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A Method inside the Madness: Understanding the European Union State Aid and Taxation Rulings

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Abstract

International headlines have been consumed with the proliferation of international tax havens and "sweetheart deals" given to multinational companies with the hopes that they would invest in a given country. In response to such concerns, the E.U. Commission has issued a spate of decisions in which it concludes that certain taxation rulings given by State Members to international corporations constitute illegal state aid. These decisions have both befuddled and outraged various parties in the international community, including states and multinational corporations, who claim that the Commission is acting both unilaterally and without precedent. This Comment surveys the applicable case law and analyzes in detail the rationale behind the Commission's decisions in order to uncover some of the fundamental principles driving the E.U.'s executive body.

This Comment reaches a number of conclusions. One, "selectivity" and "advantage" applied by the Commission in determining the existence of state aid is a purposeful conflation by the Commission rather than a brash departure from earlier precedent. The Commission's rulings also reveal the importance of both the reference system and the use of treaties in purposefully framing any tax rulings that a multinational may receive. Finally, the use of generalized and individualized schemes will have vastly different consequences, given that these two groups of measures are analyzed very differently by the Commission. Case law will also reveal significant flaws in the Commission's decisions, including the fact that the Commission has applied these terms inconsistently. Additionally, the Commission retains significant power to rule arguendo that a measure has the potential to distort competition and affect intra-state trade. The preceding considerations are important, as they ultimately affect the ex ante planning considerations of the multinationals and states involved. In the era of higher, more rigorous tax scrutiny, multinational corporations and Member States must be more purposeful and vigilant in planning.

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I. INTRODUCTION

At the end of August 2016, headlines hit the news that the E.U. would charge Apple $14.6 billion dollars in unpaid taxes, payable to Ireland.[1] Apple argued that the Commission's tax ruling "upended the international tax system and would damage jobs and investment in Europe."[2] The U.S. chimed in, arguing that the ruling would erode foreign investment, the European business climate, and, ultimately, economic partnership between the U.S. and the E.U.[3] In the eyes of the Obama Administration, the decision essentially amounted to theft, by the E.U., of revenue from U.S. taxpayers.[4] In its official response, the U.S. Treasury published a white paper outlining various objections, including concerns that the E.U. Commission's approach was new (departing from prior E.U. case law), that retroactive recoveries defied legitimate expectations on the part of both State Members and multinational companies, and that this novel approach was inconsistent with international norms.[5]

The recovery at issue was associated with a negative decision by the Commission concerning a reduction of Apple's tax base within Ireland, meaning the Commission found the reduction to constitute illegal state aid.[6] In a set of decisions, the E.U. similarly probed the tax arrangements of both Amazon and Fiat in Luxembourg and Starbucks in the Netherlands over concerns that these E.U. Member States were acting as tax havens to attract multinational companies, including, in many cases, those from the U.S.[7] The principal motivation behind these investigations was not only to achieve the common state aid goal of creating a fair marketplace for corporations in the E.U., but also to avoid the creation of international tax havens.[8]

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1 *See* Ivana Kottasova, *E.U. Hits Apple with $14.6 Billion Tax Bill,* CNN MONEY (Aug. 30, 2016) https://perma.cc/TWW5-BCQD.

2 *Id.*

3 *Id.*

4 *Id.*

5 *See* Jethro Mullen, *U.S. Warns E.U.: Don't Hit Apple with a Massive Tax Bill*, CNN MONEY (Aug. 25, 2016) https://perma.cc/23BD-F7J2 (referencing U.S. DEP'T OF THE TREASURY, THE EUROPEAN COMMISSION'S RECENT STATE AID INVESTIGATIONS OF TRANSFER PRICING RULINGS (2016)) (arguing that the decisions go against precedent and undermine international norms, and that the retroactive recoveries should not occur).

6 *See* Kottasova, *supra* note 1.

7 *See* Mullen, *supra* note 5.

8 *See* Nicholas J. DeNovio, Elisabetta Righini, & Nicolle Nonken Gibbs, *State Aid: What It is, and How It May Affect Multinationals and Tax Departments*, TAX EXECUTIVE, Apr. 6, 2016, https://perma.cc/2T8X-AREV.

In the *Apple* case, the company paid tax at 1 percent or less on profits attributed to subsidiaries in Ireland, a number well below the 35 percent top corporate tax rate in the U.S. and Ireland's own corporate tax rate of 12.5 percent.[9] Such a favorable tax rate prompted concern from European lawmakers, [10] which in turn led to retorts due to U.S. outrage against the aforementioned decision. In the Commission's view, investigations into "sweetheart deals" such as those between Apple and Ireland are not aimed at stealing U.S. tax revenue, but rather at ensuring that E.U. law applies fairly to every company with headquarters or subsidiaries in Europe.[11] Consequently, these decisions concern both international tax issues and state aid law within the E.U.[12]

On December 19, 2016, Apple appealed the decision that illegal state aid was given to the company and its subsidiaries.[13] "State aid," as defined by the Commission, consists of an advantage granted in any form whatsoever on a selective basis by a Member State to an economic actor.[14] It is illegal primarily because it distorts competition between E.U. Member States.[15] In its appeal, Apple charged that the E.U. acted unilaterally and changed the rules retroactively, alleging that there was a predetermined outcome since the start of the case.[16] Ireland also filed its own appeal, claiming that the E.U. "overstepped its powers by trying to rewrite Irish tax law."[17] Additionally, Ireland claimed in its appeal that the E.U. committed a grave error in misinterpreting Irish law, contending that its tax rules were within the reference system of the Irish tax code, following a portion stating that "nonresident companies shouldn't pay income tax on profit that isn't generated in Ireland."[18] At the heart of these claims are charges that the Commission meddled in Ireland's sovereignty to set its own tax code and laws.[19] The Commission answered that neither a consistent nor objective criteria was

9 *See* Kottasova, *supra* note 1.

10 *Id.*

11 *See* Mullen, *supra* note 5.

12 *See, for example*, Phedon Nicolaides, *Grant Versus Fiscal Aid: In Search of Economic Rationality*, 2015 EUR. ST. AID L.Q. 410, 416 (arguing that fiscal aid may induce companies to invest in countries that grant it).

13 *See* Brett Molina, *Apple Appeals E.U.'s $14B Ruling on Irish Taxes*, USA TODAY (Dec. 19, 2016) https://perma.cc/9K2Y-X3B6; *see also* John Kennedy, *European Commission Full Ruling: Claims Ireland Gave Apple Illegal State Aid*, SILICON REPUBLIC (Dec. 20, 2016) https://perma.cc/26RX-ECVC.

14 EUROPEAN COMM'N, *State Aid Control* (Sept. 9, 2016) https://perma.cc/ZXD5-GWJH.

15 *Id.*

16 *See* Sam Schechner, *Apple Hits Back Over E.U. Irish-Tax Decision*, WALL ST. J. (Dec. 19, 2016) https://perma.cc/UT38-JSBD.

17 *Id.*

18 *Id.*

19 *See* Mullen, *supra* note 5.

applied in determining the profit allocation to Apple's Irish branches.[20] What this dispute ultimately made clear is that it is impossible to forecast how E.U. courts "will rule in an area that has not been tested before."[21]

As further rulings are handed down, tax professionals, attorneys, multinational corporations, and E.U. Member States will try to decipher the decisions to determine what kinds of tax benefits they can hope to give and receive and what kinds they cannot. For many of these interested parties, billions of dollars, as well as entire national economies, are at stake in every E.U. Commission ruling.[22] The discrepancies between various E.U. Commission Rulings and the differences in local tax rulings will continue to impact companies' decisions regarding whether or not to place their subsidiaries in the E.U. for tax purposes. Finding clarity and predictability in the Commission's decisions will have wide-ranging effects, including implications for available tax revenue in the U.S. and Europe, increased certainty for international businesses, and the raising of broader questions of retroactivity and tax avoidance.

Using the *Apple* case as an anchor, this Comment aims to find some distinguishing characteristics between those instances where the Commission has found a taxation agreement by a Member State and corporation to be state aid, and those where it has not. Ultimately, it will discern a working principle distinguishing state aid from non-state aid outcomes, with the aim of predicting the outcomes of future cases and aiding multinational corporations in structuring their businesses.

The aim of this Comment is to analyze the entirety of case law surrounding taxation and state aid to develop a working understanding of the principles and concepts applied by the Commission in its decision. By identifying trends in the rulings on various taxation benefits, this Comment will reveal a number of key rules that the Commission employs when reaching its decisions.

