Fiscal State Aid and Tax Avoidance: Where Are We Now?

Chair: Rita Szudoczky | Institute for Austrian and International Tax Law - WU

Report by: Valentina Emanuele | Institute for Austrian and International Tax Law - WU

Introduction

The use of the EU state aid rules by the European Commission for fighting aggressive tax planning and tax avoidance by taxpayers and harmful tax competition by the EU Member States keeps raising controversies and debates, many of which are subject to litigation before the EU Courts.

Already 10 years ago, the Commission started the first state aid investigation against tax rulings. Many of these cases are still pending, as the Commission's decisions have been challenged before the General Court and the General Court's judgments been appealed to the Court of Justice. So far only one case has reached the finish line; the Court of Justice gave its final ruling in November 2022 in the *Fiat* case.[1] This judgement represents one of the key recent developments in the application and interpretation of the EU state aid rules on tax rulings. The *Engie* case[2] is also a landmark case where for the first time the Commission held that the non-application of a domestic anti-abuse rule constitutes state aid. Finally, on 12 January 2023, the Foreign Subsidies Regulation entered into force; this new legislation is a milestone in the history of fiscal state aid as it introduces a new regime for controlling subsidies granted by third-country governments to businesses active in the EU internal market. Each of these turning points deserves a closer examination.

Tax ruling cases – the *Fiat* case (Tomljenović)

On November 2022, the Court of Justice of the European Union (CJEU) delivered its final judgement in the *Fiat* case[3]. The CJEU annulled the Commission's decision but confirmed its power to investigate tax rulings concerning the transfer pricing practice of Member States.

The Commission in its State aid decision referred to the arm's length principle (ALP) as being enshrined in Article 107 TFEU. In arguing the case before the General Court (GC), the Commission adopted an abstract reasoning according to which the ALP can be indirectly inferred from the objective of the domestic corporate income tax system and it is part of the national tax law without the need of an explicit reference to it. Likewise, also the OECD Transfer Pricing Guidelines (OECD TPG) are part of the reference framework since they represent the main standard of interpretation of this principle.

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[1] CJEU, 8 Nov. 2022, Joined cases C-885/19 and C-898/19, *Fiat Chrysler Finance Europe v Commission*, [ECLI:EU:C:2022:859].
[2] GC, 12 May 2021, Joined cases T-516/18 and T-525/18, *Luxembourg v Commission*, [ECLI:EU:T:2021:251]. Appeal Cases before the CJEU C-451/21 and C-454/21.
[3] CJEU, Joined cases C-885/19 and C-898/19, supra n. 1.

However, the role of the OECD TPG in the state aid investigation is highly disputed. They are the main (or better the only) source of reference containing rules on how to determine the arm's length price of intragroup transactions. There are no comparable rules in domestic laws which usually only implement the ALP in the national system. For this reason, they play a major role in the interpretation and application of the ALP and they undoubtedly influence the administrative practice of Member States. However, the OECD TPG remain a soft law instrument that has only been implemented in the national system through administrative practice, if at all. It is debatable whether, without an explicit reference in the domestic law, this is enough for considering them part of the reference framework.

In the final decision of the *Fiat* case[4], the CJEU stated that the Commission may not use any external reference framework – including a reasoning that infers the arm's length standard from the objective of the corporate income tax without examining whether the standard is indeed part of domestic law – when it comes to the establishment of selectivity of the ruling. It consequently denied the existence of state aid. This was the first judgement from the CJEU on a state aid case on tax ruling and it is still unclear what impact it will have on the other pending cases and on the future of the Commission's investigation concerning fiscal state aid. On the one hand, although the Commission's reasoning was the same in all its decisions on tax rulings, the GC decided the cases differently. It confirmed the Commission's decision in *Fiat*[5] and *Engie*[6], but it rejected the existence of state aid for *Starbucks*[7], *Apple*[8] and *Amazon*[9]. Therefore, there is no certainty on the final outcome of the cases still pending before the CJEU (i.e., Amazon and Apple). On the other hand, it is unlikely that the *Fiat* case will close the door to future Commission investigations on tax rulings. Rather, the Commission itself has learnt some valuable lessons and now has the tools and knowledge on how to structure effective investigations for the future. Specifically, the Commission has been criticized the most on the fact that it had not really looked into the national transfer pricing practice and it had failed to show that national tax authorities actually relied *de facto* on the OECD TPG. Consequently, there might have been room to use them as reference framework and these cases could have had a different outcome.

