *Starbucks* cases.[126]

3. The Belgian Excess Profit Tax Ruling System

On February 3rd 2015, the Commission announced its decision[127] to investigate the so-called Belgian "excess profit" tax ruling scheme, which allegedly allowed multinational entities in Belgium to reduce their corporate tax liability by "excess profits" that result from the advantage of being part of a multinational group.[128] On January 11th 2016, the Commission concluded[129] that the scheme is illegal

[125] ibid, paras 399-430.

[126] Dimitrios Kyriazis, 'Playing Chess Like Commissioner Vestager' (European Law Blog, 12 November 2019) <https://europeanlawblog.eu/2019/11/12/playing-chess-like-commissioner-vestager/> accessed 20 January 2020.

[127] SA.37667 (2015/C) Belgium - Excess profit tax ruling system in Belgium – Art. 185§2 b) CIR92 [2015] OJ C 563 final, hereafter 'Belgian Excess Profit Opening Decision'.

[128] Commission Press Release, IP/15/4080 (February 3 2015), available at <http://europa.eu/rapid/press-release_IP-15-4080_en.htm> accessed 10 May 2019.

[129] Commission Decision of 11 January 2016 on the Excess Profit Exemption State Aid Scheme Implemented by Belgium, Case SA.37667 (2015/C) (ex 2015/NN), hereafter "Belgian Excess Profit".

under State aid rules and ordered Belgium to recover approximately €700 million from 35 multinational companies.[130]

This probe is different from all other probes that have been launched since the current wave of investigations began, because the Commission is not scrutinizing a specific tax ruling favouring a particular multinational company. On the contrary, as Commissioner Vestager put it in non-legal terms, this is a "generalized scheme", affecting (and allegedly favouring) dozens of (mostly European) multinationals that have been granted a tax ruling on its basis. This distinction is significant from an analytical point of view. Moreover, this decision merits a lengthier assessment, since the Commission's state aid reasoning differs at places, most notably in relation to selectivity. However, it will be seen that its principal novel argument, i.e. the nexus between Article 107 TFEU and the new EU law arm's length principle, retains its significance here as well.

3.1. The Belgian legislative framework

The Belgian Corporate Income Tax Code ("Code des Impôts sur les Revenus 1992", hereinafter "CIR92") provides in Article 185 (1) that companies are taxed on the entire amount of their profits, including distributed dividends. In 2004, a second paragraph was added to Article 185. This paragraph sets out special provisions "for two companies that are part of a multinational group of associated companies and, more specifically, in respect of their reciprocal cross-border relationships".

[130] Commission Press Release, IP/16/42 (January 11 2016), available at <http://europa.eu/rapid/press-release_IP-16-42_en.htm> accessed 20 August 2019.

According to Art. 235 (2) of the same Code, these provisions also apply to Belgian permanent establishments of foreign companies, i.e. to non-resident or foreign companies.

What exactly do these provisions mandate? Article 185 (2) states that

> (a) when two companies are in their commercial and financial relationships linked by conditions agreed upon or imposed on them which are different from those which would have been agreed upon between independent companies, the profits which - under those conditions – would have been realized by one of the companies but are not because of those conditions, may be included in the profits of that company.
>
> (b) when profits are included in the profits of one company which are already included in the profits of another company and the profits so included are profits which should have been realized by that other company if the conditions agreed between the two companies had been those which would have been agreed between independent companies, the profits of the first company are adjusted in an appropriate manner.

As is evident, it is subparagraph (b) that attracted the Commission's attention, since it provides for a downward adjustment of profits, and could potentially result in a selective advantage. Crucially, the 2004 law that introduced these provisions also stated that the competent Ruling Commission, a body of the Belgian Finance Ministry, was obliged to approve every application lodged on the basis of Article 185 (2) (b). Due to this compulsory prior authorization procedure, every multinational group applying for such an adjustment would get one. According to the Belgian government, the legislative intent behind these provisions was to transpose Article 9 of the OECD Model Tax Convention.[131] Moreover, it claimed that the objective of any downward adjustment would be to

[131] *Belgian Excess Profit Opening Decision*, para 35.

avoid a (potential) double taxation problem, and not to favour multinational companies over others.[132]

However, more than the actual wording of the Excess Profit Exemption scheme (hereafter "EPE scheme"), the Commission was interested in its application. According to the Belgian government, in practice, the amount of excess profit that was exempted was calculated on the basis of a two-step approach. First, the tax report provided by the taxpayer fixed the arm's length prices charged between itself and its associated enterprises.[133] The profit that the taxpayer was left with was the residual profit, but this was not the profit it was taxed on. Its taxable profit was established in accordance with a crucial second step, which lies at the epicenter of the Commission's State aid concerns.

According to Belgium, the residual profit could exceed the profit that a comparable standalone company would have realised without being part of a multinational group.[134] For this reason, under the second step of the EPE scheme, the Commission allowed the taxpayer to submit a second transfer pricing report employing the TNMM, in order to come up with a hypothetical average profit based on a benchmark study comparing the taxpayer to comparable standalone companies.[135] This hypothetical average profit is key, since it is considered by

[132] *Belgian Excess Profit*, para 34.

[133] ibid, para 15.

[134] ibid.

[135] ibid, para 17.

Belgium 'as the profit that the Belgian group entity would have made if it had been a standalone company instead of part of a multinational group.'[136] This profit is referred to by the Commission as the 'adjusted arm's length profit'.[137]

The difference between the taxpayer's average residual profit, determined in accordance with the first step, and its average adjusted arm's length profit, determined under the second step, represents its 'excess profit', which is expressed as a percentage of pre-tax profit and is discounted from its tax base.[138] For the reasons set out in the following section, this annual downward adjustment of the qualifying taxpayer's tax base is regarded by the Commission as constituting a selective advantage under Article 107 TFEU.

3.2. The Commission's state aid assessment

Firstly, the Commission makes it clear[139] that it considers Article 185 (2) (b) of the Belgian Income Tax Code to constitute an aid scheme.[140] Following its approach in the opening decision, the Commission, in its State aid assessment of the EPE scheme, is quick to demonstrate that all the State aid conditions can effortlessly be shown to be fulfilled, apart from the conferral of a 'selective advantage'.[141] The Commission's emphasis is tellingly portrayed by the length of

[136] ibid, para 17.

[137] ibid, para 17.

[138] ibid, para 18.

[139] ibid, paras 94-110.

[140] As defined in Article 1(d) of Regulation No. 2015/1589.

[141] The problematic bundling of these two separate conditions is discussed at Part B.1.1 *infra.*

its respective analyses, with the first three State aid conditions occupying one page in total, while the selective advantage section runs for almost twenty pages. This is no surprise, since the Commission's assertions regarding these two conditions, i.e. "advantage" and "selectivity", are the most controversial features of all its final decisions.

The Commission embarks on its analysis by invoking the long-established three-step selectivity test that the Court has applied in fiscal State aid cases.[142] First, the reference system needs to be identified. Second, a derogation from this reference system must be found to exist, i.e. it needs to be shown that the alleged aid measure differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. Third, if Belgium cannot prove that this *prima facie* selective measure is justified by the nature or general scheme of the reference system, then it is found to be conclusively selective.

Starting off from the first step, the Commission identifies the reference system to be the general Belgian corporate tax system, whose objective is the taxation of profits of all companies subject to tax in Belgium.[143] The taxable profits of standalone and integrated companies are determined differently: the former can take their accounting profits as a starting point since these are dictated by the market, while the latter cannot, since these profits are the result of controlled

[142] *Belgian Excess Profit*, para 119.

[143] *Belgian Excess Profit*, para 121.

transactions between companies belonging to the same corporate group.[144] However, this difference, in the Commission's view, does not affect the objective of the Belgian corporate tax system, since the latter's aim is to tax the profits of both integrated and standalone companies without distinction.[145]

In identifying the appropriate reference system, the Commission went to great lengths in order to justify its rejection of Belgium's argument that the EPE scheme formed an 'inherent part' of the reference system.[146] This is obviously a essential element of the Commission's case: if the EPE were to form part of the reference system, then it could not possibly also constitute a derogation therefrom. The main reason why, in the Commission's view, the EPE scheme was not part of the reference system, i.e. the Belgian corporate income tax system, was that the latter's objective is to tax all corporate taxpayers, while the EPE downward adjustment was only available to Belgian companies forming part of a sufficiently large multinational group which had recently launched commercial activities.[147] As will be seen in the following paragraphs, the Commission substantiated these "accusations" while describing the scheme's allegedly derogatory effects in detail.

[144] ibid, para 127.

[145] ibid, para 127.

[146] ibid, para 123-128.

[147] ibid, para 126.

Having concluded[148] that the reference system was the general Belgian corporate tax system, the Commission swiftly jumped to the second step of the selectivity test, i.e. it endeavoured to demonstrate that the EPE scheme derogated from the reference system by treating comparable companies differently. The Commission's principal argument here was that the objective of the reference system, namely the ordinary Belgian tax system, was to tax companies on their actual profits, and the EPE scheme departed from this system by allowing certain companies to be taxed on the basis of hypothetically adjusted profits.[149] The Commission's subsidiary line of argument was that, even if it could be said that there was a 'a general rule according to which multinational group companies resident or operating through a permanent establishment in Belgium should not be taxed on profit actually recorded that exceeds an arm's length profit', which somehow formed part of the Belgian reference system, the Excess Profit exemption constituted 'a misapplication of and thus a deviation from the arm's length principle, which forms a part of that system.'[150] Let us briefly examine these arguments in turn.

As regards its principal argument, the Commission asserted that the EPE scheme was a derogatory measure because its beneficial provisions did not apply to all companies subject to tax in Belgium, but were instead restricted by three sets of conditions. First, the EPE scheme was allegedly *de jure* selective because it

[148] ibid, para 129.

[149] ibid, para 133.

[150] ibid, para 134.

was only available to companies forming part of a multinational corporate group and not to standalone companies, or companies forming part of a domestic corporate group.[151] Second, the EPE scheme was allegedly *de jure* selective because an excess profit ruling could only be obtained 'in respect of future situations or operations that [had] not yet had tax effects, not for existing situations.'[152] Finally, the EPE scheme was allegedly *de facto* selective because only Belgian companies forming part of a 'large or at best medium-sized multinational group' could actually benefit from it.[153] Consequently, the EPE scheme was shown to confer a selective advantage only on companies fulfilling all three conditions.

Coming now to its subsidiary argument, the Commission asserted that '[r]egardless of whether the Belgian corporate income tax system could be said to contain a general rule according to which profit actually recorded' by companies belonging to multinational groups should not be taxed, to the extent that it exceeded an arm's length profit, the EPE scheme was still derogatory.[154] Why? The reason was that both the rationale underpinning the exemption of excess profit, and the methodology used for arriving at it, departed from the EU law ALP,[155] which necessarily forms part of the reference system (and with which we are by now very familiar). Under a proper application of the ALP, there was no room for

[151] ibid, para 138.

[152] ibid, para 139.

[153] ibid, para 140.

[154] ibid, para 144.

[155] ibid, para 144.

the second step that the EPE scheme provided for, namely the deduction of the adjusted arm's length profit from the taxpayer's residual profit and the corresponding identification of the taxpayer's 'excess profit'. On the contrary, the EU law ALP dictates the attribution of the entire residual profit - calculated under the first step - to the taxpayer.[156] Any further minimization of its tax burden was found to constitute a breach of the ALP and an 'unjustified derogation from a market-based outcome'.[157] Since Belgium employed both steps in its calculations of qualifying taxpayers' liability, the EPE scheme was found to derogate from the reference system under this subsidiary line of reasoning too.

3.3. Recovery

Following its conclusion that the EPE scheme had conferred a selective advantage on the companies that had received a tax ruling on its basis,[158] the Commission also found that the Belgian government had not persuasively demonstrated that the derogation was justified by the nature or general scheme of the tax system.[159] Moreover, after concluding that the EPE scheme was incompatible with the internal market [160] and that no defence against recovery existed, [161] the

[156] See Ricardo André Galendi Júnior, 'State Aid and Transfer Pricing: The Inherent Flaw Under a Supranational Reference System' (2018) 46 Intertax 994, 998. He presents some persuasive critical thoughts, arguing that both steps are hypothetical exercises, even though the Commission chooses to only treat the second step as such, and notes that 'allocating all synergy rents to the central entrepreneur is as plausible as allocating no synergy rent to it.'

[157] *Belgian Excess Profit*, para 156.

[158] ibid, paras 169-170.

[159] ibid, para 181.

[160] ibid, para 192.

[161] ibid, para 204.

Commission ordered the recovery of the aid from all beneficiaries. The size of the recoverable amount (approximately €700 million) was unsurprising, given that in many cases the excess profit amounted to 60%-80% of the taxpayer's pre-tax profit.[162]

3.4. The General Court Judgment[163]

On February 14th 2019, the General Court handed down its judgment in the *Belgian Excess Profits* case.[164] This judgment had been eagerly expected. The primary reason was that it was the first case from the most recent wave of fiscal state aid investigations to reach the General Court. Ever since June 11th 2014, when then Competition Commissioner Almunia opened in-depth investigations against Apple, Fiat and Starbucks, the Commission's voice had dominated the relevant dialogue. What Member States, state aid lawyers and tax advisors kept "hearing" was the Commission's viewpoint, whether in its decisions or its soft law Notice, on a fiercely disputed EU law issue.

In a nutshell, three questions awaited an answer. First, does an EU law arm's length principle (ALP) stem from Article 107 (1) TFEU and is it derived from a 'general principle of equal treatment in taxation'? Second, what exactly is this EU law ALP and where can more details on its substantive content be found? Third,

[162] ibid, Annex.

[163] This section draws upon my blog post on the General Court's Judgment: Dimitrios Kyriazis,' The Belgian Excess Profits Case – A State Aid Anticlimax' (Kluwer Competition Law Blog, 5 March 2019)<http://competitionlawblog.kluwercompetitionlaw.com/2019/03/05/the-belgian-excess-profits-case-a-state-aid-anticlimax/> accessed 20 November 2019.

[164] Cases T-131/16 and T-263/16 Kingdom of Belgium and Magnetron International v European Commission (Belgian Excess Profit) EU:T:2019:91

does a tax arrangement (ruling or otherwise) which deviates from said ALP confer a 'selective advantage' on the relevant taxpayer?

These three questions were key to the Commission's state aid analysis and it was hoped that the General Court would examine DG COMP's assertions and rule on their validity. However, as will be seen, these hopes did not materialize, since the Court annulled the Commission's decision on different grounds.

3.4.1. The applicants' arguments

In their action for annulment, the Kingdom of Belgium and Magnetrol International (one of the alleged aid beneficiaries), essentially put forward four pleas in law. First, they asserted that the Commission had encroached upon the exclusive tax jurisdiction of Belgium and thus exceeded its powers. Second, they maintained that the Commission had committed an error in law by identifying a "state aid scheme" within the meaning of Article 1 (d) of Regulation 2015/1589. Third, they argued that the advance rulings did not amount to state aid since the Treaty's conditions were not fulfilled. Finally, they accused the Commission of violating the principles of legality and of the protection of legitimate expectations by ordering the recovery of the alleged aid. The General Court rejected the first plea but upheld the second plea; it did not examine the third and fourth pleas. Let us examine the two pleas in turn.

3.4.2. Exclusive tax jurisdiction versus…exclusive EU competence

The argument here is not novel. In fact, as discussed in Chapter 1, Member States have been employing various iterations of the same argument ever since the inception of the European Union. Its crux is as follows: direct taxation falls within the competence of Member States. It is one of the last vestiges of state sovereignty in an ever-evolving supranational project and it should, for numerous reasons, not be interfered with. Therefore, fiscal state aid scrutiny by the Commission is not welcome and is, moreover, open to criticism as constitutionally improper, since it affects both the vertical distribution of competences between the EU and its Member states and the horizontal distribution of powers between the EU's own institutions.

The EU judicature's reply has always been fairly consistent. In what has become a *jurisprudence constante*,[165] the CJEU has made it clear that Member States must exercise their direct tax competence consistently with EU law, and their interventions are not automatically shielded from Article 107 TFEU simply because they are of a fiscal nature. Belgium's exclusive competence in direct tax matters is monitored by, inter alia, the EU's exclusive competence in competition law matters, which include the state aid prohibition (Article 3 (1) (b) TFEU). The applicants' first plea in law was thus summarily shot down. In the Court's words: [166] 'since the Commission is competent to ensure compliance with

[165] See e.g. Case 173/73 *Commission v Italy* EU:C:1974:71.

[166] Cases T-131/16 and T-263/16 *Kingdom of Belgium and Magnetron International v European Commission (Belgian Excess Profit)* EU:T:2019:91, para 67.

Article 107 TFEU, it cannot be accused of having exceeded its powers by examining the measures comprising the alleged scheme at issue'.

However, before moving to the second plea in law, the General Court gave Belgium a rap on the knuckles and made an interesting remark. Belgium had argued that it is exclusively competent to adopt measures that prevent double taxation, such as the alleged aid measure. Notwithstanding the fact that, as already mentioned, such an assertion, even if true, would not suffice to protect the measures from the Commission's scrutiny, the General Court went a step further and noted that 'it does not appear that the non-taxation of excess profit, as applied by the Belgian tax authorities, pursued the objective of avoiding double taxation'. [167] In essence, this means that, should the alleged aid measures' classification as state aid make its way back before the Court and *prima facie* selectivity be established, the "avoidance of double taxation" justification will most probably not be available to them and they will be found to be conclusively selective.

3.4.3. The state aid scheme that never was

The applicants' argument that was eventually upheld by the General Court and decided this case was that the Commission had incorrectly characterized the relevant Belgian measures as constituting an 'aid scheme' within the meaning of Regulation 2015/1589. Under Article 1 (d) of that Regulation, an 'aid scheme' means 'any act on the basis of which, without further implementing measures

[167] ibid, para 72

being required, individual aid awards 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'.

Why is this classification important in practical terms? If the Belgian measures indeed constituted an aid scheme, the Commission would have been allowed to simply examine the characteristics of the scheme at issue to determine its state aid character; an analysis of the aid granted in individual cases under the scheme would have been unnecessary. This difference in the breadth of review is crucial, and thus the aforementioned classification bears practical significance. This is the reason why the Commission had devoted almost four pages on this issue in its final decision (paras 94-110). Alas, in the General Court's view, its conclusion was erroneous.

As explained in the judgment itself, three cumulative conditions need to be fulfilled in order for a state aid scheme to be found to exist. Firstly, further implementing measures should not be required, which means that the essential elements of the aid scheme in question must necessarily emerge from the provisions identified as the basis of the scheme (para 86). In the Court's view, this was not the case, since not all essential elements emerged from the Belgian acts identified by the Commission (paras 93-94 & 98). Secondly, national tax authorities cannot have any margin of discretion as regards the aforementioned essential elements of the aid and whether it should be awarded (para 87). Again, in the Court's view, this condition was not fulfilled either, since the Belgian tax

administration 'enjoyed a genuine margin of discretion' on whether to grant downward adjustments (para 104). Thirdly and finally, for an aid scheme to exist, the beneficiaries must be defined in a general and abstract manner (para 88). Unsurprisingly, the General Court concluded that they were not defined in such a manner and further implementing measures needed to be taken to define the alleged aid beneficiaries (paras 115-119).

The absence of just one of the three conditions analysed *supra* would have been enough to call the Commission's conclusions into question, so the absence of all three was a devastating blow to its decision's validity. The Court's review was rigorous (see, for instance, paras 127-128[168]) and its remarks were, at times, perhaps slightly mordacious (see e.g. its comment on the Commission's apparent ambivalence in paragraph 82). The judges' conclusion came naturally: the Commission 'erroneously considered that the Belgian Excess Profit System […] constituted an aid scheme'.[169] The consequence was that the Commission's decision had infringed Article 1 (d) of Regulation 2015/1589 and had to be annulled in its entirety.

[168] For instance, the Court chastised the Commission for not explaining why it only examined 22 of the 66 rulings concerned, why it thought the sample was sufficiently representative, and how the latter could justify its conclusions 'regarding the existence of a systematic approach by the Belgian tax authorities'.

[169] Cases T-131/16 and T-263/16 *Kingdom of Belgium and Magnetron International v European Commission (Belgian Excess Profit)* EU:T:2019:91, para 88.

3.4.4. Lingering questions

As mentioned earlier, out of the four pleas raised by the applicants, only the first two were scrutinised by the Court, since the second plea was well-founded and thus sufficient to decide the case. This meant that the third plea, which concerned the fulfillment of the substantive state aid conditions and the existence of a 'selective advantage', did not receive any attention. This was regrettable, because it concerned the single most controversial assertion made by the Commission in its recent fiscal state aid crusade, namely that an EU law arm's length principle exists and 'necessarily forms part of the Commission's assessment under Article 107 (1) of the Treaty' as maintained by the Commission in paragraph 150 of its now-annulled decision on the Belgian excess profits regime.

Thankfully, as will be seen *infra*, the General Court provided an answer in its *Starbucks* and *Fiat* judgments in late September 2019.

3.4.5. Conclusion

Compared to how important this judgment could have been, had it touched upon the most contested issues in this area of law, the General Court's ruling in Cases T-131 & 263/16 was rather anticlimactic. Following its defeat, the Commission's reaction was swift and decisive. First, it appealed the General Court's ruling before the ECJ, asserting that it did not err in identifying an aid scheme. Second, in order to make sure that the alleged aid beneficiaries would not benefit from their victory for too long, the Commission in September 2019 opened thirty-nine in-depth

investigations into individual excess profit tax rulings.[170] The Commission's investigations had not been concluded at the time of writing.

[170] Commission Press Release, IP/19/5578 (September 16 2019), available at <https://ec.europa.eu/commission/presscorner/detail/en/IP_19_5578> accessed 20 December 2019.

B) The Common Threads

1. The ALP Leap of Faith – making sense of the 'general principle of equal treatment in taxation falling within the application of Article 107 (1) of the Treaty'

Of all the conditions a measure must fulfil in order to be caught by Article 107 TFEU, the Commission's focus in all its recent probes has been on the conferral of an advantage and selectivity. In its 2014 opening decisions, the reason why the advantage condition was fulfilled was because the multinationals' APA or APAs that were validated by the tax rulings under scrutiny did not comply with the arm's length principle (ALP). Their deviation from this principle had as a *direct* consequence the conferral of an advantage on the taxpayer, and thus the fulfillment of the first state aid condition. It was absolutely clear that the Commission considered this causality link to be direct; its relevant assertions were unequivocal. For example, in paragraph 77 of the opening decision in the *Amazon* case, which was almost identical to the corresponding Apple/Fiat/Starbucks/Belgian decisions' paragraphs,[171] the Commission had stated that:[172]

> On the basis of these observations, the Commission is of the opinion that the Amazon ruling does not comply with the arm's length principle. *Accordingly*, the Commission is of the opinion that through the contested tax ruling the Luxembourgish authorities confer an advantage on Amazon.

How was the advantage condition connected to the arm's length principle? The Commission's view appeared to be that the ALP could be integrated

[171] *Apple Opening Decision*, para 69; *Fiat Opening Decision*, para 81; *Starbucks Opening Decision*, para 124; *Belgian Opening Decision*, para 83.