Section II of this Comment briefly discusses the concept of state aid as it has been applied to taxation and transfer pricing arrangements. It then analyzes both the facts behind and rationale given in the group of recent decisions regarding Amazon, Apple, Fiat, and Starbucks. Section III outlines the various rules applied by the E.U. Commission in the decisions concerning taxation and state aid law. Section IV analyzes the history of decisions handed down by the Commission with regard to state aid and taxation, pulling out various trends that indirectly articulate the principles being applied. Section V concludes by addressing normative aspects of the Commission decisions and policy

20 *See* Kennedy, *supra* note 13.

21 *See, for example*, Julia Fioretti, *Apple Appeals Against E.U. Tax Ruling, Brussels Says No Cause for Low Tax Bill*, REUTERS (Dec. 19, 2016) https://perma.cc/GR6G-NVKX.

22 U.S. DEPARTMENT OF THE TREASURY, *The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings* 22 (2016).

considerations for multinational corporations and E.U. Member States moving forward.

II. BACKGROUND

The aggressive application of tax rulings to E.U. state aid law presents uncharted waters for lawyers, tax planners, and multinational corporations.[23] To fully understand the arc of the case law on this issue, it is important to first review the concept of "state aid" and its relatively new application to the realm of tax law. As will be outlined below, state aid law is geared towards a variety of measures, and is typically applied to "positive" forms of aid such as subsidies or aid granted to certain industries or corporations.[24] Section II first explains the concept of state aid and how the regime is applied to tax rulings by Member States. It then uses the *Apple* case as an example of the regime as applied to a specific tax ruling, and further discusses the controversy surrounding the decision as a staging area for determining the principles behind the controversial decisions.

A. The Concept of State Aid and Taxation

The European Commission is in charge of ensuring that companies operating within Member States do not gain unfair advantage over competitors through government support.[25] This advantage can be granted in any form whatsoever, conferred on a selective basis, and is known as "state aid."[26] In order to qualify as state aid, a measure must typically have four features. It must (1) be an "intervention by the State or through State resources,"[27] (2) give the "recipient an advantage on a selective basis," (3) distort competition, and (4) be capable of affecting trade between Member States.[28] Even if some aid meets the four features, a number of exemptions exist and may be invoked as long as they fit within the policy objectives of the E.U.[29]

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23 *See* DeNovio et al., *supra* note 8.

24 *Id.*

25 *See State Aid Control*, *supra* note 14.

26 *Id.*

27 This factor will nearly always be met in tax cases because the European Commission stated that "a loss of tax revenue is equivalent to a consumption of State resources in the form of fiscal expenditure." Commission Notice 98/C, 1998 O.J. 384/0 § 10, https://perma.cc/TME6-6NL4.

28 *Id.* at §§ 9–12. For an explanation of how these factors are specifically applied to tax measures, see generally *id.*

29 *Id.*

The E.U. requires that any new aid measures be reported to the Commission, which triggers a preliminary investigation.[30] If the Commission finds that aid has been misused, it can open a formal investigation procedure. If a new aid measure is not reported, an investigation can also arise from a third-party complaint or through the Commission's own initiative.[31] Typically, the Commission has challenged specific tax rulings as opposed to tax regimes generally, although there is one case where the latter has been investigated.[32] There are three possible outcomes at the end of a formal investigation: a positive decision (no aid, or aid is compatible with internal market), a conditional decision (compatible aid subject to conditions in report), or a negative decision (the measure is incompatible).[33] All decisions made by the Commission are subject to review by the General Court, and if appealed, the European Court of Justice (ECJ).[34] The typical case of state aid involves direct grants or subsidies that must be examined in light of the factors mentioned above. However, indirect measures, such as relief from tax burdens or a reduction of the tax base, can also be considered state aid.[35]

With regards to taxation,[36] the intersection of tax law and state aid law in the E.U. contains no parallels in domestic U.S. law, making these cases troublesome for both U.S. tax practitioners and corporations.[37] The concept of state aid rules as applied to tax law relies on the theory that a decreased amount of owed tax could "constitute an impermissible advantage provided by an E.U. member state to a beneficiary."[38] The Commission's increased use of state aid law to challenge individual E.U. Member State tax rulings arose directly after the Great Recession.[39]

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30 European Commission, *State Aid Procedures* (May 29, 2015) https://perma.cc/655N-YZV4.

31 *See* DeNovio et al., *supra* note 8 (There are many cases where the member state has not notified the Commission of their tax rulings or tax regimes due to the simple fact that these E.U. countries have "not generally contemplated the possibility that individual rulings or ruling systems would constitute state aid.").

32 *Id.* (The Belgian "excess profit" ruling system is the only regime that has been challenged.).

33 *See State Aid Procedures*, *supra* note 30.

34 *Id.*

35 *See State Aid Control*, *supra* note 14.

36 For a history of the evolution of state aid and its eventual application to harmful tax practices, see Edoardo Traversa & Alessandra Flamini, *Fighting Harmful Tax Competition Through E.U. State Aid Law: Will the Hardening of Soft Law Suffice?*, 2015 EUR ST. AID L.Q. 323 (arguing that the use of state aid in tax cases has evolved in the face of pressure to combat tax avoidance and the constraints on the rules that would traditionally be used to do so).

37 *See* DeNovio et al., *supra* note 8.

38 *Id.*

39 *Id.* ("[I]n a period of tight public budgets and sluggish growth, the E.C. considered its two options to attempt to reduce the effects of a lack of unified tax treatment of company profits throughout the E.U.: tax harmonizing legislation (which requires unanimity by the EC and thus is very difficult to reach) or state aid control (for which the EC has exclusive competence).").

Chief among the Commission's concerns were aggressive tax planning measures by member states and the misuse of international tax treaties to proactively justify double non-taxation rather than avoid double taxation.[40]

In "transfer pricing" tax relief cases, such as the *Apple* case, state aid comes in the form of tax rulings, which are comfort letters issued by national tax authorities to give a company more specific information on how its corporate tax will be calculated.[41] Specifically, the Member States issue advanced price agreements to the multinational companies in question. These price agreements set the prices between subsidiaries engaged in transactions for purposes of calculating the company's taxable base.[42] In the *Apple* case and others dealing with "transfer pricing," the Commission found that the Member States endorsed "artificial and complex methods" in their advanced pricing agreements to create favorable taxable profits that attracted and kept multinational corporations.[43] Rather than reflecting market prices (i.e. economic reality), the transfer prices set between subsidiaries reduced their tax burden, which ultimately conferred an advantage to their parent companies.[44]

The Organization for Economic Co-operation and Development (OECD) Guidelines are the method used by the Commission to determine an arm's length price that prudent independent operators would accept. Typically, advanced pricing agreements (APAs) not falling within the Guidelines are considered distorted, and therefore illegal state aid.[45] Even those that do fall within accepted methodologies for determining APAs may be considered illegal state aid if they confer a selective advantage to the corporations involved.[46] E.U. Commission investigations on tax rulings have ruled favorably on metrics other than market

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40 *Id.*

41 European Commission Press Release, IP/15/5880, Commission Decides Selective Tax Advantages for Fiat in Luxembourg and Starbucks in The Netherlands are Illegal Under E.U. State Aid Rules (Oct. 21, 2015), https://perma.cc/EN42-DJF2.

42 *Id.*

43 *Id.*

44 *Id.*

45 *See* Org. for Econ. Co-operation and Dev. [OECD], *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2010) at 32, https://perma.cc/P6MH-AAZ6 [hereinafter OECD Transfer Pricing Guidelines].

46 For example, in the *Apple* ruling, the court determined that even though the method used to determine taxable profits followed an OECD-approved formula, neither Irish Revenue nor Apple provided sufficient justification for the decision. European Commission, Ireland and Alleged Aid to Apple, SA.38373 (2014/C).

price,[47] have given special designation for uses of certain products,[48] and have allowed special circumstances for certain corporations.[49] These considerations demonstrate the seeming unpredictability for when the Commission will determine whether a ruling contains advantage or selectivity. Meanwhile, the Commission continues to pursue its inquiry into the tax ruling practices of all E.U. Member States.[50]

While not every tax ruling involves APAs, these cases present significant challenges to the parties involved in Member State tax rulings. Whether it is APAs, an exemption from a certain amount of corporate taxes for a coordination center in an E.U. country, or a tax deduction granted to players in a specific industry, the terms of the ruling may have been hammered out between the State and the multinational corporation years or decades prior to an ECJ ruling.[51] Consequently, a multinational corporation may have determined its further tax planning using the tax ruling as a basis.[52] The Commission's actions, therefore, have retroactive consequences for these corporations "beyond anything a taxpayer might have considered possible under the typical challenges."[53] Ultimately, these ramifications make a clear understanding of the Commission's motivations that much more important.

