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State Aid and Tax Rulings: The Problem of Harmful Tax Competition.

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ANNO ACCADEMICO
2017/2018

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INTRODUCTION

The rules on State aid contained in the Treaty on the Functioning of the European Union are one of the pillars on which the EU internal market has been built up. Indeed, as it will be explained, not only the behaviour of private market players, but also the possibility for the Member States to boost their own national economy might be a significant impediment to the establishment of a competition-based internal market common to the European States, which in turn constitutes one of the ultimate goals of the Union.

The most common example of aid is surely represented by "subsidies", as also some instruments adopted within the general international legal order seem to confirm, with reference to the GATT of 1994 and the SCM. By the way, as it will be stressed in detail in the present essay, anti-subsidies rules were already foreseen within the framework of the ECSC, in the very first phase of the process of European economic integration. However, there are various forms by which aid might be granted by sovereign authorities to private entities. In fact, besides subsidies and labour deregulation, it is of fundamental importance to observe that *"around 30% of* [unlawful] *State aid is allocated by means of tax measures"* ([1]).

In fact, as its most recent decisions show at best, the European Commission has shown great interest towards aids granted through instruments of a particular kind: namely "tax rulings". These arrangements nowadays play a hugely important role in the practice of the European national tax administrations. And thus, although the Commission still considered tax rulings to be an instrument liable to grant illegal aid under the TFEU already in 1998, as one of the most highly respected academic doctrine observed ([2]).

These tools in fact, along with any other kind of mean by which State aid is granted by EU Member States to single companies or multinational groups, made it possible for national authorities to grant unfair aid to the market players, enhancing national economy and appreciably distorting competition within the

[1] Leigh Hancer, Tom Ottervanger, Piet Jan Slot, *EU State Aid* (London: Sweet & Maxwell, 2016), 13-001.
[2] Amedeo Arena, *op. cit.* (2017), at 928.

internal market.

It is for this reason that the European Commission has initiated to heavily investigate into the Member States' administrations' tax practices since June 2013. Such action has been even strengthened under the Juncker Commission since December 2014, when it was extended to the whole Union, also as a reaction to the recent *Panama Papers* and *LuxLeax* scandals ([3]). In fact, as the present EU Commissioner for competition Margrethe Vestager stated: *"We – Member States and the Commission – are completing the State Aid Modernisation (SAM) programme, the biggest overhaul of our rules in more than 50 years of State aid control. To me this symbols a new partnership where we work together, listen to each other and have the same general principles* […] *At the same time, we need to step up our efforts to stamp out bad aid. The SAM slashed a lot of red tape, by hugely expanding the scope of aid that can be granted quickly without the need to notify the Commission"* ([4]). Indeed, the State Aid Modernization programme, which will be subject to in depth analysis in the coming chapters, well embodies the European Commission's s.c. "new approach" in matters of tax aids.

Besides the efforts of the European Commission in the enforcement of the State aid rules in the field of taxation, it is important to mention that the EU institutions as a whole have acknowledged the importance to provide a better coordination at European level in the field of taxation and in matters of Tax Rulings. Thus, provided mainly through the approximation of laws under the rules of the TFEU on harmonization, which finds its main obstacle in the fact that direct taxation is a field which still fundamentally falls within the competence of the Member States. In this respect, as it will be explained in detail at the end of this work, it is of fundamental importance to observe that a permanent and stable solution to the problem of harmful tax competition in the EU must necessarily be

[3] Indeed, ARENA observes that: *"lo scandalo LuxLeaks ha rivelato che, almeno fino al 2014, il ricoroso ai tax rulings da parte delle grandi imprese è stato piuttosto frequente e che il contenuto di tali provvedimenti era tenuto segreto dalle autorità degli Stati Membri"*(Amedeo Arena, *Le decisioni sui Tax Rulings al vaglio della CGUE: un nuovo capitolo sul controllo degli aiuti di Stato, un passo in avanti verso l'Unione fiscale?, Diritto del Commercio Interazionale,* 31.4 (October-December 2017), at 932).

[4] Margrethe Vestager, Commissioner for Competition, *Speech at High Level Forum of Member States* (18th December 2014), available at: <https://ec.europa.eu/commission/commissioners/2014-2019/vestager/announcements/speech-high-level-forum-member-states-margrethe-vestager-commissioner-competition-18-december-2014_en>

based on further efforts for harmonization and for a reform of EU law in the field of direct taxation, thereby forcibly requiring a general reconceptualization of the balance between the powers conferred upon the EU institutions on one hand, and those accorded to the Member States on the other.

The aim of this essay is to provide an overview on tax aid through Tax Rulings in the framework of EU law, highlighting the rationales and the purposes related to the use of national tax rulings as well as the counter-measures which have been undertaken at European level in order to impede the phenomenon of "harmful tax competition", which is likely to impede the fullest realization of the European internal market.

This work is divided into four chapters. The first one contains a preliminary overview on important preparatory concepts which are instrumental for what concerns to the issue of "harmful tax competition" and to the individuation of the legal basis according to which Tax Rulings are framed under EU law. Indeed, the issues which will be observed in the first chapter are: the systematic rationale of the State aid rules with respect to EU competition law as a whole; the historical and economic background standing behind the very concept of competition and the way according to which it influenced the construction of the European Communities and of the Union; the problem of harmful tax competition in the EU and the measures which have been undertaken at EU legislative level in order to counter it and, finally, an overview on the rules concerning State aid contained in the TFEU (arts. 107, 108 and 109) and the most relevant related case-law of both the Commission and the CJEU, which all constitute the main legal basis through which harmful tax competition is fought in the framework of the EU.

The second chapter, instead, concerns the matter of Tax rulings in detail. Indeed, after having explained the notion and features characterizing this kind of instruments, this essay will further focus on the most important kind of rulings generally adopted by national administrations; on the most relevant problems which are linked to them, with particular attention given to transfer pricing practices and profit shifting; on the approach adopted by the European Commission in general towards national rulings; on an in-depth case study concerning the most recent and relevant Decisions of the Commission in matters of tax rulings and, finally, on the comments and criticism which have been expressed by European and extra-European commentators and scholars with respect to the Commission's "new approach".

The third chapter focuses on the jurisprudence of the Court of Justice of the European Union in matters of State aid granted through tax remedies. In particular, this work will analyse the Court's approach towards the elements constituting State aid in the meaning of the TFEU and the differences which exist between the CJEU's view and the practice of the European Commission. Moreover, the third chapter will also focus on the CJEU's relevant case law concerning some peculiar principles which are relevant with respect to the matter of tax rulings and tax competition: namely the arm's length principle, mismatches and taxation on share profits.

Indeed, in the lack of a consolidated case-law with respect to the issue of tax rulings, which will perhaps be formed after the Court will have the possibility to express itself on the Commission's most recent Decisions on national rulings, it will be observed how the principles which are in principle applicable to Tax Rulings have been elaborated by the CJEU with reference to illegal general tax schemes or State aid cases in general.

Finally, the fourth chapter will conclude this essay by illustrating the present and future efforts which are and will be undertaken at European level to secure better transparency and anti-State aid enforcement, in order to improve the effectiveness by which the EU institutions face and counter the phenomenon of harmful tax competition in the internal market, along with the proposals for a solution of the problematic at stake at international and "supra-European" level. In extreme conclusion, in the light of the withdrawal of the United Kingdom from the Union which will be definitely carried out in the near future, aspects of the future State aid relationships between Britain and the Union will be subject to a brief analysis too.

CHAPTER I

The issue of taxation in the framework of the EU internal market.

1.1 Introductive remarks on the general legal framework related to tax measures.

As the Commission's recent investigations prove, tax rulings have gained a certain importance among the measures which are liable to be considered unlawful under the principles governing the legal order of the European Union. The latter instruments consist in administrative arrangements issued by the administration of a Member State and which have the effect to provide a favourable treatment to the taxpayers to which they are addressed. Therefore, as it will be explained in detail in the coming pages, it might possible that such arrangements may, in principle, breach the rules of EU law concerning the prohibition of State aid. Before starting the in-depth analysis of the legal features and aspects of tax rulings, it is of absolute importance to highlight the systematic rationale of the EU State aid rules with respect to the whole structure provided by the founding Treaties of the Union. In fact, the *corpus* of rules contemplated in arts. 107 and 108 TFEU, along with the prohibition of custom duties (arts. 28 and 30 TFEU) as well as quantitative restrictions and "measures having equivalent effect" (arts. 34, 35 TFEU), pursues the aim to secure the recognition and respect of the "four Fundamental Freedoms" established under art. 26(2) TFEU. Therefore, such rules should perhaps be considered somewhat as the "public counterpart" to arts. 101, 102 and the Merger Regulation 40/2014, for the contemplated norms and acts all pursue the ultimate aim to build up a common European legal framework based on free competition within the internal market securing free trade in the Community. In fact, if the rules concerning competition have been conceived by the drafters of the Treaties to prevent private subjects or companies to provide distortions in the structure of the internal market, on the other hand the purpose of the above-mentioned four freedoms and the prohibition of State Aid laid down by the TFEU consists in impeding that such distortions may flow from measures directly provided by the Member States themselves. Thus, to indirectly favour national economy and growth, thereby scarifying the integrity and the very functioning of the common market ([5]).

It is therefore clear that, even if it is faced with different approaches, the overall structure of the above-mentioned Treaty-law is characterized by a general and unitary goal: namely the purpose to realize as much as possible the ideal model of "perfect competition" elaborated by the economic theory in the dimension of the European internal market. It is clear, in fact, that the rationale which stands behind the prohibition of State Aid in the framework of EU law relies upon the prohibition for Member States to directly or indirectly help national enterprises, recognizing such economic and legal advantages upon them in order to better withstand confrontation with the market players of other Member States. As it is self-evident with respect to the wording of art. 107 TFEU ([6]), if the rules on State aid are provided to prevent the granting of individual advantages to single companies or sectors, the rules enforcing the free movement of labour, capital, goods and services are clearly aimed at catching those measures provided by State authorities with the purpose to favour domestic economy as a whole, in a way which is inconsistent with the needs of a properly functioning internal market. Therefore, it is of absolute importance for the EU institutions (and the EU legislator) to intervene and develop their own policies and approaches in the field of taxation. Thus, clearly, provided that the lack of a common taxation policy is one of the greatest impediments for a complete economic integration at European level.

In particular, as said, this essay will focus on those instruments generally identified as "tax rulings", which in fact fall within such important framework.

Nevertheless, even though this is the main legal framework in which tax rulings are inevitably caught, it is important to observe that the issue of taxation in the internal market is not only concerned by arts. 107 and 108 TFEU, as it is also addressed by other important Treaty provisions (*e.g.* arts. 110 TFEU and arts. 114 and 115 TFEU for what concerns the approximation of laws). Moreover, if the

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[5] According to WESSELING, indeed, at the very beginning *"antitrust rules were no more than the private counterpart to the rules, enshrined in arts. 28-30 EC"*, while nowadays *"although the system was originally devised for promoting market integration, antitrust policy is now also -and mainly- directed at promoting the various other objectives of the Community"* (Rein Wesseling, *The Modernization of EC Antitrust Law* (Oxford: Hart, 2000) at 48-49).

[6] The s.c. principle of "selectivity" will be discussed later on in the following paragraphs.

Treaty provisions individuate the general legal framework in general, the principles applicable to tax rulings and general tax measures have been mainly developed and established through the Commission's decisions and the judgements of the European Court of Justice, as in any other area covered by EU law.

Therefore, it is absolutely important to stress out the fact that the legal order of the Union is really a living reality, which is constantly in an evolving stage. Thus, also because of the dynamic nature of the internal market itself, which may rise new problems and concerns by the time. Their solution is and will be for the Commission and the Court to be determined ([7]).

By the way, the evolving dimension of the internal market does, finally, also entail that the legislative and jurisprudential framework of the State aid rules might be subject to further developments. Indeed, in the following pages we will see how the rules concerning State aid have evolved from the framework of the ECSC to the European Union of the 21st century. Nevertheless, consequent to the referendum of June 2016 on the withdrawal of the United Kingdom from the EU, which in turn has been announced for the 29th March 2019, as it will be analysed at the end of this essay, it seems that the present rules concerning State aid will require an adjustment, at least for what concerns the economic relationship between the Union and Great Britain which will result after 'Brexit' will be carried out ([8]), for the withdrawal of the UK from the Community will give rise to important problematic issues with respect to State aid.

[7] Indeed, already in the 40s the famous Italian economist and statesman Luigi Einaudi affirmed: *"La pianta della concorrenza non muore da sé e non cresce da sola [...], è un arboscello delicato, il quale deve essere difeso con affetto contro le malattie dell'egoismo e degli interessi particolari"* (Luigi Eunaudi, *Economia di Concorrenza e Capitalismo storico,* Rivista di storia economica (June 1942) at 65, in: Vincenzo Guizzi, *Manuale di diritto e politica dell'Unione Europea* (Naples: Editoriale Scientifica, 2015) at 714).

[8] It seems that the British Prime Minister has recently proposed to further shift the actual exit of the UK to 2020; see Rob Merrick, *Theresa May announces she will keep UK under EU laws for another 21 months, risking Brexiteer fury*, Indipendent (24 July 2018), available at: <*https://www.independent.co.uk/news/uk/politics/theresa-may-brexit-eu-law-transition-conservative-mp-uk-talks-deal-a8461581.html*>.

1.2. Historical background.

It has been said that the need to preserve the competitive structure of the internal market is a goal which does not only characterize those Treaty provisions which are directly addressed to private market players, but also the rules concerning State monopolies, public services and State aid. In fact, we may consider both the need and the principle of the protection of competition as being inherent to the system laid down by the two founding Treaties.

Nevertheless, the definition if competition is by itself a terrain of academic debate since the establishment of capitalist economy in the West ([9]), which has been mainly achieved through the revolutions of the 18th and 19th century, the spread of the illuminist ideals and the success of the theories of David Ricardo and Adam Smith. However, the concept at stake has even older origins, finding its roots already in ancient history. In fact, as LIBERTINI observed, the origin of the conceptual figure of “competition” may be identified in the idea of “opposition” first exposed by the Greek philosopher Heraclitus of Ephesus (c. 535 – c. 475 B.C) ([10]), who identified the necessary antithesis between the abstract conception of “self” and everything which is “not self”, while explaining the nature of the *apeiron* ([11]).

Accordingly, it shall be observed that “inter-Sate” competition is an older concept than competition between private entities, for the first capitalistic organizations having a kind of “corporate” structure have been established only during the Modern Age ([12]) and were still subject to State control or protection for

[9] See *inter alia*: Neri Salvadori and Rodolfo Signorino, *The Classical Notion of Competition Revisited*, History of Political Economy n.45 (2013), at 149-175.

[10] Mario Libertini, *Relazione generale tra concorrenza tra imprese e concorrenza tra Stati*, in: Paolo Montalenti, *Unione Europea: concorrenza tra imprese e concorrenza tra Stati*, Quaderni di giurisprudenza commerciale n. 394, (Giuffrè Editore, 2016) at 1.

[11] Heraclitus was not the only pre-Socratic philosopher who developed an idea of competition. In fact, already according to Anaximander, birth was possible only through a primordial opposition.

[12] Nevertheless, it should not be forgotten that already during the Middle Ages organizations having a “private nature”, due to their great economic power, were often able to exercise a big influence in politics. This happened particularly in such provinces and territories of the Holy Roman Empire which were capable to reach a high level of political autonomy, *e.g.* The Italian City-States or the German *Hansestädte*.

a long time ([13]). During the decades following the French revolution, the 'reconfiguration' of International politics and economics after the principle of *laissez faire* did not prevent sovereign subjects, which in the 19th century were organized according well-established structure of the national State since centuries, to solve International disputes through the use of force. Indeed, the recognition of full sovereignty upon States, after the traditional principle of *Rex in regno suo est Imperator*, did not only entail warlike confrontations and the systematic seizing of strategic resources through colonial settlement, but also that States were absolutely free to regulate trade relations and the establishment and investment of foreigners in its own territory as they wished. In a certain way, this absolute sovereign freedom may be considered as the mirror of economic liberalism in the sphere of the State.