[172] *Amazon Opening Decision*, para 77 [emphasis added].

into State aid "orthodoxy" rather naturally.[173] More specifically, in the Commission's opening decisions, the sentence that implicitly linked the advantage State aid condition to the arm's length principle (and then to the OECD Guidelines) was the following, as found in paragraph 54 of the opening decision in *Apple*:[174]

> In order to determine whether a method of assessment of the taxable income of an undertaking gives rise to an advantage, it is necessary to compare that method to the *ordinary tax system*, based on the difference between profits and losses of an undertaking carrying on its activities under *normal* market conditions

The implicit premise here seemed to be that companies are normally taxed on the basis of economic data that are the result of non-manipulated transactions. Thus, in the case of multinationals, market conditions can only be arrived at through transfer pricing established at arm's length. If the arm's length principle is not respected, an advantage is conferred on the taxpayer, and this triggers the application of Article 107 TFEU.

This line of reasoning was one of the most problematic aspects of the Commission's opening decisions. It was hoped that the Commission would produce a more robust legal analysis in its final decisions, when all parties had expressed their views and DG COMP officials had more carefully constructed their case. This hope failed to materialise. The Commission's legal approach - as set out in its final decisions in *Fiat*, *Starbucks*, *Belgian Excess Profit* and in its Final Notice on the Notion of aid - has become more "creative" and even more problematic.

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[173] See option 3 in Anna Gunn and Joris Luts, 'Tax Rulings, APAs and State Aid: Legal Issues' (2015) 2 EC Tax Review 119 123.

[174] *Apple Opening Decision*, para 54 [emphasis added].

More specifically, the Commission now asserts that the 'arm's length principle necessarily forms part of the Commission's assessment of tax measures granted to group companies under Article 107(1) of the Treaty, independently of whether a Member State has incorporated this principle into its national legal system and in what form.'[175] Moreover, it claims that '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 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'.[176] As will be discussed later, this departure from the OECD's ALP is controversial for many reasons; it is also quite odd, since the Commission in all its final decisions acknowledges that the OECD's ALP represents the 'authoritative statement of the arm's length principle'.[177] In any case, the Commission insists that this different, standalone ALP is simply 'an application of Article 107 (1) of the Treaty, which prohibits unequal treatment in taxation of undertakings in a similar factual and legal situation.'[178]

[175] *Final Notice*, para 172.

[176] *Starbucks*, para 264 [footnotes omitted].

[177] *Starbucks*, para 64; *Fiat*, para 86; *Belgian Excess Profit*, para 53.

[178] *Final Notice*, para 172.

It is obvious that the Commission's final approach is different from its initial one, i.e. more ambitious, more provocative, more assertive and more legally problematic. Some of the problems with this approach will be analysed below.

1.1. "Selective advantage" and State aid analysis

To begin with, this principle emerges in the Commission's Decisions in a subsection entitled "selective advantage resulting from a deviation from the arm's length principle" which falls under the Decisions' largest section (occupying almost half its Decisions) entitled "existence of a selective advantage".[179] This conflation of the advantage and selectivity conditions echoes the Commission's approach in its opening decisions, where it also conflated these conditions and only examined the existence of a "selective advantage".

Such an approach is, in principle, unsatisfactory. The advantage and selectivity conditions are two separate conditions that a measure must fulfill in order for it to fall foul of Article 107 (1) TFEU. The Commission's apparent excuse[180] for bundling them together is to be found in paragraph 60 of the *MOL* case, where the ECJ noted that, in cases of individual aid 'the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective'.[181]

[179] See, for example, *Starbucks*, pp. 55 & 60.

[180] *Starbucks*, para 254.

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

However, this appears to be an *obiter dictum* by the ECJ, since it was not directly relevant to the case before it. In any case, it constitutes an 'overbroad' statement, inter alia since it disregards the possibility of justification.[182] Moreover, the Commission seems to "forget" the immediately preceding paragraph of that very same ruling. In paragraph 59, the ECJ clearly stated that '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'.[183] As I have noted elsewhere,[184] the fact that the Court established the presumption to which the Commission refers does not mean that these two State aid conditions become one, but merely that in principle, i.e. not always, the fulfilment of the advantage condition creates a (rebuttable) presumption that the (separate) selectivity condition is also fulfilled. This is important: so long as the two conditions are separate, they merit a separate analysis.[185] If the Commission wanted to take advantage of the rebuttable presumption articulated in *MOL*, it should have first separately established the conferral of an advantage on the

[182] Andreas von Bonin, 'EU Commission Initiative Against "Aggressive Tax Planning as it Affects the Member States" (Berliner Gesprächskreis zum Europäischen Beihilferecht e.V., 29th Roundtable, Berlin, June 2016).

[183] Case C-15/14 P *Commission v MOL* EU:C:2015:362, paragraph 59.

[184] Dimitrios Kyriazis, 'Actions for Annulment in the Fiat and Starbucks Cases: A First Taste of What Will Ensue' Wolters Kluwer Competition Law Blog (2016) <http://kluwercompetitionlawblog.com/2016/02/29/actions-for-annulment-in-the-fiat-and-starbucks-cases-afirst-taste-of-what-will-ensue/> accessed 30 June 2019.

[185] Advocate General Wahl, in his opinion in the *MOL* case, also stressed that the 'requirement as to selectivity […] must be clearly distinguished from the detection of an economic advantage'. See Case C-15/14P *MOL* EU:C:2015:32, Opinion of AG Wahl, para 47.

alleged aid recipient, and then used it to argue that the selectivity condition is presumed to be fulfilled. The ECJ in its *MOL* judgment did not intend to pardon the conflation of the two most important State aid conditions.[186]

Moreover, previous ECJ case law on selectivity stemming from discretionary administrative practices neither supports the Commission's arguments nor allows it to take any legal shortcuts. More specifically, in its Notice on the Notion of State aid, the Commission asserts that '[g]eneral measures which *prima facie* apply to all undertakings but are limited by the discretionary power of the public administration are selective.'[187]

The authority usually relied upon is the *Kimberly Clark* ECJ case of 1996.[188] In a nutshell, in that case French legislation allowed redundancy payments to be made using public funds at the discretion of a public body (the National Employment Fund). The 'degree of latitude' afforded to the Fund meant that 'by virtue of its aim and general scheme, the system under which the [Fund] contribute[d] to measures accompanying social plans' was liable to be selective.[189]

It is essential to take note of how carefully the ECJ phrased its judgment and how closely connected its dicta are to the facts of this specific case. Advocate

[186] See also Mario Tenore, 'APAs and State Aid: A New Era of European Tax Law?' in Dennis Weber (ed.) *EU Law and the Building of Global Supranational Tax Law* (IBFD 2017) 212&216-217.

[187] European Commission, 'Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU' COM (2016), para 123.

[188] Case C-241/94 *France v Commission* EU:C:1996:353.

[189] ibid, paras 23-24.

General Jacobs in his Opinion referred to the 'significant element of discretion' involved and to the fact that France repeatedly referred to the general flexibility of the parameters under which the Fund operated.[190] This lucidly illustrates that the case is more facts-specific than the Commission admits in its Notice. Moreover, the *Kimberly Clark* case, as Quigley has perspicaciously observed, is not directly relevant to the tax ruling cases, since in that case there 'was a liability under the general rules which was reduced by the intervention of the public authority.'[191] This, as will be shown in the next few sections of this chapter, does not seem to be the case in the tax ruling cases.

To conclude, as regards the conflation between advantage and selectivity and the relationship between the latter and administrative discretion, a precise and more nuanced account of the case law suggests that 'the mere fact that certain aspects of an individual tax assessment may require the tax authorities to exercise a discretion in determining liability does not necessarily lead to the conclusion that State aid is granted, in particular where the margin of discretion is transparent and non-discriminatory.'[192]

However, the Commission's choices are understandable. The conflation of the advantage and selectivity conditions allows it to kill two birds with one stone,

[190] Case C-241/94 France v Commission EU:C: 1996:195, Opinion of AG Jacobs, para 26.

[191] Conor Quigley QC, 'Tax Rulings and State Aid' (2016) Tax Journal 8, 9.

[192] Conor Quigley, *European State Aid Law and policy*, (3rd edn, Hart Publishing 2015), 104-105. See also Case C-06/12 *P Oy* EU:C:2013:525, paras 23-27 and Case C-15/14P *Commission v MOL* EU:C:2015:362, para 64.

and makes it more difficult for Member States and alleged beneficiaries to effectively counter its assertions. Still, at the same time, it leads to certain inconsistencies.

1.2. Inconsistency in the identification of the counterfactual

In its final Starbucks Decision, and more specifically in the section where it argues that a selective advantage has been conferred on Starbucks due to a deviation from the arm's length principle, the Commission provides the following guidance for ascertaining the conferral of the relevant advantage:[193]

> An advantage pursuant to Article 107(1) of the Treaty is any economic benefit that an undertaking would not have obtained under normal market conditions, i.e. in the absence of the State intervention. Thus, whenever the financial situation of an undertaking is improved as a result of a State intervention, an advantage is present. Such improvement is shown by comparing the financial situation of the undertaking as a result of the contested measure with the financial situation of that undertaking had the measure not been granted. An advantage can consist both in the granting of positive economic advantages as well as in the mitigation of charges normally included in the budget of an undertaking.

This is the Commission's approach in general, and it is exactly the same as its approach in the Final Notice.[194] This paragraph is an accurate representation of the case law, and as such is correctly relied upon by the Commission.

This paragraph's crucial point is that, in order to ascertain the existence of an advantage, one needs to compare the financial situation of the undertaking with and without the measure. In State aid jargon, one needs to compare the

[193] *Starbucks*, para 256. The Commission said exactly the same in *Fiat*, para 220.

[194] *Final Notice*, paras 66-67.

'factual', i.e. the undertaking's situation following the grant of the alleged aid, with the 'counterfactual', i.e. the undertaking's situation had the alleged aid not been granted. The first half is relatively easy to assess, since it has already taken place, at least in cases of unlawful aid. The second half is more difficult, but one thing is clear: the necessary starting point must again be realistic and not fictional, i.e. one needs to think what kind of treatment the undertaking would realistically receive if the aid had never been granted under the laws in place. For example, when a company is given one million euros, the factual is the receipt of one million euros by the State and the counterfactual is the receipt of zero euros. The difference between the factual and the counterfactual represents the advantage, i.e. one million euros. If the general corporate tax rate is 30% and a company's tax rate is cut to 15%, the factual is a taxation at 15% and the counterfactual is a taxation at 30% of its profits, with the advantage being the 15% difference.

In the case of a tax ruling which is based on a national tax law, if the company had never received a tax ruling that (allegedly) provided for beneficial treatment, it would have been taxed under the national tax law that would have been applicable to it. In case the Member State in question had not implemented the arm's length principle, then the company would have been taxed under the relevant "ALP-agnostic" tax provision. Thus, the crucial takeaway is the following: in both the factual and the counterfactual, the necessary point of reference is a national measure.[195] In the Commission's own words, '[t]he advantage must be

[195] In the context of tax rulings, the question whether they violate state aid law 'must be addressed separately against the background of each legal system.' See Michael Lang, 'Tax Rulings and State Aid Law' (2015) 3 British Tax Review 391, 394.

assessed, within the framework of the state aid investigation, purely at national level'.[196] The Commission therefore needs to identify the counterfactual based on the position in which the undertaking would actually be under national law in the absence of the tax ruling, instead of engaging into thought experiments based on normative tests or fictitious "versions" of national laws that were never actually in place. As has been aptly noted, 'the relevant benchmark treatment cannot be derived autonomously from European law and it cannot be determined by reference to fiscal standards as applied in other States inside or outside the European Union. In order to protect the Member States' prerogative in tax matters, the decisive benchmark for fiscal state aid can only be the tax legislation of the relevant country itself.'[197] In the unequivocal words of another academic, 'the national tax regime is the only relevant benchmark for a State aid analysis' and state aid law 'cannot serve as a tool to impose "best practices" on a Member State that did not adopt them on its own.'[198] To sum up, according to State aid orthodoxy, the criteria 'can only be defined on the basis of the national law generally applicable, and cannot be substituted by EU and/or international standards or best practices.'[199]

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[196] Commission Decision 2003/515/EC *Dutch International Financing Activities* [2003] OJ L 180, p. 52, para 82.

[197] Wolfgang Schön, 'Tax Legislation and the Notion of Fiscal Aid - A Review of Five Years of European Jurisprudence' (2015) Max Planck Institute for Tax Law and Public Finance Working Paper, p. 6.

[198] Raymond Luja, 'Will the EU's State Aid Regime Survive BEPS?' (2015) 3 British Tax Review 379, 381.

[199] Sjoerd Douma and Alexia Kardachaki, 'The Impact of European Union Law on the Possibilities of European Union Member States to Adapt International Tax Rules to the Business Models of Multinational Enterprises' [2016] 44 Intertax 746, 751.

However, even though the Commission correctly sets out the legal test for the identification of a (selective) advantage, it then goes on to disregard it in its decisions, since it effectively uses its version of the arm's length principle as the relevant counterfactual, and finds that an advantage has been conferred because there is a difference between the factual (the tax ruling) and the counterfactual (the arm's length principle).[200] Is the Commission on to something? Is its approach perhaps warranted by a proper interpretation of *Forum 187*?

1.3. Overstretching Forum 187

In bridging the gap between Article 107 TFEU and the arm's length principle, the Commission asserts that it is relying on ECJ case law, both in its Final Notice and in its recent decisions. More specifically, as the Commission keeps repeating:

> The Court of Justice has already held that a reduction in the taxable base 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 accounting profits as a basis to determine their taxable base.[201]

The only ECJ case the Commission cites is the *Forum 187* case.[202] The *Forum 187* case was the culmination of the Belgian Coordination Centres saga. In

[200] See *Starbucks*, para 265, which obviously refers to the arm's length principle as defined by the Commission in para 264.

[201] *Starbucks*, para 258 [footnotes omitted]. The same is stated in *Fiat*, para 222.

[202] Joined Cases C-182/03 & C-217/03 *Belgium and Forum 187 ASBL v Commission* EU:C:2006:416.

a nutshell, in this case the Commission managed to persuade the Court that a Belgian tax regime favouring multinational groups amounted to incompatible state aid.

The paragraphs on which the Commission relies are paragraphs 95 to 97 of *Forum 187*. In these paragraphs the ECJ had stated that[203]

> 95 [i]n order to decide whether a method of assessment of taxable income such as that laid down under the regime for coordination centres confers an advantage on them, *it is necessary, as the Commission suggests at point 95 of the contested decision, to compare that 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.*
>
> 96 In that regard, the staff costs and the financial costs incurred in cash-flow management and financing are factors which make a major contribution to enabling the coordination centres to earn revenue, inasmuch as those centres provide services, particularly of a financial nature. Accordingly, the effect of the exclusion of those costs from the expenditure which serves to determine the taxable income of the centres is that *the transfer prices do not resemble those which would be charged in conditions of free competition.*
>
> 97 It follows that such an exclusion confers an economic advantage on the centres.

It is not immediately clear that the ECJ said exactly what the Commission claims it did. At first glance, the Commission's recent statement appears to be broader and slightly different from the ECJ's dictum in paragraph 95. The ECJ linked the conferral of an advantage to a deviation from the ordinary tax system, while the Commission links the conferral of an advantage to a deviation from the arm's length principle. The Commission's premise - as set out e.g. in the *Belgian Excess Profit* decision - is that, in an ordinary tax system where conditions of free

[203] Emphasis added.

competition prevail, transfer prices should reflect those 'negotiated by independent undertakings negotiating under comparable circumstances at arm's length'.[204] These three seemingly innocuous words at the end of the sentence, i.e. 'at arm's length', were not uttered by the ECJ in *Forum 187*.[205] Actually, the ECJ did not even refer to the 'arm's length principle' as such; it only assessed the appropriateness of the 'cost-plus' method adopted by Belgium for the calculation of the taxable income of coordination centres.

The Court of Justice in *Forum 187* did not specify what it meant when it referred to ordinary taxation in conditions of free competition. The obvious point that comes to mind is that in 'a normal market the setting of prices between a group of related companies will be different because of economies of scale, synergy effects and alike'.[206] A normal or ordinary market cannot be one that only includes standalone companies: since when does one type of companies denote normality? Why should the taxation of standalone companies represent a sort of "golden standard" in accordance with which all companies should be taxed?

This point cannot be stressed strongly enough: '[a]cting within a market economy is not the same thing as acting as a fully independent party'.[207] In the

[204] *Belgian Excess Profit*, para 147.

[205] The last part was 'added' by the European Commission: see Raymond H.C. Luja 'Do State Aid Rules Still Allow European Union Member States to Claim Fiscal Sovereignty?' (2016) 5-6 EC Tax Review 312, 323.

[206] Raymond H.C. Luja 'Do State Aid Rules Still Allow European Union Member States to Claim Fiscal Sovereignty?' (2016) 5-6 EC Tax Review 312, 323.

[207] Raymond H.C. Luja 'Just a Notion of Aid: How (Not) to Create A Fiscal State Aid Doctrine' (2016) 44 Intertax 788, 789.

words of Peter J. Wattel, the judgment in *Forum 187* 'may therefore merely say that the ordinary tax system should be applied, but *not* what that ordinary system should consist of as regards transfer pricing regulation.'[208]

To sum up on this issue, when the ECJ in *Forum 187* referred to 'an ordinary tax system' and to 'conditions of free competition', it was not reinventing the wheel or making some revolutionary statement. Its dicta have to be read 'in the context of the Belgian tax measure in question, which determined tax liability on the basis of a reduced cost base'; so, what the Court 'merely said' was that 'in conditions of free competition a company would have to bear all of its costs, not only a part of them'.[209]

Still, let us for a minute assume that the Commission is right, and that it is only elaborating on an idea whose seed can indeed be found in *Forum 187*. Even if we assume that the ECJ accepted that the arm's length principle should sometimes form part of the Commission's assessment under Article 107 TFEU (which, I repeat, it did not explicitly do), what kind of arm's length principle was the Court referring to? Was the Court referring to the OECD's version of the arm's length principle, or was it instead referring to the Commission's preferred version, namely one that is not '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

[208] Peter J. Wattel, 'Stateless Income, State Aid and the (which?) Arm's Length Principle (2016) 44 Intertax 791, 794.

[209] Phedon Nicolaides, 'State Aid Rules and Tax Rulings' (2016) European State Aid Law Quarterly 416, 426.

taxation 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'?[210]

The answer is clear: if the Court in *Forum 187* was referring to a certain version of the arm's length principle (which, again, is doubtful) then that was the arm's length principle of the OECD.[211] First, in paragraph 94, the Court explicitly refers to the OECD's 'cost-plus' method. Secondly and most importantly, in paragraph 95 it cites paragraph 95 of the relevant Commission Decision[212] with approval, where the Commission explains that is applying the OECD's soft law instruments. Consequently, *Forum 187* cannot persuasively be relied upon as authority for the existence of an independent, EU law-specific, arm's length principle.[213]

There is yet another reason why the ECJ in *Forum 187*, contrary to the Commission's assertions, did not introduce a new EU law ALP: it did not need to

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[210] *Starbucks*, para 264 [footnotes omitted]; *Fiat*, para 228; and *Belgian Excess Profit*, para 150.

[211] Both academics and practitioners seem to agree on this reading of *Forum* 187. See, for example, Liza Lovdahl Gormsen, 'EU State Aid Law and Transfer Pricing: A Critical Introduction to a New Saga' (2016) Journal of European Competition Law & Practice, section vii; Philip Andrews, 'Uncle Sam Is Right: The EU Probe Into Ireland's Tax Treatment of Apple Is Overreach' Wolters Kluwer Competition Law Blog (2016) <http://kluwercompetitionlawblog.com/2016/06/30/uncle-sam-is-right-the-eu-probe-into-irelands-tax-treatment-of-apple-is-overreach/> accessed 30 June 2019.

[212] Commission Decision 2003/755/EC *Belgian Coordination Centres* [2003] OJ L 282/25, emphasis added.

[213] In the same vein, Professor C.H. Panayi stated that the ECJ in *Forum 187* did not make any references to the arm's length test, but rather 'limited itself to a more traditional state aid analysis.' See Christiana Panayi, *Advanced Issues in International and European Tax Law* (Oxford Hart Publishing 2015) 269.

do so! The reason is simple: the national counterfactual, i.e. the Belgian tax law at issue, expressly incorporated the OECD's ALP. Belgium had previously made a sovereign decision to adopt the OECD's Guidelines and thus to be bound by them in all relevant assessments. The Commission itself admits this in paragraph 43 of its underlying decision regarding the Belgian Coordination Centres regime, where it is noted that the Belgian authorities had stated that 'when determining transfer prices, the Belgian administration must base itself on the OECD reports'. In other words, there was no need for the ECJ to "invent" an EU law arm's length principle in order to find that Belgium had granted a selective advantage to the coordination centres: the fact that Belgium allowed the latter to exclude certain costs when applying the "cost plus" method meant that the Belgian authorities were departing from national tax law, which incorporated the OECD's ALP, which in turn disallowed the exclusion of such costs. No jurisprudential revolution was, therefore, needed to conclude that an advantage had been conferred:[214] the typical "factual versus counterfactual" juxtaposition was sufficient, and this is indeed what the ECJ actually did in *Forum 187*.[215]

Through the preceding analysis it is becoming increasingly clear that

[214] In its intervention before the General Court in the Starbucks case, Ireland submitted that the ECJ in Forum 187 'did not identify an arm's length principle particular to EU law, in so far as, in that case, first, the arm's length principle had been incorporated into Belgian national law and, second, the judgment referred to the OECD Guidelines, which had also been incorporated into Belgian national law.' See Case T-760/15 and T-636/16 *Kingdom of the Netherlands and Others v European Commission (Starbucks)* EU:T:2019:669, para 134.

[215] In the words of Phedon Nicolaides, the Court just 'reasoned, correctly, that any company, regardless of whether it was in a group or not, had to bear all of its costs', but 'nowhere in that judgment is there a stipulation that costs have to be those that would have been charged by an independent company.' See Phedon Nicolaides, 'State Aid Rules and Tax Rulings' (2016) European State Aid Law Quarterly 416, 425.

Forum 187 does not support all of the Commission's assertions, but is instead being overstretched.[216] Even more importantly, to the best of my knowledge, neither does any other judgment of the European Courts.[217] We can also safely assume that if there had been another State aid case explicitly enshrining an EU law version of the arm's length principle into Article 107 TFEU, the Commission would have spotted it and heavily relied on it in its decisions.[218]

This overstretching of *Forum 187* by the Commission is not an accidental but a deliberate and strategic move.[219] While, in the Draft Notice of 2014, *Forum 187* was only fleetingly mentioned in a footnote, in the Final Notice it receives an extensive analysis.[220] This obviously reflects the increased significance which this ECJ case enjoyed in the Commission's investigations and decisions that had taken place in the meantime. It is revealing that, in paragraph 176 of the Draft Notice of

[216] Even the more "lenient" academic commentators have observed that 'the existing State aid case law seems rather inconclusive': see Peter J. Wattel, 'Stateless Income, State Aid and the (which?) Arm's Length Principle (2016) 44 Intertax 791, 794.

[217] See Philip Andrews, 'Uncle Sam Is Right: The EU Probe Into Ireland's Tax Treatment of Apple Is Overreach' Wolters Kluwer Competition Law Blog (2016) <http://kluwercompetitionlawblog.com/2016/06/30/uncle-sam-is-right-the-eu-probe-into-irelands-tax-treatment-of-apple-is-overreach/> accessed 30 June 2019, who notes that there are only two cases – Case C-524/04 and Case C-311/08 - in which the term "arm's length" was used by the European courts in the context of tax calculations, neither of which involved State aid or transfer pricing; they were both concerned with the freedom of establishment and the free movement of capital.

[218] To put it differently, it seems that the Commission has 'invented a totally new concept', i.e. the EU law ALP, with no serious basis on *Forum 187* and with no evidence of existence prior to the final Commission Decisions in Fiat and Starbucks in 2015: See Philip Baker QC, 'Business in an Uncertain World – State Aid' (OUCBT Summer Conference 2017, London, June 2017).