B. The *Apple* Decision

1. The contested decision.

a) Facts.

The *Apple* decision concerned the tax treatment in Ireland of two companies, Apple Operations Europe (AOE) and Apple Sales International (ASI), incorporated in Ireland but not tax residents there under Irish rules defining residence.[54] Apple used these Irish non-resident entities to achieve U.S. tax

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47 European Commission Press Release IP/16/2683, State Aid: Commission Authorises Alternative Income Tax Regime for Wholesale Diamond Sector in Belgium (July 29, 2016), https://perma.cc/ZD94-AFA9.

48 Commission Notice, 2015 O.J. (C44/02), https://perma.cc/2VQ8-LNKB.

49 Commission Notice, 2016 O.J. C 25/02, https://perma.cc/Q6NJ-LGWZ.

50 *See State Aid Procedures*, *supra* note 30.

51 *See* DeNovio et al., *supra* note 8.

52 *Id.*

53 *Id.*

54 *See* Romero J.S. Tavares, Bret N. Bogenschneider, & Marta Pankiv, *The Intersection of E.U. State Aid and U.S. Tax Deferral: A Spectacle of Fireworks, Smoke, and Mirrors*, 19 FLA. TAX REV. 121, 150 (2016). (While the legal entities at issue were formed under Irish corporate law, they were not "managed and controlled" from within Ireland.).

deferral. These entities own valuable intangibles developed in the U.S., hold substantial amounts of capital, and bear significant risks associated with Apple's European value chain.[55] The Commission alleged that both of these branches benefited from unlawful state aid.[56] At issue was the fact that Apple's extremely valuable intellectual property was, for determining taxable profit, not attributed to any of the Irish operating branches.[57] At the same time, both AOE and ASI benefited from such intellectual property in the conduct of their operations.[58]

AOE and ASI are 100 percent subsidiaries of Apple Operations International, an entity that is also incorporated in Ireland but not a taxable resident.[59] Both AOE and ASI are parties to a research and development sharing agreement with other Apple subsidiaries worldwide.[60] All of the parties to this R&D agreement pool the costs of the group's worldwide R&D.[61]

b) The Contested Measure.

In 1991, a basis for determining AOE's Irish branch net profit was proposed by Apple and agreed to by Irish Revenue (Revenue).[62] According to that ruling, the net profit attributed to the AOE branch would be calculated as 65 percent of operating expenses up to an annual cap of between $60 and $70 million USD, and 20 percent of operating expenses for any amount in excess of the $60–$70 million USD range.[63] AOE's agreement was also subject to a provision that if the overall profit from the Irish operations under Apple Operations International was less than the figure resulting from the agreed upon formula, the lower figure would be used for determining taxable net profits. The ASI branch, on the other hand, would be considered to have a net profit of 12.5 percent of all of that branch's operating cost.[64]

In 2007, Apple and Revenue drafted a revised agreement for determining the taxable profits for both AOE and ASI. It was agreed that AOE would have a 10–15 percent margin on branch operating costs, excluding any costs attributable to any branch outside of Ireland, and a taxable intellectual property return of 1–5

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55 *Id.* at 130.

56 *Id.* at 150.

57 *Id.* at 151.

58 *Id.* at 133.

59 *See Ireland and Alleged Aid to Apple*, *supra* note 46, at recital 47.

60 *Id.* at recitals 118, 120–121.

61 *Id.* at recital 121.

62 *Id.* at recital 61.

63 *Id.*

64 *Id.* at recital 59.

percent.[65] For ASI, the basis for determining taxable net profit was modified in that same year with a 10–15 percent margin on any branch operating costs (except those attributed to a different branch).[66]

A major issue for both the 1991 and 2007 agreements between Apple and Revenue was the method used to determine the taxable profit. Revenue asked Apple to state if there was any basis for the figure determined, and the corporation stated there was no "scientific basis . . . however the figure was of such a magnitude that [Apple] hoped that it would be seen to be a bona-fide proposal."[67] None of the documents provided by Apple and Revenue to the European Commission provided any explanation for the figures regarding the 2007 ruling, nor did they provide a transfer pricing report or cost sharing agreement.[68] Consequently, the Commission decided to launch an investigation to determine whether the agreement constituted illegal state aid.

c) The Ruling.

The court ultimately determined that the 1991 ruling was "negotiated" rather than properly substantiated by comparable transactions as if the subsidiaries in question were independent operators (and thus purchasing the rights to intellectual property on the open market).[69] As for the 2007 agreement, the transfer pricing method was in effect one of the arm's-length principle pricing methods known as the "transactional net margin method" (TNMM).[70] In this specific case, the net profit indicator used for the TNMM method was operating costs.[71] However, neither Apple nor Revenue offered a rationale for the choice of that particular net profit indicator. Ultimately, the determination that the agreements at hand were either negotiated or used methods lacking proper rationale led to a determination of state aid.

When evaluating whether a given agreement constitutes state aid, the Commission relies on the test articulated in Article 107(1) of the Treaty on the Functioning of the European Union. In order to determine that the agreements in 1991 and 2007 constituted state aid, the Commission applied the test, determining whether (1) the measure was approved by Ireland and financed through its funds; (2) the measure conferred an advantage on Apple; (3) the advantage was selective; and (4) the measure had a distortive or potentially

65 *Id.* at recital 62.

66 *Id.* at recital 60.

67 *Id.* at recital 64.

68 *Id.* at recitals 67–68.

69 *Id.* at recital 147.

70 *Id.* at recitals 92–93. *See* Section III.B, *infra.*

71 *Id.* at recitals 93–94.

distortive effect on competition and trade between E.U. Member States.[72] With respect to the first prong, the Commission determined that the measure was obviously imputed by and financed through Ireland, since lowering Apple's tax liability directly resulted in a loss to Ireland's resources through taxation.[73] The Commission quickly brushed through the fourth prong, assuming without argument that because Apple is "globally active" and operates in multiple Member States, any aid in its favor could have the potential to distort competition among Member States and negatively affect intra-Union trade.[74]

In reaching its decision, the Commission spent the majority of its time on prongs (2) and (3). It collapsed these prongs into one test of "selective advantage" (ordinarily, to determine whether a given measure confers an advantage on a taxable entity, a court must compare the taxable method or regime to the ordinary or "reference" tax system).[75] When the substance of a given ruling concerns transfer-pricing arrangements between subsidiaries of a multinational corporation, that ruling should not be materially different from one concerning two independent operators acting under "normal market conditions."[76] Using the rationale outlined above, the court concluded that the arrangement here was negotiated in 1991 and unsubstantiated by proper rationale in 2007. Because of the very nature of the measure (the fact that it was a negotiated practice deviating from the arm's-length principle), the Commission presumed it was selective.[77]

2. Reactions to the decisions.

In a reaction to the *Apple* decision and other cases against companies including Fiat, Starbucks, and Amazon, the U.S. Department of the Treasury authored a white paper criticizing the E.U.'s decisions and methodologies.[78] In that paper, the U.S. Treasury argued that the Commission's approach departed from prior E.U. case law, wrongly authorized retroactive recoveries, and would undermine the international tax system.[79] With regard to the first allegation—that the approach departed from prior E.U. case law—the Treasury Department

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72 *Id.* at sections 8.1–8.4.

73 *Id.*

74 *Id.* at recital 222.

75 *Id.* at section 8.2.

76 *Id.* at recital 150.

77 *Id.*

78 *See* WHITE PAPER, *supra* note 22, at 1 (arguing that the decisions go against precedent and undermine international norms, and that the retroactive recoveries should not occur). For another example of a work criticizing the decisions for going against precedent and ignoring bilateral treaties, see Lowell D. Yoder, *The Disturbing E.U. State Aid Proceedings*, 42 INT'L TAX J. 3 (2016).