The two World Wars putted an end to the old order. As we know, at international level, action has been taken with the aim to build up a system of international economic relations which has been defined as "granted liberalism" ([14]), thereby meaning an order on one hand inspired by free market ideology but subject to coordination efforts and regulated by arrangements and organizations at international level at the same time; first and foremost: the World Trade Organization and the institutions of Bretton Woods ([15]).

1.3. Economic theory and "Regulatory Competition".

As it has been said, the concept of competition is extremely old. In fact, competition itself, thereby understanding contraposition between different subjects, finds its application in a great variety of fields, such as Sports, Politics and Religion.

However interesting this might be, this essay will rather focus on the legal

[13] The reference is made with respect to the system of the *octroy*, by which *inter alia* the British East India Company was established in 1600, by will of Queen Elizabeth 1st of England who conferred the monopoly over trade in the Indian Ocean upon to it; Also see: Marcello Clarich, *Manuale di diritto amministrativo* (Bologna: Il Mulino, 2015) at 19 ff.

[14] "Liberismo garantito", in: Elena Sciso, *Appunti di diritto internazionale dell'economia*, (Torino: Giappichelli Editore, 2017) at 25.

[15] In fact, such new conception of international trade and economics finds its ideological roots in the acknowledgement, foremost represented by the adoption of the Sherman Act (1890) in the US and which was strengthened after the "black Tuesday" in 1929, that a genuine free market had to be regulated through public intervention and the establishment of authorities having the aim to preserve the competitive structure of the market and the genuine provision of fundamental services.

and therefore economic aspects of competition, which means those topics related to the opposition between individuals or entities in economic terms.

In this respect, indeed, a fundamental distinction must be drawn. If on one hand the most direct form of competition is clearly represented by the struggle between private players, which means competition in the market, it is nevertheless true that economic confrontation is also heavily influenced by competition between States, which means competition between national markets in economic terms.

Throughout history, indeed, the most common kind of contention has been political confrontation between States or sovereign entities, which mostly culminated into armed conflicts, being the ultimate framework where the nations' economic potential and industrial effort capacity could be measured ([16]).

This did not mean that competition between markets ceased to exist, as it is still to be considered as the most common kind of competition.

However, in this respect, from a theoretical point of view, we may oppose "market competition " to the concept of "competition among legal orders" or "regulatory competition", thereby indicating that kind of top-*down competition* between territorial entities which consists in the decrease of guarantees and rules pursuing the aim to establish more attractive conditions for companies looking for cost reduction for their productive activity. Thus, mainly provided through deregulation. This is, in fact, the logic behind the birth of the concept of "race to the bottom" ([17]), which is typical in federal and supranational legal orders such as the European Union ([18]).

Indeed, DOS SANTOS ([19]) distinguishes the general *genus* of "regulatory

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[16] As it is well known, the famous Prussian strategist and General Carl von Clausewitz (1780 – 1831) held that war was nothing more than *"the continuation of politics by other means"* (*"Der Krieg ist nichts als eine Fortsetzung des politischen Verkehrs mit Einmischung anderer Mittel";* Carl Von Clausewitz, *Vom Kriege*, Rowohlt (Berlin: Taschenbuch Verlag, 2004)).

[17] The concept does not find its application only with respect to competition between sovereign authorities. Indeed, it may also be defined as that direct kind of circumstance "*in which companies compete with each other to reduce costs by paying the lowest wages or giving workers the worst conditions"* ("Race to the bottom", Cambridge Dictionary, available at: https://dictionary.cambridge.org/it/dizionario/inglese/race-to-the-bottom).

[18] In fact, it is not a case that HANCER, OTTERVANGER and SLOT use the term *"fiscal federalism"* to identify the system according to which direct taxation is treated in the framework of the European Union (Leigh Hancer, Tom Ottervanger, Piet Jan Slot, *op. cit*., 2017, 13-008).

[19] António Carlos Dos Santos, *L'Union européenne et la régulation de la concurrence fiscale* (Brussels: Bruylant, 2009) at 28 ff.

competition" between "passive competition" (*"la concurrence implicite"*), thereby meaning the competitive effect between States generated by the interpretation of norms provided by Courts belonging to different territorial entities of the system, and "active rivalry" (*"la concurrence active"*) , as two different subcategories of competition between legal orders, identifying the latter in the deregulatory race between governments in attracting foreign investments ([20]).

More concretely, we may indeed distinguish two main matters in which regulatory competition between legislators or rule-setters does realize itself: on one hand, fundamental relevance must be recognized upon the deregulation in labour law matters, which often culminates in that kind of race to the bottom which applies to the rules concerning the economic and legal treatment of workers, thereby inevitably influencing the overall production costs which employers established in the State concerned will have to face in carrying out their productive activity.

Therefore, we may affirm that the main feature of this kind of regulatory competition consists in the fact that the social aspects inherent to this issue of competition in this field are mainly about competition in industrial relations. Nevertheless, provided that the centrality of workers protection in the framework of the Union aiming at establishing a political, social and economic order pursuing sustainable growth and development ([21]), has been recognized by both primary and secondary law as well as by the ECJ case-law ([22]), the "type" of regulatory competition this work is rather concerned with consists in such competition existing between legislators trying to directly lower as much as possible the economic burden imposed upon the undertakings operating on their respective territories. It is to say: competition in tax matters. In this light, it is self-evident that taxation policy

[20] The author concerned also individuates a third kind of "competition", which consists in the s.c. "yardstick competition". Such kind of competition will be discussed later on, as it has a certain relevance according to tax regulations in the EU.

[21] In the following pages we will address the issue in particular, mainly with reference to the model of "social market economy", by which the entire EU construction process was and continues to be inspired.

[22] Although the outcome of the case has been hugely criticized because of the consequences which such pronunciation entailed for national welfare protection, in *Laval* the ECJ has still recognized the compatibility of Member States' derogative regulation for worker protection with the goals of the Union (Case C-341/05, *Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet, Svenska Byggnadsarbetareförbundets avdelning 1, Byggettan and Svenska Elektrikerförbundet* (2007) *ECLI:EU:C:2007:809*).

represents one of the main instruments by which States, *in casu* the Member of the European Union, may attract foreign companies and investments.

Conclusively, it is worth to observe that some commentators, as DOS SANTOS, actually refer to “competition between jurisdictions” as a synonym of “regulatory competition”, thereby referring to a *latu sensu* meaning of the concept of jurisdiction itself ([23]). Indeed, this is justified by the fact that jurisdiction *strictu sensu*, thereby understanding *“the authority of a court or official organization to make decisions and judgments”* ([24]), is by itself an expression of the same *unicum* from which regulatory power flows, namely the State’s sovereignty over its people and territory. Although the judicial power must be obviously separated from the legislative one and the executive, according to the fundamental teachings of Montesquieu ([25]), the latter aspect has still a great conceptual importance.

1.4. Competition and State aid as the pillars of European economic integration.

The project of European integration is undoubtedly the most blatant and ambitious example of international regional integration, and thereby a kind of “neighbour-product” of the adoption of the ideology of the above-mentioned granted liberalism. In fact, it really is by virtue of this aspect that competition has become so important in the framework of what has become nowadays European Union. After all, the reason itself why the Union’s forerunner was established, namely the European Coal and Steal Community, was to prevent war breaking out again between major European powers, thereby expressing, in other terms, the will of the European governments at that time to hinder “competition” between States

[23] António Carlos Dos Santos, *op. cit.* (2009) *supra.*
[24] “Jurisdiction”, Cambridge Dictionary, available at: https://dictionary.cambridge.org/dictionary/english/jurisdiction.
[25] As in fact the founder of modern constitutionalism stated*: “Je crois que ceci fut une des grandes causes de la séparation de la justice d'avec le fief, d'où s'est formée la règle des jurisconsultes français: Autre chose est le fief, autre chose est la justice.”* (Charles de Secondat de Montesquieu, *L’Esprit des Lois,* (1758), Edited by Laurent Versini (Paris: Éditions Gallimard, 1995) , at 360.

to reach again the catastrophic dimension and impact of the two World Wars ([26]).

In fact, the conception which stood behind such provisions, and which constituted the rationale of the rules governing intra-State economic relationships in the framework of the European Communities until the 1990s was (as it still is) entirely based of the positive effects of competition. Such basic thought, which on one hand indirectly implies adherence to the fundamental principles of the free market ideology ([27]) in the act of conceiving a united Europe, is based on the idea that the struggle between the market forces is the real engine of economic growth. It is therefore assumed that the functioning and the very realization of the space of "Freedom, Security and Justice" ([28]), which constitutes the final purpose of the Union, largely depends on the capacity of both national and European institutions to secure balance between the market players, at least from an economic point of view. Therefore, competition has been considered for a long time a goal to be achieved in order to secure economic development within the Communities.

Indeed, this is why the Community legislator and the drafters of the Treaties dedicated so much attention to competition, also in the light of the long period of development which led the ECSC of 1952 to become the European Union by 2009. In fact, the ECSC Treaty did already provide rules safeguarding competition in the fields falling within the competence of the organization in Chapters III and IV of its third Title.

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[26] In fact, in its famous speech in Zurich (1946) former British Prime Minister Sir Winston Churchill claimed for the need to *"build a kind of United States of Europe"*. Moreover, it may be stated that the ideal of European unity has very ancient roots. The strong symbol represented by the Roman Empire did in fact survive in the Middle Ages through the idea of Europe as *Res Publica Christiana* which permeated the Holy Roman Empire and the course of History in the West. After the establishment of the Modern State, the liberal revolutions of 1848 started to conceive European integration in a way consistent with the contemporary conception. It is in fact not a coincidence that the famous French writer Victor Hugo opened the Paris Congress of Peace of 1849 by stating: *"Un jour viendra où il n'y aura plus d'autres champs de bataille que les marchés s'ouvrant au commerce et les esprits s'ouvrant aux idées."* (Victor Hugo, Congrès de la Paix à Paris, Discours d'ouverture (21 août 1849)).

[27] In fact, CRAIG and DE BÚRCA argue that *"conceptions of market freedom are not value-free"* while in this respect WEILER observed the controversial role of the European Commission being on one hand *"an autonomous force shaping the agenda and brokering the decisionmaking on the Community"* but being, on the other hand *"at the same time, the Commission, as a broker, must be ideologically neutral"* (Paul Graig and Gráienne De Búrca, *EU Law: Text, Cases and Materials* (Oxford: Oxford, 2015) at 630; Josef Halevi Horowitz Weiler, *The Transformation of Europe*, Yale Law Journal n. 100 (June 1991), at 2403).

[28] Art. 3(2) TEU.

This point will be subject to further analysis later on. For now, it is sufficient to state that it clearly is for this reason that the EU legislator, the European institutions and the Contracting Parties payed particular attention to the issue of taxation not only in the drafting of the Treaties, but also in the development of the Union's competences and approaches with respect to that matter.

On the other hand, the establishment of an economic community entailed the need to provide an institutional structure capable to secure that obstacles to effective competition and to the goals of the organization in general could be hampered by both the market players and the State actors. In fact, contrary to the natural environment in which regulatory competition is doomed to take place through the "invisible hand" of the market, namely federal States ([29]), the lack of a central authority in a supranational order like the EU necessarily entails the co-existence of a kind of *legal* competition, this is to say competition between jurisdictions.

As a matter of fact, the need to establish the Union's, *rectius*, the Communities' own judicial body was already felt at the very beginning of the process of European integration ([30]).

By the way, the same might be stated for what concerns the necessity to foresee an independent executive body having the task to execute the measures necessary to attain the goals of the Community itself ([31]). This aspect entails a fundamental difference between the legal order of the European Union and the one resulting from the structure provided by the rules and the Treaties of General International Law. In fact, as highlighted by DEL VECCHIO, speaking of international jurisdiction, it must by highlighted that in the framework of general International Law there is a never-ending competition between "overlapping jurisdictions", due to the fact that the different competences of the different Courts

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[29] Indeed, the natural example of the concept of "race to the bottom" is represented by the deregulation contest which characterizes economic relations between the American Federated States. In particular, the most known reference to such competition is represented by the State of Delaware, which nowadays possesses the most competitive legislation within the US.

[30] The CJEU was established in 1952 as the CJECSC (Court of Justice of the European Coal and Steel Community) with the Treaty of Paris (Tit. I Ch. IV ECSC Treaty)

[31] The ECSC had its own 'High Authority', which was competent for the common production of Steel and the extraction of Coal among the Member States (Tit. I Ch. I ECSC Treaty).

and judicial or *quasi*-judicial bodies existing at international level may easly intersect, given that there is no clear hierarchy between those bodies ([32]). So, if competition between the institutions at hand is mainly "horizontal", at EU level instead, such competition is fundamentally 'vertical'. Thus, because the CJEU has the ultimate task to grant the uniform application of EU law, thereby being in a hierarchically higher position with respect to its "competitors", namely national Courts. This is unsurprising in the light of what has been stated before because even though at international level the WTO has become an organization of extreme importance, the deeper degree of economic integration and the establishment of a common market necessarily entailed the need of a limitation of the principle of sovereign equality, which finds an expression in this kind of vertical integration between national jurisdiction and the CJEU.

Moreover, in order to really achieve the internal market by 1992 as set forth by the European Single Act of 1986, it was necessary to adequately empower the EU institutions, and in particular that of the ECJ, in order to prevent national authorities to circumvent the rules governing the whole system. Therefore, it is obvious that the whole complex of rules provided in the Treaties and the very structural conception of the Union ultimately respond to the aim to secure fair play in economic relations between the market players in the framework of the EU, at least for what concerns the aspects dedicated to internal market. Indeed, the Treaty rules preventing the behaviour of both public authorities and private market players to hinder proper market functioning, vertical integration through the recognition of the primacy of the European Commission as main enforcement instrument and, finally, the key-role of the CJEU as the guarantor of EU law on the other are clearly meant to secure the functioning of the whole system.

At the beginning of the 21st century however, a further step forward was made. As it is well-known, the entry into force of the Treaty of Lisbon in 2009 deeply changed the whole structure and the very functioning of the European Communities, which from that moment on became the European Union. In fact, the Treaty concerned might be considered as *the* step forward towards a more profound

[32] Angela Del Vecchio, *I Tribunali internazionali tra globalizzazione e localismi* (Bari: Cacucci, 2015).

integration. Among the numerous changes which have been provided by the new Treaty, one of the most important ones is clearly represented by the provision contained in art. 3(3) TEU. Indeed, the mentioned rule provides the aim of the establishing of the internal market which shall be based on *"balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment* [and] *it shall promote scientific and technological advance"*. The whole combination of such aims may be summarized under a principle contained in the provision itself: namely, the model of *"Social Market Economy*" ([33]).

1.5. The Concept of *Social Market Economy*.

The ideals on which the economic paradigm of Social Market Economy is founded have been commendably exposed by LIBERTINI as follows ([34]). First, as the term itself may suggest, free market economy is conceived as the best economic system ever, for it is the only one which was capable to grant a *quasi*-universal respect for individuals and economic wellbeing. Secondly, however, it shall be acknowledged that if free market is *the* precondition for the existence of a democratic society, on the other hand limitless competition *"tends to be a destructive mechanism"* ([35]) because it is liable to crystallize market power position and consequently capable to dissolve itself. Thirdly, market itself alone is not capable to secure the full satisfaction of the needs of people, provided that the equilibrium automatically reached by it through the struggle of market forces may not necessarily take into account such social fundamentals on which democratic civilization shall be based. Finally, there is a reconfiguration of the role of the State. In fact, contrary to the *laissez fare* philosophy, the model of social market economy

[33] The phrase was first coined by the German economist Alfred Müller-Armack (1901 – 1978) in 1946 as theorized by the Ordoliberal school of Freiburg lead by Walter Eucken (1846 – 1926) and Franz Böhm (1895 – 1977). It was first introduced in the public debate by the former German minister of financial affairs Ludwig Wilhelm Erhard (1897 – 1977) as the main principle of the German Christian Democratic Union during the Adenauer administrations.
[34] Mario Libertini, *op. cit.*, (2016), at 25 ff.
[35] *Ibidem,* at 26.

the State does not only passively observe private autonomy making its natural course, but public authority rather plays the role of the active grantor of the functioning of the market and of its outwards competitivity. Nevertheless, such a role does not become as central as it is in collectivist systems or command economy, for its task is still limited at securing the existence of a free market and to maximize private enterprise as much as possible as long as it does not adversely affect social-welfare.