[219] The Commission seems, in the words of other academics, 'to be doing a rather isolated reading of the cited excerpts of [the Forum 187 judgment]', even though the Court there 'did nothing different than following a traditional state aid analysis': see Sjoerd Douma and Alexia Kardachaki, 'The Impact of European Union Law on the Possibilities of European Union Member States to Adapt International Tax Rules to the Business Models of Multinational Enterprises' [2016] 44 Intertax 746, 751.

[220] *Final Notice,* para 171 fn 254.

2014, where one would have expected the Commission to discuss the existence of such a principle if it was already aware of it, we read nothing relevant. Instead, what we got was one self-evident statement concerning selectivity, namely that tax rulings should not provide for lower taxation of certain taxpayers than other comparable undertakings, as well as a reference to the Commission's decisional practice which allegedly showed that 'rulings allowing taxpayers to use alternative methods for calculating taxable profits, e.g. the use of fixed margins for a cost-plus or resale-minus method for determining an appropriate transfer pricing, may involve State aid'.[221] To back up this last sentence the Commission cited many of its decisions from the early 2000s, as well as - interestingly enough - the ECJ's *Forum 187* judgment. This is the only time the Commission cited *Forum 187* in the section of its Draft Notice that dealt with fiscal State aid.

It is thus obvious that, in 2014, the sentence quoted directly above was, in the Commission's own view, all that *Forum 187* had to offer as regards the State aid assessment of tax rulings. However, in that sentence the Commission did *not* interpret *Forum 187* as meaning that any deviation from the arm's length principle confers a selective advantage; in fact, the arm's length principle is not mentioned at all there, let alone linked to a general principle of EU law which "transposes" the ALP to Article 107 TFEU! To put it bluntly, what this shows is, that between 2014 and 2016, the Commission's interpretation of *Forum 187* has changed. It is as if the Commission has only lately realised this judgment's “potential” and has started to generalize its significance in order to forge a sharp weapon that might

[221] *Draft Notice,* para 176.

help it obtain a series of decisive Court victories. Naturally, changing and refining one's arguments is perfectly fine, but this is much different, since the Commission asserts that its arguments are firmly grounded on a fundamental and pre-existing EU law principle: surely this principle cannot only have come to its attention sometime between 2014 and 2016...[222]

For all the above reasons, the Commission's overreliance on *Forum 187* is objectionable. It can also, at times, be misleading. For example, to support its most controversial assertion that there exists 'a general principle of equal treatment in taxation 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',[223] the Commission cites paragraph 81 of *Forum 187*. However, all this paragraph says is the following: '[i]t should be pointed out, first, that rules relating to tax are not excluded from the scope of Article 87 EC'. This is far from controversial. Actually, this paragraph only lends support to the final phrase of the aforementioned assertion of the Commission[224] and does not in any way demonstrate the existence of a general principle.[225]

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[222] In the words of Professor Biondi, as accurate in 2013 as they are today, 'the European Commission continues its constitutionally dubious practice of adopting a series of soft law instruments that are directly affecting how State aid control should be understood'; see Andrea Biondi, 'State aid is falling down, falling down: An analysis of the case law on the notion of aid' (2013) 50 Common Market Law Review 1719.

[223] *Starbucks*, para 264 [footnotes omitted]. The same is stated in *Fiat*, para 228.

[224] In paragraph 172 of the Commission's Final Notice where the same assertion is made, paragraph 81 of Forum 187 is again cited, together with paragraphs 65 and 66 of Case T-538/11 *Belgium v Commission* EU:T:2015:188, which essentially say the same thing, i.e. that tax measures are not shielded from State aid scrutiny.

[225] On the various problematic aspects of the fiscal aid section of the Commission's Final Notice on the Notion of Aid, see, inter alia, Andrea Biondi & Oana Stefan 'The Notice on the Notion of State Aid: Every light has its shadow' in B. Nascimbene (ed.) The Modernisation of EU State Aid Control

1.4. Are group companies comparable to standalone companies?

As has now been demonstrated, this newly-minted EU law arm's length principle allegedly stems from the principle of equality and non-discrimination in the area taxation. The implication is that, if the EU law ALP did not exist, discrimination between group and standalone companies would arise, to the detriment of the latter category of undertakings. However, even if we allow ourselves to follow this train of thought, we need to remember the fundamentals of EU discrimination law: discrimination *only* exists if similar (or comparable) entities are treated dissimilarly, or different (non-comparable) entities are treated similarly. Is this the case in the state aid decisions under review? Are group companies and standalone companies "similar"? In state aid jargon, are companies that belong to multinational groups and standalone companies "in a comparable factual and legal situation"? In this section it will be argued that this question needs to be answered in the negative.

The comparability exercise, which constitutes a key step of the selectivity test, takes place 'in the light of the objective pursued by the measure in question', as stated by the ECJ in paragraph 41 of its landmark *Adria Wien* judgment.[226] What, then, is the objective of national transfer pricing rules? It is to align the taxation of group companies to standalone companies. Given that this is the objective these two kinds of companies cannot logically be in a comparable factual

- Evolution and Perspectives of the EU Rules on State Aids and Services of General Economic Interest (Springer 2018), esp. section 3.3.

[226] Case C-143/99 *Adria Wien* EU:C:2001:598.

and legal situation, since otherwise the transfer pricing rules would be unnecessary to begin with.[227]

The Commission does not adequately explain why associated and standalone companies are in a comparable situation. In fact, it seems to assume that they are comparable because they both earn income: 'all undertakings having an income are considered to be in a similar legal and factual situation from the perspective of direct company taxation'.[228] Even the commentators who agree with the Commission's conclusions as regards comparability are quick to note that DG COMP 'does not provide a convincing motivation' for its findings.[229]

One argument in favour of the comparability of group companies to standalone companies would be that both types of companies 'are most likely to aim at the realization of profits, and a corporate income tax system should aim, under the control of the state aid rules, at taxing such profits in a similar manner, no matter the ownership or organization of the respective undertakings.'[230] It cannot be said that this view is entirely without merit, but it underplays the differences between the two types of companies and does not assign full weight

[227] Andreas von Bonin, 'EU Commission Initiative Against "Aggressive Tax Planning as it Affects the Member States" (Berliner Gesprächskreis zum Europäischen Beihilferecht e.V., 29th Roundtable, Berlin, June 2016).

[228] Commission Decision of 21 October 2015 on State Aid which Luxembourg Granted to Fiat, Case SA.38375 (2014/C ex 2014/NN), fn 87.

[229] Jérôme Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (Wolters Kluwer 2018), 101 fn 403.

[230] Jérôme Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (Wolters Kluwer 2018), 101.

to the Commission's previous decisional practice and to the pivotal role that tax sovereignty plays in this debate.

Starting with the Commission's decisional practice, there are two decisions that need to be mentioned here, both from 2009, i.e. after the ECJ handed down its *Forum 187* judgment in 2006. In July 2009, the Commission found that the Dutch "group interest box" scheme (groepsrentebox) did not amount to state aid, since no selective advantage was present.[231] This regime provided for lower taxation and deductibility of interest received or paid in the context of intra-group relations.[232] In other words, Dutch tax law treated integrated companies more favourably than standalone companies. A key question, thus, was whether the two groups of companies were in a 'comparable factual and legal situation'. If they were, the measure would be selective and would most probably fall foul of Article 107 TFEU.

Interestingly enough, the Commission's conclusion was that the measure was not selective, because '[w]ith respect to debt financing activities, related companies are not in a legal and factual situation comparable to that of unrelated companies.' [233] The justification provided was that 'related companies, unlike unrelated companies, are not engaged in a merely commercial transaction when

[231] Commission Decision 2009/809/EC of 8 July 2009 on the groepsrentebox scheme which the Netherlands is planning to implement (C 4/07 (ex N 465/06)).

[232] ibid, para 1.

[233] ibid, para 103.

they try to obtain loan or equity financing within the group.'[234] Then came the key statement, with the Commission (rightly) admitting that the 'parent and the subsidiary share the same interests, which is not the case in a commercial transaction with a third-party provider of finance, where each party tries to maximise its profits at the expense of the other.'[235]

This is indeed the crux of the matter. It is obvious that the key difference between integrated and standalone companies is not confined to the strict contours of debt financing activities and can readily be generalised: no transaction between two affiliated companies is truly comparable to the same transaction between two independent companies: the former ultimately share the same interests, while the latter do not. The Commission reiterated this approach in October 2009, in another decision concerning a Hungarian tax regime providing for the favourable taxation of net interest income between affiliated companies belonging to the same group.[236]

It is worth stressing that an overwhelming number of contributors to this debate agree with the Commission's early approach, and thus question the comparability of MNEs to standalone companies. But, before getting to their views, we need to pause and ask a simple question: what are MNEs exactly? It's worth providing a widely accepted definition, so as to avoid the "demonisation" of

[234] ibid.

[235] ibid.

[236] Commission Decision 2010/95/EC of 28 October 2009 on State aid implemented by Hungary for tax deductions for intra-group interest (C 10/07 (ex NN 13/07)).

such entities. According to the definition of the United Nations Conference on Trade and Development (UNCTAD) in its World Investment Report, MNEs are integrated firms, i.e. with subsidiaries (or "affiliates"), pursuing profit across borders.[237] It is worth noting that we shouldn't imagine all MNEs as being behemoths like Apple or Amazon: actually 66.5% of MNEs worldwide are simple firms made of just one parent and one subsidiary operating across a border.[238]

Coming to the academic literature, it is true that it is not difficult to argue that group companies are in many ways different to standalone companies: 'the mere existence of mergers & acquisitions already serves as a strong indicator that the economics of a company's operations may change because of being part of a group, be it economies of scale, synergy effects at large or otherwise.'[239] In fact, the factual differences separating group companies from independent/standalone companies make one 'wonder whether it is even possible to argue that group companies and independent companies are in a similar situation to start with.'[240] In the words of other commentators, 'at least from an economic perspective it is questionable whether group companies and standalone companies are indeed

[237] UNCTAD, World Investment Report 2016 <https://unctad.org/en/PublicationsLibrary/wir2016_en.pdf> accessed 11 October 2019.

[238] UNCTAD, World Investment Report 2016 <https://unctad.org/en/PublicationsLibrary/wir2016_en.pdf> accessed 11 October 2019, p. 134. See also the interesting analysis of Robin F. Hansen, 'Taking More Than They Give: MNE Tax Privateering and Apple's "Ocean" Income' (2018) 19 (4) 693, 711-714.

[239] Raymond H.C. Luja 'Just a Notion of Aid: How (Not) to Create A Fiscal State Aid Doctrine' (2016) 44 Intertax 788, 789.

[240] Raymond H.C. Luja 'Do State Aid Rules Still Allow European Union Member States to Claim Fiscal Sovereignty?' (2016) 5-6 EC Tax Review 312, 323.

equal.'[241]

The sensible conclusion, and the one better rooted in real life, is that 'group companies and standalone companies are not in a similar legal and factual situation exactly because the first are part of a group of related companies.'[242] Related companies 'are economically different creatures than unrelated ones'.[243] It is difficult to compare these two types of companies, and it is equally difficult to compare the transaction between related and unrelated companies, inter alia because the former 'are subject to a higher degree of transparency, lower degree of risk and more control over quality' of the products/services being exchanged.[244]

It is, therefore, more convincing to argue that multinationals are 'in a different factual situation than that of non-integrated companies with respect to corporate taxation' and that it would have been more logical for the Commission to 'define the reference system as that of corporate taxation applied to multinationals.'[245]

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[241] Sjoerd Douma and Alexia Kardachaki, 'The Impact of European Union Law on the Possibilities of European Union Member States to Adapt International Tax Rules to the Business Models of Multinational Enterprises' [2016] 44 Intertax 746, 751.

[242] Raymond Luja, 'State Aid Benchmarking and Tax Rulings: Can We Keep it Simple?' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 114.

[243] Brian E Lebowitz, 'Transfer Pricing and the End of International Taxation' (1999) 13 Tax Notes International 1202.

[244] Phedon Nicolaides, 'State Aid Rules and Tax Rulings' (2016) European State Aid Law Quarterly 416, 422.

[245] Adrien Girard and Sylvain Petit, 'Tax Rulings and State Aid Qualification: Should Reality Matter?' (2017) 16 European State Aid Law Quarterly 233, 238.

By way of conclusion of this section, it is apposite to remark, as I have done elsewhere,[246] that *Forum 187*, i.e. the Commission's "holy grail", might in fact undermine the latter's selectivity analysis and lend support to the non-comparability approach. More specifically, as has already been shown in Part A of this chapter, the Commission in its decisions in *Starbucks* etc. identified the general corporate tax system of the Member States in question as the appropriate reference framework. However, paragraphs 122-123 of *Forum 187*, combined with paragraph 104 of the Commission's relevant decision and paragraph 297 of AG Léger's Opinion in *Forum 187*, suggest that the appropriate reference framework in that case was limited to the universe of multinational companies, to the exclusion of standalone entities. It was solely because the cost-plus method for determining taxable income was only limited to certain multinationals, e.g. those established in at least four countries, that this measure was found to be selective.[247]

Through the preceding analysis in this section, it has been shown that the Commission's assertion that integrated and standalone companies are comparable, on which much of its argumentation rests, is highly questionable.

[246] Dimitrios A Kyriazis, 'From Soft Law to Soft Law Through Hard Law: The Commission's Approach to the State Aid Assessment of Tax Rulings' (2016) 15(3) European State Aid Law Quarterly 428, n 55.

[247] ibid.

1.5. Stealthy tax harmonisation?

Apart from these objections, another objection to this new principle is that, in a sense, it amounts to 'tax harmonisation through the back door'. I know that this phrase has been used *ad nauseam*, but no other phrase better encapsulates the practical legal effect of this new EU law principle. Were it not for it, the counterfactual in the advantage analysis in the case of a Member State that had not implemented the ALP when it granted the tax ruling (like Ireland - which however only granted non-binding advance opinions) would be its ALP-agnostic national law. Consequently, if the advance opinion merely reflected and applied that national law to the facts of a specific company, no advantage would be conferred since the factual and the counterfactual would practically be the same.

However, this new EU law principle represents an additional layer that is inserted in-between the aforementioned factual and counterfactual, to the effect that once the factual (advance opinion) is removed, we fall back to this new EU law principle which is ALP-compliant and which applies across all 27 Member States. Thus, there is now a difference between the factual and the counterfactual and if this difference results in a comparatively reduced tax bill, an advantage is conferred. To put it bluntly, this is a whole new ballgame compared to the previous scenario.[248]

[248] Concerns such as these have led commentators to the conclusion that 'there is currently no appropriately rational limitation to the power of the European Commission to interfere with the trade off of the Member States between tax competition and tax harmonisation.' See Cees Peters,

This approach 'shifts the determination of the reference system from sovereign States to the Commission and the ECJ' and it is, thus, 'no longer up to the States to determine the content of their transfer pricing law, the foundational principles of which will be derived from EU law.'[249]

It is also clear that this new EU law principle affects Member States' fiscal sovereignty, since it pushes national counterfactuals, i.e. national tax laws, aside in the context of the State aid exercise, and replaces them with a murky EU law principle which has not been put in place by national parliaments.[250] [251] Still, although this is true, I always found legal arguments against EU action that were *solely* based on an incursion into national sovereignty to be relatively weak.[252] This is because national sovereignty is not of a static nature; when it comes to State measures that could potentially qualify as State aid, there are no definitive lines that could resemble a "Rubicon" meant to signal inappropriate trespassing by the European Commission or Courts. In practical terms, a national tax measure only falls within the sacred area of national tax sovereignty as long as it has not

'Tax Policy Convergence and EU Fiscal State Aid Control: In Search of Rationality' (2019) 1 EC Tax Review 6, 16.

[249] Ricardo André Galendi Júnior, 'State Aid and Transfer Pricing: The Inherent Flaw Under a Supranational Reference System' (2018) 46 Intertax 994, 1005.

[250] It is also worth keeping in mind that the ALP is not a rule of public international law either.

[251] It should be noted that, not only does the Commission apply the ALP against Member States which may have never voluntarily adopted it, but it also 'seems to have its own interpretation of the OECD [Transfer Pricing Guidelines] that it substitutes for that of the Member State concerned: see Luc de Broe, 'The State Aid Review Against Aggressive Tax Planning: 'Always Look a Gift Horse in the Mouth'' (2015) 6 EC Tax Review 290, 292.

[252] Political arguments of this sort can be very effective, as evidenced by the decision of the majority of UK voters to abandon the EU in the "Brexit" referendum.

been found to constitute State aid by the ECJ. This is because State aid measures are part of the Treaties' competition rules, which fall squarely within the EU's exclusive competence.[253] In practice, there are no clear 'external' limits to the scope of the EU's exclusive competence.[254] As ECJ President Lenaerts eloquently put it many years ago, albeit in a different context, 'there simply is no nucleus of sovereignty that the Member States can invoke, as such, against the Community'.[255] Still, in the context of Article 107 TFEU, Advocate General Kokott recently emphasised the importance of avoiding an overly broad interpretation of selectivity, since this could upset the division of competences between the EU and Member States, [256] thus limiting Member States' competence and fiscal sovereignty.

1.6. A new principle with an uncertain origin and formulation

Another problem that lawyers and tax advisors will surely take issue with is that this newly-minted general principle looks rather murky and its formulation is unclear. General principles are of course by definition vague and nebulous, especially when they first appear in EU discourse, but this one is particularly so. The Commission only devotes a couple of paragraphs to this EU Law principle,

[253] Article 3 (1) (b) TFEU.

[254] Or, in fact, to any other kind of EU competence.

[255] Koen Lenaerts, 'Constitutionalism and the Many Faces of Federalism' (1990) 38 The American Journal of Comparative Law 205, 220.

[256] Case C-66/14 *Finanzamt Linz* EU:C:2015:661, Opinion of AG Kokott, para 113. These concerns were recently echoed by Spain, Ireland and Germany in their interventions before the ECJ in the *Spanish* Goodwill case: Joined Cases C-20/15 P and C-21/15 P *Commission v World Duty Free Group* EU:C:2016:624, Opinion of AG Wathelet, para 71.

without providing specifics on the exact sources of the principle, the reasoning behind it, its interaction with the principle of national fiscal sovereignty and, most importantly, its application in practice. One cannot claim that the Commission did not have the requisite time and motivation to elaborate; quite the opposite. Its State Aid Notice is now final, and its decisions against Luxembourg, Belgium, Ireland and the Netherlands are also final. Thus, the clarity of the Commission's reasoning is of paramount importance to litigants and their rights of defense, as they need to know precisely what they will be arguing against before the General Court.

Contrary to the alleged aid beneficiaries and the Member States, Competition Commissioner Margrethe Vestager appears satisfied with the clarifications that her Directorate-General (DG COMP) has provided. In fact, she has stressed that 'the primary responsibility for ensuring that all tax arrangements comply with EU State aid rules rests fairly and squarely with Member States themselves', a fact that 'does not absolve companies from themselves double-checking any special tax treatment', since in case 'the actual amount of tax paid looks too good to be true, then it may well be problematic under State aid rules.'[257] Still, the Commissioner acknowledged that companies need 'reassurance that they haven't accidentally broken the rules', which is why the Commission adopted the Final Notice on the Notion of State Aid and

[257] Margrethe Vestager, 'Working together for fairer taxation' (The Tax Dialogue, Copenhagen, 2 September 2016) <http://ec.europa.eu/commission/2014-2019/vestager/announcements/working-together-fairer-taxation_en> accessed 20 August 2019.

supplemented it with a Working Paper on State Aid and Tax Rulings.[258] In the Commission's view, these two documents shed light on all contentious and complicated issues.

Unfortunately, Commissioner Vestager's optimism is misplaced. As we have seen, none of these two soft law instruments provides any meaningful guidance to tax ruling recipients; quite the opposite. Paragraph 23 of DG COMP's Working Paper on State Aid and Tax Rulings is a good example of how extra "guidance" is not always better: it is stated there that the Commission's 'focus is on cases where there is a *manifest* breach of the arm's length principle.'[259] It was hard enough trying to pin down what the new EU law ALP is and when a tax ruling breaches it; now companies need to make sure that the breach is not 'manifest' in order to avoid drawing the Commission's attention, an adjective that is not defined by the Commission. Not only does, therefore, this extra guidance fail to fully clarify the Commission's assertions, but it also unnecessarily adds another layer of complexity.

The ensuing lack of clarity is not only detrimental to the alleged aid beneficiaries; tax predictability is crucial for companies in general. Undertakings need to know whether they can participate in a tax scheme or receive a tax ruling without getting in trouble. It is no coincidence that this is the crux of the concerns expressed in a letter sent to Commissioner Vestager by the American Chamber of

[258] European Commission, 'DG Competition – Internal Working Paper – Background to the High Level Forum on State Aid of 3 June 2016', hereafter 'Working Paper'.

[259] *Working Paper*, para 23 [emphasis added].

Commerce to the EU (AmCham EU) in July 2016. The Chamber, which represents 164 American companies accounting for more than €2 trillion of investment in Europe, complained that the Commission's shift 'to an Article 107-derived arm's length principle of unknown scope would not provide sufficient guidance on how companies can or should comply with it, and it is not in line with transfer pricing principles under the OECD Guidelines and with Member States' domestic legislations.'[260] The US Treasury was even more vocal: in an unprecedented move, just six days before the Commission issued its landmark decision against Ireland and Apple, it published a 25-page white paper in which it heavily criticised the Commission's approach. The Treasury's comments are highly elaborate and cannot be fully summarized here, but the nub is that the Commission's approach is novel and constitutes "an unforeseeable departure from the status quo" which is "inconsistent with international norms and undermines the international tax system".[261] For this reason, the US government strongly advised the Commission not to apply its new theory retroactively, but instead refrain from ordering the recovery of aid. By then it was already too late: the die had been cast.

In addition to its detrimental effect on companies as underlined *supra*, the legal uncertainty that the Commission's probes have given rise to means that DG COMP's effectiveness in ensuring compliance with State aid rules is at stake. If the

[260] American Chamber of Commerce to the European Union, 'Letter to Commissioner Vestager on the European Commission's state aid investigations' <http://www.amchameu.eu/system/files/position_papers/amcham_eu_letter_to_commissioner_margrethe_vestager.pdf> accessed 22 September 2019.

[261] U.S. Department of the Treasury, 'The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings' (24th August 2016) <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/White-Paper-State-Aid.pdf> accessed 22 September 2019, p. 1.

reach of these rules does not become clear, the Commission risks being inundated with thousands of notifications from Member States in relation to individual tax rulings which the Commission will be practically unable to assess. Since its 'Final Notice on the Notion of Aid' and its 'Working Paper on Tax Rulings' have proven to be far too vague and wanting in detail, the Commission, if it decides to stick to its novel approach, needs to provide further guidance on how a company can comply with this new EU law ALP.

The main conclusion to be drawn is that legal certainty and tax predictability are key considerations when it comes to fiscal state aid. Both the lawfulness of deep-rooted national tax regimes and many companies' tax bills hang in the balance: the stakes are high.

1.7. A thought experiment

Having voiced some critical remarks on the Commission's approach, it would perhaps be intriguing to take a step back and conduct a thought experiment. Let us stand in the Commission's shoes when it was drafting its final decisions in the Fiat and Starbucks cases and when it was adopting its Final notice. An interesting question is this: should the Commission have "simply" asserted that the OECD ALP is somehow part of EU law? Leaving aside the fact that such an assertion would be legally problematic, would it be wiser policy-wise if it were legally possible? This question leads us, I think, to an underlying thematic tension that has yet to be explored in the (scarce) existing literature, namely the tension between legitimacy and legal certainty.