79 *See* WHITE PAPER, *supra* note 22 at 1.

alleged that the Commission "collapsed the concept of 'advantage' and 'selectivity,'" which previously had been two separate tests under E.U. state aid law.[80] This collapsing was particularly troubling because it was an abrupt departure from the status quo by reducing the number of factors necessary for a finding of state aid from four to three.[81] The white paper also argued that any economic advantage given to a multinational corporation would be presumed to be selective, unlike a standalone corporation.[82]

The Treasury Department maintained their second allegation—that the Commission wrongly authorized retroactive recoveries—because the approach in the recent cases was "new and was not foreseeable by the relevant companies," and thus, any recovery of tax unpaid in the past would be retroactive and a novel approach to state aid.[83] Furthermore, the white paper argues that these retroactive recoveries are inconsistent with the legal principles of the E.U.[84] Finally, the white paper asserts that the E.U.'s approach in newer state aid cases departs from international norms because the "arm's length principle" undermines the global consensus on transfer pricing standards and prevents Member States from fulfilling the conditions of their bilateral tax treaties.[85]

Academics and tax professionals have also responded to the newer collection of E.U. Commission decisions concerning taxation and state aid. Scholars have argued that the state aid reviews of advanced pricing agreements create legal uncertainty for a significant number of tax assessments, and that a new procedural framework is required to provide for more legal certainty.[86] Other professionals argue that, while the results may not be uncertain, they are unsatisfactory and for that reason conceptual reform is necessary.[87] Additionally, some professionals think that the recent decisions are so controversial that the important task of international tax reform should be pursued through other means.[88] However, there has yet to be a systematic overview of the facts and rules applied to the various state aid cases concerning taxation. The next two Sections aim to provide

80 *Id.* at 6.

81 *Id.*

82 *Id.*

83 *Id.* at 14.

84 *Id.*

85 *Id.* at 17.

86 *See, for example*, Pierpaolo Rossi-Maccanico, *A New Framework for State Aid Review of Tax Rulings,* 2015 EUR. ST. AID L.Q. 371 (arguing that the Commission should adopt a new framework specifically to fulfill their obligation of advance notification).

87 *See, for example*, Georgios Matsos, *Systematic Misconceptions of State Aid Law in the Area of Taxation: Principles for Conceptual Reform*, 2014 EUR. ST. AID L.Q. 491 (2014).

88 *See, for example*, Elizabeth A. Jone, *State Aid in the E.U. Through Tax Rulings and Transfer Pricing*, Seton Hall Law School Student Scholarship (2016) https://perma.cc/5X4P-57KE.

clarity by outlining the rules applied in cases such as *Apple* and proposing a coherent methodology used in the case law.

III. Rules Applied by the European Commission in Taxation and State Aid Rulings

While the rules applied by the Commission in analyzing Member State tax rulings are few in number, they provide the main framework for determining whether illegal state aid exists. Article 107 of the Treaty on the Functioning of the European Union (TFEU), the primary source of law in these contested decisions, contains a four-prong test to help courts analyze the rulings at issue. As will be outlined in this section, the application of the TFEU to the fact-specific circumstances of a given ruling is far more important than the test itself in the abstract. TFEU has provided a flexible mechanism for analyzing a diverse range of government aid. Section III.A provides a framework for analyzing the case law by outlining the factors of the test as applied to taxation. Section III.B describes the applicable rules for determining the proper reference transactions for cases involving transfer-pricing rulings for subsidiaries.

A. Article 107 of the Treaty on the Functioning of the European Union (TFEU)

The TFEU contains the main test used to determine whether a measure constitutes illegal state aid.[89] Forming the detailed basis of E.U. law, the TFEU sets out the scope of the E.U.'s legal authority and the legal principles where the E.U.'s authority applies (all E.U. Member States are signatories to the TFEU).[90] Whereas Article 9 of the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines are non-binding instruments, the TFEU is binding on Member States.[91] Additionally, their national tax rules are not excluded from the scope of the TFEU.[92] The TFEU constitutes the rules used by the Commission to analyze tax rulings and state aid concerns, and consequently serves as a critical starting point for analyzing decisions such as *Apple*.

Article 107 of the TFEU (formerly Article 87 of the Treaty Establishing the European Community) covers "aid granted by states."[93] As previously discussed,

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89 Consolidated Version of the Treaty on the Functioning of the European Union, Art. 107, 2008 O.J. C 115/47 at 91–2 [hereinafter TFEU], https://perma.cc/WT9X-JPDL.

90 *See id.* at arts. 1–2.

91 *See* European Commission, *Excess Profit Exemption in Belgium: Letter to Member State*, 2016 O.J. (L 260), at recital 47.

92 *Id.*

93 *See* Matsos, *supra* note 87, at 493 (citing Article 107 et seq. TFEU).

Article 107(1) outlines the four-part test historically used by the Commission to determine the existence of state aid, namely, whether the aid is imputed and paid for by the State, whether it threatens or indeed does distort competition and affect trade between Member States, and whether it is selective and confers an advantage on the recipient.[94] Additionally, subsections (2) and (3) of the TFEU cover additional factors that, when present, either *ensure* or *may* make aid compatible with the internal market, respectively.[95] Aid that has a "social character, granted to individual consumers," aid designed to repair damage from natural disasters, or aid specifically meant for "the economy of certain areas of . . . Germany affected by the division of Germany" ensure that the measure at issue is considered compatible with the internal market.[96] Additional factors that may push aid to be compatible with the internal market include promotion of economic development in depressed areas and promotion of "common European interest," among others.[97]

Specifically, with regards to taxation and state aid, Commission Notice 98/C 384/03 outlines the application of the factors under the TFEU Article 107(1) on taxation.[98] For the first prong (whether it is imputed and paid for by the state), a tax ruling can be considered granted by the State or through its resources if it entails a loss of tax revenues. This is because, according to the Commission, "a loss of tax revenue is equivalent to consumption of State resources in the form of fiscal expenditure."[99] The second prong, whether the ruling affects competition and trade between Member States, is met if the recipient of the tax ruling engages in an economic activity that deals with trade between Member States.[100] According to the Commission, the sole fact of strengthened activity relative to other economic competitors is enough to satisfy this prong, regardless of the size of the aid, the market share of the recipient, or whether the recipient exports.[101]

With regards to taxation, the third prong, "selectivity," may be satisfied through an exception to national tax provisions or through discretion on the part of the revenue administration. However, if this selectivity is justified by the nature of the reference system, it is not considered aid.[102] Lastly, the fourth prong, the

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94 *See* European Commission, *supra* note 91.

95 *Id.*

96 *Id.*

97 *Id.*

98 *See* Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation, 1998 O.J. (C384/03), https://perma.cc/5GAC-GGW6.

99 *Id.* at recital 10.

100 *Id.* at recital 11.

101 *Id.*

102 *Id.* at recital 12.

"advantage" factor, is provided through any reduction in a firm's tax burden, which can include reduction in tax base, amount of tax, or even a deferment of tax obligations.[103] Because prongs three and four are arguably the most important and most scrutinized of the EU tax provisions, it is critically important for Member States and multinationals to consider the scope and nature of their respective tax rulings.

B. Article 9 of the OECD Model Tax Convention & OECD Transfer Pricing Guidelines

Unlike Article 107(1) of the TFEU, Article 9 of the Organization for Economic Co-operation and Development (OECD) Model Tax Convention is non-binding on Member States, but does help guide the Commission when it rules on state aid investigations.[104] Article 9 essentially codifies the "arm's-length principle" for transfer-pricing specific state aid investigations.[105] Essentially, Article 9 recommends that in the case of transactions between two subsidiaries or conjoined enterprises, the taxing Member State should treat any profits which would have accrued had the two enterprises been independent operators as taxable income.[106] This principle attempts to mitigate the benefit that multinational companies receive from being taxed at a reduced rate on certain transactions between independent operators who conduct most, if not all, of their transactions in the open market.

The Commission also applies the OECD "Transfer Pricing Guidelines" when adjudicating cases involving transfer-pricing tax rulings.[107] Similar to the OECD Model Tax Convention, the Transfer Pricing Guidelines are non-binding. However, they also provide guidance to the Commission when determining whether the methodology used to determine the net profit of a multinational transfer pricing arrangement provides a "selective advantage."[108] By providing a set of acceptable transfer-pricing methods, the Guidelines help determine whether a given arrangement deviates from the net profit between independent operators,

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103 *Id.* at recital 9.

104 *See* Jone, *supra* note 88, at 1.

105 *See* OECD, *Articles of the Model Convention With Respect to Taxes on Income and Capital*, art. 9 (2003), https://perma.cc/S9Y3-YB86 [hereinafter OECD Model Tax Convention]; *see also* Tavares et al., *supra* note 54 at 172 ("Article 9 . . . aims to ensure that entities which enter into contracts within a corporate group establish conditions that do not differ from those of unrelated parties, in order to protect the relevant taxable base from a potentially distortive influence of the group relations.").

