ECJ Fiat Ruling Sets Clear Boundaries For EU State Aid Law

By **Andreas Reindl and Pietro Stella** (January 9, 2023)

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The Grand Chamber of the European Court of Justice recently delivered a landmark judgment[1] limiting the reach of EU state aid law as a tool to prevent EU member states from offering multinational corporations tax arrangements that reduce their global tax liabilities.

In joined cases Fiat Chrysler Finance Europe v. Commission and Ireland v. Commission,[2] the ECJ held that a transfer price tax arrangement between Fiat Chrysler Finance Europe and Luxembourg by means of an advance tax ruling did not constitute unlawful state aid.

The court therefore annulled a 2015 commission decision [3] that had considered the tax ruling incompatible with EU state aid law and also overturned the European General Court's first instance judgment[4] that had sided with the commission.

With this judgment, the ECJ has forcefully intervened in the EU's long-standing tax ruling saga, which has witnessed the commission spend approximately 10 years investing allegedly unfair tax advantages granted by certain EU member states to multinational corporations under EU state aid law.

The ECJ did not completely shut the door to these investigations. But the court set clear boundaries for the commission's powers when assessing member state tax arrangements under state aid law by emphasizing that the pursuit of fairness policy goals cannot justify deviating from clear and well-established legal rules and allocation of powers under EU law.

Background and Commission Decision

As a result of the public debate concerning unfair tax treatments offered by certain member states to multinational corporations, in around 2013 the commission started to investigate individual tax arrangements between a number of EU member states and multinational corporations. Corporate taxation is not subject to harmonization under EU law.

There is therefore no EU corporate tax law that would empower the commission to force member states to change their rules in this area. Instead, the commission — controversially — sought to limit the ability of member states to compete through favorable corporate tax arrangements by framing certain tax arrangements as unlawful state aid.

In this context, the commission found that certain member states had granted unlawful state aid to certain corporations by means of individual tax rulings on company-internal transfer pricing. Examples included the Netherlands and Starbucks, Ireland and Apple, as well as Luxemburg and Amazon, Engie and Fiat Chrysler Finance Europe.

In its 2015 decision concerning Fiat Chrysler Finance Europe, the commission found that Luxembourg had granted Fiat unlawful state aid by way of a tax ruling that enabled Fiat to determine its tax liability in Luxembourg on an annual basis for a period of five years.

In essence, the commission considered that the tax ruling allowed Fiat companies to charge company-internal transfer prices that did not comply with the arm's length principle, an international tax law principle requiring that intra-group transactions must be remunerated as if they had been agreed by independent companies.

As a consequence, the commission concluded that Fiat's reduced tax liability constituted unlawful state aid within the meaning of Article 107(1) of the Treaty on the Functioning of the EU and ordered Luxembourg to recover unlawful aid of approximately €20-30 million ($21.3-32 million).

Although Luxembourg tax law did incorporate the arm's length principle, the commission disregarded the national transfer pricing rules in its state aid assessment.

Instead, the commission relied on the Organization for Economic Co-operation and Development Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, although Luxembourg had not fully incorporated them into national law.

The Judgment of the General Court

On appeal, the General Court upheld the commission's assessment and its decision. The General Court found that the commission was entitled to base its analysis on methodologies that are extraneous to Luxembourg tax law. It reasoned that since Luxembourg law provides that integrated companies are to be taxed on the same terms as stand-alone companies, Article 107(1) TFEU allowed the commission to examine whether the transfer prices accepted by the national authorities corresponded to arm's length prices.

The General Court's Fiat Chrysler Finance Europe judgment was a rare win for the commission in judicial proceedings involving its tax or state aid decisions. The commission's efforts to tackle the unfair tax treatment of group companies had faced stiff resistance by EU courts, which had annulled most commission decisions finding that tax rulings constituted unlawful state aid.[6]

The Judgment of the ECJ

The ECJ overturned the ruling of the General Court and annulled the commission decision. The ECJ's analysis mainly focused on the commission's assessment that the tax ruling had conferred a selective advantage to Fiat, as selectivity and the existence of an advantage are necessary conditions for a tax measure to be regarded as state aid.[5]

In this context, the ECJ emphasized that the commission must first correctly identify the reference system against which the state measure's selectiveness can be assessed, since the existence of an economic advantage may be established only when compared with normal taxation.

As a second step, the commission needs to demonstrate that the tax measure at issue derogates from that reference system. If there is a derogation, the measure is considered selective if the derogation is not justified by the nature or general structure of the system.

In a key step in its analysis, the ECJ relied on the core legal principle that member states have the right to determine the characteristics of their tax systems, as corporate tax law is not harmonized at EU level. Consequently, it was in principle for member states to define the reference system or the normal tax regime.

