Van Bael & Bellis

Court of Justice's landmark State aid judgment sets clear limits to Commission's crusade against "unfair" tax arrangements

14 Nov 2022

SUMMARY

On 8 November 2022, the Grand Chamber of the European Court of Justice ("ECJ") delivered its judgment in Joined Cases C-885/19 P, ***Fiat Chrysler Finance Europe v Commission***, and C-898/19 P, ***Ireland v Commission***, annulling a 2015 Commission decision which had found that a transfer price tax arrangement between Fiat Chrysler Finance Europe ("FFT") and Luxembourg by means of an advance tax ruling constituted unlawful State aid, and had ordered Luxembourg to recover approximately EUR 20-30 million in unlawful aid.

With this landmark judgment, the ECJ firmly sides with the rule of law and the principles of legal certainty and predictability, emphasizing that the Commission must respect clear and well-established legal rules in EU law when assessing Member State tax arrangements under State aid law, and must not deviate from these rules in the pursuit of "fairness" policy goals.

In 2013, the Commission started investigating Luxembourg's tax arrangements with multinational corporations, as part of a wider, controversial effort to use EU State aid law to combat Member State taxation systems that – allegedly "unfairly" – enabled multinational corporations to reduce their tax liabilities. In this context, it determined that Luxembourg had granted FTT unlawful state aid by way of a tax ruling that did not comply with the arm's length principle (an international tax law principle requiring that intra-group transactions must include remuneration as if they had been agreed to by independent companies) and therefore conferred an advantage to FFT.

Luxembourg tax law incorporated the arm's length principle, and the tax ruling was consistent with the national legal framework. It was, in fact, not disputed that Luxembourg had consistently applied its rules in all relevant situations. The Commission, however, reviewed whether the methodology used in Luxembourg law and the tax ruling confirming compliance of FTT's intra-company transfers with the arm's length principle departed from a methodology that would lead to a reliable approximation of a market-based outcome. For this review, the Commission relied on methodologies it derived from OECD Transfer Pricing Guidelines, although these had not been incorporated in Luxembourg tax law. Against this background, it determined that the methodology used in the Luxembourg tax ruling resulted in a lowering of FFT's tax liability, compared to the amount of taxes which would have been payable by a stand-alone company. Thus, the Luxembourg tax ruling conferred on FTT a selective advantage.

In an action for annulment of the Commission decision, FFT and Luxembourg claimed, among others, that the Commission violated the principles of legal certainty and protection of legitimate expectations. In one of the Commission's rare wins in a number of similar "tax fairness" cases, the General Court ("GC") had initially upheld the Commission decision. The ECJ, however, has now annulled the GC's judgment and, at the same time, the Commission decision.

KEY ELEMENTS OF THE ECJ'S ANALYSIS

The ECJ observed that, in order to assess whether a state measure confers a selective advantage, the Commission must first identify the reference system against which the state measure's selectiveness can be assessed. It emphasized that in the area of tax law, which has not been harmonized by EU law, such a reference system must be constructed by reference to the national law applicable in the Member State concerned. If the national law was clear and applied consistently in all like situations, there was in principle no basis for a finding of selectivity. In light of this, the Court faulted the GC for upholding the Commission's analysis which had, in essence, used its own definition of the arm's length principle for the purposes of applying Article 107(1) TFEU and ignored the definition used in Luxembourg law. The Commission's approach of substituting its own understanding of the arm's length principle for that used by a Member State was therefore found to be flawed, as it failed – contrary to EU law – to consider Luxembourg's legitimate legislative choices.

OBSERVATIONS AND TAKE-AWAYS

Fiat Chrysler creates significant limits to the Commission's attempts to get around the lack of EU powers in the area of tax law by using State aid law to attack, in the name of "tax fairness," Member State tax arrangements with multinational corporations. The judgment does confirm that the Commission can in principle review national tax laws under EU State aid rules. But it sets a high threshold for the Commission to prove that tax arrangements constitute unlawful State aid – if a Member State has adopted clear rules incorporating the arm's length principle to assess the transfer prices of integrated companies, the Commission can establish unlawful state aid only if it can demonstrate that "*the parameters laid down by national law are manifestly inconsistent with the objective of non-discriminatory taxation of all resident companies, whether integrated or not, pursued by the national tax system, by systematically leading to an undervaluation of the transfer prices applicable to integrated companies* [...] *as compared to market prices for comparable transactions carried out by non-integrated companies*."

Fiat Chrysler likely will have consequences far beyond its impact on ongoing judicial proceedings related to Commission decisions concerning comparable tax rulings, where it clearly signals that these decisions cannot be sustained. Going forward, the judgment provides Member States a clear path for how to maintain tax incentives for multinational corporations without running afoul of EU State aid rules, and is likely to limit future Commission's investigations in similar circumstances. Thus, tax competition among EU Member States is likely to continue, within the framework set out in *Fiat Chrysler.*

In addition, the judgment is also bound to affect the application of the EU's Regulation on foreign subsidies distorting the internal market ("FSR"), which is expected to be formally adopted before the end of this year. The FSR uses a very wide definition of financial contributions that could constitute a distorting subsidy, reflecting both EU state aid law and EU trade/anti-subsidy law. In principle, any third country tax arrangement could potentially have been considered a notifiable financial contribution and constitute a distorting subsidy. As a result of Fiat Chrysler, however, tax agreements of third countries that comply with the judgment's framework should fall outside the scope of the FSR and thus escape future FSR investigations.

Lawyers to contact

Andreas Reindl
Partner
areindl@vbb.com

Markus Wellinger
Partner
mwellinger@vbb.com

Pietro Stella
Associate
pstella@vbb.com