According to what has been just exposed, three main observations may be formulated. On one hand, it seems quite clear that the preliminary assumptions concerning the concept of social market economy are not far away from those premises which stood behind the affirmation of the already explained idea of "granted liberalism", which so heavily influenced the establishment of the new economic world order after the end of World War two. On the other hand, such a conception does not entail a passive approach coming from public authority limiting itself in establishing the fundamental rules which shall govern economy, for the model concerned clearly entails positive efforts of political authority, as the latter shall be considered not only to be the grantor of capitalist economy but also the subject which is ultimately in charge for the existence of the market and competition. Finally and most importantly however, the economic model at stake is founded on a fundamental assumption: it is to say that competition is not anymore considered to be a target to be fulfilled, but rather an instrument which is necessary to secure both the proper functioning of private economy and the respect of those non-trade values which shall characterize the political and social framework of the European Union ([36]). Therefore, it shall be concluded that the safeguarding of the competitive structure of the market does not aim at preserving the market itself, but rather at protecting another central figure, namely consumers, which in political terms are the citizens of the European Union themselves indeed.

[36] In this respect: Mario Libertini, *op. cit.*, at 27 ff.

1.6. The problem of Harmful Tax Competition.

Once we have highlighted the general features of regulatory competition, thereby understanding the phenomenon according to which national legislators compete between each other, mainly through legislative deregulation, to create the more favourable legal conditions in order to attract foreign capitals and undertakings, a deeper analysis about the factors and the means by which such confrontation between national economies does realize itself must be carried on.

Clearly, with reference to the general characters of the production cycle and chain, it is undoubted that companies do not generally determine the market conditions on their own, for in principle, in a free-market oriented economy such as the European one, the latter are established automatically according to the behaviours of the market players collectively ([37]). In fact, entrepreneurs and managers do not create successful business *ex nihil*, for this is rather the result of the choices they make with respect to economic circumstances which are mainly determined externally, according to the environment in which the concerned undertakings operate. This also entails that even price determination, in a competitive market as well as in monopolies, must necessarily be linked to the "market power" or the "competitive price" of the interested product in a certain market, for wrong choices will sooner or later impose the exit of the interested entrepreneur from the market concerned.

The number of variables is even multiplied when the dimension of the market crosses the boarder of the national context concerned, as this does not only entail a mere enlargement of the geographical market, but also a respective increase of competitor companies and substitutes, of potential customers, of laws and rules applicable to products, services and trade etc.. Therefore, if *how* and *in what to invest* are issues which concern the psychology of investors and entrepreneurs with respect to their private competitors, the question *where to invest* does instead belongs in the framework of regulatory competition. If such a dynamic applies between different legal orders in general, it does clearly characterize productive choices in an even stronger way in the European dimension, for on one hand, the

[37] In planned economy it is the State.

Community has established both a customs union and a single market which potentially comprises all the Member States ([38]). Furthermore, on the other hand, art. 49 TFEU recognizes the freedom of establishment upon European service providers in the territory of every Member State of the Union.

A legal framework as such is of course likely to enhance intra-State competition in the Union and therefore, as it has been said, the EU legislator and the Contracting Parties of the European Treaties have foreseen mechanisms to prevent State behaviour to affect fair competition in the internal market. Such remedies will be analysed later on, especially those which are doomed to collide with the tax rulings issued by the Member States. For now, by way of introductive framing, it is important to highlight the means by which regulatory competition realizes itself between the Member States. On one hand, the traditional legal framework in which such contest finds its obvious *habitat* is of course the field of Labour Law. In fact, the *Laval* and *Viking* cases ([39]) must be considered the two cornerstones in the history of the ECJ case-law which light up more than others how much statutory provisions on the treatment of workers are likely to influence the private market players' choices. It is really self-explaining that the less guarantees are accorded to workers by domestic law, the more a national framework will be attractive for foreign investments, for companies will have their costs of production reduced ([40]). Such dynamic has in fact been conceived by both commentators and by an important part of European civil society as a thread to those welfare systems which constitute a traditional aspect of most of the European

[38] It is interesting to observe that if Regional Integration of economies is a well-established academical category in General International Law, commentators differently categorize systems. By way of example, SCISO individuates three main categories of Regional economic integration (Free Trade Area, Customs Union, Single Market), whilst SWANN adds the Economic Union to the list (Elena Sciso, *op. cit.* (2017), at 9; Dennis Swann, *The Economics of the Common Market* (Great Britain: Penguin, 1992) at 11-12.

[39] Case C-438/05, *International Transport Workers' Federation and Finnish Seamen's Union v Viking Line ABP and OÜ Viking Line Eesti* (2007), ECLI:EU:C:2007:772.

[40] It is surely well-known that Eastern European countries, which acceded the European Community progressively after the downfall of the Soviet Union heavily benefitted from the relatively low-cost of labour which they were able to offer on the single market, Poland and Romania in particular. On this point, see *e.g.*: McKignsey&Company Report, *Poland 2025: Europe's new growth engine* (January 2015); Georgiana Bendre, *Romania champions EU economic growth in Q1*, Business Review, business-review.eu (16th MAY 2017) available at: <http://business-review.eu/news/romania-champions-eu-economic-growth-in-q1-137861>

constitutional orders ([41]).

Nevertheless, as far as the present essay is concerned, we shall focus on another primary element on which the efforts of the Member States are generally concentrated when it comes to regulatory competition. As it has already been highlighted, such important leverage clearly consists in taxation policy. As a matter of fact, tax competition is one of the main aspects which characterizes competition between legal orders among the Member States of the European Union. By reference to the categories highlighted by DOS SANTOS, tax competition may be framed as a field in which both *yardstick competition* (thereby meaning virtual competition between two systems which realizes itself through the comparison made by the user of the different results which are obtainable in the systems at stake) and *active rivalry* between different legislators converge ([42]). Although such observation may apply *mutatis mutandis* to intra-State competition through Labour legislation as well, there is a great difference between the two fields. In fact, the 'flexibilization' of labour law and of the labour market necessarily collides with the needs inherent to workers protection rules, which, at least in Europe, are also often provided at constitutional level. Taxation instead, while being normally the primary source of income for a State's budget, does not necessarily require a balancing between the need for economic growth and the aim to provide for the respect of non-trade values, as lower taxation rates do not necessarily correspond to a decrease of governmental resources. By contrast, in general, the lower taxes are, the more national systems become attractive for foreign companies and, as a result, taxpayers

[41] By the way, the heavy criticism by which the civil society replied to the outcome of *Laval* encouraged the European institutions to take action. As CRAIG and DE BÚRCA pointed out *"the judgement has been much criticised"* because *"not only did it involve the disruption of the much-admired Swedish social model, pitting this against the economic freedoms of the treaty, but it did so in the context of the 'new socio-economic diversity in the Union subsequent to its Eastern Enlargement', bringing to prominence the significant economic disparities between different parts of the European Union"* (Paul Graig and Gráienne De Búrca, *op. cit.* (2015) at 837). Indeed, the fear before the loss of social rights is one of the major aspects behind the growing Euroscepticism in the western Member States which eventually lead to the results of the Brexit referendum. Also see: Sharon Baute, Bart Meuleman, Koen Abts, Marc Swyngedow, *European integration as a threat to social security: Another source of Euroscepticism?*, European Union Politics n. 19 (June 2018), at 209-232.

[42] CPB Netherlands Bureau of Economic Analysis, *Working Paper 133* (1st December 2000), available at: https://www.cpb.nl/sites/default/files/publicaties/download/yardstick-competition-theory-design-and-practice.pdf

will normally and consequently increase by number and therefore, virtually speaking, there might be no impact on social security and welfare aspects at all ([43]).

Thus said, further analysis of the phenomenon concerned must be provided. From the market players' point of view, indeed, a first distinction must be drawn, for the aim to pay less taxes is generally pursued in order to better withstand the pressure of competitors in the market. In fact, on one hand we may distinguish *praeter legem* or *extra legem* competition, thereby understanding the challenge carried out through the choice and the setting forth of relieved statutory taxation regimes, and *contra legem* competition, mainly individuated in subjective strategies of the taxpayers aimed at paying less taxes illegally. If the latter characterizes itself for the purpose of "tax evasion", the former clearly aims at reaching "tax optimization" ([44]). For *contra legem* tax competition depends on the individual attitude of the market players towards the respect of the legal order in which it operates, it is clear that it is the field of *prater* or *extra legem* competition which is the real framework for the self-development of statutory tax competition, thus again understood as the merger of *active rivalry* between regulatory powers and *yardstick competition* flowing from the investors' calculations pursuing profit maximization. Once this aspect is clarified, it shall be reminded that the ultimate goal of the Treaty provisions concerned with issue is to safeguard an entire economic system for the consumers' sake. Therefore, if market competition is in general conceived as a rather positive thing because of its liability to decrease prices and improve product and service quality, in principle there is no reason why tax competition should be considered otherwise, given that regulatory competition is an important booster for overall economy. The EU has indeed adhered to the latter conception, for taxation policy is an issue which still largely falls within the shared competence of the

[43] ARENA perfectly highlights the functioning and effects of harmful tax competition in the internal market as follows: *"se uno Stato intraprende una politica fiscal aggressiva, c'è il rischio che gli altri Stati Membri reagiscano abbassando a loro volta la pressione impositiva, dando luogo ad una corsa al ribasso: non a caso, tra il 1995 e il 2014, il livello di tassazione medio del reddito d'impresa nei Paesi dell'Unione si è ridotto dal 35% al 23%"* (Amedeo Arena, *op. cit., (*2017) at 932).

[44] Indeed, it is interesting to notice that, according to RAPP, *"tax optimisation is not illegal per se, member states have an obligation under Article 4(3) TFEU to exercise their national competencies in line with EU law (in particular, with their obligations under Article 107 TFEU)"* (Julia Rapp, European State Aid Coordination Unit, in: William Spence Ukael, *William Spence UKAEL Report FIDE Conference 2018* (May 2018) at 1, available at: <*http://www.ukael.org/files/Spence-FIDE-Conference-Report-2018.pdf*>.

Member States and the Union itself as it will be explained in detail in the coming paragraphs. According to what has been said then, it is necessary to draw a further distinction. On one hand, taxation might be used to foster growth with respect to national economy as a whole, thereby including both foreign capital and enterprises which operate on the territory of the interested State. In this case, provided that tax policies are not applied in a discriminatory manner towards investments from other Member States, there is no reason why the Commission or the Union in general should catch the policy measures at stake as unlawful in the internal market, for the fostering of growth can be considered the mean by which social and non-trade values the Union is based upon may be secured (*e.g.* unemployment reduction, technological development etc.) ([45]). On the other hand, things radically change with respect to taxation policy, whenever the latter is aimed at attracting foreign investments depriving other States from important resources for economic development in a way which may be deemed unfair. Such latter kind of practice is therefore identified with the designation of *harmful tax competition* ([46]). It is clear that, given the deceitful character of such sort of policies, governments have been driven to set up initiatives with the purpose to hinder as much as possible the spread of the phenomenon at stake, provided that according to the principles of general International Law the power to determine the tax burden through national law still falls in the States' *domain reservé*.

[45] In fact, GUIZZI seems to confirm this reasoning affirming the following: *"È interessante notare che nelle prese di posizione delle istituzioni comunitarie il rilievo dato all'esigenza di alleggerire il carico fiscale sui lavoratori dipendenti ed in particolare su quelli meno qualificati, ritenendosi che l'elevata pressione tributaria sul lavoro dipendente abbia effetti negativi sull'occupazione e più in generale sulla crescita* […] *in altre parole la lotta alla disoccupazione non si realizza solo con un'attiva politica dell'occupazione, ma anche con un'adeguata politica fiscale"* (Vincenzo Guizzi, *op. cit.* (2015) at 724).

[46] Indeed, RUBENS defined harmful tax competition as "*les mesures fiscales discriminatoires par rapport au régime de droi commun"* (in António Carlos Dos Santos, *op. cit.* (2009) at 60). This point will be discussed later on.

1.7. The relationship between the OECD and the framework of the European Union in matters of tax competition.

In order to prevent harmful tax competition at international level, important efforts to counter harmful tax practices have been made in the framework of the Organization for Economic Cooperation and Development (OECD) since 1998, with the publication of the Report on *"Harmful Tax Competition: An Emerging Global Issue"* ([47]). In fact, the organization at hand has been the main forum where the international community addressed the issue of harmful tax competition, having acknowledged its liability to undermine fairness in international trade relations. The action of the OECD in this framework is aimed in particular at preventing the s.c. *Base Erosion and Tax shifting* practices, thereby understanding such *"tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations"* ([48]). Nevertheless, it has been pointed out ([49]) that the framework of the organization concerned is still based on a wide conception of harmful tax competition, provided that *"tax competition and the interaction of tax systems can have effects that some countries may view as negative or harmful but others may not"* ([50]) , given that *"harmful effects may also occur because of unintentional mismatches between existing tax systems, which do not involve a country deliberately exploiting the interaction of tax systems to erode the tax base of another country"*([51]). Moreover, in the 2017 Report on Harmful Tax Practices, it is highlighted that *"every regime has different features, and considerations of how the substantial activities requirement applies must take place in the context of the category of regime being considered"* and therefore *"the degree of* [such] *activities that might be appropriate for one type of regime will not necessarily be adequate in the context of another type of regime"* ([52]). It shall consequently be concluded that *"decisions on one type of regime do therefore not necessarily have an implication for decisions on other regimes"*. Such case-to-case

[47] OECD, *Harmful Tax Competition: An Emerging Global Issue* (1998).
[48] See: OECD Website, available at http://www.oecd.org/tax/beps/.
[49] António Carlos Dos Santos, *op. cit.* (2009) at 61-62.
[50] OECD Report: *Harmful Tax Competition: An Emerging Global Issue*, § 27, at15
[51] *Ibidem*, §28 at 15
[52] OECD, *Harmful Tax Practices - 2017 Progress Report on Preferential Regimes* (2017), Note 2., at 14.

approach reflects the nature of the OECD being a 'traditional' International Organization based on the idea of "sovereign-equality" of its Members.

Consequently, the approach at issue mirrors the need to safeguard the States' sovereignty, of which the power to freely choose and impose the preferred taxation regimes is certainly an important element. Such general approach based on a generic hostility against preferential tax regimes therefore differs from the perspective adopted in the EU, although the centrality of the national taxation matters is a well-established principle also at Community level. The existence of a system of economic integration concretized in the "internal market" ex art. 3(3) TEU entails that approaches based on the research of merely *in casu* solutions does not fit the regulatory needs of the Union, for the interpenetration of the Member States' economy surely requires application of different rules and principles which shall be sufficiently clear as well as pre-established. As we will see in the following pages, in fact, the issue of taxation is addressed by EU law under several points of view and through various instruments which are certainly 'less respectful' of the sovereign dimension of the Member States if compared to the OECD model ([53]). In this light, it becomes clear that the model by which the Community legislator and the drafters of the Treaties were mainly and naturally inspired has been again the experience of the already existing federal systems. This is, after all, the consequence of the fact that, if from a legal and constitutional point of view there is a self-evident difference between the model of the federal state and an international organization, although supranational, from another perspective the economic consequences of both systems are, in principle, essentially the same. Indeed, this consists in the establishment of a common economic room in which competition between the single entities is enhanced by the loss of certain 'sovereign' prerogatives of the central authorities of the system itself ([54]). In fact, the establishment of a common market concerning products, services, workers and capital which is shared by all the Member States of the Union clearly increases both private and regulatory

[53] The OECD clearly pursues its aims mainly through a soft-law approach.
[54] It must however be highlighted that in the case concerned, a big difference still exists between the compared systems. In fact, for what concerns taxation matters especially, it is important to remind that while in the EU the rules governing such competition are enforced through a vertically integrated system of judicial remedies, in federate States such as the US or Canada.

competition in the framework of the market itself.

But such reality does also entail the creation of a kind of "neighbour common market" in taxation matters as it happens in practice in federal States too: namely the s.c. *"marché des impôts"* ([55]). According to neoclassical economic theories in fact, taxation has to be considered nothing else than the price paid by a subject (the taxpayer) to the State in order to obtain a service provided by the latter in exchange. Therefore, taxation, as inherently characterized by the mechanism of Demand and Supply, shall be considered as being itself part of a market *strictu sensu* as any other service-related price.