106 *See* OECD Model Tax Convention, *supra* note 105, at art. 9.

107 *See* OECD Transfer Pricing Guidelines, *supra* note 45.

108 *See* Consolidated Version of the Treaty on the Functioning of the European Union, *supra* note 89.

rather than associated enterprises.[109] These guidelines recognize five acceptable methods of determining net profits, three of which are regarded as "traditional" transaction methods and two of which are considered "transactional profit methods."[110] Traditional methods are used to compare the terms and conditions of transactions between subsidiaries of multinationals to those of similar standalone corporations, whereas the "transactional profit" method compares the profitability of the subsidiary at issue with similar subsidiaries or independent operators.[111]

As stated earlier, the Commission uses the guidelines when a reference tax system is required to determine the existence of a selective advantage for the subsidiary in question. The three traditional methods are the comparable uncontrolled price (CUP) method, the resale price method, and the cost-plus method. These methods use various metrics to compare the prices charged between the subsidiaries at issue and independent operators to determine deviations from calculations of net profits.[112] The two transactional profit methods include the TNMM method as well as the "transactional profit split" method, which compare profits between the reference system and the transfer price ruling in question.[113]

IV. UNDERSTANDING THE E.U. DECISIONS: DISTINGUISHING STATE AID FROM NON-STATE AID

In the following Section, this Comment will first use the rules previously discussed in concert with E.U. Commission case law to identify trends in Commission decisions. Using these trends, this Comment will develop policy and planning considerations for both Member States and multinational corporations. Such considerations will aid in crafting national policy, making future business decisions, and clarifying the nature of tax rulings given by States to multinationals in the future.

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109 *See* Richard Lyal, *Transfer Pricing Rules and State Aid*, 38 FORDHAM INT'L L.J. 1017, 1022–23 (2015); *see also* James Kavanagh & Nicole Robins, *Corporate Tax Arrangements Under E.U. State Aid Scrutiny: The Application of the Market Economy Operator Principle*, 2015 EUR. ST. AID L.Q. 358 (arguing that recent decisions show that conformity with the OECD Transfer Pricing Guidelines is not necessarily sufficient to demonstrate compliance with the arm's length principle. Recent cases have demonstrated that the Commission retains a clear preference for the Comparable Uncontrolled Price (CUP) method, a form of a "traditional" method).

110 *See* Lyal, *supra* note 109, at 1021.

111 *See* Kavanagh & Robins, *supra* note 109, at 361–62.

112 *See* OECD Model Tax Convention, *supra* note 105.

113 *Id.*

A. Case Analysis

The case analysis in the following section will focus primarily on the four-prong test of Article 107(1) of TFEU. Because this test is the primary "rule" used to analyze tax rulings in case law, a separate analysis of each of the four factors will elucidate the Commission's motivations in declaring that a given tax ruling constitutes illegal state aid. Within the four-prong test, the following analysis will also focus on important considerations such as the reference regime used by the commission (whether it involves the Member State tax code or the OECD Guidelines) and whether the Commission truly collapses the notions of "advantage" and "selectivity," and if so, under what circumstances.

1. The measures must be imputable to the state and financed through state resources.

As stated above, when tax rulings come before the Commission, it is often assumed to be a *prima facie* fulfillment of the prong that the measure must be imputable to the State and financed through State resources.[114] Just because a measure lessens a burden on a corporation does not mean that it cannot be considered a "positive" form of aid. In Commission Notice 98/C 384/03, the E.U. executive body clarified its position on this prong as applied to taxation by stating that, "a loss of tax revenue is equivalent to consumption of State resources in the form of fiscal expenditure."[115] And this position is applied relatively uncontroversially in the case law.[116]

Once a disputed measure reaches the Commission, the Member State in question has already both provided such measure and indirectly financed it through its own resources. After all, any tax burden relieved by one Member State will mean that those resources will either be retained by the corporation through double non-taxation or acquired by another country, and hence constitutes a form

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114 *See, for example*, Commission Notice on the Application of the State Aid Rules, *supra* note 98; *see also* DeNovio et al., *supra* note 8.

115 *See* Commission Notice on the Application of the State Aid Rules, *supra* note 98. Furthermore, this position also applies to any aid granted through a lessening of tax burdens in local bodies inside of Member States and State support through taxation can be provided "just as much through tax provisions of a legislative, regulatory, or administrative nature as through the practice of tax authorities."

116 *See, for example*, Ireland and Alleged Aid to Apple, *supra* note 46, at recital 221; *see also* Case C-46/01, France v. Comm'n. (Cent. Crp. Treasuries), 2002 E.C.R. II-330/23, at recital 28 (The Commission spends only two sentences analyzing the "state resources" prong: "Second, the advantage is granted through state resources. In the case at issue, the reduction in the tax base of central corporate treasuries established in France results in a loss of tax revenue constituting State resources."); *see also* European Commission v. Luxembourg (Fiat), 2014/C ex 2014/NN, [2015], E.C.R. at recital 188.

of aid granted from that particular State to the multinational corporation at issue. The use of state resources has been found in various kinds of tax measures, including deferrals of tax burdens, waiver of tax obligations, or a reduction of an entity's tax base, among others.[117] The use of state resources has also been consistently found in cases where state aid was ultimately not found.[118]

Because this factor of the Article 107(1) TFEU test is virtually always fulfilled in the case law, whether the financing was imputable to the State and financed through its resources often has little effect on the outcome of the case. Indeed, this factor has always been fulfilled, even in cases where the measure granting body was local rather than the national in its authority,[119] or when there was no ultimate decision of illegal state aid.[120] Therefore, this Comment will spend little time analyzing this point, as it will not be determinative.

2. The measure must confer an advantage on its recipient and the advantage must be selective.

The concepts of "advantage" and "selectivity" in state aid cases are deceptively simple. On the one hand, the basic question for the Commission is merely whether (1) a benefit of some kind was conferred on the recipient, and whether (2) that recipient alone or that recipient among a select class of taxpayers received that benefit which was denied to others. However, because the concepts have been hopelessly conflated by the Commission, sometimes admittedly, and sometimes not, understanding how the two operate in isolation can prove quite difficult. For example, when an individual taxpayer receives a benefit bestowed on it and it alone, that certainly constitutes both an advantage and a selective measure without further or separate analysis.[121] Additionally, just because a "selective

117 *See* Commission Notice 1998 O.J. (C384/03), *supra* note 98; *see also* Case C-15/14, Comm'n v. MOL Magyar Olaj-es Gazipari Nyrt, https://perma.cc/8S5G-94W2 (case concerning reduction of mining fees provided by Member State); *see also* Joined Cases 78 & 80/08, Paint Graphos v. Comm'n, 2011 E.C.R., https://perma.cc/64F8-QWEA (tax breaks provided for cooperative societies by member state); Case C-143/99, Adria-Wien Pipeline GmbH v. Comm'n, 2001 E.C.R. (government provided energy tax rebates); Case T-210/02, British Aggregates Assoc. v. Comm'n, 2006 E.C.R., https://perma.cc/2BKQ-ZTLY (corporation claimed state resources were used in scheme because they were subject to environmental tax whereas alleged competitors were not).

118 *See, for example*, MOL Magyar, *supra* note 117, at recitals 43–46. (Here, although an ultimate finding of state aid was negative, the court assumed the use of state resources to finance the measure without argument.)

119 *See* Case C-88/03, Portuguese Republic v. Comm'n, 2006 E.C.R.

120 *See MOL Magyar*, *supra* note 117.

121 *See, for example*, European Commission, *Procedures Relating to the Implementation of the Competition Policy: State Aid – Luxembourg*, 2016/C 258/03, [2015], E.C.R. ("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 the measure").

advantage" was bestowed upon a taxpayer does not necessarily mean that said taxpayer received illegal state aid. Cases abound where the taxpayer's selective benefit via reduced tax burden was justified by the "guiding principle of that [tax] system."[122] For these reasons, this Comment will analyze the two factors together, given how often they are conjoined in cases and how many of their factors coincide.

a) Case law definitions of "selective" and "advantage."