Let us assume, for a moment, that the Commission had actually concluded that the OECD's definition of the ALP and its Transfer Pricing Guidelines were the criteria based on which the conferral of a State aid advantage should be examined, regardless of whether a Member State had implemented the OECD ALP in its national tax law. Member States and their lawyers would surely be outraged by what would seem to be a magical transformation of soft law into hard law. "The OECD's work is not binding", they would cry: how dare the Commission make it binding through the back door, i.e. via the State aid rules, when the latter 'cannot be used to impose the OECD transfer pricing guidelines on Member States without prior consent'? [262] This would surely be perceived as an affront to Member States' fiscal sovereignty and as a circumvention of the unanimity requirement in EU tax law-making.

On the other hand, there are many who would have preferred such a solution if it was legally tenable. Why? Because they would argue that it better serves legal certainty, about which most lawyers and tax advisors are concerned. "How are we to advise our clients?", they now ask. When is a tax ruling suspicious from a State aid perspective? What does this EU Law arm's length principle mean in practice? To which document should we resort for guidance? At least for the OECD ALP we have extensive Guidelines, for this EU ALP we have no such thing, since the Commission's Final Notice and DG COMP's Working Paper offer no

[262] Raymond Luja, 'Will the EU's State Aid Regime Survive BEPS?' (2015) 3 British Tax Review 379, 390.

detailed guidance of a level even remotely comparable to the relevant OECD documents.

Leaving the issue of legal constraints aside, both policy choices have their merits and drawbacks. It was, however, next to impossible for the Commission to fully quell both concerns, namely legitimacy and legal certainty; it had to choose. It is clear that the path the Commission has taken in its soft and hard law initiatives does not place great emphasis on legal certainty and legal clarity. At the same time, as has been demonstrated above, legitimacy concerns linger, especially because of the murky origins and vague formulation of this new principle.

Still, it is worth noting that the Commission is apparently trying to make the gap between the OECD ALP and its very own EU ALP appear insignificant, by stating in its Final Notice that the Commission 'may have regard' to the OECD Guidelines and that if a tax ruling complies with the OECD ALP it is 'unlikely' to breach State aid rules.[263] However, this statement is neither here nor there. On the one hand, it *does not guarantee* that compliance with the OECD ALP will always shield a tax ruling from classification as State aid; thus, legal uncertainty lingers. On the other hand, it does make it seem as if the Commission wanted to make the OECD ALP binding, but since it found no persuasive way of doing so through Article 107 TFEU, it could only go so far as to effectively say it will probably not disturb States that properly apply the OECD ALP. To borrow Theo Angelopoulos's movie title, this resembles the suspended step of a stork: the Commission would

[263] *Final Notice*, para 173.

probably prefer to go all the way, but legal constraints stopped it mid-air, and this is the picture we are left with today.

1.8. The Arm's Length Principle is Arguably Inherently Flawed; The EU Law Arm's Length Principle Potentially Contradicts Other Parts of EU Tax Law

There are two more major objections to the Commission's support of an independent, primary EU law-based, arm's length principle. The first is more general and has to do with the nature of the ALP itself, while the second concerns the potential inconsistencies an EU law ALP would create within the EU legal order. These important points will be examined in turn.

The international/OECD norms around the ALP are changing and many commentators would argue that they do not make much sense, neither economically nor legally. For instance, Devereux and Vella note that the 'practical weaknesses of the ALP are well-known and have been frequently pointed out' by various academics and practitioners.[264] Examples abound: most importantly, the ALP 'necessarily struggles with transactions which are undertaken by related but not by unrelated parties, as comparables cannot be found.'[265] Moreover, it cannot satisfactorily divide profits arising from synergies, since standalone companies do not create them at all, and it can also end up justifying 'wildly varying prices, thus undermining its legitimacy and creating uncertainty.'[266] Devereux and Vella

[264] Michael P. Devereux and John Vella, 'Are We Heading Towards a Corporate Tax System Fit for the 21st Century?' (2014) 35 Fiscal Studies 449, 453-454.

[265] ibid, 454.

[266] ibid.

conclude that 'the rules on the application of the ALP are complex and impose extremely high compliance costs.'[267]

This critical stance is popular among academics, with another pair arguing that 'the arm's length standard has become administratively unworkable in its complexity' and it 'rarely provides useful guidance regarding economic value.'[268] In addition to the aforementioned objections, it is also a rather nebulous concept. As argued by Monsenego, 'the expression "arm's length principle" does not have a clear material content in itself, apart from the conceptual idea of requiring some form of similar pricing or profit margins between independent and associated enterprises. The arm's length principle can be interpreted in different manners and be given different material contents.' As he perspicaciously adds, '[t]he ever-increasing number of transfer pricing disputes, the differences between the OECD Guidelines and the UN Manual, or between domestic legislations as well as court cases, evidence the variety of views potentially embedded in the expression "arm's length principle".'[269]

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[267] ibid.

[268] Kimberly A Clausing and Reuven S. Avi-Yonah, 'Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment' (2007) The Brookings Institution <https://www.brookings.edu/wp-content/uploads/2016/06/200706clausing_aviyonah.pdf> accessed 20 October 2019.

[269] Jérôme Monsenego, 'Some observations on Starbucks, Fiat, and their potential impact on future amendments to the arm's length principle' (Kluwer International Tax Blog, 28 September 2019) <http://kluwertaxblog.com/2019/09/28/some-observations-on-starbucks-fiat-and-their-potential-impact-on-future-amendments-to-the-arms-length-principle/> accessed 20 November 2019.

There are voices that are yet more castigatory. More specifically, the ALP has been criticised as being 'inherently flawed'.[270] One of the reasons provided is that it seeks to allocate profits between related entities as if they were independent parties, but 'some gains do not appear in uncontrolled transactions and, therefore, the allocation of such gains is not possible by means of comparison with what independent transacting parties would have done.'[271] In other words, the ALP is inherently flawed in that 'it is not able to allocate profits which are an immediate consequence of the structure of the firm', since some rents 'arise only in the case of MNEs' such as 'transactions costs attributable to asymmetry of information in the negotiation of a contract.'[272]

In the same vein, 'knowledge and expertise are very difficult to price correctly at arm's length.'[273] It is indeed, as has been aptly remarked, ironic that 'according to current economic thinking multinationals exist precisely because the market mechanism for these transactions does not work', thus putting the appropriateness of arm's length pricing 'into question.'[274] Especially as regards royalties, the difficulty of determining arm's length prices can be significant, making mispricing 'a particularly severe problem in this area.'[275]

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[270] Ricardo André Galendi Júnior, 'State Aid and Transfer Pricing: The Inherent Flaw Under a Supranational Reference System' (2018) 46 Intertax 994.

[271] ibid, 996.

[272] Ibid

[273] Thomas Rixen & Susanne Uhl, 'Europeanising Company Taxation – Regaining National Tax Policy Autonomy' (2007) Friedrich-Ebert-Stiftung <https://library.fes.de/pdf-files/id/04750.pdf> accessed 30 August 2019, 10 fn 23

[274] ibid.

[275] Richard Collier, Seppo Kari, Olli Ropponen, Martin Simmler and Maximilian Todtenhaupt, 'Dissecting the EU's Recent Anti-Tax Avoidance Measures: Merits and Problems' (2018) 2 Econ Pol

Finally, to conclude this subsection on the inherent flaws, or at least limitations, of the arm's length principle, it is imperative to stress that the OECD is acutely aware of them. The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017 acknowledge the existence of the so-called "integration behaviour", i.e. the behaviour of related companies, which can inhibit the proper application of the ALP. More specifically, as stated in the Guidelines, '[a] practical difficulty in applying the arm's length principle is that associated enterprises may engage in transactions that independent enterprises would not undertake. Such transactions may not necessarily be motivated by tax avoidance but may occur because in transacting business with each other, members of an MNE group face different commercial circumstances than would independent enterprises.'[276]

Through the foregoing analysis it has become apparent that the application of the arm's length principle is considered problematic by a large part of the tax community.[277] However, as noted already, apart from the principle's inherent flaws, the Commission's insistence that such a principle exists in primary EU law raises various difficult questions. The most important potential conundrum is the

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Europe < https://www.ifo.de/DocDL/EconPol_Policy_Report_08_2018.pdf> accessed 25 October 2019, 3.

[276] OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing, 2017), 37.

[277] For a quick summary of the opposing views see Lorraine Eden, 'Insight: The Arm's-Length Standard Is Not the Problem' *Bloomberg* (17 October 2019), <https://news.bloombergtax.com/transfer-pricing/insight-the-arms-length-standard-is-not-the-problem> accessed 17 December 2019.

conflict between the Commission's CCCTB proposal, as set out in Chapter 2, and the existence of an independent ALP in primary EU law. The CCCTB project is partially designed to move away from the need for ALP rules. Consequently, their description as a fundamental EU law principle by the Commission in its state aid decisions is strange to say the least. Furthermore, attaching so much weight to a supposedly preexisting ALP would inhibit the more radical tax reform that the Commission and the European Parliament have been arguing for; any such legislative proposal would not only require unanimous approval, but also an amendment of the Treaties!

These issues have been raised repeatedly in the literature. For instance, it has been noted that 'a serious issue arises whether [the] EU ALP (if it is derived from Art. 107 of the Treaty) renders CCCTB unlawful'.[278] As has been aptly noted, 'the OECD is currently working on a fundamental change to the transfer pricing rules, the purpose of which is to allocate a portion of the residual profits to the market jurisdictions, i.e. the countries where sales are made or where users are located.' This would in essence mean that '[a] relief from tax in the country of origin would per definition not apply to independent enterprises or to domestic groups' and 'it can be wondered if the envisaged changes do not amount to a selective advantage in the country of origin to the benefit of multinational enterprises'.[279]

[278] Philip Baker QC, 'Business in an Uncertain World – State Aid' (OUCBT Summer Conference 2017, London, June 2017).

[279] Jérôme Monsenego, 'Some observations on Starbucks, Fiat, and their potential impact on future amendments to the arm's length principle' (Kluwer International Tax Blog, 28 September 2019) <http://kluwertaxblog.com/2019/09/28/some-observations-on-starbucks-fiat-and-their-

Furthermore, in the words of another commentator, we are 'left with the question how the juxtaposition of formula apportionment in the CCCTB proposal for multinationals and the taxation of stand-alone companies on net income, can be brought in line with the equal treatment requirement of Article 107 (1) TFEU.'[280] Finally, another academic put it in more unequivocal terms: 'if the arm's length principle is necessarily contained in Article 107 TFEU, then the [CCCTB] is illegal.' [281]

To sum up, the Commission's support of an EU law ALP is not only considered inherently problematic due to the nature of the ALP in general, but it is rendered even more contentious due to its inconsistency with the Commission's other proposed measures in the EU law tax arena.

1.9. Are tax rulings an "intervention by the State" under Article 107 TFEU?

According to Article 107 TFEU and the CJEU's case law interpreting it, four cumulative conditions need to be fulfilled in order for a measure to qualify as state aid. The first, and most important one for the purposes of this section, is that 'there must be an intervention by the State or through State resources.'[282] As Quigley has

potential-impact-on-future-amendments-to-the-arms-length-principle/> accessed 20 November 2019.

[280] Frans Vanistendael, 'Foreword' in Jérôme Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (Wolters Kluwer 2018), xv.

[281] Peter J. Wattel, 'Stateless Income, State Aid and the (which?) Arm's Length Principle (2016) 44 Intertax 791, 794.

[282] Conor Quigley, *European State Aid Law and policy*, (3rd edn, Hart Publishing 2015), p. 4 and the case law cited therein.

persuasively demonstrated, despite the fact that the notion of State intervention appears to be key, the EU courts 'have allowed the criteria for the application of Article 107 (1) TFEU to be muddled.'[283] Consequently, and even though the Courts frequently refer to measures of state intervention,[284] the notions of, inter alia, "intervention", "aid" and "advantage" have been conflated.[285] Put differently, the applicability of the state aid criteria 'has been whittled down so as to be largely meaningless.'[286]

Under the correct interpretation of the (economic) advantage test, the benchmark in a fiscal state aid case should be 'the tax liability of that undertaking before and after the adoption of the new provisions.'[287] This means that the Commission should 'identify the preexisting tax liability under the general scheme and then analyse whether […] there has been an intervention by the state, which must consist in the adoption by the public authorities of a measure that derogates or differentiates from the general measure'.[288]

This leads us to a question, first and most forcefully raised by Conor Quigley QC: are tax rulings a "state intervention" under Article 107 TFEU? As

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[283] ibid.

[284] ibid, 22.

[285] ibid, 4-5.

[286] Conor Quigley QC, 'Tax Rulings and State Aid' (2016) Tax Journal 8.

[287] ibid.

[288] ibid.

argued by Quigley, the Commission 'appears to assume that any tax ruling is by its nature an intervention by the State' and, in some of the cases, 'the Commission without analysing the notion of an intervention as being a derogation, merely state[d] that the tax rulings were adopted by the tax authorities and burdened state resources in that they resulted in a reduction of tax.'[289]

Quigley is right to posit that the Commission appears to misunderstand the role tax rulings play in the context of the tax assessment process. More specifically, it does not seem to fully grasp 'the whole purpose of tax rulings concerning transfer pricing, which in general are merely intended to be a step in the assessment of the profits properly due to a particular company within a multinational group.'[290] Tax rulings are 'merely an advance means of determining the allocation of profits that are to be subject to the tax assessment.'[291] Therefore, a tax ruling 'is not an intervention by the state that derogates from any assessment' but 'an integral part of the assessment procedure.'[292]

Indeed, how could there have been any kind of state intervention when the tax rulings (or advance opinions in the case of Ireland)[293] did not modify the rights and obligations of the taxpayers and alleged aid beneficiaries?

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[289] ibid, 9.

[290] ibid.

[291] ibid.

[292] ibid.

[293] See also, in the same vein, Stephen Daly, 'When is a tax ruling an 'intervention' for the purposes of State aid?' (TaxAtLincoln, 22nd October 2019) <https://taxatlincolnox.wordpress.com/2019/10/22/when-is-a-tax-ruling-an-intervention-for-the-purposes-of-state-aid/> accessed 30 October 2019.

As has also been aptly noted by Professor Luja, the question in state aid cases related to tax rulings, has to be 'to what extent the ruling would be a precondition for receiving the benefit in the end' because, '[i]f a similar benefit could have been claimed without a ruling, so where the ruling merely serves to give advance legal certainty, there is little to worry about' from a state aid perspective.[294]

To conclude, as Quigley noted, in its decisions the Commission failed 'adequately to discern the notion of an intervention'.[295] This is, thus, yet another objection - from a doctrinal state aid perspective - that can be raised against the validity of its decisions.

2. The General Court and the EU Law Arm's Length Principle

This section will analyse the most interesting and controversial dicta of the General Court in its *Fiat* and *Starbucks* judgments, namely the parts of said judgments in which the General Court ruled on the existence, form and content of what the Commission had presented as an EU law-derived arm's length principle (ALP). The General Court's assessment was highly anticipated, given that, for almost four years, the Commission's voice had been the only institutional EU voice being heard on this matter.

[294] Raymond H.C. Luja 'Do State Aid Rules Still Allow European Union Member States to Claim Fiscal Sovereignty?' (2016) 5-6 EC Tax Review 312, 318.

[295] Conor Quigley QC, 'Tax Rulings and State Aid' (2016) Tax Journal 9.

Not having touched upon the Commission's assertions in its *Belgian Excess Profit* ruling of February 2019, the General Court "broke its silence" in the *Fiat* and *Starbucks* rulings. As will be argued below, despite upholding the Commission's *Fiat* decision, it did not fully and unreservedly endorse all of this assertions on the EU law-derived ALP. It will also be reasoned that the General Court actually circumscribed the Commission's conclusions by "elucidating" them, and that the Court's analysis is itself neither entirely clear and complete nor wholly convincing.

In subsection 1 *infra*, the General Court's ALP-related analysis will be set out. In subsection 2, the problems and limitations of that analysis will be examined.

1. The General Court's key dicta on the EU Law-derived ALP

Unsurprisingly, the key argument raised by all applicants in their actions for annulment against the Commission's second fiscal aid wave decision, has been the non-existence of an EU law-derived arm's length principle.[296] By way of reminder, the Commission, in its final decisions in October 2015, had asserted that the ALP it is championing 'is a general principle of equal treatment in taxation falling within the application of Article 107(1) of the Treaty, which binds the Member States' independently of whether they have incorporated it into their national legal orders.[297]

[296] See, for instance, Case T-755/15 and T-759/15 *Luxembourg v European Commission (Fiat)* EU:T:2019:670, paras 125 et seq.

[297] *Starbucks Commission Decision*, para 264.

All applicants, alleged aid beneficiaries, interveners and Member States involved, had, in one way or another, disputed the existence of such a principle. The latter had been challenged, inter alia, as not having any concrete basis in ECJ case law, as breaching Member States' fiscal autonomy, violating the protection of legitimate expectations and the principle of legal certainty.[298]

Still, this principle represented the central pillar of the Commission's argumentation in all transfer pricing cases; were this premise to collapse, the rest of the Commission's state aid arguments would collapse with it. In the General Court's words, 'the examination in the light of the arm's length principle as described by the Commission [in its decisions] forms part of its principal analysis of the selective advantage.'[299] The Court was thus obliged to consider whether 'the Commission was entitled to analyse the measure at issue in the light of the arm's length principle as described in the contested decision', which consisted in 'verifying whether intra-group transactions [were] remunerated as if they had been negotiated under market conditions.'[300]

The General Court then went on to deliver its familiar soliloquy, namely the key dicta of *its jurisprudence constante* on the relationship between tax

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[298] Case T-755/15 and T-759/15 *Luxembourg v European Commission (Fiat)* EU:T:2019:670, para 126.

[299] Case T-755/15 and T-759/15 *Luxembourg v European Commission (Fiat)* EU:T:2019:670, para 129; Case T-760/15 and T-636/16 *Kingdom of the Netherlands and Others v European Commission (Starbucks)* EU:T:2019:669, para 137.

[300] *Fiat GC Judgment*, para 133; *Starbucks GC Judgment*, para 141.

sovereignty and EU competence. Even though 'direct taxation remains within the competence of Member States, it has to be exercised consistently with EU law and 'is not excluded from the scope of the rules on the monitoring of state aid.'[301] In other words, if a tax measure, e.g. a tax ruling issued by the authorities of a Member State, fulfils the conditions of Article 107 TFEU, its fiscal nature will not be sufficient to shield it from state aid scrutiny.

The Court proceeded to address the existence of a state aid advantage conferred by the *Fiat* and *Starbucks* tax rulings. The importance of its analysis cannot be overstated: if an advantage is found to be present, the remaining state aid conditions seem to "fall" like dominoes. Whether this is the most reasonable way of interpreting Article 107 TFEU and the ECJ's case law will be investigated in subsection 2 *infra.*

Firstly, the Court kicked off its analysis by reiterating the general advantage definition: an 'economic advantage which the recipient undertaking would not have obtained under normal market conditions'.[302] Secondly, the Court zooms into fiscal aid measures. In the case of tax measures, 'the very existence of an advantage may be established only when compared with "normal" taxation'.[303]

This means that a national tax measure confers an economic advantage on

[301] *Fiat GC Judgment*, para 134; *Starbucks GC Judgment*, para 142.

[302] *Fiat GC Judgment*, para 136; *Starbucks GC Judgment*, para 144.

[303] *Fiat GC Judgment*, para 138; *Starbucks GC Judgment*, para 146.

its recipient 'if it mitigates the burdens normally included in the budget of an undertaking'.[304] How is this ascertained? In accordance with the "factual versus counterfactual" test, 'in order to determine whether there is a tax advantage, the position of the recipient as a result of the application of the measure at issue must be compared with his position in the absence of the measure at issue […] and under the normal rules of taxation.'[305]

The Court then went on to assert that, in the context of integrated companies of a multinational group, the pricing of their intra-group transactions is not determined under market conditions; it is agreed by companies of the same group and is therefore 'not subject to market forces.'[306]

The General Court then addressed the heart of the matter, namely the existence of an EU law-derived ALP and its footing in ECJ case law. This is by far the most important part of its *Fiat* and *Starbucks* judgments, and it is as the epicentre of the analysis and critique that will take place in Part B.2.2 *infra.*

The Court set the scene with a bold statement; all four paragraphs, which are identical in the *Fiat* and *Starbucks* judgments, are worth quoting in full:

> Where national tax law does not make a distinction between integrated undertakings and stand-alone undertakings for the purposes of their liability to corporate income tax, that law is intended to tax the profit arising from the economic activity of such an integrated undertaking as though it had arisen from transactions carried out at market prices. In those circumstances, it must be held that, when examining, pursuant to

[304] *Fiat GC Judgment*, para 138; *Starbucks GC Judgment*, para 146.

[305] *Fiat GC Judgment*, para 139; *Starbucks GC Judgment*, para 147.

[306] *Fiat GC Judgment*, para 140; *Starbucks GC Judgment*, para 148.

the power conferred on it by Article 107(1) TFEU, a fiscal measure granted to such an integrated company, the Commission may compare the fiscal burden of such an integrated undertaking resulting from the application of that fiscal measure with the fiscal burden resulting from the application of the normal rules of taxation under national law of an undertaking, placed in a comparable factual situation, carrying on its activities under market conditions.

Furthermore, and as the Commission correctly stated in the contested decision, those findings are supported by the judgment of 22 June 2006, *Belgium and Forum 187* v *Commission* (C-182/03 and C-217/03, EU:C:2006:416), concerning Belgian tax law, which provided for integrated companies and stand-alone companies to be treated on equal terms. The Court of Justice recognised in paragraph 95 of that judgment the need to compare a regime of derogating aid 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'.

In that context, although, through that fiscal measure granted to an integrated company, national authorities have accepted a certain level of pricing for an intra-group transaction, Article 107(1) TFEU allows the Commission to check whether that pricing corresponds to pricing under market conditions, in order to determine whether there is, as a result, any mitigation of the burdens normally included in the budget of the undertaking concerned, thus conferring on that undertaking an advantage within the meaning of that article. The arm's length principle, as described by the Commission in the contested decision, is thus a tool for making that determination in the exercise of the Commission's powers under Article 107(1) TFEU. The Commission also stated, correctly, in recital 261 of the contested decision, that the arm's length principle was a 'benchmark' for establishing whether an integrated company was receiving, pursuant to a tax measure determining its transfer pricing, an advantage within the meaning of Article 107(1) TFEU.

It should also be stated that when the Commission uses that tool to check whether the taxable profit of an integrated undertaking pursuant to a tax measure corresponds to a reliable approximation of a taxable profit generated under market conditions, the Commission can identify an advantage within the meaning of Article 107(1) TFEU only if the variation between the two comparables goes beyond the inaccuracies inherent in the methodology used to obtain that approximation.[307]

[307] *Starbucks GC Judgment*, paras 149-152; *Fiat GC Judgment*, paras 141-144.

Certain observations can immediately be made as regards the General Court's assertions. Firstly, the Court made an assumption regarding the "intentions" of national tax laws. Secondly, the Court "allowed" the Commission to compare the fiscal burden of an integrated company with the fiscal burden resulting from the application of the normal rules of taxation under national law of an undertaking, placed in a comparable factual situation, operating under normal market conditions. Thirdly, the General Court arguably seems to confirm the Commission's reading of the ECJ's *Forum 187* judgment. Fourthly, the Court presents the arm's length principle as a "tool" or "benchmark" that helps the Commission in its advantage analysis, by allowing it to check whether, by way of deviation from the ALP, the burdens normally included in the budget of the alleged aid beneficiary have been mitigated.