Nevertheless, such notion does not really take into account the mandatory character of taxation, for it does not draw a distinction between the contributions which according to the French terminology classify themselves as *"taxes"*, and those taxes which have to be considered as *"impôts"* instead, due to their mandatory nature *a priori*. In fact, the definition is based on the assumption that the taxpayer always has the freedom to choose to pay for the service or to renounce to it, while no choice is permitted with respect to the obligation to pay income taxes.

Nevertheless, circumstances change when a subject (*e.g.* a company) may choose where to pay its taxes through establishing himself in a certain State, thereby also indirectly determining the general amount of taxes that he will pay through comparison with the other options on the table (here again we have an example *yardstick competition*). This is, in fact, the core of the problem.

As it has been said, in the framework of general International Law, States are normally empowered to regulate any issue falling within their sovereignty, thereby comprising the power to freely determine taxation rates applicable to activities and estates falling under its jurisdiction, limited only by their own international obligations. Therefore, a State may provide an overall legislative policy which is aimed at differentiating its own national market from the one of foreign countries, thereby limiting tax competition. In fact, a company will be able to choose to pay more taxes to accede better overall market conditions (*e.g.* a larger number of potential customers, a higher *per capita* income, more flexible labour or environmental legislation, lower prices for raw materials etc.) or to rather scarify

[55] António Carlos Dos Santos, *op. cit.* (2015), at 72.

the need for a more advantageous environment to capitalize on lower tax rates granted by another State. Moreover, a State might in general even penalize products or services provided by foreign companies which pay less taxes abroad through protectionist policies; thus, having the collateral effect to undermine the efficacy of foreign harmful tax practices with respect to its own national market ([56]). The situation is completely different when it comes to federal systems and supranational framework the European internal market alike. In fact, by referring to the memorable wording used by the ECJ in *Dassonville*, the idea of the internal market is based upon the elimination every State policy or measure *"capable of hindering, directly or indirectly, actually or potentially, intra-Community trade"* ([57]), as to annihilate as much as possible any distinction between the individual national markets of the Member States and the European market as a whole. Such a framework has huge consequences with respect to the earlier reasoning, for regardless of the Member State in which it is established, the taxpayer company will have, in principle, market-access to the whole Union. Such a reality is therefore liable to strongly enhance regulatory competition in taxation policy, as under this light, it becomes very clear that the suppression of unfair taxation policies is an aspect of primary importance in the framework of the European Union. In fact, if on one hand the initiatives which have been undertaken in the OECD context pursue the wider aim to grant more fair and cooperative conditions in international trade, the fight against harmful tax competition becomes essential for the functioning and safeguarding of the whole system constituting the EU. Indeed, this rationale applies to the matter of State aid, which is by the way one of the legal frameworks that inexorably catch intra-community taxation practices (and therefore also Tax Rulings).

Furthermore, the problem becomes even heavier if confronted with some requirements laid down by law in general, as if action taken at international level

[56] However, it is clear that such possibility has become very limited in practice because of the establishment of a world economic order strongly based upon a free market ideology. At international level, in fact, although they provide lighter restrictions with respect to both EU primary and secondary law, the possibility to implement restrictive policies has been strongly limited since the GATT of 1947 for what concerns trade in goods, and by the other multilateral agreements concluded within the WTO in general.

[57] Case C-8/74, *Procureur du Roi vs. Benoît and Gustave Dassonville* (1974), ECLI:EU:C:1974:82.

has to be balanced with the general principles of international taxation law only (first of all, the prohibition of double taxation), at Community level, such need has to be added to the fundamental aim to impede that discriminatory measures are provided by a Member State disadvantaging the others and their nationals, which is something that often had a certain primacy as the ECJ case-law clearly shows. In fact, the OECD's approach tends towards a States' overall recognition of the same taxation conditions imposed upon foreign nationals with respect to those recognized by their State of origin to its own citizens abroad according to the principle of reciprocity. By contrast, the EU pursues the application of the national treatment at domestic level by the universality of its Members towards foreign nationals of other Member States. Thus all said, we may conclude that tax competition is something which does not have negative effects *per se*, for both foreign and domestic investments provided on a same territorial framework may benefit from economic advantages through a general or sectoral tax cuts. On the other hand, however, such decreases of tax burden aimed at distracting resources from one State in order to foster domestic growth in a non-cooperative way (*harmful tax competition*), do attract the worries of the general international community. Thus, especially for what concerns systems of regional integration which functioning really depends on an overall maintenance of competition condition, as the EU internal market indeed.

1.8. The development of the competences of the EU in tax matters.

Once the essential differences existing between the needs behind the OECD and the EU approaches towards regulatory competition in taxation matters have been underlined, it is worth to recognize that neither the OECD nor the Union do in fact clearly identify the economic, technical and political criteria on the grounds of which they identify a distinction between *fair* and *harmful* tax competition ([58]). Therefore, the approach towards taxation has a multiple nature in the framework of EU law.

In fact, harmful tax competition is regulated through both *hard law* and *soft law* measures. This "double approach" has been adopted by the EU legislator in

[58] On this point, see: António Carlos Dos Santos, *op. cit.* (2015).

order to better balance the needs for a uniform set of rules and for the unitary dimension of the common market on one hand and the Member States' sovereignty in taxation matters on the other. The reason behind the latter need is based on the assumption that taxes still represent the main and primary source of income for the governments' budgets, which in turn constitutes the resources necessary to provide the s.c. *economic services of general interest*, whose special recognition by the European legislator is another pillar of the single market. Therefore, the lawmakers felt that a certain margin of discretion had to be recognized upon the Member States and, consequently, besides hard law harmonization, the adoption of soft law instruments was considered to be the right path.

However, it must first be recalled that the present European legal system applying to tax matters is the result of a long and quite troubled evolution, guided by the assumption that due to the supranational dimension of the Union the issue concerned had to be addressed differently by the EU law-makers when compared to the approach common to national legislators ([59]). Such evolution followed a double path: on one hand, the need for a competence in tax matters at European level became more and more felt with respect to the urgency to grant the Community's own budgetary incomes to better face the progressive increase of its competences and powers. On the other hand, it was equally necessary to establish a common legal framework regarding taxation with the aim to construct a coherent legal order in the light of the aim to set up the internal market. Under the former profile, although the issue of taxation was not directly addressed, it is interesting to highlight the fact that according to the Treaty of Paris the ECSC could already benefit from its own sources of income through the production of steel under the monitoring of the High Authority. Such approach was however impossible to be adopted for what concerns the European Economic Community, and therefore, according art. 200 of the Treaty of Rome of 1957 (the EC Treaty), while the

[59] According to BERLIN*: "C'est que la notion meme de droit fiscal communautaire, par sa nouveauté, est susceptible de dérouter le juriste habitué aux décupages traditionnels des matières juridiques. Elle suggere a priori l'impression qu'il existe des règles fiscales propres aux Communautés européennes, ce que personne n'ignore plus aujourd'hu. Mais elle laisse entendre également que ces règles n'appartiennent ni au droit fiscal ni au droit fiscal international, fut-il eruopéen."* (Dominique Berlin, *Droit Fiscal Communotaire* (Paris: Presses Universitaires, 1989), at11).

adoption of the budget had to be approved at Community level by the Council of Ministers through unanimity vote, the EEC exclusively depended on the contribution of its Member States for more than ten years.

In this respect, the first milestone towards the recognition of the Community's financial autonomy has been laid down through the conclusion of Treaty of Luxembourg in 1970. Such reference is very important, for besides the Member States' direct contributions, custom duties and levies on agricultural imports, indirect taxation was also included in the list of the four own sources of income of the EEC, thereby imposing the primacy of EC law for what concerns the Value Added Tax (VAT). Then, in 1988 a further source was foreseen through the Delors I Package, which introduced a new resource consisting in further individual contribution based on the Gross National Products of the Member States (the s.c. GNP resource), while expanding the VAT resources in the meanwhile. However, the system needed soon to be reconceived because, since the foundation of the Steal and Coal Community, the Member States doubled by number.

In fact, in addition to the six original founding States (Belgium, France, Germany, Italy, Luxembourg and the Netherlands), new countries joined the Community in 1973 (Denmark, Ireland and the United Kingdom), in 1981 (Greece) and in 1986 (Portugal and Spain). In the light of the entry of three further States in 1995, namely Austria, Finland and Sweden, it became absolutely necessary to grant balance in the budgetary system of the EC. Therefore, the Delors package II (1993-1999) increased the weight of the GNP resource while decreasing the one of the VAT; thus, in order to accommodate the needs of those 'new' Member States having weaker economies ([60]). The final step of the evolution towards the Union's present financial autonomy is represented by the conclusion of the Treaty of Maastricht in 1993 and by the Interinstitutional Agreement of 1999 ([61]), which

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[60] This action was crucial also in the light of the entry of most of the States of the former eastern block in 2004 and 2007.

[61] Measures in force provided to compensate the disequilibriums are mainly the following: *"The United Kingdom is reimbursed by 66% of the difference between its contribution and what it receives back from the budget"*, *"lump-sum payments* [are granted] *to Denmark, the Netherlands, Sweden and Austria"*, *"reduced VAT call rates for the Netherlands, Sweden and Germany"*
(European Commission, Budget, Multiannual Financial Framework, available at:
:<http://ec.europa.eu/budget/mff/resources/index_en.cfm>)

eventually culminated in the adoption of several secondary law acts which constitute the present regulatory framework of the EU's sources of income (mainly: Reg. 2040/2000, Dec. 2000/597, Reg. 1605/2002, Reg. 2342/2002) ([62]).

According to the second aspect instead, as explained, in the 1960s it became already clear that the European Economic Community could not properly function without a coherent set of rules with regard to taxation. The question, however, was about what approach to follow in drafting such regulatory framework. On one hand, it was clear that indirect taxation required full harmonization ([63]), for the creation of a common economic space without barriers in trade made it necessary to provide equal rules for taxation on commercial transactions ([64]). According to what had been experimented in framing the regulation of the VAT, the European legislator had first tried an approach based on harmonization for what concerns direct taxation too ([65]). In fact, the first step forward in such direction has been undertaken with the adoption of the well-known *Neumark Report* by the Fiscal and Financial Committee in 1960, which was fundamentally based on two main aims.

[62] Some commentators have however invoked the necessity for a further reform of the system at stake. In fact, already in 2007, RIVOSECCHI claimed that: *"Nelle fasi successive della costruzione europea […] si sarebbe dovuto procedere ad una riforma dei meccanismi ridistributivi […]. La scelta, invece, di riservare ai nuovi Sati membri analoghi benefici rispetto a quelli spettanti ai Quindici sembra trascurare i costi economici rilevanti di un'Europa allargata. Questi ultimi potranno essere infatti soltanto relativamente "temperati" dal previsto periodo di transizione, nel quale i nuovi membri dell'Unione contribuiranno ad alimentare le entrate del bilancio comunitario, ma i trasferimenti in loro favore entreranno a regime soltanto nel 2013"* (Guido Rivosecchi, in, *Trattato di diritto amministrativo europeo – Tomo* Mario Chiti e Guido Greco *II; Parte Generale*, (Milano: Giuffrè 2007)).

[63] Art. 99 of the EC Treaty provided that: *"the Commission shall consider how the legislation of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation, including countervailing measures applicable to trade between Member States, can be harmonized in the interest of the common market."*

[64] The rationale behind the VAT regulation in the Union has been well and effectively described by BIRKENFELD: *„Der Binnenmarkt der EG umfasst einen Raum ohne Binnengrenzen […], in dem der freie Verkehr von Waren, Personen, Dienstleistungen und Kapital gemäss den Bestimmungen des EWGV gewährleistet ist. Zur schrittweisen Verwirklichung des Binnenmarkts trifft die Gemeinschaft die erforderlichen Maßnahmen, zu denen ausdrücklich die weitere Harmonisierung der Rechtsvorschriften über die Umsatzsteuer […] zählt. Die Ziele des gemeinsamen Binnenmarkts sind umsatzsteuerrechtlich – im Endstadium – erreicht, wenn grenzüberschreitende innergemeinschaftliche Umsätze behandelt werden. Das setzt voraus, dass der Grenzausgleich, d.h. die Besteuerung der Einfuhren und die Steuerbefreiung der Ausfuhren, bei innergemeinschaftlichen Umsätzen beseitigt wird"* (Wolfram Birkenfeld, *Umsatzbesteuerung im Binnenmarkt* (Berlin: Erich Schmidt Verlag, 1996)).

[65] Indeed, in principle, *"EU law leaves to the Member States plenty of room for manoeuvring in the field of* [direct] *taxation"* for *"there can be no doubt that it is for the Member States to decide the overall tax burden within their jurisdiction"* (Leigh Hancer, Tom Ottervanger, Piet Jan Slot, *op. cit.* (2016) at 13-006/13-007.).

First, it highlighted the need to strongly decrease the disparities between national legislations among the Member States to better secure intra-community coordination in both taxation and financial matters. Thus, again, with the purpose to ultimately grant better fair play conditions in the common market. Secondly however, such goal had to be balanced with the fundamental requirement of non-interference in national policies of the Member States insofar they were aimed at conserving the *"*national characters*"* resulting from *"*natural factors*"* or from their *"*historical evolution*"* ([66]). Two further steps towards harmonization of direct taxation have been undertaken through the *Van der Tempel Report* (1975) and, finally, with the *Burke Report* (1980). The former formalized a proposal for partial harmonization of corporate and dividends taxation, while the latter focused on the need to establish an EU-wide common tax base, which is an issue that still has centrality in the political debate at Community level ([67]). However, if the Van Tempel Report has barely lead to the adoption of the 77/799/CEE Directive, the hostile attitude of the Member States combined with the unanimity rule contained in the former art. 100 EC Treaty did prevent the Burke Report of 1980 to achieve concrete results. This substantial failure encouraged the Commission to abandon the desire to provide a system of full harmonization of direct taxation in the near future. In this respect, the abandonment of the project at issue entailed the establishment of the s.c. '*two tracks'* approach. On one hand direct taxation was finally recognized to be a subject matter falling, from a general point of view, still within the regulatory competence of the Member States' authorities on the basis of the principle of subsidiarity. In fact, such rule has been implicitly concretized by the Treaty of Lisbon in the present wording of art. 113 TFEU, where it is stated that *"the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation* [only] *to the extent that such harmonisation is necessary to ensure the establishment and the*

[66] *Neumark Report*, in: Gaetano Casertano and Claudio Sacchetto, *Tributi*¸ in: Mario Chiti e Guido Greco, *Trattato di diritto amministrativo europeo – Tomo IV; Parte Speciale* (Giuffrè 2007) at 2278.
[67] Such aspect will be analysed later in this essay, for the Commission has not abandoned to highlight the necessity of such a step forward for a better integration in taxation matters.

functioning of the internal market and to avoid distortion of competition". Such article fundamentally affirms the primacy of national law in freely determining the internal taxation regime applicable to incomes, which is limited only insofar the system provided by national legislation has a discriminatory effect towards nationals of other Member States according to the principle of neutrality.

By the way, this rule is explicitly established by art. 110 TFEU with respect to intra-community trade in goods, where it affirms that *"no Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products"* at paragraph 1 and that *"no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products"* at paragraph 2. On the other hand, however, it has been acknowledged that such a general rule could not be applied to certain categories of direct taxes, for the harmonization of the rules concerned had to be deemed as crucial for the very functioning of the internal market. Thus, in fact, in a way not dissimilar to what has already been stated with respect to indirect taxation.

For this reason, a harmonized taxation system has been provided not solely for transactions, but for intra-community operations too. In this respect, the *Ruding Report* of 1993 contained a first proposal based on three main pillars: 1) the harmonization in the field of taxation on dividends and interests; 2) deeper harmonization of corporate law; 3) the identification of a set of criteria for the determination of the tax base.

While such project failed, in 1997 the Commission and the Council enacted a fundamental Notice ([68]), which constitutes the founding stone of the present approach of the European Union in the field of direct taxation. In fact, such document contained two main proposals. On one hand, it highlighted the necessity for the adoption of a "Code of Conduct" with the aim to guide the Member States' policies in order to counter harmful tax competition in the Community. On the other hand, it promoted the enactment of legislative acts at European level, pursuing the aim of harmonization in matter of taxes applicable to companies and corporations.