Whether the measure confers an advantage on the recipient corporation is one of the most important factors in determining whether illegal state aid is present. Without the presence of a real advantage, the tax benefits will not be substantial enough to affect intra-community trade and distort competition. Within the realm of taxation, advantages are not positive benefits but rather relief of tax burdens that are normally borne from the budget of the recipient.[123]

In the case law, "advantages" usually stem from either a regime that favors a certain kind of taxpayer, such as multinational corporations, or from a special deal that a single taxpayer receives that relieves that entity from charges normally taken from their budgets and still levied on other taxpayers in similar factual and legal circumstances. For example, in the case concerning an aid scheme implemented by Germany for control and coordination centers,[124] the advantage was found in the fact that the subsidiaries in question had their taxable profit determined not according to the normal method (difference between income and expenditure), but according to a cost-plus method.[125] Under the cost-plus method, the control and coordination centers apply to their costs a certain profit margin between 5 percent and 10 percent.[126] The advantage in this case arose because the

122 *See, for example*, Paint Graphos, *supra* note 117 (deciding that while granting favorable tax treatment to cooperative societies did constitute state aid compared to the normal tax treatment of corporations, it was necessary to determine whether this favorable treatment was justified by the general purposes of the Italian tax scheme given the differences between ordinary corporations and the way cooperative societies operate).

123 *See* European Commission Notice on the Application of the State Aid Rules, *supra* note 98 (an advantage may be provided through a reduction in tax base, an exemption from tax or tax credit, or even through a deferment of tax obligation/debt).

124 A case-specific definition of "control and coordination center" outlines a subsidiary whose activities include those to "service the needs of the group (e.g. accounting, consolidation reports, marketing, production plans and research coordination)." Commission Decision: On the Aid Scheme Implemented by Germany for Control and Coordination Centres, 2003/512/EC, [2002], E.C.R. at recital 7.

125 *Id.* at recital 8.

126 *Id.*

"limitation to 10% may artificially reduce the tax burden of control and coordination centers in cases where actual margins exceed 10%."[127]

Selectivity is also one of the most important considerations; an advantage conferred to every taxpayer would not be considered an illegal form of state aid. To determine whether a tax measure is selective, the Commission decisions typically divert in either one of two directions. As is evident from a review of the state aid case law applied to taxation, when the aid at issue does not involve a transfer pricing agreement between subsidiaries,[128] the courts will begin the "selectivity" analysis by identifying and examining the "common" regime, which is applicable in the subject Member State.[129] After determining the common regime, the court will then determine whether the measure at issue derogates from that common regime in such a way that it results in a substantial difference between "economic operators who are in comparable legal and factual situations."[130] On the other hand, cases dealing with transfer-price rulings, such as *Apple*, forgo the lengthy analysis in lieu of focusing more on the "advantage" prong, in many cases assuming a prima facie case for selectivity once the advantage is established.[131] The likely explanation for this divergence is that, because transfer pricing rulings comprise individual agreements between nations and companies, "selectivity" is a safe assumption without further analysis.

An example of the former can be seen in *Portuguese Republic v. European Union Commission*. The aid in that case comprised a reduction in the rates of personal income of 20 percent and a similar reduction in the corporate tax at a rate of 30 percent in the semi-autonomous Azores region of Portugal only.[132] While Portuguese national law authorized this reduction, it allowed regions like the Azores to overcome deficiencies due to their location in an isolated region of the country.[133] In determining whether this measure was selective, the Commission

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127 *Id.* at recital 22.

128 *See, for example*, Paint Graphos, *supra* note 117 (a case dealing with aid in the form of tax breaks for cooperative societies); *see also* Portuguese Republic, *supra* note 119 (a case dealing with aid in the form of a local semi-autonomous region granting lower tax rates than the national government); *see also* Case T-399/11, Banco Santander v. Comm'n, 2014 E.C.R. (a case dealing with aid in the form of provisions allowing corporations which are tax residents in Spain to amortize goodwill resulting from the acquisition of shareholdings in companies which are tax resident abroad).

129 *See* Paint Graphos, *supra* note 117, at recital 49.

130 *Id.*

131 *See, for example*, Ireland and Alleged Aid to Apple, *supra* note 46, at recital 381 (arguing that the deviation from OECD administrative practice leads to a presumption of selectivity); *see also* Commission Decision: On the Aid Scheme Implemented by Germany, *supra* note 124, at recital 32 (the fact that the regime at hand was limited to multinational companies renders it selective); Excess Profit Exemption in Belgium, *supra* note 91.

132 *See* Portuguese Republic, *supra* note 119, at recital 14.

133 *Id.*

first examined whether the "common regime" was the Azores region or the entirety of Portugal.[134] After analyzing a number of factors, the court determined that the relevant legal framework was in fact that of the nation of Portugal and in that context the measures were selective.[135]

For the purposes of selectivity, types of entities, rather than kinds of transactions, are considered to be selective. For example, the E.U. Commission has held that a measure applying solely to multinational groups,[136] large corporations,[137] and new listings on the market[138] are considered selective. Conversely, it has also held that a measure that discriminates between some forms of transactions over others cannot be held to be selective if all entities are able to enter into such transactions.[139]

b) Collapsing the line between "advantage" and "selectivity."

One of the biggest points of confusion that arises among scholars is the thin, often blurry, line between the concepts of advantage and selectivity.[140] As stated earlier, the U.S. Treasury Department's white paper contends that the Commission's approach in recent cases has collapsed the concepts of advantage and selectivity,[141] arguing that "a foundational principle of E.U. state aid law is that advantage and selectivity are distinct elements."[142] The Treasury Department maintained that the Commission departed from the separation of these two factors only at the advent of the *Apple* and *Amazon* cases, and that the executive body no longer uses this "decisive criterion" in their decisions.[143] A review of the case law demonstrates that not only is this view misguided, but it is also overly simplistic in its assessment of the Commission's application of these two factors.

There are in fact three separate approaches that have been utilized by the Commission in applying state aid to taxation measures. In some of the case law,

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134 *Id.* at 67–77.

135 *Id.* at 78.

136 *See* Excess Profit Exemption in Belgium, *supra* note 91, at recital 138.

137 *Id.* at recital 141.

138 *See* Case T-211/05, Italian Republic v. Comm'n, 2009 E.C.RII-02777 at recital 120, https://perma.cc/3URF-6UQZ.

139 *See, for example*, Banco Santander, *supra* note 128, at recitals 57–61 ("the measure at issue applies to all shareholdings of at least 5% in foreign companies which are held for uninterrupted period of at least one year. It is therefore aimed not at any particular category of undertakings or production, but at a category of economic transactions.").

140 *See, for example*, U.S. Department of Treasury, *supra* note 22.

141 *See id.* at 6.

142 *Id.*

143 *Id.* at 8.

the Commission dutifully separates the two.[144] In at least one case, the Commission notes the similarity between the two and advocates collapsing the concepts for cases involving individual aid (which is considered *prima facie* selective since it applies to one corporate entity and that corporate entity alone), while still maintaining a separate analysis in the case of general aid schemes.[145] Finally, some of the most recent case law utterly collapses the two.[146] The notion of how the courts apply the "selectivity" and "advantage" factors, and whether they are truly conflated, is of much debate.

Air Liquide Industries provides a good example of a case where the Commission dutifully separated the "advantage" and "selectivity" factors.[147] In this case, Air Liquide Industries, an industrial group specializing in gases, alleged that a Belgian tax regime was discriminatory because it had to be borne by undertakings producing and transporting industrial gas but not those doing the same for natural gas.[148] Here, the court separately determined that the measure granted an advantage because the exemption put some taxpayers in a more favorable position than others.[149] Next, the court determined that the measure was selective because the exemptions *only* applied to the natural gas sector.[150] Notably, all of the cases separating the two factors concern themselves with measures that are general regimes aimed at specific sectors rather than personal negotiations with individual taxpayers.[151]

In contrast, those cases that tend to collapse the "advantage" and "selectivity" factors concern measures that are, effectively or actually, individual "deals" rather than broad regimes aimed at a larger swathe of taxpayers.[152] As

144 *See, for example*, Commission Decision: On the Aid Scheme Implemented by Germany, *supra* note 124; *see also* Commission Decision: On the Aid Scheme Implemented by Belgium for Coordination Centres Established in Belgium, 2003/755/EC, [2003] E.C.R.

145 *See* MOL Magyar, *supra* note 117; *see also* European Commission, *supra* note 121.

146 *See* Ireland and Alleged Aid to Apple, *supra* note 46; *see also* Commission Decision on the Measure SA.14588 (C 20/09) Implemented by Belgium in Favour of De Post-La Poste, 2012321/E.U., [2012], E.C.R.

147 Joined Cases C-393/04 and C-41/05, Air Liquide Industries Belgium, 2006 E.C.R.

148 *Id.* at recitals 10–19.