The final takeaway from these paragraphs is the only sentence where the Court appears keen to restrict the Commission's room for manoeuvre, by stressing that the Commission can identify the existence of an advantage 'only if the variation between the two comparables goes beyond the inaccuracies inherent in the methodology used to obtain that approximation.'[308]

The General Court finished its doctrinally significant advantage analysis in emphatic manner by profusely "complimenting" the OECD's Transfer Pricing Guidelines and concluding that the Commission's "leap of faith" from Article 107 TFEU to an arm's length principle was merited:[309]

[308] *Fiat GC Judgment*, para 144; *Starbucks GC Judgment*, para 152.

[309] *Starbucks GC Judgment*, paras 155-156; *Fiat GC Judgment*, paras 147-148.

> Even though the Commission correctly observed that it cannot be formally bound by the OECD Guidelines, the fact remains that those guidelines are based on important work carried out by groups of renowned experts, that they reflect the international consensus achieved with regard to transfer pricing and that they thus have a certain practical significance in the interpretation of issues relating to transfer pricing, as the Commission acknowledged in recital 66 of the contested decision.
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> Consequently, the Commission correctly concluded that it was entitled to examine, in the context of its analysis under Article 107(1) TFEU, whether intra-group transactions were remunerated as though they had been negotiated under market conditions. That finding is not called into question by the other arguments of the Kingdom of the Netherlands and of Starbucks.

The validity of the Court's reasoning will be critically assessed in section B.2.2. *infra*.

However, before critically engaging with the Court's ALP-related advantage analysis, it is important to also briefly present its selectivity analysis. In the *Starbucks* judgment, selectivity was not examined in much depth, and this was only natural, given that the Court had already decided that the Commission's decision had to be annulled for not having proven that an advantage had been conferred on Starbucks.[310]

The Court thus managed to avoid the different selectivity questions that usually arise in fiscal state aid cases, such as the definition of the reference framework and the existence of a derogation, the latter arguably presupposing the comparability of standalone to integrated companies, which was disputed in Part B1 of this chapter. Therefore, the General Court in *Starbucks* handed down its judgment without having to 'take a position on the exact nature and scope of the

[310] *Starbucks GC Judgment*, paras 550-558.

reasoning in respect of the Commission's limited reference system'.[311]

One would assume that the aforementioned, admittedly tricky, selectivity questions would have been impossible to avoid in the *Fiat* case, where the General Court upheld the Commission's decision in its entirety. Impossible is…nothing, as Nike would say.

Embarking on its selectivity analysis in paragraph 332, the Court observed that 'the requirement as to selectivity under Article 107 (1) TFEU must be clearly distinguished from the concomitant detection of an economic advantage', relying on the now familiar expression the ECJ first uttered in the *MOL* case.[312] Unsurprisingly, it also reiterated the *MOL* presumption, namely the ECJ's dictum on how, in cases of individual aid, the 'identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective'.[313]

The discussion then naturally shifted to whether the *MOL* presumption was applicable, namely to whether the Fiat tax ruling amounted to individual aid. Both Fiat and Luxembourg had disputed this finding, arguing instead that the tax ruling amounted to 'an individual implementing measure which [was] part of a general scheme', similarly to the factual matrix in the *MOL* case.[314]

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[311] *Starbucks GC Judgment*, para 558.

[312] Case C-15/14 P *Commission v MOL* EU:C:2015:362, paragraph 59.

[313] *Fiat GC Judgment*, para 333.

[314] ibid, para 341.

The General Court was not persuaded, siding with the Commission instead and confirming that the Fiat tax ruling amounted to individual aid.[315] The level of detail here reminds one of the technical analysis undertaken by the General Court in the *Belgian Excess Profits* case, where it had concluded that the Commission's identification of an aid scheme in that case had been erroneous.[316]

In the final eight paragraphs of its selectivity analysis, the General Court arguably tackled the most thought-provoking issue, namely whether the tax ruling would have been selective under the traditional three-step selectivity analysis, i.e. without any reliance on the *MOL* "shortcut".[317]

Why is this more interesting? Because this exercise, had it been undertaken properly, would have allowed us to understand what the appropriate reference framework was and whether a derogation existed, thus inevitably clarifying whether integrated companies are comparable to standalone companies or only to other integrated companies. Yet, as will be shown in Part B.2.2. *infra*, the General Court proved to be very elusive and actually avoided answering this question.

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[315] ibid, paras 355 & 359.

[316] Dimitrios Kyriazis,' The Belgian Excess Profits Case – A State Aid Anticlimax' (Kluwer Competition Law Blog, 5 March 2019) <http://competitionlawblog.kluwercompetitionlaw.com/2019/03/05/the-belgian-excess-profits-case-a-state-aid-anticlimax/> accessed 20 December 2019.

[317] *Fiat GC Judgment*, paras 360-367.

Having set out the Court's advantage and selectivity analysis in the *Fiat* and *Starbucks* judgments, the next section will proceed to critically approach said analysis.

2. A Critical Assessment of the General Court's reasoning in the Fiat and Starbucks rulings

In this section, two main arguments will be advanced. Firstly, it will be argued that the victory of the Commission in the *Fiat* case, and its legal (in principle) victory in the *Starbucks* case, do not signify a full and unconditional endorsement of the Commission's legal approach by the General Court. A careful reading of the two judgments evinces a more nuanced conclusion; the General Court actually clarified and "amended" the Commission's ALP-related approach by restricting it. In other words, the potency of the Commission's doctrinal assertions was mitigated by the General Court and the scope of its rather exaggerated statements was reduced.

Secondly, it will be reasoned that, not only did the General Court not fully endorse the Commission's analysis, but its very own judicial reasoning is, at points, problematic and not entirely convincing. These two arguments will now be presented in turn.

2.1. The General Court did not fully endorse the Commission's ALP-related approach

In order to determine whether the Commission's definition of the arm's length principle (ALP) and its related analysis were fully sanctioned by the General Court,

one needs to compare and contrast the relevant dicta from the Commission's decision and the General Court's judgment. The *Starbucks* case will be used here, although the relevant dicta are the same in the *Fiat* case too.

In its final *Starbucks* decision of October 2015, the European Commission had made it clear that the 'the arm's length principle that the Commission applies in its State aid assessment is not' the OECD's ALP, but is 'a general principle of equal treatment in taxation 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.'[318] One can see that the Commission was audacious and used strong words when it ambitiously defined the EU law-derived ALP as 'a general principle of equal treatment in taxation'.

Let us now contrast the Commission's definition with the one eventually accepted by the General Court. This "exercise" will illustrate what this section set out to prove, namely that the Commission's decision, even though it was upheld on this point in *Starbucks* (and upheld fully in *Fiat*), was not entirely endorsed by the General Court in its judgments.

To begin with, in one of the preliminary paragraphs of its *Starbucks* judgment, the ALP is referred to as a "notion", i.e. the 'notion that transactions between intra-group companies were to be remunerated as if they had been agreed to by stand-alone companies negotiating under conditions of free

[318] *Starbucks,* para 264.

competition.'[319] From a general principle to a…notion, and this was just the beginning.

In paragraphs 137 onwards of its *Starbucks* judgment, where the General Court discusses the ALP in depth, the shift in language becomes more manifest. The ALP is referred to not as a general principle but as a "tool", a 'tool for assessing the price level of intragroup transactions'.[320] This definition is actually what the Commission argued for during the oral hearing in *Starbucks*, and the 'Court took formal note of that in the minutes of the hearing.'[321] This is reminiscent of a student-teacher relationship, with the teacher (Court) making sure the student (Commission) knows what she is talking about. As the judgment continued, this method of communication became even more evident and the shift in language more patent.

For instance, in paragraphs 151-152 of the same judgment, the Court twice referred to the ALP as a 'tool' which the Commission uses in its advantage analysis.[322] Not a general principle, not even a notion, but a "tool". Who would take issue with a "tool"? A general EU law principle that was created by judicial fiat so late in the stage of the evolution of the EU would arguably have Member States up in arms, but a humble and harmless "tool" would never cause an uproar.

[319] *Starbucks GC Judgment*, para 38.

[320] *Starbucks GC Judgment*, para 138.

[321] ibid.

[322] ibid, paras 151-152.

This is why, in the remainder of its ruling,[323] the General Court not only keeps referring to the ALP as a "tool", but also explicitly rules out its definition as a 'general principle of equal treatment in relation to tax', i.e. the very definition which, as we saw at the beginning of this section, the Commission had audaciously adopted in paragraph 264 of its final *Starbucks* decision! How can this be, the reader might cry? How did the General Court manage to avoid annulling the Commission's decision in *Fiat*, which contains the exact same dicta as the ones cited *supra* from Starbucks, while so blatantly contradicting the Commission's legal assertions on the ALP? In other words, how did the Court manage to uphold the Commission's analysis without endorsing it, and even while openly going against it at times?

The author does not possess the General Court's elusive eloquence and is not particularly adept at solving puzzles. Still, the Court's explanation will be presented and a comment will be provided; from that point on, the reader is invited to draw her own conclusions.

In paragraphs 167 to 170 of its *Starbucks* ruling, the General Court assesses a powerful argument that had been raised by the Netherlands and Ireland (intervening). More specifically, the two Member States had argued that the Commission 'wrongly asserted, in the contested decision, that there was a general principle of equal treatment in taxation.'[324] The Court's superficial dismissal of

[323] See, e.g., ibid, paras 163 & 169.

[324] ibid, para 167.

this argument is worth reading in full:

> It is true that the Commission indicated, in recital 264 of the contested decision, that the arm's length principle was a general principle of equal treatment in taxation, which fell within the scope of Article 107(1) TFEU. However, that wording must not be taken out of context and cannot be interpreted as meaning that the Commission asserted that there was a general principle of equal treatment in relation to tax inherent in Article 107(1) TFEU, which would give that article too broad a scope.
>
> In any event, it is implicitly but necessarily evident from recitals 258 to 267 of the contested decision, and in particular from recitals 262 and 265 of that decision, that the arm's length principle as described by the Commission in the contested decision was perceived by the Commission only as a tool enabling it to check that intra-group transactions are remunerated as though they had been negotiated between independent companies. The argument of the Kingdom of the Netherlands and of Ireland does not alter the finding in paragraphs 147 to 156 above that the Commission was entitled to examine, in its analysis under Article 107(1) TFEU, whether intra-group transactions were remunerated as though they had been negotiated under market conditions.
>
> Accordingly, the Court must reject the argument of the Kingdom of the Netherlands and of Ireland in that respect.[325]

This is perhaps one of the most badly drafted judicial non-statements ever put forward by the General Court. What it replied, in essence, was that, even though the Commission explicitly referred to the ALP it relied on as a 'general principle of equal treatment in taxation', this statement should not be taken out of context, since the ALP is a simple "tool".

What context is the Court referring to? Which paragraphs of the Commission's final decision should the two Member States have taken into account in order to understand that what the Commission explicitly said was actually not…what it meant? The answer, according to the Court, is paragraphs 258 to 267, but especially paragraphs 262 and 265.[326] However, not only do these

[325] *Starbucks GC Judgment*, paras 168-170.

[326] ibid, para 169.

paragraphs not refute the Commission's ambitious definition of the ALP, not only is the word "tool" not used once (!) by the Commission in these recitals, but it is actually not used at all in its entire final decision![327]

In other words, nothing was taken out of context. In fact, it is the General Court that is here acting as the "apologist" of the European Commission, or rather as its "spokesperson", retrospectively amending its statements and accusing everyone who does not acquiesce to such a distortion of the truth of an inability to read between the lines.

The most ironic part of the Court's aforecited "rebuttal" of Member States' arguments is that the Court did, obviously, discern the problematic nature of the Commission's assertions, yet refused to acknowledge that they constitute a problem! In paragraph 168, the Court stressed that the Commission could not possibly have meant what it said when it referred to a general principle of equal treatment in taxation, since this would give Article 107 TFEU 'too broad a scope'. Yet this is exactly what the Commission said, and arguably this is precisely what it was aiming for, given that broadening the scope of Article 107 TFEU would expand its (exclusive) competition policy competence. This is what many commentators have argued against in their writings that criticised the Commission's approach,[328] and it was hoped that the General Court would not

[327] *Starbucks,* para 76, is, to be precise, the only instance where the word "tool" was used by the Commission in its entire Starbucks decision of October 2015, and this had nothing to do with the legal nature of the EU law-derived ALP. The relevant sentence in paragraph 76 was about the use of statistical "tools" in the OECD's Transfer Pricing Guidelines.

[328] See n 1.

allow it to happen. These hopes failed to materialise.

Even though the Court, in its twin September 2019 judgments, arguably blunted the Commission's sharp language, by not annulling its decisions it allowed the justification of … unjustifiable assertions and handed DG COMP a crucial legal victory. Pontius Pilate would have been proud of his Luxembourg imitators.

In this section, an attempt has been made to prove that the Commission's legal approach was not unconditionally and fully endorsed by the General Court: the latter's conclusion and word selection were more nuanced and careful. This shows that said approach was clarified and its effects were mitigated. However, given that the Commission's decision was actually upheld in *Fiat*, the practical effects of this lack of complete endorsement are not easy to pinpoint.

Before moving on to the next section, where the General Court's analysis will be further criticised, an effort will be made to end this section on a positive note as regards the General Court's ALP-related analysis. First, the Court made it clear that the nature of the ALP is "approximate", sine, as the OECD would put it, it 'is not an exact science'.[329] This means that the sole purpose of the Commission's ALP-related review is not to dictate how it should be performed, but to verify whether any errors 'go beyond the inaccuracies inherent in the application of a method designed to obtain a reliable approximation of a market-based outcome.' [330] Moreover, 'mere non-compliance with methodological

[329] *Fiat GC Judgment*, para 207.

[330] ibid.

requirements' or the mere choice of a transfer pricing method, even though the Commission would prefer a different one, are not enough to prove that an advantage has been conferred.[331] As it rigorously showed in its Starbucks judgment, the General Court will not allow a reversal of the burden of proof as regards the advantage condition: this is partly why the Commission lost the Starbucks case.[332]

2.2. The General Court's state aid argumentation is not entirely convincing

In this section it will be argued that, apart from not fully endorsing the Commission's approach (as shown in the previous section), the General Court's own analysis in the *Fiat* and *Starbucks* judgments of September 2019 was, at points, problematic and, in any case, not entirely convincing.

Let us now begin with the Court's advantage analysis. In paragraph 147 of its Starbucks judgment, the General Court asserted that

> 'in order to determine whether there is a tax advantage, the position of the recipient as a result of the application of the measure at issue must be compared with his position in the absence of the measure at issue [case law citations omitted] and under the normal rules of taxation.'

The final seven words of the preceding sentence are not supported by any

[331] General Court of the EU Press Release, 119/19 (September 24 2019), available at <https://curia.europa.eu/jcms/upload/docs/application/pdf/2019-09/cp190119en.pdf> accessed 20 January 2020.

[332] On why it decided not to appeal its defeat, see Dimitrios Kyriazis, 'Why the EU Commission won't appeal the Starbucks judgment' (MNE Tax, 10 December 2019) <https://mnetax.com/why-the-eu-commission-wont-appeal-the-starbucks-judgment-37043> accessed 20 January 2020.

case law and the Court provided no relevant citations for them, in contrast with the orthodox advantage test cited before the brackets, for which the Court did cite ECJ case law. Was this a covert attempt to slightly modify the well-established "factual versus counterfactual" advantage test by inserting an additional layer of complexity? It is hard to tell, especially when looking at this paragraph in isolation. The only answer to this question has to be: it depends. If by 'the normal rules of taxation' the Court merely meant the counterfactual scenario, where we determine which *national* tax rules would apply in the absence of the alleged aid measure, then this addition is both harmless and superfluous, since it changes nothing. If not, then "normality" is a dangerous concept, and one whose content is defined and "controlled" by EU Courts, thus removing the definition of the normal rules of taxation from the remit of Member States' sovereignty and absorbing it within the EU's exclusive competence.

What is the answer? What was meant by this…abnormal addition to the orthodox advantage test? Even though a few paragraphs later the General Court referred to 'the application of the normal rules of taxation under national law',[333] no direct answer was provided by the Court in its judgment. On the contrary, as will now be seen, the Court's advantage analysis contains even more controversial (and arguably disconcerting) dicta.

Firstly, the Court's opinion on how the "market" is defined and what costs are "normally" included in the budget of an integrated company is arguably

[333] *Fiat GC Judgment*, para 141; *Starbucks GC Judgment*, para 149.

formalistic and misconstrued. The General Court asserted that the pricing of intra-group transactions 'is agreed to by companies belonging to the same group, and is therefore not subject to market forces.'[334] It also referred to the Commission's ALP "tool" as using as a comparator an undertaking 'carrying on its activities under market conditions'[335] and as checking whether intra-group pricing 'corresponds to pricing under market conditions'.[336] The goal of this exercise is to determine whether there is 'any mitigation of the burdens normally included in the budget of the undertaking concerned'.[337]

The question naturally arises once again: how is the nebulous concept of the "market" defined by the Court and why don't multinational companies belong to it? Why is this a "sterilised" market that only included standalone companies? Does it exist somewhere? Can it be replicated with precision? Moreover, since when are standalone companies the only (or more significant) market players, who should thus define normality? Also, since when does the budget of an integrated company "normally" include costs associated with trading between independent undertakings? These questions were neither addressed nor (of course) answered by the Court. On the contrary, the following paragraphs of its *Fiat* and *Starbucks* judgments further obfuscated matter and somewhat contradicted the aforementioned assertions.

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[334] *Fiat GC Judgment*, para 140; *Starbucks GC Judgment*, para 148.

[335] *Fiat GC Judgment*, para 141; *Starbucks GC Judgment*, para 149.

[336] *Fiat GC Judgment*, para 143; *Starbucks GC Judgment*, para 151.

[337] ibid.

One paragraph, in particular, stands out in both judgments. It is worth copying it here in full, before analysing it:[338]

> Where national tax law does not make a distinction between integrated undertakings and stand-alone undertakings for the purposes of their liability to corporate income tax, that law is intended to tax the profit arising from the economic activity of such an integrated undertaking as though it had arisen from transactions carried out at market prices. In those circumstances, it must be held that, when examining, pursuant to the power conferred on it by Article 107(1) TFEU, a fiscal measure granted to such an integrated company, the Commission may compare the fiscal burden of such an integrated undertaking resulting from the application of that fiscal measure with the fiscal burden resulting from the application of the normal rules of taxation under national law of an undertaking, placed in a comparable factual situation, carrying on its activities under market conditions.

Any first-year EU law student will detect a problem here. Under what legal basis in EU law is an *EU Court* entitled to infer the "intentions" of *national tax* law? The boldness of this statement is startling. Under what authority can the aims of a democratically elected national legislature be fashioned by a panel of judges in Luxembourg? Please note the definitive nature of the General Court's assertion, whose formulation leaves no room for qualifications or caveats ('that law is intended to tax'). From a (general) EU law perspective, the Court's contention is potentially highly problematic.

There is also, perhaps, a further twist here. The General Court, in the paragraph copied *supra*, seems to assume that national tax law intends to treat (i.e. tax) standalone and integrated companies similarly. However, if these two

[338] *Fiat GC Judgment*, para 141; *Starbucks GC Judgment*, para 149.

categories of undertakings are not comparable (in state aid jargon) or similar (in more general EU law jargon), then the Court unjustifiably assumes that the Member State is being discriminatory, by treating dissimilar situations similarly! As we will see when we scrutinise Court's selectivity reasoning, the judges skillfully avoided the question of comparability, even though it is key. The fact remains that, assuming similar treatment, while failing to establish comparability, possibly amounts to discrimination on behalf of the Member States, discrimination mandated by an EU Court! To sum up on this point, not only is the Court's aforementioned crucial paragraph problematic due to the repercussions it has on the division of powers between the EU and its Member States, but also because it raises important discrimination questions.

Finally, this paragraph is controversial because its audacity contradicts a subsequent, much more deferential, dictum by the General Court. While, in the aforecited paragraph, the Court seemed to intrude into Member States territory, and had previously attempted to usurp the definition of "normal" taxation and "normal" costs included in undertakings' budgets, it went on to remark that 'the Commission does not have, at this stage of the development of EU law, competence to allow it to define in an autonomous manner the 'normal' taxation of an integrated undertaking, by disregarding national tax rules.'[339]

This is absolutely right and consistent with European judicial precedent. However, it does not sit well with the Court's more assertive statements, which

[339] *Starbucks GC Judgment*, para 159.

were previously presented and dissected. Put differently, the Court's reasoning is at times both misleading and perplexing.

The Court is also, at points, overly laconic when it comes to explaining its reasoning, to the extent that the latter appears to be circular. More specifically, here is the paragraph where the Court sanctioned the Commission's interpretation of *Forum 187*:[340]

> Furthermore, and as the Commission correctly stated in the contested decision, those findings are supported by the judgment of 22 June 2006, *Belgium and Forum 187* v *Commission* (C-182/03 and C-217/03, EU:C:2006:416), concerning Belgian tax law, which provided for integrated companies and stand-alone companies to be treated on equal terms. The Court of Justice recognised in paragraph 95 of that judgment the need to compare a regime of derogating aid 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'.

The General Court asserts that the ECJ, in its *Forum 187* ruling, 'provided for integrated companies and stand-alone companies to be treated on equal terms'. Did it, though? This is, in fact, the biggest question raised by the second fiscal state aid wave. Reaching such a consequential conclusion so tersely resembles a *petitio principii*. This problem is magnified by the fact that, as argued in section B1 above, there is an alternative, less far-reaching and imaginative, interpretation of what the ECJ meant by "free competition" in *Forum 187*, an interpretation which is arguably more convincing.

The final piece of the "advantage puzzle" that we need to assess, before concluding this section by considering the Court's selectivity analysis, is the ease

[340] ibid, para 150.

and zeal with which the General Court endorsed the OECD's Transfer Pricing Guidelines. In its view, even though 'the Commission correctly observed that it cannot be formally bound by the OECD Guidelines, the fact remains that those guidelines are based on important work carried out by groups of renowned experts, that they reflect the international consensus achieved with regard to transfer pricing and that they thus have a certain practical significance in the interpretation of issues relating to transfer pricing'.[341]

The General Court showered the OECD with praise. Why is that? In the author's view, it is because of the underlying theme in the Commission's crusade against harmful tax competition and corporate tax avoidance, a theme that the General Court is, obviously, willing to support. This theme is that a single solution needs to be found, and if (legally) there is no permissible way of achieving this, then the two solutions will have to be two only in name. The more the EU can move towards the OECD's agenda without getting express permission from all its Member States, the more it will do so. An approximation of solutions will take the place of a single solution, and the legal gap will be closed by a legal "leap of faith". Thus, in the Court's dictum that was quoted in the previous paragraph, the General Court was paving the way for this to happen, legitimising the Commission's leap of faith towards the OECD's arms.

In the author's view, all the General Court achieved this way is further confusion. Since neither the General Court nor the Commission can magically

[341] *Fiat GC Judgment*, para 147; *Starbucks GC Judgment*, para 155.

transform OECD soft law into EU hard law, they are left with inelegant choices. The wording the Court used reveals its…discomfort and the impossible position it finds itself in.