[68] Notice (97) 495 of the Council and the Commission.

Such *corpus* of rules, along with the rules concerning State aid which will be analysed in detail later on, may be considered as the legal basis of EU law and the exercise of its competences in taxation matters, although this overall regulation is clearly characterized by a lack of uniformity due to the fact that the norms concerned do not aim at building the internal market, as they are rather necessary to secure its well-functioning.

Before looking at the contempt of such measures, we may draw an important conclusion. In fact, the rationale behind the whole system may be explained in the light that the Member States, while being willing to liberalize trade within the community, have on the other hand not accepted any strong limitation of their *souveraineté fiscale*, for their budget strongly depends on their freedom to flexibly determinate the internal taxation regimes applicable to private incomes.

By the way, such need is confirmed by the fact that the Code of Conduct itself, as being a *soft law* act, is founded on the assumption that the solutions to harmful tax competition should be better found at political level, without further limiting the Member States' sovereignty through binding rules of law. Legally speaking, the persistent need for the centrality of the national dimension in the subject matter of direct taxation may be explained under two main profiles, both linked to the entry into force of the Maastricht Treaty (1993). On one hand, in fact, such conclusion is in a certain way inherent to the establishment of the principle of subsidiarity as one of the guiding pillars for Community action ([69]). As it is well-known, the latter imposes upon the Union the duty to abstain from intervening as long as the Member State is capable to achieve the objectives of European integration in the matters falling within its shared competence with the EU itself through its individual effort and resources ([70]). Secondly, moreover, the fail to concretely provide a reform of nowadays art. 65 TFEU, due to the ongoing veto of

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[69] As ROCCATAGLIATA affirmed: *"è chiaro a questo proposito che i sistemi fiscali rappresentano un punto fondamentale delle identità nazionali e che una loro progressiva uniformizzazione non può che avere come conseguenza un cambiamento importante della stessa struttura sociale degli Stati Membri, dato che il prelievo fiscale rappresenta normalmente la fonte principale di finanziamento del bilancio dello Stato e pertanto l'elemento chiave per determinare le scelte della sua politica di spesa"* (Franco Roccatagliata, *Diritto tributario comunitario*, contenuto in: Victor Uckmar, *Diritto tributario internazionale* (CEDAM, 2005) at 144-ss).

[70] Article 5(3) TEU and Protocol N.2 on the application of the principles of subsidiarity and proportionality.

the Grand-duchy of Luxembourg, has always prevented the recourse to an important instrument which could be used to eventually limit the Member States' sovereignty, and therefore to indirectly counter harmful tax competition: namely, cross-border cooperation between national authorities. However, it must be observed that the *two tracks* approach does not entail a strict separation between the two regulatory channels described above, for the two paths are necessarily doomed towards reciprocal interpenetration ([71]).

1.9. The Code of Conduct for business taxation.

As said before, different approaches have been adopted by the European institutions for what concerns the issue of taxation in the internal market, provided that the fight against harmful tax competition has been recognized as being the main rationale guiding the Community legislator in drafting the interested rules ([72]). The Code of Conduct ([73]) represents such soft law approach deemed necessary to preserve as much as possible the Member States' sovereign prerogatives in the field of taxation. Such instrument was elaborated after a resolution adopted by the Council in 1997 on the grounds of both the s.c. *Monti Package* (1997) ([74]) and the s.c. *Primarolo*

[71] As CASERTANO and SACCHETTO observed with respect to such aspect with respect to the Italian reform of domestic taxation legislation: *"La recente riforma fiscale ne è un esempio laddove nella legge delega prevede espressamente che il legislatore delegato debba adeguarsi alle misure prese in sede comunitaria non solo per ottemperare alle regole del divieto di non discriminazione, ma anche per rendere più competitivo il nostro sistema fiscale"* (Gaetano Casertano and Claudio Sacchetto, *op. cit.* (2007), at 2278 ff.)

[72] *"L'attenzione delle autorità comunitarie sulle politiche degli aiuti di Stato fiscali ha assunto una prospettiva nuova e più ampia anche a seguito della loro inclusione tra le misure rilevanti ai fini del Codice di Condotta, che hanno peraltro una diversa specifica finalità: quella di contrastare il fenomeno della c.d. concorrenza fiscale dannosa. Il Consiglio ha posto infatti sotto il controllo della Commissione gli interventi/aiuti statuali adottati in materia di imposte dirette, in tal modo riducendo ulteriormente le competenze fiscali degli Stati Membri in uno dei settori più sensibili della politica economica, come quello della fiscalità di vantaggio"* (Harmful tax Competition)" (Gaetano Casertano e Claudio Sacchetto, *op. cit* (2007) at 2271).

[73] Conclusions of the Council of Economics and Finance Ministers (ECOFIN) (1 December 1997).

[74] The Monti Package is the name by which a set of acts proposed by former European Commissioner Mario Monti pursuing a better coordination in taxation matters is identified. The package consists in following instruments: Decision 2005/842/EC, Reg. 2005/C 297/04 (rules on State Aid through compensation for the provision of public services) and the Directive 2005/81/CE (80/723/EEC on transparency in financial relationship within State controlled companies and certain companies and the Union); also see: Antonina Giordano, *Aiuti di Stato: tempi rapidi per l'attuazione del pacchetto Monti"*, Fisco Oggi (25th November 2011).

Report (1999) ([75]), as the first attempt to regulate taxation practices within the EU. Section M regulates the geographical scope of application of the Code in a quite ambitious way. In fact, contrary to mandatory EU law provisions, the Code shall be applied on a geographical basis which shall be *"as broad as possible"* and the Member States are encouraged to promote the adoption of the rules contained in the act concerned not only in their detached territories, but also among third States ([76]).

By contrast, section A of the Code identifies its material scope, stating that the Code shall apply to *"business taxation"*, thereby understanding every kind of *"measures which affect, or may affect, in a significant way the location of business activity in the Community"*, including *"all the activities carried out between a group of companies"* regardless of their nature of being statutory provisions or administrative decisions.

Section B, in fact, affirms that such measures shall be in particular those which, by virtue of a derogation to general domestic taxation regimes, *"are to be regarded as potentially harmful"*. According to this point, section B imposes the duty upon the Member States to assess whether a measure is harmful or not, in particular with respect to following criteria: *a)* if the advantage is accorded to non-resident companies or concerns transactions between residents and non-residents; *b)* if the advantage is not considered in the calculation of the tax base ; *c)* if the advantage is conceded regardless of a *"real economic activity"* or a present establishment on the Member States' territory; *d)* if the rules for profit determination of multinational companies are consistent with the international standards such as those provided by the OECD; and *e)* if there is a general lack of transparency with respect to the measure concerned ([77]).

Once the measure has been identified as harmful, the two provisions flowing from sections C and D shall be activated. The former imposes upon the Member

[75] Report of the Code of Conduct Group, Business Taxation, (23 November 1999).
[76] The provision is clearly referred to those territories, mainly islands, which are still nowadays subject to the sovereignty of some member States as the vestiges of their former colonial Empires. A certain primacy is clearly recognized upon Gibraltar, as being still formally part of the United Kingdom. In fact, such latter situation characterizes one of the most debated and controversial issues concerning the consequences of the 'Brexit' referendum of June 2016 (*Inter alia*; Sean O'Grady, *Gibraltar is going to be an even bigger Brexit problem than Ireland – so why does no one want to talk about it?*, The Indipendent (1st March 2018); Sandrine Morel, *Brexit : Gibraltar veut garder une « relation étroite » avec l'Europe*, Le Monde (19th October 2016)).
[77] Code of Conduct, sec. B *lit. c).*

States to abstain from providing further tax measures liable to fall within sections A and B with respect to the existing ones (s.c. *Standstill* clause). By contrast, the latter establishes the obligation to re-examine the existing tax provisions and to amend the ones which are not lawful under the previous rules (s.c. *Rollback* clause); thus, on the base of a procedure laid down in the following sections (E-I) in which also an *ad hoc* group established by the Council shall be involved. Although not imposing legally binding obligations, the Council has foreseen some clauses with the aim to mitigate the extent of the commitments flowing from the above-mentioned sections. In particular, the second phrase on section G states that *"insofar as tax measures are used to support the economic development of particular regions, an assessment will be made of whether the measures are in proportion to, and targeted as, the aims sought"*; thus, in the assumption that *"the Council also emphasizes the need to evaluate carefully in that assessment the effects that the tax measures have on other Member States, inter alia in the light of how the activities concerned are effectively taxed throughout the Community"* ([78]).

But *"tax maximisation"* is not the exclusive object of the Code of Conduct, for also the unlawful behaviour of private market players enters in the scope of the instrument at stake. In fact, sections L and M provide exhortation upon the Member States to engage in cooperation in order to counter tax avoidance and evasion, mainly through an exchange of information between national authorities. Nevertheless, the soft law character of the Code is reminded through the provisions concerned where it is stated that such cooperation shall be established, besides the uniform rules provided by the international conventions to which the Member States might be parties themselves, also *"in accordance with their respective national law"* ([79]). Conclusively, section N contains a final provision, which encourages the European Commission to submit annual reports on the implementation of the Code of Conduct and, in general, on the application of the State Aid rules provided by the Treaties. Such final rule once again confirms that although the rules and regulations concerning the matter of taxation are quite patchy, the overall aim pursued is basically the same: to contrast by any means

[78] Code of Conduct, section G.
[79] Code of Conduct, section L.

unfair regulatory competition between European legislators within the internal market.

1.10. Harmonization in tax matters.

As it has been explained, the European legislator has laid down three important Directives with the purpose to provide uniform rules for taxation in certain critical fields. This mainly occurred on the grounds of arts. 114 TFEU and 15 TFEU, which empower the Concil to provide measures for the approximation of laws respectively along with the Parliament through the ordinary legislative procedure ex art. 294 TFEU or by its own through the special procedure. The acts which concretized such harmonization are the 90/435/EEC Directive (the s.c. “Parent-Subsidiary” directive), the 90/434/EEC Directive on cross-border mergers, the 69/355/EEC Directive on capital taxation and the 90/436/EEC Directive on double taxation and.

a) the “Parent-Subsidiary” Directive. ([80])

The Directive of the 23rd July 1990 n. 435 regulates taxation for transnational groups within the European Union. In particular it applies to the infra-community distribution of dividends between the undertakings which compose the group. Its core principle relies on the choice of the Member State in which the holding is established to whether exempt the dividends which the holding gets from the controlled company or to count the taxes which the controlled undertaking has already paid in the Member State in which it is established into the amount payed by the holding. Thus, provided that the Member States remain free to set rules and conditions concerning the costs of participations.

b) The 90/434/EEC Directive. ([81])

The Directive of the 23rd July 1990 n. 434 applies to all cross-border operations which entail a corporations’ change of structure. The core rule concerns the duty for the Member State of the “stable organization” which is the beneficiary of tax

[80] Massimiliano Di Pace, *Manuale di Diritto Comunitario dell’Economia* (Padova: CEDAM, 2000), at 124-125.
[81] Massimiliano Di Pace, *op. cit.*, at 125-126.

exemptions imposed by virtue of the operation to abstain from taxing them. The same rule applies to the transfer of shares or other instruments to the shareholders of the beneficiary corporation.

c) The 69/355/ECC Directive. ([82])

The Directive of the 17th July 1969 n. 355 has been subject to several recasts (through Directive 73/79/EEC, Directive 74/553/EEC and Directive 85/303/EEC). The aim of the directive consists in hindering obstacles to the free circulation of capitals, providing *inter alia* the criteria for the determinations of the tax base for contributions.

d) The 90/436/ECC Directive. ([83])

The Directive of the 23rd July 1990 n. 436 pursues the aim to eliminate double taxation on profits. To this end, it lays down a particular procedure which may be initiated by a claim of the undertaking before the competent national authority, which will cooperate in order to overtake the problem with the authority of the other Member State concerned if it may not solve it on its own. The national authorities may moreover request an opinion to the European Commission, which becomes binding if the administration concerned will be incapable to agree upon a solution.

1.11. The notion of State aid.

As it has been already pointed out at the very beginning of this work, infra-state economic struggle is an ancient form of competition, maybe even the oldest existing. State aid is clearly one of the main ways by which competition between States realizes itself, although it has existed in various forms. In fact, as it has been stressed, even the forerunners of modern corporations became, in the Modern Era, one of the main engines for imperial expansion through the continents. An example of such dynamic is clearly represented by the two historical British and Dutch

[82] *Ibidem*, at 127-128.
[83] *Ibidem*, at 126-127.

companies for the management of trade roots with the eastern colonies. Although the unlawful nature of their activities is beyond any doubt, even privateers of the late 16th century could be considered as beneficiaries of a kind of State endorsement and support for the activities of private operators, which clearly coincides with the rationale characterizing the core idea standing behind the concept of State aid. In fact, the natural environment for the evolution of the latter concept itself has been the application of protectionism after the second industrial revolution in the second halfth of the 19th century, where subsidies and barriers to trade were used by national legislators in order to enhance domestic economy and growth. Thus, mainly provided through the resources coming from the colonies and at the expenses of the neighbour-powers ([84]). After the catastrophic events of the first decades of the 20th century, the World has partially and progressively evolved towards an international trade system based on free market, although protectionism still exists in various forms not only in developing countries but also in the West. Nevertheless, in order to favour reciprocal investments, governments throughout the World, also with reference to foreign colonies, have progressively undertaken action towards liberalization in trade. Such an important evolution has reached its turning point with the establishment of the WTO after the Uruguay Round of 1994 and the adoption of the multilateral agreements constituting the s.c. *single undertaking* ([85]). Accordingly, the phenomenon of State Capitalism is even a greater impediment in trade relations when it comes to systems of Regional Economic Integration, especially for what concerns the EU, in the light of the establishment of the internal market ex art. 3(3) TEU. The harmful effects which State intervention might have on the competitive structure of the market have been already been sufficiently explained above. Nevertheless, it is important to remind that besides harmonization, which consists in the approximation of laws, the Treaty drafters also felt the need to lay down such rules to prevent the Member States to alter fair play on the market. Therefore, the rules concerning State aid were adopted,

[84] In fact, according to LIBERTINI, *"un punto debole del protezionismo, così come storicamente vissuto nel mondo occidentale, sta nel fatto che esso si è intrecciato ad una competizione tra Stati che, per lungo tempo, ha visto sovrapporsi al terreno economico/commerciale profili di politica di potenza, cioè di conquista coloniale o paracoloniale di territori e popoli da assoggettare all'egemonia politica di un paese più avanzato"* (Mario Libertini, *op cit.* (2016) at 12)

[85] Namely the GATT of 1994, the GATS and the TRIPS.

pursuing the aim to sanction the Member States which try to help their own economy damaging the economic potentialities of their partners, while imposing the obligation to eliminate direct and indirect measures provided to that ends.

According to this point, it becomes clear that the matter has huge importance with reference to the fight against harmful tax competition and therefore with respect to the instrument of Tax Rulings.

1.12. The rules on State aid provided by the TFEU.

In order to continue the analysis about the practice concerning Tax Rulings, it is important to highlight the general framework provided by EU law. Indeed, according to what has been just explained above, Tax Rulings and general discriminatory tax policies carried out by Member States are liable to fall within the general framework of State Aid, as contemplated in arts. 107 ss. TFEU.

As the Treaty provides, we should identify State Aid as such measures undertaken through the use of the resources of a Member State, which have the effect to *"distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States"* ([86]). In fact, such measures are to be considered incompatible with the internal market. Nevertheless, some commentators have highlighted the inexistence of an authentic legal definition of State Aid in the EU legal framework and the consequent lack of an authoritative notion ([87]). For this reason, legal writings and scholars have tried over time to identify the elements which shall compose the legal concept of State Aid. In fact, according to SANTACRUZ, there should be a distinction between those elements which compose the definition, with explicit reference to the requirements of the "selectivity" of the measure interested and its "imputability" to the State and resources, and those which by contrast represent the condition for the

[86] *Art. 107 § 1 TFEU.*
[87] António Carlos Dos Santos, *op. cit.* (2009), at 397; José Manuel Caseiro Alves, *Lições de Direito Comunitário da Concorrência* (Coimbra: Coimbra Editora 1989), at 170.

occurrence of the incompatibility of the measures with art. 107 TFEU itself. Thus, with a specific importance given to the element of "distortion" of competition ([88]).