149 *Id.* at 40.

150 *Id.* at 41.

151 *See, for example*, DeNovio et al., *supra* note 8; *see also* Commission Decision: On the Aid Scheme Implemented by Germany, *supra* note 124; Commission Decision: On the Aid Scheme Implemented by Spain in Favour of Coordination Centers in Vizcaya, 2003/81/EC, [2002], E.C.R.; Commission Decision: On the Aid Scheme Implemented by Belgium for Coordination Centres Established in Belgium, *supra* note 144 (concerning a scheme targeting coordination centers specifically).

152 *See, for example*, France v. Commission, *supra* note 116; *see also* Paint Graphos, *supra* note 117; Ireland and Alleged Aid to Apple, *supra* note 46; and In Favour of De Post-La Poste, *supra* note 146.

discussed earlier in this Comment, the *Apple* case and others concerning individual transfer price rulings often collapse the "selectivity" prong into the determination of an advantage.[153] However, this is not without good reason. There are a few cases in which the Commission explicitly holds that, while the notion of advantage and the notion of selectivity cannot be completely separated, they should be considered separately in some instances. For example, in *European Commission v. MOL Magyar Olaj-es Gazipiari Nyrt,* the Commission held that the selectivity prong plays a separate role when the measure is a "general scheme."[154] After all, separately knowing whether a general scheme is aimed at certain types of corporations, rather than all economic operators, is useful in the determination of illegal state aid. On the other hand, when the measure is "individual," the finding of an advantage is "in principle, sufficient to support the presumption that it is 'specific' and, therefore, the conclusion that it is also selective."[155]

Given this analysis, it makes quite a bit of sense that the Commission would separate the two factors in cases where the measure in question constitutes a "general scheme," whereas measures concerning individual negotiations would cause the E.U. body to collapse them. After all, it is not logical to analyze whether selectivity is present in an advantage aimed at only a single taxpayer. Such an analysis reveals that the Commission may not have been so inconsistent as the U.S. Treasury Department maintains.

c) The critical importance of the reference regime.

Another important concept related to the "selectivity" and "advantage" factors is the reference system used as an anchor point for the measure at issue. In the case of individualized transfer prices, the reference system will typically be "rolled" into the concept of advantage.[156] This follows logically, as in the case of individual negotiations the concept of advantage is analyzed more in-depth than selectivity. For these cases, the reference system used consists of the OECD Transfer Pricing Guidelines, which provide for far more discretion on the part of the Commission as opposed to the Member State's corporate tax system.[157] For regimes aimed at specific groups of taxpayers in a Member State, the reference

153 *See* Ireland and Alleged Aid to Apple, *supra* note 46, at recital 223–224; *see also* Commission Decision: On the Aid Scheme Implemented by Germany, *supra* note 124, at recital 32; Excess Profit Exemption in Belgium, *supra* note 91.

154 *See* MOL Magyar, *supra* note 117, at recital 52.

155 *Id.* at recital 51.

156 *See* Ireland and Alleged Aid to Apple, *supra* note 46; *see also* Commission Decision: On the Aid Scheme Implemented by Spain, *supra* note 151.

157 *See* Excess Profit Exemption in Belgium, *supra* note 91; *see also* Commission Decision: On the Aid Scheme Implemented by Germany, *supra* note 124.

system will typically be the corporate tax system itself.[158] While not always discussed in depth in the case law, the reference system can truly make or break a state aid case, because the larger the Commission tends to define the reference system, the more likely illegal state aid results.[159]

For example, in *Portuguese Republic v. European Commission,* the semi-autonomous Azores region had a special tax reduction that applied automatically to all economic operators, designed to support undertakings in overcoming barriers resulting from the isolation of said region.[160] In order to determine whether the measure was selective, the Commission set about determining whether the Azores itself or Portugal should provide the reference system, stating, "it is possible that an infra-State body enjoys a . . . status which makes it sufficiently autonomous . . . with the result that, by the measure it adopts, it is that body . . . that constitutes the relevant context."[161] Because ultimately the Azores was not autonomous enough (given that it did not have sufficient power to reduce its tax rates independently of the Portuguese government), the measure was considered selective against the national tax system as a reference.[162] On the other hand, in *Government of Gibraltar v. Commission of the European Communities*, a tax reform in Gibraltar established to lower corporate tax rates was determined *not* to be illegal state aid, chiefly because Gibraltar was the reference system and not the U.K.[163] Because the reference system for material selectivity constituted solely Gibraltar and not the remainder of the U.K., the measure was seen not to favor any specific undertakings or regions.[164]

Additionally, even when the geographic scope of the reference system is not at issue, other factors can expand or shrink the common regime. For example, in the *McDonald's* case, in which a measure offered by Luxembourg to McDonald's provided favorable tax consequences on its intellectual property rights, the Commission included a double tax treaty between the U.S. and Luxembourg as part of the reference system.[165]

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158 *See* Paint Graphos, *supra* note 117; *see also* France Telecom v. European Commission, Case C-81/10 P, [2011], E.C.R.

159 *Compare, for example,* Portuguese Republic, *supra* note 119, *with* Government of Gibraltar v. Commission of the European Communities, Cases T-211/04 and T-215/04, [2008], E.C.R.

160 *See* Portuguese Republic, *supra* note 119, at recital 14.

161 *Id.* at recital 58.

162 *Id.* at recitals 76–78.

163 *See* Government of Gibraltar, *supra* note 159, at recital 115.

164 *Id.*

165 *See* Procedures Relating to the Implementation of the Competition Policy*, supra* note 121, at recital 72 ("the Luxembourg corporate income tax system constitutes the reference system against which that ruling should be examined for a selective advantage . . . [it] should also be considered to include the double tax treaties to which Luxembourg is a party.").

A final consideration the Commission notes concerning the "selective" and "advantage" factors is the exception to illegal state aid when the subject measure results from a guiding principle of the tax regime at issue. One example, *British Aggregates Association v. Commission of the European Communities,*[166] concerned environmental levies raised against virgin aggregates in the U.K. based on environmental concerns.[167] In that case, a British company complained to the Commission, alleging that the levy put them in a worse situation compared to other producers in a similar factual and legal situation (exports were exempt from the levy).[168] In its decision, the Commission determined that, while ordinarily there could be a selective advantage conferring a detriment to the applicant, because the exemption for exports was "justified by the nature of the [statutory levy] as an indirect tax," no selectivity was present.[169] Part of the rationale in this case was that an environmental levy is subsumed under state powers, and a state is "free to set its priorities as regards its environmental policy."[170] Typically, the justification of a selective advantage through guiding principle of the tax regime at issue is difficult to obtain. The Commission has held that courts must distinguish between measures that are intrinsic and extrinsic to the tax regime, disallowing justification in the latter.[171] Additionally, courts have engaged in a detailed analysis of the Member State's attempt to justify their regimes, with no small amount of skepticism involved.[172]

Ultimately, for planning purposes, E.U. Member States hoping to attract industry while avoiding Commission scrutiny would be well advised to craft a regime amenable to multinational investment rather than issue likely advantageous and selective tax rulings. To do this, Member States would be wise to somehow limit the scope of their reference regimes (as shown above, smaller reference

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166 *See* British Aggregates, *supra* note 117.

167 *Id.* at recitals 1–25.

168 *Id.*

169 *Id.* at recital 153.

170 *Id.* at recital 171.

171 *See* Paint Graphos, *supra* note 117, at recital 69.

172 *See, for example*, Commission Decision: On the Aid Scheme Implemented by Germany, *supra* note 124; *see also* Portuguese Republic, *supra* note 119, at recitals 41 and 82 (Member State attempted to argue that allowing a corporate tax reduction in an insular region such as the Azores is justified by the guiding principle of "ability to pay, with the aim of redistribution." The Commission retorted that because the measure applied to all economic operators with no distinction as to financial situation, there is no true redistribution principle involved); Adria-Wien Pipeline, *supra* note 117, at recital 48 ("neither the large number of eligible undertakings nor the diversity and size of the sectors . . . provide any grounds for concluding that a State initiative constitutes a general measure of economic policy); *Excess Profit Exemption in Belgium*, *supra* note 91 (Member State attempted to justify non-taxation of subsidiary due to fears of double taxation; Commission argued that adjustment was done "proactively and unilaterally" regardless of any true risk).

regimes are generally respected whereas larger ones are not). This step may prove difficult, but somehow limiting the geographic scope of the reference system will likely only help the Member State receive a favorable ruling. Additionally, further steps such as justifying the measure granted as part of the tax regime will also only help a Member State receive deference from the Commission.