For instance, what did the Court mean when, in the aforementioned paragraph, it asserted that 'the Commission correctly observed that it cannot be formally bound by the OECD Guidelines'? Does this mean that the Commission can be bound…informally? In law, one is either bound or not; no middle ground exists. Yet, this is exactly the ground where the General Court wishes to stand on, i.e. the middle ground between the OECD's arm's length principle and the Commission's EU law-derived arm's length principle. The Court's inability, as a matter of law, to properly wed the two principles, leads to such linguistic faux pas.[342]

The scrutiny of the General Court's analysis of the advantage condition in its *Fiat* and *Starbucks* judgments is now complete. The following section will bring this chapter to a conclusion, by identifying the flaws in the Court's selectivity analysis.

2.3. The General Court's selectivity analysis: a critical assessment

In this section, the General Court's selectivity analysis will be critically assessed.[343] The critique will mostly revolve around four points. First, it will once again be

[342] See also *Fiat GC Judgment*, para 176, where the Court stated that 'the Commission refers *broadly* […] to the OECD Guidelines' [emphasis added].

[343] Given that in the *Starbucks* judgment the Commission lost at the advantage "stage", most of the references to selectivity in this section are from the General Court's *Fiat* judgment.

argued that the General Court assumed the objectives of national tax law, therefore improperly influencing the outcome of the selectivity exercise. Second, it will be reasoned that the Court avoided taking a firm stance on what the correct reference framework was, i.e. whether it included both standalone and integrated companies, or only the latter. The Court, thus, also avoided an in-depth discussion of whether the two types of companies are in a comparable factual and legal situation.[344]

Thirdly, the Court's approach to the *MOL* selectivity presumption was both misconceived and confusing. Fourthly and finally, the Court's selectivity analysis is generally rather cursory and superficial, resulting, inter alia, in a "short-circuiting" of the selectivity test. The aforementioned criticisms will now be expounded in turn.

As regards the first point, its problematic nature has already been explicated in this chapter's previous section dealing with the Court's advantage analysis. Suffice it here to say that, apart from the more general EU law problems it creates, the General Court, by assuming the intentions of national tax law,[345] is also critically affecting the outcome of the selectivity test, given that a key component of the latter is the objective of the national measure in question.

[344] The author, in section B.1.4 of this chapter, has argued that they are not.

[345] Jérôme Monsenego, 'Some observations on Starbucks, Fiat, and their potential impact on future amendments to the arm's length principle' (Kluwer International Tax Blog, 28 September 2019) <http://kluwertaxblog.com/2019/09/28/some-observations-on-starbucks-fiat-and-their-potential-impact-on-future-amendments-to-the-arms-length-principle/> accessed 20 November 2019.

Moving on to the second weakness in the Court's selectivity analysis, the Court unfortunately avoided taking a firm stance on what the appropriate reference framework was, simultaneously, also avoiding any in-depth discussion in relation to the comparability of standalone to integrated companies. The key paragraphs are paragraphs 360-367 of its *Fiat* judgment, which encompass its entire (!) three-step selectivity analysis. Under the three-step test, which is well-established in ECJ case law, the Commission (and the EU courts) need to identify the reference framework and establish the existence of a derogation therefrom, i.e. the differential treatment of companies in a comparable factual and legal situation. If this is done, then the Member State must show that this "discriminatory" treatment is justified; otherwise, the measure is conclusively selective.

Arguably, the Court did not ensure that the Commission had fulfilled its obligation to rigorously prove the satisfaction of all conditions relating to the first two steps of the selectivity exercise.

First, as regards the identification of the correct reference framework, the General Court remarked that 'irrespective of the reference framework used by the Commission, whether that is the general corporate income tax system or Article 164 of the Tax Code and the circular, the Commission correctly found that the tax ruling at issue derogated from the rules constituting each of those reference frameworks.'[346]

[346] *Fiat GC Judgment*, para 361.

This illustrates the General Court's inability (or reluctance) to identify the correct reference framework.[347] Is it the broader or the narrower reference framework? Shouldn't the General Court be tackling these difficult questions? Moreover, this was its opportunity to analyse, in depth, whether and why standalone companies are comparable to integrated companies; this question, as discussed before, received no in-depth analysis.[348]

By boldly asserting that a derogation was in any conceivable case identifiable, we cannot be as certain as the General Court appeared to be, without possessing more information, that Fiat's tax ruling would have constituted a derogation even if the reference framework had been defined more narrowly, i.e. had been limited to the universe of integrated companies. How can one be sure that Fiat received preferential treatment in comparison to companies requesting similar tax rulings and also belonging to multinational groups?

The Commission would offer us two words by way of an answer: "*MOL* presumption". Since the alleged aid measure is individual aid, selectivity is presumed. However, the General Court in its *Fiat* judgment made an (arguably colossal) error when it set out its understanding of the *MOL* presumption.

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[347] See also *Starbucks GC Judgment*, para 558.

[348] Jérôme Monsenego, 'Some observations on Starbucks, Fiat, and their potential impact on future amendments to the arm's length principle' (Kluwer International Tax Blog, 28 September 2019) <http://kluwertaxblog.com/2019/09/28/some-observations-on-starbucks-fiat-and-their-potential-impact-on-future-amendments-to-the-arms-length-principle/> accessed 20 March 2020.

More specifically, the Court stated the following:[349]

> 'as regards the presumption of selectivity, it must be recalled that, as is evident, in essence, from the case-law cited in paragraph 333 above, this applies subject to the twofold condition that the measure at issue constitutes individual aid (and not an aid scheme) and that it grants an advantage to the undertaking that is the beneficiary of the aid. In the case of a simple presumption, it is therefore for the applicant to establish that one or other of those two conditions is not met, if the presumption is to be rebutted.'

This is a clear misunderstanding and misstatement of the ECJ's judgment in the *MOL* case. As just discussed, the General Court asserted that for the presumption to apply, two conditions need to be met. However, in its next sentence, the Court stated that the applicant (here Luxembourg and Fiat) have to show that one of the conditions were not fulfilled, in order to rebut the presumption.

It is impossible for both these assertions to be correct. It is the Commission that needs to show that the two conditions for the applicability of the *MOL* presumption are fulfilled, i.e. that the measure constitutes individual aid and confers an advantage on the recipient. After the Commission has successfully demonstrated this, the presumption is "activated", and now the applicants have to rebut it, by showing that the measure was actually not selective. In other words, the General Court seems to be attempting to shift the burden of proof on the applicants even before the presumption has been found to apply, which would make the Commission's task even easier than it would be under a proper

[349] *Fiat GC Judgment*, para 339.

interpretation of the *MOL* case.

Therefore, we need to be careful not to accept the General Court's analysis here otherwise, as Quigley has eloquently argued, we run the risk of allowing the EU court and the Commission to further 'whittle down the effect of the criteria for the application of article 107 (1) of the TFEU.'[350] We thus need to be clear: it is *not*, as the Court asserted, 'for the applicant to establish that one or other of those two conditions is not met, if the presumption is to be rebutted.' It is *for the Commission* to prove that they have indeed been met, so that it can then "sit back" and let the applicants prove that the measure is, nevertheless, non-selective. By misstating the *MOL* presumption, and by conflating two different concepts (non-applicability versus rebuttal of the presumption) the General Court risks having its judgment quashed by the Court of Justice.

The fourth, and final, argument against the General Court's selectivity analysis is more general and endeavours to answer the following question: is this cursory selectivity analysis appropriate in fiscal state aid cases of such a magnitude and doctrinal significance? Is the Commission, with the blessings of the General Court, slowly eroding the quintessence of the selectivity test and attempting to short-circuit it?

It is worth trying to answer these questions, since they concern the scope of Article 107 TFEU and thus the limits of the EU's exclusive competence (and,

[350] Conor Quigley QC, 'Tax Rulings and State Aid' (2016) Tax Journal 8.

correspondingly, the limits of Member States' sovereignty).

Firstly, the Court's selectivity analysis was overly laconic, occupying only a small part of its judgment. Secondly, within the short space of its terse treatment of the selectivity condition, which is key to all fiscal aid cases, the Court managed to misstate the *MOL* presumption, avoid identifying the correct reference framework and escape an in-depth discussion on the comparability of integrated to standalone companies. Quite an achievement, one could remark.

The Court also, most disconcertingly, demonstrated that it is not reluctant to endorse an interpretation of Article 107 TFEU that would make the European Commission's tasks more bearable. More specifically, it upheld the Commission's argumentation by stating that 'the question whether the tax ruling at issue constitutes a derogation from the reference framework coincides with the identification of the advantage granted to the beneficiary by that measure.'[351]

This seemingly innocuous assertion has far-reaching consequences for the aforementioned division of competences in the European Union. In fiscal state aid cases, only two conditions pose a real difficulty for the Commission, namely advantage and selectivity. The problems with the Commission's advantage analysis have been discussed ad nauseam in this chapter, particularly in relation to its connection to an EU law-derived arm's length principle. A deviation from that nebulous principle will coincide with the conferral of an advantage! What is

[351] *Fiat GC Judgment*, para 361.

more, in cases of individual aid, such a deviation will also mean that selectivity is present, due to the *MOL* presumption. Furthermore, even under the traditional three-step selectivity analysis, the General Court agreed with the Commission, as quoted *supra*, that a derogation from the reference framework coincides with the identification of the advantage.

So, what is the major takeaway? Not only are two (out of the six) state aid conditions important in fiscal state aid cases, but the fulfillment of the first one almost automatically results to the fulfillment of the second one! In other words, should the Commission manage to prevail before the Court of Justice, it will have successfully "short-circuited" Article 107 TFEU. Member States, as well as tax law and state aid practitioners and academics, need to be acutely aware of the perils of such an approach, lest they find themselves before a *fait accompli*.

Conclusion

The second fiscal state aid wave has created a tide that is not going to ebb away any time soon. However, now that the General Court has arguably "endorsed" the key parts of the Commission's controversial state aid analysis, we have entered the endgame. The last hope for Member States and alleged aid beneficiaries rests with the European Court of Justice. Should the latter agree with the way in which its lower court has interpreted Article 107 TFEU and the *Forum 187* case, a new era will dawn for EU fiscal state aid law, one in which its scope will cover tax rulings that deviate from the EU's (and indirectly the OECD's) arm's length principle. In one sweep, the ambit of Article 107 TFEU will have been expanded significantly. The outcome remains to be seen.

CHAPTER 5: The Nexus between the Two Fiscal State Aid Waves and Harmful Tax Competition

In this chapter, the most important thread binding the two fiscal State aid waves will be analysed in depth, namely their common link (and contribution) to the EU's fight against harmful tax competition. By referring to the work of the Code of Conduct group, Commission press releases, official statements by Competition Commissioners and various academic sources, it will be shown that many of the cases pursued by the Commission in both fiscal aid waves concerned tax measures that presented actual or potential harmful tax competition elements. It will, moreover, be reiterated that the Commission's expansive interpretation of the 'selectivity' and 'advantage' conditions in the first and second waves, respectively, was instrumental in targeting such tax measures, which might have otherwise escaped State aid scrutiny. On the basis of the above, it will be concluded that the Commission has at times employed its powerful hard law apparatus under Article 107 TFEU in order to further the soft law goals of the Code of Conduct for Business Taxation.

Introduction

As already discussed in Chapter 2, in October 1st 1997, the European Commission published a communication entitled 'Towards tax co-ordination in the European Union: A package to tackle harmful tax competition'.[1] In this communication, the Commission identified a need for action at the European level in order to reduce

[1] Commission, 'Towards tax co-ordination in the European Union: a package to tackle harmful tax competition' (Communication) COM (97) 495 final.

distortions in the internal market, prevent significant losses of tax revenue, and reverse the trend of an increasing tax burden on labour as compared to more mobile tax bases. [2] Market integration would otherwise dangerously curtail Member States' freedom to choose the appropriate tax structure for the achievement of their goals.[3] The key element of the proposed tax package was the adoption of a code of conduct for business taxation, which would take the form of a non-legally binding instrument exhorting Member States to respect principles of fair competition.[4] Precisely two months later, on December 1st 1997, the Code of Conduct for business taxation was adopted (hereinafter 'CoC' or simply 'the Code').[5]

This Code, which was essentially a political agreement, signified the EU's determination in fighting against the problems the Commission had identified. The Council noted the need for coordinated action in order to reduce distortions in the internal market and help tax structures develop in a more employment-friendly way. It also acknowledged the positive effects of 'fair' competition, whilst noting that tax competition might also lead to tax measures with harmful effects, which it then went on to describe.

[2] ibid, para 2.

[3] ibid, para 3.

[4] ibid, para 14.

[5] Council Conclusions of the ECOFIN Council Meeting on 1 Dec 1997 concerning taxation policy, O.J. of 6 Jan 1998, C 2/01, hereafter "Code of Conduct".

The Code of Conduct covers business taxation and concerns measures which affect, actually or potentially, the location of business activity in the Union in a significant way. What is implied here is that, in order for a Member State measure to be harmful, it must play an important role in companies' decisions on their investment location.[6] These measures can be laws, regulations, or simply administrative practices. Still, this is just the general scope of the Code: not all these measures are necessarily harmful. To be caught by the Code, national measures must also provide for a significantly lower effective level of taxation, including zero taxation, than those levels generally applicable in the Member State in question. Such measures are potentially harmful.

Although a low or zero tax rate is the necessary starting point for the evaluation of a tax measure, the final assessment of their harmfulness must take into account, *inter alia,* five important criteria. The first criterion is whether tax advantages are accorded only to non-residents or in respect of transactions carried out with non-residents. The second criterion is whether these advantages are ring-fenced from the domestic market, so as not to affect the national tax base. Thirdly, a further indication of a regime's harmfulness will be the grant of tax advantages even without any real economic activity and substantial economic presence within the Member State granting them. The penultimate criterion concerns whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD. Finally, the lack of

[6] Carlo Pinto, 'EU and OECD to Fight Harmful Tax Competition: Has the Right Path Been Undertaken?', (1998) Intertax 386, 389.

transparency, which includes cases where legal provisions are relaxed at administrative level in a non-transparent way, also "betrays" a regime's harmfulness.

In subchapter 5A *infra*, the links between the first fiscal aid wave and harmful tax competition will be explored, while, in subchapter 5B, the same "exercise" will be repeated for the second wave. The chapter's conclusion will summarise the key findings.

A) The link between the First Fiscal State Aid Wave and Harmful Tax Competition

The Code of Conduct for business taxation on which, as mentioned, EU Member States agreed in late 1997, made clear mention of the possible application of state aid rules to harmful tax practices. To begin with, in the Code's preamble, the Council acknowledged that, in drafting the Code, it had taken into account the Commission's 'undertaking on fiscal State aid', namely its promise to 'publish guidelines on the application of the State aid rules to measures relating to direct business taxation by mid-1998'.[7] Moreover, the Code specifically stated that certain tax measures covered by it could also fall within the scope of Article 107 TFEU, thus expressly predicting the possibility of an overlap.[8] The Code also included an acknowledgment, by the Council (i.e. Member States), of the unambiguous commitment by the Commission to strictly apply state aid rules in such cases, 'taking into account, inter alia, the negative effects of aid that [would be] brought to light in the application' of the Code.[9] An overlap, in the Council's eyes, meant an opportunity for synergies.

Furthermore, perhaps most importantly, as hindsight now allows us to say, the Council noted the Commission's (i.e. DG COMP's) intention 'to examine or re-examine existing tax arrangements', thus 'ensuring that the rules and objectives of the Treaty [were] applied consistently and equally to all.'[10] Suffice it to say that

[7] Code of Conduct, Preamble and para J.

[8] ibid, para J.

[9] ibid.

[10] ibid.

the Belgian coordination centres case, which culminated in the *Forum 187* ECJ judgment, was a case that the Commission reopened after re-examining the Belgian regime's state aid compatibility.

Finally, before concluding our brief discussion of the links between the Code of Conduct and fiscal state aid control, it is worth stressing that the Council asked the *Commission* to report to it annually on the implementation of the Code *and* on the application of fiscal state aid.[11] This lucidly illustrates how closely the Council considered the two to be connected, and perhaps how unproblematic (and possibly desirable) it found their interaction. From its birth, the Code of Conduct, and thus the EU's soft law fight against harmful tax competition between Member States, was conjoined to the state aid prohibition.

The Commission, it is fair to say, did not disappoint. True to its "undertaking", in late 1998, the Union's state aid watchdog set out in detail its approach to the control of fiscal state aid, by publishing the Notice on the application of state aid rules to direct taxation measures ("Fiscal Aid Notice").[12] It had already signaled its "matching commitment" to the Member States' political agreement, namely the Code of Conduct, in its 1997 Communication on a package to tackle harmful tax competition.[13] More specifically, the Commission had clearly

[11] ibid, para N.

[12] Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ 1998, C 384/03, hereafter "Fiscal Aid Notice".

[13] Commission, 'Towards tax co-ordination in the European Union: a package to tackle harmful tax competition' (Communication) COM (97) 495 final.

promised to 'respond positively and associate itself' with the Code, notably 'by presenting separately and under its own initiative a communication that clarifies and refines' its fiscal aid policy.[14]

Published in late 1998, the Fiscal Aid Notice remained "in force" until 2016, when it was replaced by the Commission's final Notice on the Notion of Aid.[15] The 1998 Fiscal Aid Notice was an interesting read in its entirety; however, for the purposes of this chapter, only its explicit references to the Code of Conduct will be explored.

To begin with, the very first paragraph of the Notice mentioned the adoption of the Code of Conduct in December 1997 and its own commitment to publish guidelines on fiscal state aid and strictly apply the relevant rules.[16] More importantly, the Commission included the following subtle "threat" in the very same paragraph: 'the State aid provisions of the Treaty will also contribute through their own mechanism to the objective of tackling harmful tax competition.'[17] This meant that the Commission would, as it actually did, 'examine or re-examine case by case, on the basis of this notice, the tax arrangements in force in the Member States.'[18]

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[14] ibid, para 17.

[15] European Commission, 'Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU' COM (2016), hereafter "Final Notice".

[16] Fiscal Aid Notice, para 1.

[17] ibid.

[18] ibid, para 4.

The final mention of the Code of Conduct in the Fiscal Aid Notice came in paragraph 30 thereof, where it was clarified that, even though 'the qualification of a tax measure as harmful under the Code of Conduct [would] not affect its possible qualification as State aid, the effects of aid brought to light in the application of the Code would be taken into account when assessing the compatibility of the fiscal aid measure with the internal market.'[19]

In other words, from a legal standpoint, the two sets of provisions, though of a different scope and purpose, were closely intertwined. The Union's hard law apparatus (Article 107 TFEU) was to serve the Union's soft law goals (the Code of Conduct against harmful tax competition). The EU's political leaders were not coy. For instance, Mario Monti, then Competition Commissioner, openly admitted in 1999 that one of the goals of the Fiscal Aid Notice was to 'to link the provisions of the Treaty and related rules on state aid to the fight against harmful tax competition'.[20]

All the above point in a single direction: the Commission's approach to the soft law definition of fiscal state aid in its 1998 Fiscal Aid Notice, which was the basis on which it launched its investigations, was de facto shaped by the EU's fight against harmful tax competition. In other words, it could sensibly be argued that its "impending" hard law state aid campaign actually influenced the preceding

[19] ibid, para 30.

[20] Mario Monti, 'How State Aid Affects Tax Competition' (1999) 4 EC Tax Review 208, 209.

formulation of the Commission's soft law approach, thus rendering its soft law definition of fiscal state aid more likely to "catch" harmful tax measures.

Shortly after the adoption of the Fiscal Aid Notice, a new era began for fiscal state aid control. Following the instructions of Competition Commissioner Mario Monti, the Commission's services scrutinized the most important cases identified by the Code of Conduct (or 'Primarolo') group, in order to observe the Commission's undertaking regarding its fight against harmful tax competition. To this end, as discussed in Chapter 3, on July 11th 2001, the Commission initiated fifteen state aid procedures in relation to special corporation taxation regimes in twelve Member States. Out of those fifteen investigations, thirteen concerned tax measures that had been blacklisted by the Primarolo Group in its report, i.e. belonged to the list's initial 66 harmful measures.

Thus, from the outset, one fifth (20%) of the measures under Code of Conduct scrutiny were also placed under State aid scrutiny. These measures were mainly related to special tax advantages granted to multinational groups of companies, and to companies active in the insurance and financial sectors.[21] In eleven of these procedures, concerning eight Member States, the Commission decided to open formal state aid investigations,[22] with the purpose of determining

[21] Mario Monti, 'EU Policy Towards Fiscal State Aid' (Seminar on State Aid and Tax, Netherlands, 22 January 2002) < http://europa.eu/rapid/press-release_SPEECH-02-15_en.htm?locale=en > accessed 20 May 2014, p. 4.

[22] These Member States were: Germany, Spain, France, Ireland, Luxembourg, The Netherlands, Finland and the UK. For more details see Commission Press Release, IP/01/982 (July 11 2001), available at <http://europa.eu/rapid/press-release_IP-01-982_en.htm> accessed 20 May 2014.

whether the regimes in question amounted to illegal operating aid. These investigations generated a lot of litigation, the most important of which was thoroughly analysed in Chapter 3.

In 1999, i.e. after the adoption of the Code of Conduct and the Fiscal Aid Notice, but before the initiation of any fiscal aid probes, Commissioner Monti published an editorial in an tax law journal.[23] It was full of thought-provoking remarks. Firstly, he stressed that using state aid policy against harmful tax competition is an 'exercise' that 'has its limits'.[24] These limits stem from the state aid conditions themselves, especially selectivity, and from EU competence, which e.g. does not allow the Commission to deal with beneficial measures granted by third country States.[25] Most importantly, Commissioner Monti emphasised the need for global cooperation and for EU-OECD alignment. Finally, he concluded by pointing out how important it was 'to obtain concrete results in the short term in the fight against harmful tax competition in the EU by mobilizing all available tools and by removing any remaining reticence on the part of Member States.'[26]

His final sentence, and his cautious tone more generally, proved to be prescient. Sixteen years later, in 2015, the European Parliament's TAXE 2 Committee would chastise Member States for their 'systematic obstruction' to any

[23] Mario Monti, 'How State Aid Affects Tax Competition' (1999) 4 EC Tax Review 208.

[24] ibid, 209.

[25] ibid, 210.

[26] ibid.

relevant progress, lamenting the fact that 'discussions on administrative practices (rulings) [had been] going on in the Code of Conduct for nearly two decades' with no tangible results.[27]

Still, the Commission kept its part of the bargain and launched a wave of fiscal aid investigations in 2001, as previously discussed. Apart from the many pieces of "evidence" already adduced, relevant data and dicta abound. For instance, according to paragraph 8 of the Primarolo report, it was the commission that first gave the Primarolo group some material (i.e. national tax measures) to assess, namely an "initial indicative list of measures" that might fall under the scope of the Code of Conduct.[28] It could be argued that the Commission was obliged to do so based on para I of the Code of Conduct, where the Council had "invited" it to 'assist the group in carrying out the necessary preparatory work for its meetings and to facilitate the provision of information and the review process.'[29] It would not be an exaggeration to say that the Commission handed the Primarolo group a table d'hôte, a set menu of measures which it found problematic, and on which the Code of Conduct group then focused.

[27] European Parliament, 'Resolution of 6 July 2016 on Tax Rulings and Other Measures Similar in Nature or Effect' (2016/2038 (INI)), para 53. For a succinct overall summary of the evolution of the EU's strategy against harmful tax competition see Edoardo Traversa and Alessandra Flamini, 'Fighting Harmful Tax Competition Through EU State Aid Law: Will the Hardening of Soft Law Suffice?' ESTAL 2015 (3) 323, 325.

[28] Council of the European Union, 'Report from the Code of Conduct Group (Business Taxation)' (Report) SN 4901/99, para 8.

[29] Code of Conduct, para I.