Other commentators instead, like CHÉROT ([89]), affirm that it should not be important to define a precise notion of State Aid according to art. 107(1) TFEU, for the only elements which shall occur in order to concretely apply the restriction of the mentioned article shall consist, on one hand, in the criteria of "abnormality" of the measure, with reference to its derogatory character with respect to the general domestic legal order ([90]), and the affection of intracommunity trade on the other. In fact, the idea that it actually was in the Community legislator's intention to omit a authentic and authoritative definition of State Aid in the Treaties, thereby pursuing a kind of *soft-law* approach based on the will to strengthen the Commission's interpretative power on that point, is a common opinion among certain commentators ([91]).

Nevertheless, it should be underlined that the majority opinion never endorsed such doctrinal constructions. In fact, as illustrated by DOS SANTOS ([92]), the CJEU case-law shows that the Court itself followed a different path, trying to identify those elements which must occur in order to catch a public measure under art. 107(1), without determining their essential legal nature as SANTACRUZ did.

This methodical approach has been endorsed by the European Commission at last, showing once again the importance of the role played by the Court in the progressive construction of the EU legal order ([93]), although the Commission still

[88] Juan Lorenzo Arpio Santacruz, *Las ayudas públicas ante el Derecho europeo de la competencia*, (Navarra: Editorial Aranzadi, 2000), at 59.
[89] Jean-Yves Chérot, *Les Aides d'États dans les Communautés Européennes*, (Paris: Economica, 1998), at 17.
[90] According to CHÉROT himself, *"l'anormalité peut se définir par rapport à un critère de choérence lorsque le législateur se donne un système [...]. Dans ce cas constituent des aides les dérogations au système general qui ne son pas justifies au regard des objectifs même poursuivis par la réglementation générale."* (*Ibidem*, at 24, in: António Carlos Dos Santos, *op. cit.* (2009) at 397).
[91] On this point, see: Augusto Fantozzi, *The applicability of State Aid rules to tax competition measures: A process of "De Facto" harmonization in tax fields?,* 2002, in Wolfgang Schön , *Tax Competition in Europe* (Munich: IBDF Publications, 2003), at 121-132.
[92] António Carlos Dos Santos, *op. cit.* (2009) at 400-401.
[93] *i.e.*, ARENA excellently highlighted the phenomenon of the s.c. "Judicialization" of EU legislation, with the CJEU acting as the core engine for the development of the internal market (Amedeo Arena, "*The Court of Justice as EU's Informal Agenda-Setter: The Judicialization of European Audiovisual Policy"*, in *Studi sull'Integrazione europea, n. 2,* (Cacucci Editore 2013), at 285 ff.)

plays a central role in drafting policies in the field of State Aid ([94]). In fact, in notice 2016/C 262/01, the Commission recognized the features according to which the Commission itself, as well as the competent national authorities of the Member States, shall identify a measure as being a State aid and, therefore, declare it to be incompatible with the scope of art. 107(1).

Those elements are: 1) the fact that the measure is addressed towards one or more "undertakings" in the meaning given to the term by the CJEU's case-law ([95]); 2) the State origin of the measure itself; 3) the fact that the measure shall determine a comparative advantage to the undertaking concerned ([96]); 4) the selectivity of the measure with respect to the undertakings which are caught by it and 5) the distortive effect on intra-EU trade and on competition in the internal market. This approach clearly shows, again, that the general effort of the EU institutions and the rationale according to which arts. 101 to 109 TFEU were originally drafted are both reached out to secure as much as possible that the single market players within the EU will act on an equal "level playing field". In fact, the anti-competitive aspect of art. 107 has to be considered as the key-element of the provision itself, given the fact that, according to the wording of the article, public economic intervention measures are not prohibited, *rectius* incompatible with the Treaties *a priori.*

Besides the general rule of art. 107(1), the following paragraphs regulate the cases in which a State may lawfully lay down such measures which otherwise would be caught *prima facie* by the prohibition laid down in paragraph 1. Thus,

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[94] In fact, as pointed out by CRAIG and DE BÚRCA, the CJEU, although having its own view of the matter concerned, has only the power to verify "*whether the Commission complied with procedural rules*" (Paul Craig and Gráienne De Búrca , *op. cit* (2015) at 1130).

[95] According to the position expressed by the Court in the well-known *Höfner and Elser v. Macrotron* case, the term "undertaking" shall be liable to catch *"every entity engaged in an economic activity, regardless of the legal status of the entity or the way in which it is financed"* (Case C-41/90, *Klaus Höfner and Fritz Elser v Macrotron GmbH* (1991), ECLI:EU:C:1991:161) excepting only those entities which pursue non-lucrative purposes (*ex multis,* see Paul Craig and Gráienne De Búrca, *op. cit.* (2015)) while art. 107 continues to apply to State monopolies *"in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them"* (art. 106(2) TFEU).

[96] The Commission's Notice 16/261 identifies the notion of advantage according to "*any economic benefit which an undertaking could not have obtained under normal market conditions, that is to say in the absence of State intervention"* (*Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union n. 16/262,* § 66*).*

indeed, according to a rationale which is not way dissimilar from the "justificatory" mechanism standing behind art. 101(3) TFEU.

It is moreover interesting to notice that, contrary to art. 87 of the EC Treaty and therefore to art. 107 TFEU, the former art. 4 of the Treaty establishing the European Coal and Steel Community did not provide any ground for justification for State Aid measures. In fact, the mentioned norm firmly prohibited any kind of "*subsidies or state assistance*" ([97]), without mentioning any case in which such help could be permitted.

The evolution towards a more "permissive" framework for public measures has clearly to be explained according to the fact that, if such a firm restriction could be accepted and borne by the Member States in a regulatory framework which solely concerned the production of steel and the extraction of coal, the economic need of State intervention clearly became different when it came to the establishment of a European common market, characterized by an overall integration of national economies. In fact, art. 107 TFEU does not provide an absolute prohibition nor an absence of conditions which, if fulfilled, are liable to legitimize a State intervention. Indeed, art. 107 TFEU is not even the only ground for justification for State intervention in national economy, for the wording of paragraph 1 expressly contemplates the case in which it is "*otherwise provided in the Treaties"*. This formula is mainly a reference to art. 106(2) TFEU, as legitimate State monopolies are not caught by the prohibition laid down in art. 107(1) as long as the application of art. 107 ([98]) does not legally or factually obstruct the particular economic function assigned to them by public authority. On the other hand, we observe that the ss.cc. "services of general economic interest" are liable to fall out of the scope of State Aid incompatibility too. The conditions according to which activities concerning public services may be 'safe' from the application of art.

[97] Art. 4 at1 lit. c) ECSC Treaty.

[98] N.B: Art. 106(1) states that EU competition law, thereby meaning arts. 101 to 109 TFEU, remains *prima facie* applicable to State-owned companies contemplated in the provision itself: *"In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109"* (art. 106 §1 TFEU).

107(1) have been laid down by the ECJ, as it is well known, in *Altmark Trans* ([99]).

Those conditions are: 1) that the obligations according to the activity concerned must be "*clearly defined*" by domestic law; 2) that the criteria for the computation of compensation are established in advance and in a transparent way; 3) that there should not be any overcompensation and 4) that the provision of the service is based on the outcome of a previous public procurement procedure.

A further exemption from art. 107(1) TFEU is represented by the rules laid down by the General block exemption Regulation 651/2014 ([100]), which identifies the conditions for certain categories of aid to escape the general prohibition provided by the Treaty ([101]). Such activities shall be considered falling, according to art. 3 of the Regulation, within the State Aid measures compatible with the internal market listed in paragraphs 2 and 3 of art. 107 TFEU. Moreover, they are also exempted from the obligation concerning notification to the Commission ex art. 108(3) TFEU.

The conditions which must be met in order to activate the "safe harbour" granted by the block exemption are the respect of the thresholds provided by art. 4 ([102]), the transparency requirements ([103]) and the "incentive effect" of the aid measure concerned ([104]).

The existence of such a block exemption Regulation once more shows the overlapping rationale behind EU State aid legislation and case-law with respect to EU competition law; especially for what concerns anticompetitive agreements ex art. 101 TFEU. In fact, in both cases, with a common reference to Reg. 330/2010 and to the above illustrated Reg. 651/2014, the community legislator wanted to prevent that practices and measures which have a positive effect on economy could be considered as not being compatible with the internal market. Thus, even if *prima*

[99] Case C-280/00, *Altmark Trans GmbH and Regierungspräsidium Magdeburg v. Nahverkehrsgesellschaft Altmark GmbH* (2003), ECLI:EU:C:2003:415.
[100] Regulation (EU) of 17th June 2014 n. 651.
[101] Art. 1, *Ibidem.*
[102] Art. 4(1) Reg. 651/2014 provides a long list of thresholds for different activities, whose amount varies between a minimum of 2 million euro (*i.e.* individual per-year investments aiming to foster the participation of companies in fairs ex *lit. (e)*) and a maximum amount of 150 million euro (*i.e.* for investments protecting or promoting cultural heritage ex *lit. (z)*).
[103] Art. 5, *Ibidem.*
[104] Art. 6 Reg. 651/2014 sets up different requirements, which may be both formal and informal, which must be fulfilled in order to classify the aid as having an "incentive effect".

facie they should be considered as dangerous for competition. Moreover, such identical approach becomes even more evident if we look at the fact that the EU Commission provided, in the same way as it did for cartels falling within art. 101 TFEU, for a further ground of justification based on the *de minimis* doctrine in the framework of art. 107 TFEU too.

In fact, according to Regulation 1998/2006 ([105]), which replaced the former Reg. (EC) n. 994/98, art. 107(1) TFEU shall not be applied to State Aid measures which do not exceed 1) a value equal EUR 200.000 granted over a period of three financial years, or 2) a value equal to EUR 100.000 only for road transportation activities ([106]). Thus, however, provided that some transparency requirements are fulfilled ([107]).

Finally, we may come to the principal exceptions to art. 107(1) contained in the general provision itself. Firstly, paragraph 2 contemplates those which are known to be the "automatic exceptions". Those may consist in non-discriminatory aid having a social character to individual consumers ([108]), in measures aimed to "*make good damage caused by natural disaster or exceptional occurrences"* ([109]) and, finally, in aid granted from the German State with respect to certain of its territories, in order to compensate the economic gaps which existed between western German *Länder* and the eastern regions after reunification occurred in 1991 ([110]).

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[105] Commission Regulation (EC) of 15 December 2006 n. 1998.
[106] Art. 2(2), *Ibidem*.
[107] The transparency requirement is considered according to the criteria laid down by art. 2(4) Reg. (EU) No. 1998/2006 which contemplates: *1) aid comprised in loans when the amount has been calculated on the basis of market interest rates prevailing at the time of the grant; 2) aid comprised in capital injections if the total amount of the public injection does not exceed the de minimis ceiling"; 3) "aid comprised in risk-capital measures if the risk-capital scheme concerned provides capital only up to the de minimis ceiling to each target undertaking"; 4) "aid provided under a loan-guarantee scheme when the guaranteed part of the underlying loan does not exceed EUR 1 500 000 (or EUR 750 000 in road transport)"*. Moreover, MSs can also provide loan guarantees on amounts which value is higher than EUR 1 500 000 if they are able to demonstrate that the aid element does not exceed EUR 200 000.
[108] Art. 107(2) *lit. a)* TFEU.
[109] Art. 107(2) *lit. b)* TFEU.
[110] Such a provision, contained in art. 107.3 *lit. c)* TFEU, seems to confirm the position expressed by PEPE, according to whom "*l'allargamento dell'Unione agli Stati dell'ex-est europeo avvenuto a partire dal 2000, è apparso legato soprattutto alla necessità di assegnare all'Europa un ruolo geo-politico "paritario", con USA e Russia, sulla scena internazionale e nell'ambito della stessa NATO*" (Francesco Pepe, "*Concorrenza fiscale dannosa" e tax rulings: l'uso "strategico" dell'arm's lenght principle nella disciplina europea sugli aiuti di Stato e l'imprevista (?)*

Art. 107(3), instead, provides five types of "discretionary exceptions". This means that such aids are only liable be considered compatible with the internal market, contrary to the situations foreseen by art. 107(2) TFEU, which are instead always legitimate in the light of the restriction laid down in paragraph 1. Therefore, it is up to the Commission, according to the level of distortion that such measures may provoke on the internal market and provided that the requirement of "development support" is fulfilled, to verify if State Aid ex art. 107(3) shall be censured or not. For instance, for what concerns the situation contemplated in paragraph 3 *lit. a)*, which means *"aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation*", criteria chosen by national administration *in casu* have been deemed to be incompatible with the internal market by the Commission in *Philip Morris Holland BV* ([111]). In the case concerned, the ECJ recognized the discretionary power of the Commission to determine the legitimacy of such aid with an economic overview "*made in a Community context".* Again, relating to the condition laid down in paragraph 3 *lit. b)* instead, where it provides that *"aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State"* may be justified in the light of paragraph 1, in *Glaverbel* ([112]), the ECJ clarified the Commission's discretion in determining the conditions for the application of the exception thus foreseen. *In casu*, the Court held that the requirement of the "common interest" ex art. 107(3) TFEU could not be considered existing from a general and macroscopical point of view, as the latter should have a direct and concrete nature ([113]). The situation becomes a little more complicated

"egemonia" della Commissione europea nell'area della fiscalità internazionale, Federalismi.it – rivista di Diritto pubblico italiano, comparato, europeo (February the 28th 2018), p 3).

[111] Case C-730/79, *Philip Morris Holland BV v. Commision* (1980), ECLI:EU:C:1980:209

[112] Cases C-62/87 and C-72/87, *Executif Régional Wallon and Glaverbel v. Commission* (1988) ECLI:EU:C:1988:132.

[113] In particular, the ECJ held that *"none of the documents laid before the Court lends any support whatever the conclusion that the aid at issue might contribute to the implementation of an 'important' project of 'common' European interest. The mere fact the investments enabled new technology to be used does not make the project one of common European interest"* (Case *ibidem,* § 25).

with respect to the third exceptional circumstance foreseen by the interested paragraph.

As a matter of fact, the contemplated provision enables Member States to actively intervene in industrial economy, in order to support growth in certain underdeveloped territorial areas ([114]). On one hand, the discretionary power of the Commission in considering the compatibility of the internal market with the aid measure falling within the scope of paragraph 3 is confirmed. Thus has been concretized in particular in the Guidelines on regional State Aid ([115]) laid down by the Commission, which provide for a *summa divisio* between areas which are predefined, and therefore provide *ex ante* the compatibility of the aid measures provided therein (the so called "predefined "c" areas") and territories which, by contrast, may be declared "c" areas by the Member State itself when certain economic as well as social requirements are satisfied (those regions are consequently identified as "non-predifined "c" areas"). On the other hand, however, the ECJ has shown a more intrusive approach with respect to such discretionary power with reference to *Philipp Morris BV* and *Glaverbel*. In fact, if in *Kahla Thüringen* ([116]) the Tribunal confirmed the centrality of the Commission's discretionary power, in *Intermills* ([117]) the Court stated on the other hand, that the Commission must motivate its action with indicating the reasons why "*the applicant's activities on the market, following the conversion of its production with the assistance of the aid granted, were likely to have such an adverse effect on trading conditions*" ([118]) in order to justify its infringement measure. Clearly, from another perspective, this statement once more empowers the CJEU as the ultimate guardian of the Commission's exercise of powers and, therefore, of the very functioning of the internal market. Finally, art. 107(3) provides further discretionary exceptions according to *litt. d)* and *e),* which respectively concern aid measures provided by the Member States in order to protect national cultural heritage and

[114] The exact wording of art. 107.3 *lit. c)* reads as follows: "*aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest".*

[115] European Commission, *Guidelines on regional State aid* (2014-2020), OJ C209/01.

[116] Case T-20/03, *Kahla/Thüringen Porzellan GmbH v. Commission* (2008), ECLI:EU:T:2008:395

[117] Case C-323/82, *Intermills SA v. Commission* (1984), ECLI:EU:C:1984:345.