The court concluded, accordingly, that only the national law applicable in the member state concerned must be taken into account to identify the reference system for direct taxation.

The ECJ found that the commission's main line of argument was therefore flawed in that it had refused to take into account Luxembourg's own law when identifying the reference system.

In essence, the commission was wrong to rely on rules that were not part of Luxembourg law to examine compliance with the arm's length principle and to disregard

the way in which the arm's length principle was incorporated in Luxembourg's legal order.

Consequently, the General Court also erred in law by endorsing the commission's approach.

Main Takeaways of the ECJ Judgment

Clearer Boundaries to the Commission's Powers in EU State Aid Law

In general, the ECJ findings in Fiat Chrysler set significant limits to the commission's attempts to circumvent the lack of EU powers in the area of tax law by using state aid law to challenge member state tax arrangements with multinational corporations in the name of tax fairness. Fairness is thus not a legitimate reason to derogate from foundational principles of EU law.

Nevertheless, while setting clear boundaries to the commission's powers, the ECJ also confirms that member states' measures in areas that are not subject to harmonization by EU law are not completely immune from challenge under state aid law. Thus, the commission may in principle review national tax laws and individual tax arrangements under EU state aid rules, although within the narrower limits drawn by Fiat Chrysler.

In this context, the commission will be able to establish unlawful state aid only if it can demonstrate that:

the parameters laid down by national law are manifestly inconsistent with the objective of nondiscriminatory 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.

Thus, member states must not establish manifestly discriminatory tax regimes, but can offer slightly more advantageous tax treatment to some companies. Although the distinction between these two situations is not necessarily easy to draw, the court's delineation may nonetheless protect some degree of competition among member states in the field of corporate taxation.

By setting limits to the commission's powers, the ECJ also implicitly offers member states guidance on how much room they continue to have when seeking to attract multinational corporations through favorable tax regimes.

Member states will be able to fine-tune their tax systems according to the findings of the ECJ to offer potential tax incentives to multinational companies without running afoul of EU state aid rules. More specifically, member states will be allowed to foster fiscal arbitrage by determining which methodologies they wish to incorporate into national law for the purposes of assessing whether intragroup transactions comply with the arm's length principle.

Implications Beyond EU State Aid Law

Fiat Chrysler has important implications beyond EU state aid law. The ECJ's clear and firm position should apply to the commission's ubiquitous pursuit of fairness not only in state aid matters, but more generally in all competition law matters.

For a while now, the competition commissioner has promoted fairness as one of her guiding principles in competition cases. The ECJ made clear, however, that fairness objectives cannot extend the boundaries of EU law. This suggests that competition law compliant conduct cannot become unlawful simply because it violates the commission's vaguely defined fairness goals.

Fairness therefore can be seen as political rhetoric, but it is not an operational principle in competition cases.

Fiat Chrysler could also affect the commission's powers under EU's recently adopted regulation[7] on foreign subsidies distorting the internal market. The Foreign Subsidy Regulation's definition of a financial contribution that could constitute a distorting subsidy is grounded in both EU state aid law and international trade law instruments.

Considering that the FSR's main objective of leveling the playing field between EU-based companies and those based in third countries, it would appear compelling that third country tax measures that do not constitute unlawful state aid under EU law — such as the tax measures examined in Fiat Chrysler — cannot be considered a distortive foreign subsidy under the FSR either.

Advance tax rulings by third countries that are designed to offer an attractive tax regime for multinational corporations should therefore fall outside the scope of the FSR and escape future commission investigations, provided they remain within the limits set forth in Fiat Chrysler.

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[1] https://curia.europa.eu/juris/document/document.jsf?text=&docid=267888&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=769.

[2] C-885/19 P and C-898/19 P.

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D2326&from=en.

[4] Judgment of 24 September 2019, Cases T-755/15 and T-759/15, Luxembourg v Commission, EU:T:2019:670.

[5] See, for instance, judgments of 12 May 2021, Joined Cases T-816/17 and T-318/18, Luxembourg v Commission¸ EU:T:2021:252; of 24 September 2019, Joined Cases T-760/15 and T-636/16, Netherlands v Commission, EU:T:2019:669; and of 15 July 2020, Joined Cases T-778/16 and T-892/16, Ireland v Commission, EU:T:2020:338.

[6] In individual tax ruling cases, the boundaries between the two concepts of "selectivity" and "advantage" tend to be blurred, and they are therefore generally analyzed together.

[7] https://www.europarl.europa.eu/RegData/seance_pleniere/textes_adoptes/definitif/2022/11-10/0379/P9_TA(2022)0379_EN.pdf.