Once again, these hard and soft law objectives appear to be linked from their very beginning. Unsurprisingly, they remained closely intertwined until the end of the first fiscal aid wave and, as subchapter 5B will demonstrate *infra*, are still connected today through the ongoing second fiscal aid wave. As regards the conclusion of the first wave, in addition to what has already been explored, there are a myriad more official statements from the Commission which substantiate the claims made in this chapter so far.

By way of example, in February 2003, when DG COMP concluded its investigations against Ireland, the Netherlands and Belgium, Commissioner Monti stated that these negative decisions were 'a key element in the fight against harmful tax competition, a fight launched in 1996 when I was Internal Market Commissioner'.[30] He continued even more bluntly:

> I am a great supporter of the work of the Code of conduct group on the elimination of unfair tax competition. The Commission launched State aid proceedings in July 2001 just as the Code of conduct group started to make progress in its discussions. Without our State aid proceedings, some Member States may well have not negotiated this year's tax package.[31]

The hard-soft law link could not be more pellucid and unambiguous. Apart from the official Commission statements, the nexus between Article 107 TFEU and the Code of Conduct actually made its way into the text of the final Commission decisions of the first fiscal aid wave. The first paragraph of the final Commission decision in the Belgian Coordination centres case made clear reference to this

[30] Commission Press Release, IP/03/242 (February 18 2003), available at <https://ec.europa.eu/commission/presscorner/detail/en/IP_03_242> accessed 10 April 2020.

[31] ibid.

nexus; it is, in fact, identical to the first paragraph of all the final Commission decisions analysed in Chapter 3, namely to the Dutch IFA case, the Irish Foreign scheme case and the Luxembourg 1929 Holding Companies case. It read as follows (emphasis added):[32]

> In 1997 the Council (Ecofin) approved a code of conduct for business taxation to tackle harmful tax competition and set up an ad hoc group to examine the tax measures to which the code of conduct applies. Following the undertaking in the code of conduct, the Commission issued a Notice in 1998 on the application of the state aid rules to measures relating to direct business taxation, in which it affirmed its commitment to the strict application of the rules according to the principle of equality of treatment. *Against this background, the Commission, acting in accordance with the state aid rules, began its examination of the measures identified by the code of conduct group as harmful. The Commission would stress here the parallels between the work of the code of conduct group and the Community's policy on state aid, both of which are aimed at eliminating those measures that distort or threaten to distort competition in the common market.* The Commission also notes the progress that has already been made towards this goal of eliminating harmful tax competition, and in particular the steps taken by the Member States to abolish the measures identified by the code of conduct group as harmful, or at least to remove the harmful aspects of such measures.

Moreover, the Commission, in a 2007 "post-mortem" account of the first fiscal aid wave, admitted the following about the Belgian coordination centres case: '[f]ollowing the Council's initiative on the Code of conduct on business taxation, the Commission revised the functioning of this regime and, on 11 July 2001, proposed to Belgium to align it with the state aid rules.'[33] In other words, the Commission openly "confessed" that its state aid assessment of the exact same

[32] Commission Decision 2003/755/EC of 17 February 2003, Belgian Coordination Centres, OJ L 282, 30.10.2003, p. 25, para 1; Commission Decision 2003/515/EC of 17 February 2003, Netherlands International Financing Activities, OJ L 180, 18.07.2003, p. 52, para 1; Commission Decision 2003/601/EC of 17 February 2003, Ireland Foreign Income, OJ L 204, 13.08.2003, p. 51, para 1; Commission Decision 2006/940/EC of 19 July 2006 on State Aid C 3/2006, Luxembourg 1929 exempt holding companies, OJ L 366, 21.12.2006, p.47, para 1.

[33] European Commission, 'State Aid Scoreboard: Spring 2007 update' COM (2007) 347 final, 21-22.

national tax measure changed due to a political agreement, i.e. the Code of Conduct, not due to a change of state aid law.[34]

To summarise all of the above, the 1998 Fiscal Aid Notice 'was strictly linked to the 1997 Code of Conduct on harmful tax competition between Member States, and the notion of aid was seen as one of the tools to combat harmful tax measures. Unsurprisingly, initiatives like this from the Commission prompted accusations in legal doctrine of the increasingly intrusive nature of the notion of aid.' [35]

Speaking of intrusiveness, it is important to pause for a minute and take a look at the broader picture, in order to remember how state aid rules can be applicable in the first place. The classic paradigm of a state aid measure is one that grants selective advantages to domestic undertakings, helping them improve their standing in the internal market. On the contrary, the classic paradigm of a harmful measure is a measure that offers advantages to foreign economic agents, in order to attract them to the 'poaching' state. At first, this appears to be odd, since no domestic undertakings seem to be involved. However, the 'poaching' state seeks to strengthen its own economy, and in the end it is a domestic business - e.g. the domestic subsidiary of a foreign company - which benefits from the tax incentive

[34] See Liza Lovdahl Gormsen and Clement Mifsud-Bonnici, 'Legitimate expectation of Consistent Interpretation of EU State Aid Law: Recovery in State Aid Cases Involving Advanced Pricing Agreements on Tax' (2017) 8 Journal of European Competition Law & Practice 423, 429.

[35] Massimo Merola 'The Rebus of Selectivity in Fiscal Aid: A Nonconformist View On and Beyond Caselaw' (2016) 39 World Competition 533, 537.

offered at the expense of the tax revenue of the other Member State. [36] Thus, state aid law is applicable in this context, provided that all the state aid conditions are fulfilled.

Before concluding this subchapter, it is of essence to reiterate that the Commission's expansive interpretation of the 'selectivity' condition in the first fiscal state aid wave was instrumental, once sanctioned by the ECJ, in targeting such tax measures, which would have otherwise escaped State aid scrutiny. As demonstrated in Chapter 3 (C) *supra* (entitled selectivity and harmful tax competition), the decisions of the CJEU and the European Commission had the effect of making state aid rules more effective by weakening their "impediment", i.e. the selectivity condition. As previously argued, the evolution of the selectivity condition in the ECJ's jurisprudence, and especially in the landmark *Gibraltar* case, has had the effect of making it extremely difficult for states to enact or preserve harmful tax measures. [37]

Therefore, the case law produced by the ECJ as a direct consequence of the Commission's initiatives in the first fiscal aid wave resulted in an interpretation of Article 107 TFEU that facilitated similar future initiatives, namely fiscal aid probes into harmful tax competition measures.[38]

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[36] Wolfgang Schön, 'Taxation and State Aid in the European Union' [1999] CMLR 911, p. 934-935.

[37] Giving shape to the scope of Article 107 TFEU in such a manner certainly went some way to "remedying" the Treaties' tight restrictions (limited competence and unanimity) on legislative competence on tax matters.

[38] During the same period of time, i.e. the first decade of the 2000s, the ECJ also handed down some seminal rulings that imposed even stricter procedural obligations on Member States. See, inter alia, Professor Biondi's case note on Lucchini and what he called the gradual 'remedial harmonisation' in the area of state aid law: Andrea Biondi, 'Case Law: Case C-119/05, Ministero

B) The link between the Second Fiscal State Aid Wave and Harmful Tax Competition

On June 11th 2014, Algirdas Šemeta, then EU Commissioner for Taxation, stated that

> fair tax competition is essential for the integrity of the Single Market, for the fiscal sustainability of our Member States, and for a level-playing field between our businesses. Our social and economic model relies on it, so we must do all we can to defend it.[39]

This statement was published on the day the opening decisions in the Fiat, Starbucks and Apple cases where adopted, namely on the very day the second fiscal state aid wave was launched. It is evident that, from the Commission's standpoint, these fiscal state aid probes were against harmful tax measures. The "magniloquence" of the first fiscal state aid wave remained unchanged and the investigations were once again portrayed as targeting both distortions of competition between undertakings but also, more importantly, distortions of tax competition between Member States. By going too far, certain States had exceeded the limits of what Commissioner Šemeta called "fair tax competition"; they had ventured into "harmful" tax competition and the EU would not hesitate to rely on its exclusive competition policy competence to steer them in the right direction.

Leaving the Commission's familiar line of rhetoric behind, an outside observer cannot help but wonder: were the tax regimes and tax practices under state aid scrutiny in the second fiscal state aid wave also "harmful" under the Code

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dell'Industria, del Commercio e dell'Artigianato v. Lucchini SpA, formerly Lucchini Siderurgica SpA' (2008) 45 Common Market Law Review 1459.

[39] Commission Press Release, IP/14/663 (June 11 2014), available at <http://europa.eu/rapid/press-release_IP-14-663_en.htm> accessed 20 October 2019.

of Conduct? [40] The answer to this question cannot be provided as effortlessly and surely as it was in relation to the first fiscal state aid wave. The reason is that one encounters two major difficulties that were not present then.

First, for reasons that will be explained later on in this section and are related to the inner workings of the Code of Conduct group, one does not possess, for the second wave, the "luxury" of a pre-existing report like the Primarolo report. A detailed catalogue of harmful tax practices was not, this time around, published by the Code of Conduct group in advance of the launch of the second wave in June 2014. The group's workings remain, for the most part, secret and confidential, even though the European Parliament has frequently lamented this lack of transparency, as seen in Chapter 2. This means that we are not in a position to easily match a fiscal aid case, e.g. the Belgian Excess Profit rulings scheme, to a pre-issued catalogue of harmful measures.

The second difficulty we come across, compared to the first wave, is that this time the Commission's soft law instrument anteceding its hard law investigations did not contain any references to harmful tax competition. In the case of the first fiscal aid wave, before its 2001 launch, the Commission had published the 1998 Fiscal Aid Notice (analysed in Chapter 5A *supra*), where it had explicitly linked its fiscal state aid doctrine to its soft law goal of fighting harmful tax competition. Such a "bellwether" of sorts is now missing. Neither the 2014

[40] An ad hoc analysis of Member States tax practices would of course be more appropriate, but the level of detail required would fall outside the scope of this thesis; the characteristics they share allow for a tentative general conclusion.

Draft Notice on the notion of aid, which preceded the launch of the second wave, nor the final 2016 Notice on the notion of aid, made any reference to harmful tax competition. This is perhaps understandable, given that these notices concerned the entire spectrum of state aid law and not just fiscal aid. Still they "deprive" us of an extra "sneak peek" into the motivations of DG COMP, one that was present fifteen years earlier.

Despite these two differences, it is in fact not exceedingly hard to ascertain whether the probes of the second wave were linked to the Union's harmful tax competition agenda. An analysis of the harmfulness criteria of the Code of Conduct as applied to these cases, coupled with official Commission statements and incisive comments found in the academic literature, provide us with an answer.

So, once again, here is the key question this subchapter aims to answer: was the second fiscal state aid wave also linked to the EU's fight against harmful tax competition, just the way the first fiscal state aid wave of the early 2000s was?[41] Although we must indeed be 'very careful not to put the mere existence of a ruling practice on a par with harmful tax competition',[42] if (and this is not a small if) the factual assertions made by the Commission in its opening and final decisions are correct, then the (tentative) answer under the criteria of the Code of

[41] For a succinct overall summary of the evolution of the EU's strategy against harmful tax competition see Edoardo Traversa and Alessandra Flamini, 'Fighting Harmful Tax Competition Through EU State Aid Law: Will the Hardening of Soft Law Suffice?' ESTAL 2015 (3) 323, 325.
[42] Raymond Luja, 'Will the EU's State Aid Regime Survive BEPS?' (2015) 3 British Tax Review 379.

Conduct must be "yes", both in the author's view and in the view of numerous academics.[43]

Why? Firstly, as stated above, the Code of Conduct concerns measures which affect, actually or potentially, the location of business activity in the EU in a significant way, i.e. they play an important role in companies' decisions on their investment location. This can clearly be the case with favourable tax rulings and APAs, since corporate taxation is a factor that companies take seriously into account when deciding where to invest. For instance, in the Apple opening decision, the Commission claimed that it possessed evidence proving that Apple was negotiating with the Irish tax authorities in order to decide whether Ireland would be its jurisdiction of choice within the EU. As regards Amazon's tax ruling, we have already seen that Jean-Claude Juncker used to boast about managing to lure Amazon to Luxembourg in the early 2000s.[44]

Secondly, the APAs also provide for a significantly lower effective level of taxation than the level generally applicable in the Member States in question, e.g.

[43] See, in the same vein, Henk van Arendonk, 'Editorial: The European Cooperation Project, Tax & Sovereignty' EC Tax Review 2016/5-6 242, 244; Peter J. Wattel, 'Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 59; and Romero Tavares, Bret Bogenschneider and Marta Pankiv, 'The Intersection of EU State Aid and U.S. Tax Deferral: A Spectacle of Fireworks, Smoke and Mirrors' (2016) 19 Florida Tax Review 121, 140 *et seq.*

[44] Alex Barker, Vanessa Houlder and George Parker, 'Netherlands accused of subsidising Starbucks tax bill' *Financial Times* (London, 13 November 2014), <https://www.ft.com/content/f064f922-6b56-11e4-9337-00144feabdc0> accessed 17 September 2019.

Apple's effective tax rate was much lower than the Irish 12,5% rate,[45] and FFT's effective tax rate was lower than Luxembourg's statutory tax rate. Thus, following the "orthodoxy" of the Code of Conduct, the fulfillment of these two preliminary conditions renders the administrative practice of validating such APAs potentially harmful under the Code of Conduct.

In the view of the Code of Conduct Group, advance pricing agreements (APAs) and tax rulings do indeed fall within the scope of the Code of Conduct. As a matter of fact, Member States' tax ruling practices had been reviewed by the Group between 1998 and and 2003, given that they potentially encouraged under-taxation. The Council's agreement,[46] which also took the form of EU Code of Conduct guidance, stated that any unilateral ruling which concerned transfer pricing should be spontaneously notified to all directly concerned tax administrations.[47] The implementation of this guidance was sporadic and generally not successfully, but the takeaway here is that tax rulings, especially those concerning transfer pricing, have already been found to fall within the remit of the Code of Conduct, thus being potentially harmful tax competition measures.

Moreover, certain tax ruling practices could also appear to be conclusively harmful, since they fulfill (at least) two of the Code's substantive criteria. More

[45] Allegedly reaching 0,005% in 2014, although both Ireland and Apple fiercely contest this assessment. See Commission Press Release, IP/16/2923 (August 30 2016), available at <http://europa.eu/rapid/press-release_IP-16-2923_en.htm> accessed 10 September 2019.

[46] Council of the European Union (2001), Document 8848/01 (paragraphs 21 and 22); Council of the European Union (2003), Document 10126/03.

[47] Vinod Kalloe, 'EU Code of Conduct: From Reviewing Individual Tax Regimes to Horizontal Coordinating Policy - Cracking the Code in the BEPS Era' in Dennis Weber (ed.) EU Law and the Building of Global Supranational Tax Law (IBFD 2017) 163-164

specifically, the rules for profit determination in respect of activities within a multinational group of companies allegedly depart from internationally accepted principles, notably the rules agreed upon within the OECD. The Commission's entire case, as presented *supra*, is based on the premise that the tax rulings' transfer pricing methods and outcomes violate the arm's length principle.

Furthermore, one of the Code's substantive criteria is 'whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages'.[48] It could be argued that DG COMP, in the second wave, targeted practices and rulings that, in its view, exhibited such characteristics. This is reflected in DG COMP's 2016 Working Paper on Tax Rulings, where the following is stated: 'rulings that cover intra-group transactions between two different Member States, where both companies carry out genuine economic activities on which they are taxed, have been found to be unproblematic.'[49] A contrario, this means that DG COMP would find the lack of genuine economic activities problematic, thus bringing its state aid viewpoint in line with the Code of Conduct's aforementioned criterion.

Finally, in many cases, and especially in cases involving Luxembourg, we encounter a lack of transparency, as, through the tax rulings, national legal provisions are relaxed at the administrative level in a non-transparent way. For instance, Luxembourg's secrecy forced the Commission to issue an information

[48] Code of Conduct, para B3.

[49] European Commission, 'DG Competition – Internal Working Paper – Background to the High Level Forum on State Aid of 3 June 2016', hereafter 'Working Paper'.

injunction to identify the State aid beneficiary, and the very large discretion enjoyed by individual tax inspectors is evidenced by the fact that a Luxembourgish tax inspector would allegedly issue thirty tax rulings in a single day! These combined characteristics of the tax rulings in most cases make the practice of granting them harmful under the Code of Conduct, in the author's view.

However, it is the Code of Conduct group that will have the final say on their harmfulness. Still, the practice of the Group has been that, in cases where a measure is part of an ongoing State aid procedure, the Code of Conduct discussion is suspended until the State aid procedure has taken its course (including any eventual Court proceeding).[50] If found to be harmful, paragraph D of the Code obliges Member States to bring their tax ruling practices in accordance with the Code (the so-called rollback obligation).

Regardless of what the actual outcome of these measures' harmfulness assessment may be, if it ever takes place, it is telling that the Commission has explicitly framed its State aid probes and decisions as blows to unfair taxation and unfair tax competition.

As former Competition Commissioner Almunia had emphatically stated in June 2014, when the second and ongoing fiscal State aid wave was launched, these State aid investigations were

[50] Vinod Kalloe, 'Corporate Tax Treatment of Interest: EU State aid and the EU Code of Conduct Combating Harmful Tax Competition' in Marres and Weber (eds), Tax Treatment of Interest for Corporations (IBFD, 2013), 176.

> extremely important. Selective tax advantages to the benefit of multinationals seriously distort competition in the EU Single Market. Moreover, 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.[51]

The political goal of countering harmful tax competition was openly linked to the application of fiscal state aid rules. According to a relevant news statement on Almunia

> In February 2014, when first confirming these own-initiative investigations into "aggressive tax planning" then EU Competition Commissioner, Joaqun Almunia, said he had "a political consideration" in mind. European Parliament elections were just three months away and the Commissioner was concerned that "a growing proportion of voters across the EU ... may be tempted by anti-European messages." "Pro-active policies" were needed, the Commissioner said, to show voters "the way forward is more integration, not a beggar-thy-neighbour attitude."[52]

These were strong words, and such open criticism by a Commission Vice-President must not have been well received in EU capitals. The beggar-thy-neighbour dictum is a direct reference to harmful tax competition, a direct attack on Member States' practices. Having stated the obvious, i.e. that the launch of the second fiscal state aid wave was inextricably linked to the goals of the Code of Conduct, the Commission decided to make a subtle change in its relevant rhetoric.

More specifically, as 2014 drew to a close and VP Almunia was succeeded by Commissioner Vestager, the focus shifted from the behaviour of Member States (harmful tax competition) to the behaviour of multinational companies that took

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[51] Commission Press Release, IP/14/190 (June 11 2014), available at <http://europa.eu/rapid/press-release_STATEMENT-14-190_en.htm> accessed 20 April 2020.

[52] McCann Fitzgerald, 'Apple Case Update' *Lexology* (London, 23 December 2016) <hyperlink> accessed 20 April 2020.

advantage of the opportunities created by said competition (tax avoidance and "aggressive tax planning").

By way of example, apart from President Juncker's mission letter to Commissioner Vestager that explicitly mentioned the need for competition tools to be mobilised 'in the fight against tax evasion',[53] the Commission's 2014 Report on Competition Policy said the following about its fiscal aid probes: 'the Commission is raising doubts about the compatibility of some tax practices adopted by large multinational companies in the context of aggressive tax planning.'[54]

Competition Commissioner Vestager, now also Commission Vice-President since November 2019, has been sending a strong political message in her statements and interviews throughout the duration of the second fiscal aid wave.

In her statement announcing the negative decision against Belgium, Commissioner Vestager stressed that her staff would continue to scrutinise Member States' tax rulings, but that 'to root out unfair tax competition in the EU, we need an effective combination of both legislative action and enforcement of

[53] European Commission, 'Mission Letter – Margrethe Vestager' (Brussels, 1 November 2014) <https://ec.europa.eu/commission/sites/cwt/files/commissioner_mission_letters/vestager_en.pdf> accessed 20 April 2020.

[54] European Commission, 'Report on Competition Policy 2014' (Brussels, 4 June 2015) <https://ec.europa.eu/competition/publications/annual_report/2014/part1_en.pdf> accessed 20 April 2020.

state aid rules.'[55] Furthermore, when announcing the negative decision against Amazon and Luxembourg, she emphasized that the 'ultimate goal should of course be that all companies, big or small, pay their fair share of tax where their profits are earned,' but that the 'enforcement of EU State aid rules alone cannot achieve this.'[56]

Moreover, in a letter to US Treasury Secretary Jack Lew, she admitted that 'the Commission is using a combination of its tools, namely legislative action and enforcement of EU State aid rules, with the aim of establishing fair tax competition within the European Union.'[57]In fact, Commissioner Vestager at one point went so far as to make the following assertion: '[f]or me, [the] issue of fairness is the most important message from our enforcement of state aid rules in tax cases and it is my duty as Commissioner for competition to make sure that the rules apply in a fair manner to any company that does business in the EU's single market'.[58] Furthermore, referring to the Commission's final negative decision against

[55] Commission Press Release, 'Belgian "Excess Profit" tax scheme - Statement by Commissioner Margrethe Vestager' (Brussels, 11 January 2016) <http://europa.eu/rapid/press-release_STATEMENT-16-44_en.htm> accessed 20 April 2020.

[56] European Commission, 'Statement by Commissioner Vestager on illegal tax benefits to Amazon in Luxembourg and referring Ireland to Court for failure to recover illegal tax benefits from Apple' (Brussels, 4 October 2017) <https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_17_3714> accessed 20 April 2020.

[57] Commissioner Vestager, 'Letter to U.S. Secretary of the Treasury Jack Lew' <http://static.politico.com/cf/ba/b7725d194d84a1df018c28160048/margrethe-vestager-letter-to-secty-lew-on-eu-tax-investigations.pdf> accessed 18 April 2020.

[58] Margrethe Vestager, 'Why fair taxation matters' (Copenhagen, 9 September 2016) <https://ec.europa.eu/commission/2014-2019/vestager/announcements/why-fair-taxation-matters_en> accessed 20 April 2020.

Ireland and Apple, the Competition Commissioner noted that the decision was 'all about' restoring fair competition.[59]

In a 2017 Guardian interview, when asked about the decision against Apple and the 13 billion euros recovery order, Commissioner Vestager replied: '[w]e are doing this because people are angry about tax avoidance and the [European] council knew that it already had the power to do something to change that.'[60] Political considerations and rhetorical devices have taken centre stage.

What is interesting, in this context, is that certain Commission members have at times seemed to imply that any measure that qualifies as fiscal state aid is also a measure of unfair (or harmful) tax competition. This statement of Commissioner Moscovici in April 2015 is telling:[61]

> We have also seen that some rulings may not always *be in line with fair tax competition.* As you may know, the European Commission is currently investigating several tax rulings to determine whether they comply *with state aid rules* and has asked all Member States to send the full list of their tax rulings.

[59] ibid.

[60] Tim Adams, 'Margrethe Vestager: 'We are doing this because people are angry' *Guardian* (London, 17 September 2017), <https://www.theguardian.com/world/2017/sep/17/margrethe-vestager-people-feel-angry-about-tax-avoidance-european-competition-commissioner> accessed 17 April 2020.

[61] Pierre Moscovisi, 'The future of tax policy: A matter for society as a whole' (Brussels, 29 April 2015) <http://europa.eu/rapid/press-release_SPEECH-15-4900_en.htm> accessed 20 May 2020, emphasis added.

This statement shows that, occasionally, politicians and policy-makers conflate fair inter-company competition with fair intra-EU tax competition.[62] This is perhaps at times a deliberate mistake, since the latter has been proven to capture the attention of European public opinion, e.g. with the LuxLeaks scandal, whose echo is still heard today. The Commission's high profile State aid probes have not only placed harmful tax competition back under the spotlight; they have also satisfied European taxpayers' need to witness swift and decisive action against it.