[118] *Ibidem*, § 39.

such other types of aid possibly individuated by a decision of the Council taken on the ground of a Commission's proposal. All this concludes the aspects concerning the substantial legal content of the rules concerning State Aid in the framework of the Treaties.

1.13 Procedural aspects *ex* art. 108 TFEU.

As exposed, art. 107 TFEU contains the substantive law rules on the prohibition of State aid. Clearly, the need for the enforcement of the provision concerned clearly implied the provision of appropriate *ad hoc* procedures to render art. 107(1) TFEU effective. These rules are laid down in art. 108 TFEU, whereas paragraph 3 concretizes the primacy of the Commission's role; a role, as it has been previously said, which is mainly played through the exercise of wide discretionary power in determining the measures falling within the prohibition of State Aid. In fact, the whole procedure starts with a notification by the Member State, concerning its own action liable to fall within the framework of art. 107(1) TFEU. As it has been highlighted in the previous paragraph, not *every* aid measure will be subject to the notification obligation set forth by art. 108(3). Indeed, according to the *de minimis* doctrine provided by Reg. 994/98 (thus adopted pursuing art. 109 TFEU), small aids do not fall within the scope of the interested provision. After the notification has been submitted by the MSs government or administration, the Commission must determine if the notified measure shall be deemed compatible with the internal market. If the answer to this question will be a positive one, then it would be the end of the matter ([119]). Otherwise, the Commission *"shall without delay initiate the procedure provided for in paragraph 2"* ([120]). This first procedural stage, which is identified as "preliminary review", has a suspensive effect towards the measure concerned, for the Member State shall abstain to enforce it until final decision has been taken by the Commission. Nevertheless, as established by Regulation 99/659 providing the rules for application of art. 93 EC Treaty (now art.

[119] As CRAIG and DE BÚRCA observe, *"The ECJ has emphatized that the preliminary review procedure is 'meant to be just that'"*(Paul Craig and Gráienne De Búrca, *op. cit.* (2015) at 1147).
[120] Art. 108.3 TFEU.

108 TFEU), the national authorities of the Member States may subsequently execute the aid measure concerned if the Commission fails to take its determinations within two months ([121]). Clearly, any possible amendment or modification to the instrument providing for the aid concerned will be subject to the notification obligation too.

Once the Commission has cleared the existence of a possible violation of art. 107(1), it may impose upon the Member State the obligation to *"abolish or alter such aid within a period of time to be determined by the Commission"* itself under art. 108(2). If national authorities refuse or do not in general comply with such duty, a further infringement procedure ex art. 258 and 259 TFEU may be activated.

Afterwards, the decision is published in the Official Journal of the Union and it is communicated to the "interested Member State" and the "parties concerned", which have normally a month to submit observations on the Commission's decision, safe the case in which the Commission itself may extend such deadline for "justified" reasons ([122]). It is important to observe that the notion of "parties concerned" comprehends all those subjects interested by the decision at stake, including private market players and associations (*e.g.* costumers associations or competitor companies) ([123]). As for the substantial exceptions foreseen by art. 107(2) and 3, art. 108(2) contemplates other exceptional circumstances which may legitimize a measure first caught by the prohibition of paragraph 1 art. 107 TFEU. In fact, art. 108(2) provides that *"the Council may, acting unanimously, decide that aid which the State is granting or intends to grant shall be considered to be compatible with the internal market […] if such a decision is justified by exceptional circumstances"*; thus, on the ground of an application submitted by the Member State itself. If the Council so provides, the Commission is under duty to suspend the possibly already initiated procedure. Nevertheless, the final sentence of paragraph 2 provides a further deadline of three months for the exercise of the Council's prerogative concerned. If this *caveat* is not respected, the

[121] Council Regulation (EC) of the 22nd of March n 659, art. 4(5).
[122] *Ibidem*, art. 6.
[123] In fact, the broader meaning of the formulation of "parties interested" ex art. 6 Reg. 99/659 becomes clearer if we take into consideration the versions of the rule expressed in other languages of the Union (*e.g.* in Italian it reads: "*altri interessati*", "other interested [parties]").

Commission may consequently provide its decision; given that a fundamental distinction must however be drawn. In fact, art. 108(1) TFEU states that *"the Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing"*, thereby proposing (or imposing upon) them to adopt *"any appropriate measures required by the progressive development or by the functioning of the internal market"*. This means that not only aid measures provided *ex novo*, but also those which have started to be granted previously to the laying down of the provision itself are subject, in principle, to the requirements, conditions and procedures concerning arts. 107 and 108 TFEU. Moreover, art. 108(1) also entails that, if a certain measure safely withstood the procedural requirements set forth by paragraphs 2 and 3, this could be found caught by the prohibition laid down in art. 107(1) in the future if such consequence in provoked by the nature of the internal market being a "living instrument" ([124]).

A certain relevance must be recognized to this point, for if existing aid is found incompatible with the internal market, the decision censuring the measure concerned will have an *ex nunc* effect. By contrast, if the Commission catches under art. 107(1) TFEU a measure which has been provided *ex novo*, then the decision will cover the aid *ex tunc*, which concretely entails the transformation of the temporary suspension ex art. 108(3) into a permanent prohibition. The Member State may then demonstrate that circumstances according to the measure have changed or have been modified, thereby showing that aid is not anymore liable to fall within the general prohibition. Finally, the decisions of the Commission may be subject to claims brought by the Member States before the ECJ according to the ordinary rule set forth in art. 263(2) TFEU. The Court may at that point, as it is self-evident, impose upon the interested Member State the obligation to repay unlawful aid ([125]).

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[124] According to LOPEZ *"the concept of aid is a 'living instrument' that has been applied in accordance with the main policy priorities of the European Commission, a fact that had been underexplored in the literature and the implications of this connection seldom studied"* (Juan Jorge Piernas Lopez, *The Evolving Nature of the Notion of Aid under EU Law*, European State Aid Law Quarterly No. 3 (2016), at 400.

[125] According to the ECJ, State Aid recovery has to be considered to be the general rule, as *"the only defence which a Member State to which a decision has been addressed can rise in legal proceedings […] is that the implementation of the decision is absolutely impossible"* (Case C-52/84, *Commission v. Belgium* (1995), ECLI:EU:C:1995:53).

According to what has been just explained, it remains clear that the primary role in the framework of art. 108 TFEU is played by the European Commission as the main protagonist of the procedure exposed above, for Member States play a secondary role. Thus, clearly apart from the important responsibility to initiate the procedure complying with the obligation to notify aid. In fact, this aspect becomes evident foremost under two different profiles. First, from a substantial point of view, if it is true that the activation of art. 108 depends on the Member State's notification, it must be however stated that, clearly, the failure to communicate an aid measure to the Commission does not impede the latter to be found incompatible with the internal market *ex officio*. As the ECJ observed*, "to hold otherwise would ultimately favour those Member States which grant aid in breach of the duty to notify laid down in Article 93(3) of the Treaty, to the detriment of those States which do notify aid at the planning stage."* ([126]). In fact, as it is provided by art. 1 Reg. 659/99, the Commission may examine information concerning State Aid on its own initiative, also requesting Member States to submit them. According to the same Regulation, after having given the possibility to the Member State to submit its observations, it may also adopt an "interim decision" ([127]) imposing to national authorities to suspend the measure which falls within the Commissions' investigation and to take back the payments which have been provided for aid temporarily ([128]). If the Member State refuses to comply, then the Commission may bring the case before the ECJ, which may declare that the Treaties have been breached by the failure to execute the decision. Thus, provided that the judicial proceeding does not prevent nor suspend the power of the Commission to continue its inquiry concerning the compatibility of the measure at stake with the internal market ([129]).

Secondly, even if the parallel between the incompatibility of State Aid and the rules provided by arts. 101 and 102 TFEU has already been often highlighted,

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[126] Case C-301/87, *France v. Commission* (1990), ECLI:EU:C:1990:125.
[127] Paul Craig and Gráienne De Búrca, *op. cit.* (2015) at 1150.
[128] Art. 11 Reg. (EC) No. 659/99 states that the Commission may exercise this power if following conditions are fulfilled: 1) there should be no doubts about the featuring of a State Aid ex art. 107(1) on the ground of a concerted practice; 2) there should be a situation of emergency; 3) competitors may suffer heavy damages.
[129] Art. 12 Reg. (EC) No. 659/99.

there is still an important difference. The latter consists in the fact that, as the application of the norms concerning anticompetitive behaviours provided by the Treaties falls within the shared competence of the European institutions and national courts ([130]), the same may not be affirmed in matters of State Aid. In fact, national judges are excluded from enforcement of State Aid. According to SCHEPISI ([131]), this is explainable under two fundamental aspects. The first is that the *quasi*-exclusive role of the Commission recognized by art. 108 TFEU is necessary to secure a proper development of the internal market, for inter-State competition is likely to alter its "fair" structure even more than competition between private companies and it is therefore of primary importance to grant an impartial enforcement of art. 107.

Secondly, this need of a supranational overview on State aid measures is also important according to the need to secure a better coordination of economic policies in the Union; given that the complexity of the technical economic issues which stand behind the concession of aid also depends on the different aims and priorities pursued by the Member States individually ([132]). Nevertheless, the lack of power of national courts to rule upon aid measures falling within art. 107(1) TFEU is not absolute. On one hand, art. 23 Reg. 659/99 provides appropriate mechanisms securing cooperation and information exchange between the Commission and national judges. On the other hand, it must be borne in mind that art. 108(3) TFEU still has direct effect, entailing that the Member States' courts still have the competence to catch aid measures considered to be unlawful under art. 107(1) when they have not been notified. Thus, given that the Commission may exercise its

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[130] In general, this is possible given the direct effect which has been recognized to the rules provided by the Treaties since the famous *Van Gend and Loos* case (Case C-26/62, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration* (1963), ECLI:EU:C:1963:1). In particular, national authorities have been expressly empowered by the commission for public enforcement of the rules contained in arts. 101, 102 and 106(2) TFEU through Reg. (EC) No. 1/2003.

[131] Cristina Schepisi, *Aiuti di Stato e tutela giurisdizionale. Completezza e coerenza del sistema giurisdizionale dell'Unione europea ed effettività dei rimedi dinanzi al giudice nazionale*, (Torino: Giappichelli Editore, 2012).

[132] In fact, according to the authoress, this has become even more evident in the light of the introduction of "non-trade values" in the context of the European Communities which has been pursued since the conclusion of the Treaty of Maastricht (1993) and which are now expressly foreseen in art. 3 TEU, with reference to the model of "social market economy" (Cristina Schepisi, *op. cit*, 2012, at 7-8).

powers according to what has already been exposed. Indeed, in *Produits Alimentaires*, the ECJ recognized that *"the immediate enforceability of the prohibition on implementation referred to in that article extends to all aid which has been implemented without being notified and, in the event of notification, operates during the preliminary period, and if the Commission sets in motion the contentious procedure, until the final decision"* ([133]). Thus, because *"national courts must offer to individuals in a position to rely on such breach the certain prospect that all the necessary inferences will be drawn, in accordance with their national law, as regards the validity of measures giving effect to the aid, the recovery of financial support granted in disregard of that provision and possible interim measures"* ([134]).

Finally, this exceptional role of the national judiciary has ultimately found recognition in a Notice of the European Commission in 2009 ([135]). The whole procedure and the aspects of substantial law concerning State Aid clearly highlight the inherent hostility of the EU internal market towards public intervention favouring national economy at the expenses of market players of the other Member States. However, if the intent of the Contracting Parties is thus evident, the same cannot be stated for what concerns practice.

Although the prohibition laid down by art. 107(1) TFEU undoubtedly constitutes one of the pillars of the common market, commentators have recognized that *"the Commission's present efforts to clarify the legal concept of State Aid, and therefore the scope of its powers to act in State Aid cases, do nothing to clarify the economic principles that the Commission should apply to measures that come within the concept"* ([136]). In fact, it has been pointed out that those principles are *"imprecise and confused"* and that *"the Commission does not in practice consistently apply the principles that it claims to follow"* ([137]). This is the

[133] Case C-354/90, *Fédération Nationale du Commerce Extérieur des Produits Alimentaires and Syndicat National des Négociants et Transformateurs de Saumon v France* (1991), ECLI:EU:C:1991:440, § 11.
[134] *Ibidem*, § 12.
[135] European Commission, Notice on the enforcement of State aid law by national courts, OJ C 85, (9th April 2009).
[136] John Temple Lang, *EU State Aid Rules – The Need for Substantive Reform*, European State Aid Law Quarterly No. 13 (2014), at 440-49.
[137] *Ibidem.*

consequence of the fragmentary nature of the notion of State Aid within the framework of EU law. In fact, the approach pursued by the EU institutions in banning aid measures is clearly pragmatic and case-oriented, pursuing the aim to construct a general system starting from the finding of solutions *in casu*. Besides, this was in fact in the intention of the Contracting Parties when they omitted to provide an authoritative definition of State Aid in the Treaties, for the rationale of arts. 107 TFEU ss. entirely relies on the will to empower the EU authorities, the Commission in particular, to take adequate action in order to secure the correct functioning of the internal market ([138]). To achieve such aim, it was necessary to maintain the framework of the notion of State Aid as broad as possible, in order to permit a more flexible interpretation and action at EU level ([139]).

1.14 State aid rules and taxation.

According to what has been exposed and to the wording used by the Treaty, considering the inexistence of definition of State aid, we may substantially individuate it in such measures provided by public authority through its own resources having the ultimate effect to favour selected undertakings or productions in a way which affects competition in the internal market and intracommunity trade. According to such approach, in fact, there are certain criteria which both the Commission and the ECJ apply in order to frame the measures concerned within the prohibition set forth by art. 107 TFEU.

First, since the very beginning of its activity in the framework of the ECSC, the Court has imposed in *De Gezamenlijke Steenkolenmijnen* the principle of the

[138] Livia Salvini, *Aiuti di Stato in materia fiscale* (Padova: CEDAM, 2007), at 91.
[139] Nevertheless, such "economic approach" to the issue of State Aid, which is the natural consequence of the flexibility of a broad definition of the latter, has been heavily criticized by commentators. In particular, with reference to tax aid, SALVINI pointed out that: *"l'approccio pragmatico della Commissione e della Corte di Giustizia dovrebbe essere [...] corretto, poiché limita* [inter alia] *la rilevanza di valori diversi dalla difesa della concorrenzialità del mercato unico europeo consentendo così che misure fiscali ritenute coerenti all'assetto di principi e valori recepiti dalle carte costituzionali o dalle tradizioni giuridiche dei singoli Stati Membri siano qualificati come aiuti di Stato"* (Livia Salvini, *op. cit.* (2007) , at 93).

"indifference de la forme" ([140]), according to which the notion of aid *"embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore, being subsidies in the strict meaning of the word, are similar in character and have the same effect"* ([141]). The Court thereby recognizes the possibility of 'negative measures' to be caught by the prohibition too.

Besides this element, another important *criterion* has a certain primacy in the identification of aid measures under art. 107: namely the criterion of selectivity. In fact, the wording used by the provision at stake has an important consequence, where it refers to *"favouring certain undertakings or the production of certain goods"*. According to such statement indeed, only those measures which are aimed at favouring particular companies or national economy in an unfair manner are doomed to be redacted by the Commission, for measures which favour overall economy without any discrimination between national and foreign undertakings of other Member States are not caught by art. 107, in accordance with what has already been said about the distinction between *fair* and *harmful* competition in the first paragraphs.

Thus said, it can be first observed that if also negative aid is liable to be deemed incompatible with it the internal market, then aid provided through taxation is perfectly frameable within the scope of the State aid prohibition. Indeed, tax aid has to be considered one of the most recurring *species* of the broader *genus* of State aid in the meaning of the Treaties. In fact, there are several concrete measures which have been considered falling within art. 87 TCE (nowadays art. 107 TFEU). For what concerns Italy, for instance, CASERTANO and SACCHETTO ([142]) have listed many of them, consisting in tax amnesties, TVA amnesties, amnesties on the s.c. *"scudo fiscale"* (d.l. 350/2001) ([143]), tax reliefs provided by the s.c. *Legge*

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[140] Case 30-59, *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community* (1961), ECLI:EU:C:1961:2; Also see António Carlos Dos Santos, *op. cit.* (2009), at 416.
[141] *Ibidem*, § 3.
[142] See: Gaetano Casertano e Claudio Sacchetto, *op. cit* (2007) at 2270 ff.
[143] Decreto-legge 25 settembre 2001, n. 350.