3. Measure must distort or threaten to distort competition and have the potential to affect trade between states.

Unlike the previous two factors, this factor does not comprise a majority of the Commission's efforts and is often addressed in a brief paragraph or two. This is simply because this factor is assumed to apply to the measure at issue.[173] For one thing, the Commission has held that there is no burden on the court's part to establish that the "aid in question has a *real* effect on trade between Member States . . . but only to examine whether that aid is *liable* to affect competition.[174] The Commission has additionally maintained that it is not even necessary that the subject taxpayer be involved in intra-community trade. The simple fact of the State granting a selective advantage to the taxpayer makes it even more difficult for other companies to penetrate the internal market, resulting in a distortion of competition.[175] Because of these two factors in particular, the Commission admittedly takes a fairly broad approach to this factor and affirms it in all cases.[176]

B. Policy and Planning Considerations

A number of important policy and planning considerations follow from the conclusions drawn from the case law above. For example, given the fact that "individualized" transfer pricing schemes tend to receive higher scrutiny under the advantage factor, collapsing the two into essentially a single test has important ramifications for corporate tax planning purposes. General schemes that nations apply and that corporations take advantage of will be subject to a lengthy "selectivity" test, with the result that Member States will have to craft any regimes for multinational corporations carefully so as to avoid being subject to a ruling of illegal state aid.

Additionally, for corporations, knowing the "reference system" when deciding to place a subsidiary in a new Member State will have important

173 *See, for example*, Ireland and Alleged State Aid to Apple, *supra* note 46, at recital 220 for the one-sentence analysis of this factor ("Apple is a globally active firm, operating in various Member States, so that any aid in its favour distorts or threatens to distort competition and has the potential to affect intra-Union trade.").

174 *See* Paint Graphos, *supra* note 117, at recital 78 [emphasis added]; *see also* Italian Republic, *supra* note 138, at recital 152.

175 *See* Air Liquide Industries, *supra* note 147, at recital 46.

176 *Id.*

ramifications, since how this factor is defined can reduce the risk of the measure being deemed state aid. The reference system has even more important ramifications for parties entering transfer pricing deals with Member States, given the OECD Transfer Pricing Guidelines and the Commission's strict application of it. Within that realm, using tax treaties as a background to tax rulings can have potentially beneficial results for corporations, since these will get folded in among the reference system. However, it is important to keep in mind that the Commission will analyze the application of these treaties to the measure with a high level of scrutiny.[177] Rather than merely displace treaties, as the U.S. Treasury maintains, the analysis of treaties in the cases where they may apply to the reference system reveals that the Commission is dedicated to ensuring that the spirit and letter of the treaty is upheld.[178]

It is also apparent from the case law that the distortion of competition is often assumed by the Commission, which acknowledges that this factor is broadly applied in cases concerning state aid. It is apparent from the case law that almost any activity that has the potential to affect the ability of other corporations to compete in a Member State or affects intra-state trade in any way will be found to distort competition and affect trade between states. This gives the Commission incredible power to determine that a given measure affects intra-State trade, so much so that it renders the purpose of analyzing a measure on this factor basically futile.

Additionally, the concept of "negotiation" has arisen in at least a portion of the case law. In *Apple,* one of the factors that led the Commission to determine that the transfer-pricing ruling constituted an advantage was because it was the "result of negotiation rather than a pricing methodology."[179] While negotiation was a factor tilting the measure towards illegal state aid in *Apple*, in *European Commission v. MOL Magyar Olaj-es Gazipiari Nyrt* the court determined that negotiation in fact was not enough to confer on the agreement a "selective

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177 *See, for example*, Procedures Relating to the Implementation of the Competition Policy, *supra* note 121; Excess Profit Exemption in Belgium, *supra* note 91.

178 *See, for example*, Procedures Relating to the Implementation of the Competition Policy, *supra* note 121 (E.U. Member State and taxpayer arguing that because Luxembourg would expect that McDonald's income *may* be taxed in the U.S. since it is a "permanent establishment" from a Luxembourg tax perspective, then no taxation should occur in Luxembourg. The Commission determined that the Member State and the taxpayer erred in only considering the definition of a "permanent establishment" under Luxembourg domestic law to be relevant for application of the provision of the treaty and not whether the branch also constitutes a "permanent establishment" under U.S. law. The Member State and taxpayer's error resulted in not a prevention of just double taxation, as the treaty intended, but the elimination of any tax at all).

179 *See* Ireland and Alleged Aid to Apple, *supra* note 46, at recital 150 (the Commission concluded that the negotiations reinforced the idea that the outcome of the method proposed was not consistent with what an independent operator would have accepted).

character."[180] *MOL* concerned an agreement between the Hungarian State and the oil and gas company MOL in relation to mining fees.[181] Due to this agreement and a coincidental legislative increase in the rate of mining fees, MOL was spared the latter due to conditions of the former.[182] At issue was the concern that this exemption, which was the result, on the one hand, of a legal framework, and on the other hand of negotiations with respect to fee rates, constituted a selective advantage. However, the court of appeals upheld the lower court's ruling, maintaining that negotiation towards a lower fee not subject to change in legislation by itself is not enough to confer a selective character.[183]

Such a clear discrepancy in the treatment of negotiation is troubling and presents uncertainty for tax planners. One possible way to justify these two seemingly conflicting rulings is through the fact that in *Apple*, negotiation was one of several factors that led to a finding of state aid. Similarly, in *MOL*, the court maintained that it would not *suffice* for negotiation alone to lead to a conclusion of selectivity. Spelling out this sub-factor on the part of the Commission will provide more clarity and certainty for tax planners worldwide. Additionally, it will help Member States to know that negotiation, while certainly a factor that can and does lead to a finding of state aid, can still occur if unaccompanied by other troubling factors.

Given the importance of the reference system, transfer-pricing rulings are at a severe disadvantage as compared to other types of favorable tax rulings that corporations may receive. While the reference system used in tax rulings other than transfer-pricing measures will receive high levels of scrutiny, the Commission gives a Member State deference in crafting its own policies and priorities.[184] On the other hand, the reference system used by the Commission in transfer-pricing rulings (The OECD Transfer Pricing Guidelines) is one that the Member State has zero independence to develop. Because the Transfer Pricing Guidelines are international guidelines, Member States are presumed to have far less influence over their design, which makes it a likely reference system for finding illegal state aid.

Finally, it is also worth noting that transfer-pricing disputes involve a significant degree of factual complexity. This leaves room for Member States and multinational corporations to shift to factual grounds for lower tax liabilities, while still remaining within the framework of acceptable legal standards and OECD guidelines. For example, suppose that the Member State exercised discretion not in granting a specific tax ruling or in determining how to apply the tax code, but

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180 *See* MOL Magyar, *supra* note 117, at recital 87.

181 *Id.* at recitals 5–19.

182 *Id.*

183 *Id.* at recital 87.

184 *See, for example*, British Aggregates, *supra* note 117.

rather in determining what activities are considered "comparable." It is likely that the E.U. Commission will take a broad approach to policing a factual level of discretion, given the liberal application of "selectivity" and "advantage" outlined above. However, this remains an open question which further Commission activity may elucidate for curious taxpayers.

V. CONCLUSION

While there has been and continues to be substantial confusion surrounding the Commission's recent cases determining state aid in various E.U. tax rulings, there is still some method inside the madness that is inherent in this system. For example, the U.S. Treasury Department maintains that the Commission's collapsing of the concept of "selectivity" and "advantage" represents a severe break with tradition, seemingly without explanation. However, careful analysis of the cases has revealed that the two concepts have always been applied somewhat flexibly, and in cases of individualized regime tax measures, the two factors will be conjoined because an advantageous ruling for one taxpayer is certainly selective. In more generalized regime cases, the two will be separated because an advantageous ruling applying to all does not qualify as state aid. Additionally, while the Treasury Department argues that the rulings violate international tax treaties, careful analysis of the cases will reveal a nuanced and faithful approach when including treaties in the reference system.

A review of the case law surrounding state aid and taxation should hopefully reveal a number of trends and concepts for tax planners to be aware of. Knowing that the reference system maintains key importance as a significant factor in state aid will help corporations when they negotiate with the Member States in which they have subsidiaries. Additionally, knowing how the case law has consistently applied the concept of negotiation as well as distortion of competition will help future corporations and Member States understand the ramifications of the transactions they enter together.