The debate surrounding the legitimacy of the Commission's decisions has been deeply politicized, so it comes as no surprise that various MEPs have jumped on the bandwagon. For some, this was obviously more about getting their fifteen minutes of fame rather than discussing the intersection of state aids and harmful tax measures. For example, one MEP said that Ms Vestager "deserved a medal" for her actions, while another expressed his wish to "clone" the Danish commissioner for taking on multinationals.[63]

Others' comments, however, were much more revealing and to the point. Referring to the negative decisions against Fiat and Starbucks, Elisa Ferreira MEP, the co-rapporteur for Parliament's Special Committee on Tax

[62] Still, this is not surprising. Although the primary aim of Article 107 TFEU is to minimize competition distortions between companies, the prohibition of these practices also has significant effects on a State level; Member States are discouraged from creating preferential tax regimes targeting specific multinationals in order to lure them to relocate.

[63] Suzanne Lynch, 'Apple tax deal: Controversial ruling backed by MEPs' *The irish Times* (Dublin, 14 September 2016) <http://www.irishtimes.com/business/economy/apple-tax-deal-controversial-ruling-backed-by-meps-1.2791392> accessed 20 September 2016.

Rulings, stated that these 'two cases have proven that tax competition among States to attract companies and profits is the norm in the EU', implying that the tax rulings received by these companies were not only prohibited under Article 107 TFEU, but also constituted measures of tax competition.[64] Moreover, German centre-right MEP Markus Ferber openly congratulated Commissioner Vestager for finding the "right lever" for tackling unfair taxation through state aid law. [65]

When the Commission announced that it had adopted negative decisions against Luxembourg (Fiat) and the Netherlands (Starbucks), the same MEP had noted that these decisions showed Member States that did not want to disclose their tax rulings to DG COMP that such intransigence would be 'a missed chance for fair competition in the field of taxation.'[66]

On the same date, yet another MEP framed the Starbucks state aid decision as a blow to harmful tax competition, by stressing the following: '[w]e want fair tax competition in Europe, and there is no reason why your local corner coffee bar should pay normal taxes, and big MNCs such as Starbucks should not.'[67]

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[64] European Parliament Press Release (October 21 2015), available at <http://www.europarl.europa.eu/news/en/news-room/20151021IPR98611/key-meps-verdicts-tax-rulings-starbucks-and-fiat-show-transparency-is-needed> accessed 20 August 2016.

[65] Suzanne Lynch, 'Apple tax deal: Controversial ruling backed by MEPs' *The irish Times* (Dublin, 14 September 2016) <http://www.irishtimes.com/business/economy/apple-tax-deal-controversial-ruling-backed-by-meps-1.2791392> accessed 20 September 2016.

[66] European Parliament Press Release (October 21 2015), available at <http://www.europarl.europa.eu/news/en/news-room/20151021IPR98611/key-meps-verdicts-tax-rulings-starbucks-and-fiat-show-transparency-is-needed> accessed 20 April 2020.

[67] ibid.

It does not get more explicit than this: admitting that the State aid apparatus is used to achieve the Code of Conduct's soft law goals is a taboo neither for the EU Commission nor the European Parliament. These two key EU institutions have self-assuredly stood behind their choices.

One needs to remember that getting the right message across to European citizens is crucial for the legitimation of the Commission's actions, since this makes its "intrusive" fiscal State aid decisions more palatable to taxpayers; it also puts Member States between a rock and a hard place by squeezing them between an unfriendly investment climate and an enraged electorate. How easily can an Irish SME owner accept his government's refusal to receive a 13-billion-euro windfall by Apple? How can she not be infuriated when Apple is allegedly taxed at a 0.005% tax rate?

At this public relations game, the Commission has been largely successful. The image presented to the European public opinion by the media is more or less sympathetic to the Commission's initiative: it is the image of a deeply political European Commission that is doing its best to tackle inequality in taxation and unfair tax competition. Journalists from leading European media have been quick to report that Vestager's message is that, first, 'tax competition cannot and should not mean a complete free-for-all' and, second, that 'if the EU does not stand united, the only beneficiaries will be the multinationals playing fiscal arbitrage.'[68] The

[68] Tim King, 'Apple fight tests Europe's operating system' *Politico* (Brussels, 2 September 2016) <http://www.politico.eu/article/apple-fight-tests-europes-operating-system-margrethe-vestager-ireland-european-union/> accessed 20 April 2020.

Commissioner's constant appeal to fairness has also been noticed: '[t]he underlying message is that the Irish government has failed in its duty to be fair — a duty that it owed not just to its own citizens but to the other EU member countries.'[69] Thus, the tough State aid scrutiny of multinationals' tax rulings is increasingly being viewed as 'an act of tax policy more than one of competition policy.'[70]

As a final side-note, coming back to the case law, it should be remembered that, from a "doctrinal" state aid perspective, international tax competition cannot "expiate" a Member State's breach of the State aid prohibition. Already in the landmark *Italy v Commission* case of 1974, the Court had made it clear that, in that case, the fact that 'social charges devolving upon employers in the textile sector are higher in Italy than in the other Member States' is irrelevant because 'the point of departure must necessarily be the competitive position existing within the common market before the adoption of the measure in issue.'[71] Selective tax incentives that fall within the ambit of Article 107 TFEU are not to be used as bait for international capital even if they are less attractive than those in other Member States.

Before concluding this subchapter, it is of essence to reiterate that the Commission's expansive interpretation of the 'advantage' condition in the second

[69] ibid.

[70] Martin Sandbu, 'Free Lunch: Brussels levels the playing field' *Financial Times* (London, 1 September 2016) <https://www.ft.com/content/ef9e8120-6f7d-11e6-9ac1-1055824ca907> accessed 20 September 2019.

[71] Case 173/73 *Commission v Italy* EU:C:1974:71, para 17.

fiscal state aid wave was instrumental in targeting such tax measures, which would have otherwise escaped State aid scrutiny. Of course, the ensuing discussion takes place with full knowledge that the ECJ has yet to rule on the validity of the Commission's reading of the case law underpinning the birth of the EU Law arm's length principle, most notably the ECJ's *Forum 187* judgment. Nevertheless, as analysed in Chapter 4.B.2 *supra*, the latter has been accepted (in a way) by the General Court and, pending the appeals to the ECJ, the Commission's assertions represent good law.

Going into more detail, the expansive interpretation of the advantage condition now plays the role of the expansive interpretation of the selectivity condition in the first wave. The Commission is attempting to "nudge" the jurisprudential trajectory in the direction that best serves its soft law goals, i.e. in a way that expands the remit of Article 107 TFEU and allows it to "catch" potentially harmful tax measures.

In Chapter 4.B.1.3 *supra*, it was contended that the Commission is "overstretching" *Forum 187* and is arguably over-relying on this judgment in order to add a new "chapter" to EU state aid discourse. The arguments raised will not be repeated here. What must be stressed in the context of this subchapter is that, after a decade of silence between the *Forum 187* judgment (2006) and the Commission's first allusion to an EU law-derived arm's length principle stemming therefrom (2015), the practical legal result is that EU state aid law draws nearer to the Code of Conduct for business taxation.

This is the case because now, in the Commission's view, Article 107 TFEU captures measures (tax rulings) that fulfill the Code's criteria, but which were previously not in any way certain to fall within the remit of Article 107 TFEU. Thus, the state aid advantage condition explicitly moves in the direction of criterion B4 of the Code of Conduct, under which 'rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD'.[72]

It could also be argued that, apart from the expansive interpretation of the advantage condition, two more jurisprudential "novelties", this time in relation to selectivity, took place after the launch of the second wave, and have greatly aided the Commission in its reinvigorated crusade. More specifically, two selectivity "shortcuts" have tremendously facilitated DG COMP's state aid assessments and have correspondingly made Member States' room for manoeuvre in selectivity matters quasi-evaporate.

The first selectivity shortcut came directly from the ECJ in 2015, when it arguably created an entirely new presumption in EU state aid law. Naturally, we are referring here to the *MOL* presumption. In June 2015, the ECJ handed down its *MOL* judgment, in paragraph 60 of which it stated that, in cases of individual aid, 'the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective.'[73]

[72] Code of Conduct, para B4.

[73] Case C-15/14 P *Commission v MOL* EU:C:2015:362, paragraph 60

From DG COMP's perspective, the ECJ judgment could not have chosen a more opportune moment to "appear". Frankly, one is reminded of ancient Greek theatre and the *apo mekhanes theos* literary device (deus ex machina in Latin), meaning 'god from the machine'. The idea was introduced by Aeschylus, where, towards the end of a tragedy, the actor playing god would be lowered onto the stage by a crane, unexpectedly resolving a seemingly impossible situation and concluding the drama. In our case, the god would be the selectivity presumption, the crane would be the *MOL* ruling, and the ECJ would be…Aeschylus.

Perhaps the above appears to be overly dramatic (literally). However, the parallels are there. The ECJ handed down its *MOL* judgment in June 2015, one year after the Commission had initiated the second fiscal aid wave with its probes against Apple, Fiat and Starbucks. More importantly, this ruling came before the conclusion of any of these investigations. In fact, the two first ones (Fiat and Starbucks) were concluded four months later (October 2015), and their primary reasoning on why the tax rulings were selective was based on the *MOL* judgment, a judgment that had simply not existed when DG COMP had launched its investigations. One can only imagine how relieved the Commission officials must have been when the ECJ offered them a convenient way of justifying the fulfillment of the selectivity condition, which is notoriously difficult to prove in fiscal aid cases.[74]

[74] Although, admittedly, less difficult in cases involving administrative discretion.

The above is not meant to criticise the ECJ for its judgment or the Commission for relying on it; it just goes to demonstrate how the Court's state aid case law yet again accommodates the Union's soft law goal of tackling harmful tax competition. If one wishes to tackle individual tax rulings that contribute to intra-EU harmful tax competition using Article 107 TFEU, one could not conceive a more useful and effective selectivity shortcut than the *MOL* presumption. This entire situation becomes even easier for the Commission if the (arguably erroneous) interpretation of this presumption by the General Court prevails (see the analysis in Chapter 4.B.2.3).

The second, and final, selectivity "shortcut" is the glaring lack of any in-depth analysis of the comparability between standalone and integrated companies, both in the Commission's final decisions and in the General Court's *Fiat* and *Starbucks* judgments (as explained in Chapter 4.B.2.3). Under an accurate reading of selectivity case law, as argued in Chapter 4.B.1.4, standalone companies are not comparable to integrated companies. Still, the Commission has endeavoured to push forward with this assumption, and the General Court had failed to challenge it. It is hoped that the ECJ will not accept such unconvincing reasoning and such disregard for the key comparability exercise of the selectivity test.

However, an ECJ that is sympathetic to the underlying policy objective could endorse this arguably fallacious interpretation of the selectivity condition. In the words of Professor Luja, '[a] Court with a mindset to limit harmful tax competition may well go along with the Commission's line of thought that group

companies and stand-alone companies should be treated alike, as that maxim might make sense at first to many.'[75]

Still, it is hoped that the ECJ will not allow for yet another selectivity shortcut to be established. Though the shortest distance between point A (state aid prohibition) and point B (harmful tax competition) will always be a straight line, the ECJ would be wise to choose obliquity instead.

To conclude this subchapter, it is important to summarise the two main points that have been submitted. First, like the first fiscal aid wave of the early 2000s, the second fiscal aid wave has been launched against measures, practices and rulings that present characteristics of harmful tax competition. Second, like the first fiscal aid wave, where an expansive interpretation of selectivity by the Commission and the EU Courts materialised and aided the Union's fight against harmful tax competition, this time an expansive interpretation of the advantage condition, coupled with certain selectivity shortcuts, have made EU state aid law more "accommodative" to the Union's soft law goal.

[75] Raymond Luja, 'Just a Notion of Aid: How (Not) to Create a Fiscal State Aid Doctrine (2016) Intertax 788, 789.

Conclusion

In this chapter, the most important thread binding the two fiscal State aid waves has been examined in depth, namely their common link (and contribution) to the EU's fight against harmful tax competition. By referring to the work of the Code of Conduct group, Commission press releases, official statements by Competition Commissioners and various academic sources, it has been demonstrated that many of the cases pursued by the Commission in both fiscal aid waves concerned tax measures that presented actual or potential harmful tax competition elements. It was, moreover, established that the Commission's expansive interpretation of the 'selectivity' and 'advantage' conditions in the first and second waves, respectively, was instrumental in targeting such tax measures, which would have otherwise escaped State aid scrutiny.

At the time of writing, the cases of the second fiscal aid wave had not reached the ECJ, so it was not clear whether the Union's highest court would actually endorse the Commission's audacious interpretation of the "advantage" condition. However, as regards the first wave, it has already been demonstrated in Chapter 3 (C) and Chapter 5 (A) that the ECJ supported the Commission's initiative against harmful tax competition, 'by upholding the selectivity test proposed by the European Commission, including aspects as regards the justification in by the nature or general scheme in several judgments.'[76]

[76] Juan Jorge Piernas López, *The Concept of State Aid Under EU Law: From internal market to competition and beyond* (OUP 2015), 13.

On the basis of the above, this chapter's conclusion is that the Commission has at times employed its powerful hard law apparatus under Article 107 TFEU in order to further the soft law goals of the Code of Conduct for Business Taxation.

This point of view finds support in existing academic literature. The "bridge" that the Commission built between its exclusive fiscal state aid competence and the Union's lack of (effective) competence[77] to fight harmful tax competition has not been uncontroversial.

Although, from a doctrinal point of view, 'overlap between the EU State aid rules and the Code of Conduct does not seem likely, as state aid is mainly concerned with (positive) discrimination within one national market and the Code of Conduct with excessive cross-border policy competition', [78] the Commission has endeavoured to seamlessly link the two sets of rules in both fiscal aid waves. In the second, and ongoing, fiscal aid wave, scrutinizing tax rulings, this has been the case 'even though such rulings and measures are clearly material which should have been submitted to and discussed within the Code of Conduct Group.'[79]

[77] This is the practical effect of the Union possessing limited competence to act in this area, plus the political blockage of unanimity in Council.

[78]Peter J. Wattel, 'Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 59, 69.

[79] ibid.

This is no surprise to the reader, since the Commission has on so many occasions made it 'clear that competition policy can serve its taxation agenda' and recognized 'the symbiotic relationship' between its hard and soft law goals.[80] In fact, it has persuasively been argued that, from the mid-to late 1990s, 'the most significant policy initiative pursued by the European Commission has been the use of the State aid rules to combat harmful business taxation.'[81]

As we saw in subchapter 5 (B) *supra*, the Commission is now expanding the "advantage" state aid condition in order to link it to a supposedly EU law-derived arm's length standard. However, the Commission 'does not consider the arm's length standard so much as a principle of international division of taxing jurisdiction' but as 'a principle of competition law, i.e. as an instrument for safeguarding interentrepreneurial and interstate equality that prevents Member States from selectively allocating away the tax base to yonder voids where no watchful tax administration lurks; to prevent them from soliciting BEPS in their eagerness to keep up with their neighbours in smart tax competition.'[82]

The main argument the author has advanced is that, 'even though the intent behind the activist approach of the Commission is laudable, namely the desire to harmonise transfer pricing rules and thereafter tackle harmful tax

[80] Liza Lovdahl Gormsen, "State Aid and Direct Taxation and the Big Eruption Between the U.S. and the EU" (2017) 62 The Antitrust Bulletin 348, 350.

[81] Juan Jorge Piernas López, *The Concept of State Aid Under EU Law: From internal market to competition and beyond* (OUP 2015), 13.

[82] Peter Wattel, '*Starbucks* and *Fiat*: Arm's Length Competition Law', (2020) 48 Intertax 119, 120.

competition, this is not an aim to be pursued through any means.'[83] Despite political expedience, it is not legally acceptable to allow the Commission to stretch 'its state aid powers to tackle tax rulings and smart tax competition.'[84] Indeed, as aptly noted, we should not welcome the idea that 'a morally desirable outcome should be achieved at the expense of stretching the boundaries of the law.'[85]

To conclude this chapter, it is crucial to remind ourselves that, when the Commission attempts to use state aid law to achieve a macroeconomic goal

> 'it tends to overreact: not only does it stretch the notion of aid to combat the opportunistic use of tax measures, it also increasingly uses State aid rules to counter general fiscal measures that foster State competition (as opposed to fiscal measures that distort competition between undertakings), thus extending the reach of the Treaty's provisions on competition to macroeconomic effects. […] The above two trends inevitably clash with each other and give rise to contradictions, thereby creating a permanent conflict between national fiscal policy and State aid enforcement.'[86]

[83] Liza Lovdahl Gormsen, *European State Aid and Tax Rulings* (Edward Elgar 2019), 114.

[84] Peter J. Wattel, 'Comparing Criteria: State Aid, Free Movement, Harmful Tax Competition and Market Distorting Disparities' in Isabelle Richelle, Wolfgang Schön and Edoardo Traversa (eds), *State Aid Law and Business Taxation* (Springer 2016) 59, 60.

[85] Alfonso Lamadrid, 'On the Apple State Aid Decision' (Chilin' Competition, 1 September 2016) <https://chillingcompetition.com/?s=apple+state+aid> accessed 20 April 2020.

[86] Massimo Merola 'The Rebus of Selectivity in Fiscal Aid: A Nonconformist View On and Beyond Caselaw' (2016) 39 World Competition 533, 537.

CHAPTER 6: Thesis Conclusion

The purpose of this thesis was to analyse the legal context of the harmful tax competition debate in the EU and to examine whether what the Commission seeks to achieve, i.e. the imposition of limits on harmful tax competition, is possible under State aid rules, or whether this leads to an illegitimate overextension of the rules' scope.

Thus, the theme of this thesis has been the relationship of harmful tax competition measures and prohibited fiscal State aid. The "ambition" of this thesis has been to present a targeted examination of the use of State aid rules against national tax measures, e.g. tax schemes and tax rulings, following the adoption of the EU Code of Conduct for Business Taxation in 1997.[1] The fiscal State aid decisions and judgments that were covered were divided in two parts: the "first wave" of the early 2000s and the "second wave" that started in 2014.

It was argued that an important factor connecting the two fiscal State aid waves is the link they share to the fight against harmful tax competition. It was also maintained that the first wave's cases that were linked to this fight have substantially influenced State aid doctrine, through landmark judgments like

[1] Council Conclusions of the ECOFIN Council Meeting on 1 Dec 1997 concerning taxation policy, O.J. of 6 Jan 1998, C 2/01.

Forum 187,[2] *Azores*[3] and *Gibraltar*.[4] This trend could continue should the ECJ endorse the Commission's novel and creative approach in the second wave of fiscal State aid decisions, especially as regards its expansive interpretation of *Forum 187*.

Furthermore, it was reasoned that, in the first wave, the decisions of the CJEU and the European Commission had the effect of rendering State aid rules a more effective tool against harmful tax competition by "weakening" their major limitation, i.e. the selectivity requirement. It was, moreover, asserted that the evolution of selectivity in the ECJ's jurisprudence, especially in the landmark *Gibraltar* case, had the effect of making it particularly difficult for States to enact or preserve harmful tax measures.

Finally, in relation to the second (and ongoing) fiscal aid wave, it was argued that it is now the expansive interpretation of the advantage condition[5] that is having the same effect, i.e. is making State aid rules a more effective weapon against harmful tax competition. This is mainly due to the nexus the Commission has "identified" between the advantage condition and a (recently discovered) EU Law arm's length principle (ALP), which, according to the Commission, has the effect of rendering advantageous every tax arrangement that departs from this ALP. It was argued that the Commission, by expansively interpreting the ECJ's

[2] Joined Cases C-182/03 & C-217/03 *Belgium and Forum 187 ASBL v Commission* EU:C:2006:416.

[3] Case C-88/03 *Portugal v Commission* EU:C:2006:511.

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

[5] Coupled with certain selectivity shortcuts, as argued in Chapter 5B.

Forum 187 judgment, is attempting to widen the scope of the State aid prohibition, thus capturing tax measures and administrative practices which present potentially harmful tax competition elements. It was, lastly, asserted that the Commission's novel approach is not legally sound and that the General Court's scrutiny of said approach has been unsatisfactory.

Leaving aside the legal aspects of the second wave's investigations and decisions, it is crucial to remember the political significance of the EU's ongoing crackdown on (alleged) tax avoidance. Commissioner Vestager, for instance, has repeatedly demonstrated her commitment to this fight, both in her initial 2014 confirmation hearing and after being reappointed as Competition Commissioner in 2019 and promoted to Commission Vice-President.

In an era of plummeting public revenues and "super-mobile" international capital, it is true that solidarity between Member States should not only take the form of bailouts and "haircuts". One facet of this elusive European concept of solidarity should be the gradual elimination of aggressively attractive tax regimes that allow multinationals to avoid paying their fair share of taxes to the Member States whose markets allowed them to reap profits. Although certain Member States do not adopt this definition of solidarity[6] and have proven particularly recalcitrant, multinationals are beginning to hear this message: for instance, after

[6] For an excellent summary of the debates surrounding the emerging (?) EU legal principle of solidarity, see Andrea Biondi, Eglė Dagilytė and Esin Küçük (eds.) Solidarity in EU Law: What Now? Legal Principle in the Making (2018, Edward Elgar).

DG COMP started investigating its tax affairs, Amazon announced that it would be paying taxes on sales to its UK customers in Britain rather than Luxembourg.[7]

Still, the (admittedly noble) fight against harmful tax competition cannot take place on shaky legal terrain. The Commission's creative legal approach, as presented and critically assessed in Chapter 4 *supra*, is not persuasive and could possibly be rejected following the parties' appeals to the ECJ.[8] Should the Union's supreme court reject one of the Commission's main arguments, most notably its assertion that there exists an EU law ALP, a deviation from which confers a "selective advantage" on the recipient, then most probably all of its final decisions will be overturned, since they are based on the same doctrinal "pillars". This will effectively mean that the Commission's use of the State aid apparatus to crack down on harmful tax competition will have failed dramatically.[9]

The Commission will then have to go back to the drawing board, remove its enforcement helmet and put on its legislative hat. Only by convincing Member States to unanimously adopt a certain procedural framework [10] regulating

[7] Vanessa Houlder, 'Amazon starts to book UK sales in Britain' *Financial Times* (London, 22 May 2015),<https://www.ft.com/content/7fa80a40-00b0-11e5-a908-00144feabdc0> accessed 17 September 2016.

[8] It has been questioned whether 'the European Court is the appropriate body to assess the principle of European arm's length pricing' and whether, in fact, this is a subject for a court to rule on, rather than the more political Primarolo Group. See Henk van Arendonk, 'The European Cooperation Project, Tax & Sovereignty' (2016) 5-6 EC Tax Review 242, 245.

[9] Dimitrios Kyriazis, 'Actions for Annulment in the Fiat and Starbucks Cases: A First Taste of What Will Ensue' Wolters Kluwer Competition Law Blog (2016) <http://kluwercompetitionlawblog.com/2016/02/29/actions-for-annulment-in-the-fiat-and-starbucks-cases-afirst-taste-of-what-will-ensue/> accessed 30 June 2016.

[10] See e.g. the proposal here: Pierpaolo Rossi-Maccanico, 'Fiscal State Aids, Tax Base Erosion and Profit Shifting' (2015) 2 EC Tax Review 63.

individual tax rulings will the Commission manage to uphold legal certainty in this area.

Not all problems are legal problems, and not all legal problems are state aid problems. When one treats Article 107 TFEU as a panacea, one should not be disappointed that it did not live up to the expectations.

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