State aid and abuse - the *Engie* case (Klethi)

Although it has not yet reached a final judgment, also the *Engie* case[10] is a key part of the fiscal state aid saga. The novelty of this case is the reference to abuse of law. Luxembourg had an anti-abuse provision in its domestic legislation even before the enactment of the ATAD. The tax ruling in the

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[4] CJEU, Joined cases C-885/19 and C-898/19, supra n. 1.
[5] GC, 24 Sept. 2019, Joined cases T-755/15 and T-759/15, *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission*, [ECLI:EU:T:2019:670].
[6] GC, Joined cases T-516/18 and T-525/18, supra n. 2.
[7] GC, 24 Sept. 2019, Joined cases T-760/15 and T-636/16. *Netherlands v Commission*, [ECLI:EU:T:2019:669].
[8] GC, 15 July 2020, Joined cases T-778/16 and T-892/16, *Ireland and Others v European Commission*, [ECLI:EU:T:2020:338]. Appeal Case before the CJEU C-465/20.
[9] GC, 12 May 2021, Joined cases T-816/17 and T-318/18, *Luxembourg v Commission*, [ECLI:EU:T:2021:252]. Appeal Case before the CJEU C-457/21.
[10] CJEU, Joined cases C-451/21 and C-454/21, supra n. 2.

Engie case relied on a national law that allowed the conversion of a loan into shares that led to a double non-taxation outcome. The Commission claimed that this conversion, despite being compliant with the letter of the law, was against the legislator's intentions and the non-application of the anti-abuse provision constitutes a state aid.

Determining whether a situation is abusive requires a subjective judgment and, in the absence of an EU harmonization, there must be a limit to the power of the Commission to intrude into a domain that belongs to the Member States' tax sovereignty. This is why in her opinion[11], Advocate General (AG) Kokott claimed that the ruling could only be considered state aid if it was manifestly erroneous. The AG tried to find a balance between having state aid control and, at the same time, avoiding the inappropriate circumstance in which the European Commission would become a supreme tax inspector (and, consequently, the CJEU a supreme tax court), especially for those measures which are very much open to interpretation such as transfer pricing and anti-abuse provisions.

What is questionable here is whether the concern of the AG is justifiable. If the Commission has a general competence to review fiscal measures, including tax rulings, it is also possible to argue that this competence would be inappropriately limited by setting a higher standard of review. The "manifest inconsistency" standard existed only when reviewing rules of general nature, for e.g. in the *Gibraltar* case[12], and it has never been used before for individual state aid cases. Besides, defining in practice what is manifestly erroneous seems to have the same subjective implications which are also present when defining what is abusive.

Foreign Subsidies Regulation (Luja)

With regard to the tools to fight unlawful state aid, a new regulation has also been recently introduced in the context of the economic security strategy of the European Union. The Foreign Subsidies Regulation (FSR)[13] will move into its implementation phase and start to apply as of 12 July 2023 and it represents a pivotal development in the EU state aid law.

This Regulation provides for a reporting obligation, if certain conditions are met, for any foreign subsidies received in case of concentration - no matter whether the funds are only indirectly used for the concentration itself - or in case of entering into a public procurement bid. In the latter case, the undertaking has to report not only about its own third-country subsidies, but also about those received by its holdings, subsidiaries, main suppliers and main subcontractors.

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[11] Opinion Advocate General Kokott, 4 May. 2023, Joined Cases C-451/21 and C-454/21, *Luxembourg v Commission*, [ECLI:EU:C:2023:383]

[12] CJEU, 15 Nov. 2011, Joined cases C-106/09 and C-107/09, *Commission and Spain v Government of Gibraltar and United Kingdom*, [ECLI:EU:C:2011:732].

[13] Regulation (EU), 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market.

The FSR also gives the Commission the power to proceed with an *ex officio* review of foreign subsidies already received by undertakings active in the European market. It has full discretion in the exercise of this power which is directed to the individual undertaking and not to foreign governments.

The Commission can take action only against those foreign subsidies that are selective and have a distortive effect on the internal market. The Regulation provides for a list of economic sanctions that can be adopted against the undertaking, including divestment and the repayment of the foreign subsidy, interestingly not to the foreign government but to the Commission itself. Another peculiar feature of this Regulation is that it imposes on the undertaking a reporting obligation that goes far beyond the scope of action of the Commission. All foreign financial contributions become reportable even if they are not selective, do not have a distortive effect on the internal market and do not benefit the individual undertaking. This may include most if not all tax incentives and credits. In case of failure to comply with this reporting obligation, the Commission can even apply a fine up to 10% of the annual aggregate turnover of the group. Here it is worth reminding that in case of appeal in competition law, the CJEU is not only authorized to reduce or cancel the fine but also to increase it.

It is undeniable that the FSR will have a huge impact which, however, has been fully underestimated. It can have legal implications on taxpayers' rights and it can even discourage entering into concentrations or public procurement bids with possible infringement of the freedom of capital with respect to the latter, which has a third countries effect. The Regulation does refer to state aid rules for guidance but there is no commitment to use the same standards of review. It is at least nice to know that the Commission is willing not to object to foreign subsidies if they benefit the EU overall.

Panel members:

- Vesna Tomljenović | General Court of the EU
- Pierre-Antoine Klethi | Loyens & Loeff Luxembourg
- Raymond Luja | Maastricht University