Ciampi ([144]) with the aim to foster mergers in the banking system, aids to "municipally-owned" undertakings (the s.c. "*municipalizzate"*), aids to agricultural undertakings, tax incomes and offsets and bonuses for mergers of small and medium undertakings ([145]). Such exemplification, although representing instruments aimed at regulating typical patterns of the Italian economic environment, clearly highlights how various the forms by which tax aid may be provided are. On the other hand, it clearly shows the importance of the mentioned criterion of selectivity. In fact, as it has been underlined at the beginning of this essay, taxes still constitute the main source of income for the States' budget and flexibility in the system is absolutely necessary not only for the possibility to grant those *economic services of general interests* which are so precious for the Community legislator, but for the very functioning of the whole national administration in general. Therefore, coherently with the wording of art. 107 TFEU, only those tax regimes which advantage certain undertakings and which therefore indirectly disadvantage their competitors are likely to fall within the prohibition, while general tax regimes applicable to all the players of a certain economic sector are in principle permitted insofar they do not discriminate between national and foreign EU taxpayers according to art. 110 TFEU. In other words, in practice, the criterion of selectivity takes the form of a derogation from the general legislation otherwise applicable to the case, as the latter is not deemed to be incompatible with the internal market *per se*. Thus, even in the case in which such legislation provides certain advantages to an overall sector, given that it does not apply differently or in a discriminatory way to foreign EU companies, producers or suppliers ([146]).

This is, in fact, the path which has been followed by the European Commission. which in turn has recognized that the competition policy's ultimate aim is not to eliminate the fundamental differences between the Member States' legislations concerning taxation, for nothing impedes that such differentiation might have a positive effect on the internal market ([147]). By contrast, as we have seen, its aim consists in granting equality between the economic players acting on

[144] Legge delega 23 dicembre 1998, n.461

[145] See *e.g.* Regione Siciliana, Legge Regionale 16 Aprile 2003, n.4.

[146] In this regard, see: Giovanni Graziano, *La selettività e gli aiuti* regionali, in Livia Salvini, *op. cit.* (2007);

[147] Also see: European Commission, *Report on State Aid in the European Community* (1999).

the market. After all, the necessity of a "selective advantage" in order to apply art. 107(1) is a requirement which is relevant for the enforcement of the rule in general and not only in taxation matters. In this regard, an important example is represented by *Institut Français du Petrole* ([148]), although the ECJ finally concluded that the Commission failed to prove the existence of a real advantage. In fact, the latter held that the application of national legislation concerning insolvency proceedings against State-owned companies instead of the insolvency regime applicable to private undertakings was in breach of the State aid rules, thereby applying the same reasoning adopted in *La Poste* ([149]). According to the same rationale, in *Åland* ([150]) the Commission stated that *"a measure may be selective because it is granted either as an exception to general tax arrangements established by law, regulation or administrative practice or at the discretion of the tax administration"*, and therefore *"a lower rate of taxation confers an advantage on a company by enabling it to retain a greater proportion of its profits either for distribution to its members or shareholders or for reinvestment and therefore confers an advantage on eligible companies"* ([151]).

Moreover, it is extremely important to remind that the criterion of selectivity has been interpreted broadly by both the Commission and the ECJ for the purpose of a better enforcement of the principle of the *effet utile* inherent EU law. In fact, 'selectivity' has not to be intended with respect to certain undertakings only, but it does also operate with respect to the context of the case in general. For instance, it applies to the s.c. "regional selectivity".

[148] Joined Cases T-479/11 et T-157/12, *French Republic and IFP Énergies nouvelles v. European Commission* (2016); ECLI:EU:T:2016:320.
[149] Commission Decision 2012/321/EU of the 25th January 2012.
[150] Commission Decision 2410/2002/EC of the 10th July 2002.
[151] In particular, in the same decision, the Commission found that *"the selectivity criterion is further met by the fact the conditions under which the measure applies implicitly require a certain economic strength and therefore could apply only to sufficiently large companies. It thus excludes other (owner) insurance companies operating in different sectors from qualifying for the tax relief. Indeed, the formation of a captive company implies that the group with which insurance contracts will be concluded is large enough to generate a turnover that will allow it to cover the fixed costs and obtain a profit. For example, one can hardly imagine that a group in the textile sector comprising three companies with ten employees each could afford to set up a captive insurance company. There can hardly be any doubt that the fixed costs in question would not be offset by the volume of premiums paid by the group's three companies. For these reasons, the measure is designed mainly for groups of companies which are large enough to afford to set up a captive insurance company"* (*ibidem*, § 52).

Such possibility is based on the assumption that, if art. 107(1) TFEU prohibits such State aid measures to be granted to *"certain undertakings or the production of certain goods"*, there is no reason why aids possibly provided only towards companies which operate in certain geographical areas should not be caught by the provision as well. According to GRAZIANO indeed, the liability of localized aid to fall under the mentioned prohibition is deemed to be implicitly recognized by art. 107 TFEU , where it is stated that *"aid to promote the economic development of areas where the standards of living is abnormally low or where there is serious underemployment, and of the regions referred to in art. 349"* (art. 107(3) TFEU) and again *"aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany"* (art. 107(2) TFEU) respectively may and shall be exempted from the application of paragraph 1 ([152]). Furthermore, the mere fact that such measures may be provided by local authorities rather than by the Government does not entail that the consequent situation will fall out of the scope of the provision, for *"state resources"* has to be understood with a comprehensive meaning ([153]). By way of example we may mention *Azores* ([154]). In the case at hand, the Portuguese administration challenged a decision of the European Commission sanctioning the Republic of Portugal under art. 87 TCE (now 107 TFEU) for measures reducing respectively by 20% and 30% the tax rate applied to personal and corporate incomes for people residing in the Azores region ([155]). The ECJ held that *"acting on the basis of a regional development or social cohesion policy is not sufficient in itself to justify a measure adopted within the framework of that policy"* and that *"although it is true that the disadvantages related to the insularity of the Azores might, in principle, be suffered by all economic operators regardless of their financial circumstances, the mere fact that the regional tax system is conceived in such a way as to ensure the correction of such inequalities does not allow the conclusion to be drawn that every tax advantage granted by the authorities of the autonomous region concerned is*

[152] Giovanni Graziano., *op. cit.* (2007), at 231 ff.
[153] *Ibidem.*
[154] Case C-88/03, *Portugal v. Commission* (2006), ECLI:EU:C:2006:511.
[155] See also *inter alia*: Case T-168/99, *Territorio Histórico de Álava — Diputación Foral de Álava v Commission*, II – 1372.

justified by the nature and overall structure of the national tax system"([156]). On the other hand, however, the regional character alone is not sufficient to establish a situation falling within the scope of art. 107(1), for on one hand it is still necessary that the criteria set forth by the latter provision are satisfied while, by contrast, the conditions exemption conditions ex art. 107(2) and (3) shall not exist.

According to what has been said, it becomes clear that in the matter of tax aid the criteria of selectivity plays an extremely important role; thus, because it is the criterion which is still the most evident when it comes to the application of art. 107. In fact, given that general taxation measures are not to be considered being beyond the limits laid down by the Treaties as long as they do not apply in a discriminatory or harmful way towards intra-European market players and other Member States, the requirement of selectivity might be the crucial element to demonstrate the liability of a measure to fall within the prohibition of State aid, for taxation measures always imply the use of potential State resources while the distortion of competition is rather a consequence of the aid measure itself ([157]).

Nevertheless, if this is undoubtable in practice, the activation of paragraph 1 of art. 107 TFEU still requires all its criteria to be formally fulfilled. Such requirement may be explained with respect to *Philips and Rabobank* ([158]), where the EU Commission, while first inquiring upon a leasing agreement between the two Dutch undertakings pursuing the prohibition of State aid, finally realized that the agreement at stake had to be considered lawful. Thus, because of the fact that the temporary taxation benefits flowing from it would have been compensated over time, thereby excluding the existence of an advantage granted through State resources.

Before concluding, while on one hand the Court has recognized the non-relevance of the form by which aid is granted in *De Gezamenlijke Steenkolenmijnen*, it shall be reminded that, ultimately, only 'favourable' tax measures may be considered illegal, for the competence of the Member State to

[156] *Azores,* §82.
[157] In fact, in *Åland* the Commission affirmed that "*the effect of the aid on trade between Member States is independent of any purpose for which the aid is granted"*.
[158] Commission Decision 2000/735/EC of the 21st April 1999.

adopt its own direct taxation regimes entails that the latter are absolutely free to increase the tax burdens for certain sectors or undertaking only, without therefore being caught in breach of the State aid rules insofar this is provided in "exceptional circumstances" only ([159]). However, this possibility is again subject to limitations. For instance, in *Aer Lingus and Ryanair* ([160]) the Court held that as *"*[the sale of tickets for] *domestic flights enjoyed a low rate while international flights were subject to a high rate* […] *The General Court accepted the Commission's view that the identification of "rule" and "exception" could be made on the basis of quantitative assessment"* ([161]).

By way of conclusion, it is important to remind that, from a general point of view, the application of art. 107 TFEU is only one of more perspectives according to which the EU institutions pursue the elimination of harmful tax competition in the internal market, for the ECJ has addressed the issue of taxation also through reference to other principles which the treaties foresee, such as the freedom of establishment ex present art. 56 TFEU in *Denkavit* and *Wielockx* ([162]) and the free movement of capital ex art. 67 EC Treaty in *Verkoijeen* ([163]). In fact, the systemic frame of the application of State aid rules as one or more component parties of a fragmentary but general system is further demonstrated, at last, by the coordination between the latter and the Code of conduct of business taxation which the EU legislator has tried to provide. Indeed, both Section J and the Commission's Report of 1998 establish a clear relationship between the Code and present art. 107.

On one hand, the Code of Conduct itself calls upon the Commission to exercise its powers in order to catch unlawful State aids and to submit annual Reports about it to the Council, while point 30 of the Report of 1998 recognizes the criteria set forth by the Code of conduct, which should be taken into account when

[159] Leigh Hancer, Tom Ottervanger, Piet Jan Slot, op. cit. (2016) 13-036.
[160] Joined Cases C-164/15 P and C-165/15, *European Commission v Aer Lingus Ltd and Ryanair Designated Activity Company* (2016), ECLI:EU:C:2016:990.
[161] Leigh Hancer, Tom Ottervanger, Piet Jan Slot, *op. cit.* (2016) 13-038.
[162] Case C-80/94, *G.H.E.J. Wielockx v. Inspecteur der Direkte Belastingen* (1995) ECLI:EU:C:1995:271.
[163] Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen* (2000), ECLI:EU:C:2000:294.

applying the provisions concerning State Aid ([164]). In a certain way, therefore, the Code of conduct and the State aid rules, although their numerous differences due to their respective soft-law and hard-law nature and with respect to the centrality of the Council with respect to the former and that of the Commission in the case of the latter, find themselves in a complementary relationship. Thus, clearly, always besides harmonization and within the general framework of the EU rules on taxation.

[164] According to DOS SANTOS furthermore, *"le rapport établi par le point J du Code et le régime des aides d'État démontrent, d'une façon très nette, l'influence du politique sur le juridique"* provided that *"le régime des aides d'État appliqué à la fiscalité directe devient l'instrument d'un nouvel objectif politique – la lutte contre la concurrence fiscale dommageable* (harmful tax competition) *– qui n'était pas prévu explicitement par le Traité"* (António Carlos Dos Santos, *op. cit.* (2009), at 432-433).

CHAPTER II

Tax Rulings and EU State aid enforcement

2.1. Tax Ruling: notion and features.

After having exposed the general features of the EU law rules in tax matters, it is time to approach the issue of Tax Rulings. While explaining why the State aid rules are the most appropriate to face harmful tax measures, it has been already affirmed that since *De Gezamenlijke Steenkolenmijnen*, the ECJ has concluded that *any* kind of aid granted through State resources beinh liable to alter natural competition in the market shall be considered unlawful regardless of its direct or indirect nature and of any other concrete feature. Therefore, the instrument commonly known as "Tax Ruling" is absolutely liable to be subject to a procedure pursuing art. 108 TEFU provided that the negative conditions ex art. 107(1) TFEU are met. But what exactly is a "Tax Ruling"? And why is such an instrument so relevant when speaking about harmful tax competition in the internal market?

First of all, it must be stressed that there is actually no binding general legal definition of Tax Rulings ([165]). This implies that the criteria which a certain measure or instrument shall satisfy in order to classify as a 'ruling' have been pulled out mainly through judicial and administrative practice. In fact, such notion itself has a higher "academical" value rather than a strictly legal one, as the definition at stake varies from a national context to another.

As pointed out by ROMANO in fact, in the US a tax ruling is mainly considered to be *"a written declaration furnished to the taxpayer or his legal representative by the national office, containing an interpretation and application of tax legislation to a specific case"* ([166]). In some other cases, mainly in Europe, tax rulings are rather identified in agreements or decisions having an administrative

[165] However, it should be noted that the EU legislator has recently undertaken steps in this regard, by introducing the definition of "advance cross-border ruling" and "advance pricing agreement" in Dir. 2011/16/EU as amended by Dir. 2015/2376/EU, regulating administrative cooperation in tax matters.
[166] Carlo Romano, *Advance Tax Rulings and Principles of Law: Towards a European Tax Rulings System* (University of Groningen: IBFD, 2002) at 485.

character, as in the Netherlands or in Italy ([167]). Moreover, due to the common preventive character of the instrument concerned with respect to the legal situation which constitutes its object, commentators often refer more specifically to "advance tax rulings" to indicate the measures at stake ([168]). Such context clearly shows the opportunity to affirm the fragmentary nature of the very definition of tax rulings, in the light the subtle but extremely important differences which exist among commentators and national approaches towards the notion at hand.

Nevertheless, although it might be difficult to conciliate the different features flowing from such differential overviews, an important introductive observation shall be made. In fact, it has been highlighted that the ECJ and the Commission have often targeted the State aid measures which are provided through the instrument of legislation. In both *IFP* and *Azores* ([169]), the Commission censured aid granted by the Member States with reference to law provisions establishing a legal framework caught in breach of art. 107(1) TFEU. By contrast, it follows from the nature of tax rulings that the latter notion refers instead to administrative measures and policies, thereby understanding such determinations which are not directly taken by national legislators but rather by the tax administration in the exercise of its powers and executive prerogatives. Thus, in fact, is consistent with the deeper meaning standing behind the principle of the formal irrelevance established in *De Gezamenlijke Steenkolenmijnen*, as if the positive or rather negative nature of a State aid measure has no importance for the application of art. 107(1) TFEU, the same shall undoubtfully apply with respect to aid granted through an administrative policy rather than by a provision of law. Therefore, when it comes to the framework of the Union, tax rulings have been differently defined as a *"sort of advance decisions in tax matters"* adopted by the Member States' national administrations which have the aim to communicate*"* to

[167] *Ibidem*.
[168] Nevertheless, it might be argued that precisely because of the preventive nature inherent in the definition of "advance tax ruling", such latter instrument should be better considered as a sub-category of the larger *genus* of general tax rulings rather than a synonym (as the European Parliament confirms) (European Parliament, Directorate-General for Internal Policies, Policy Department A – Economic and Scientific Policies, *'Tax Rulings' in the EU Member States*, Study for the ECON Committee, (2015), at 28).
[169] *Supra*.

taxpayer companies *"the ways according to which income taxation will be calculated* ([170]). In fact, according to the Directorate-General for internal policies of the European Parliament, the official position of the EU on the notion concerned consists in considering *"all kinds of tax 'arrangements' between the authorities and the taxpayer"* falling within the definition of tax ruling ([171]). Therefore, as we will see in the following paragraphs and chapters, not only unilateral decisions, but also agreements concluded between public authorities and companies as well as, ultimately, every administrative legal instrument regarding the taxation rates applicable to private subjects are in principle considered to be "tax ruling" according to the definition.

It follows that, as administrative action is likely to be a constituent element of the requirement of "State resources" set forth by art. 107(1) TFEU, it might be concluded that when a tax ruling and its effects do meet the conditions of the s.c. "four-prong test" (selectivity of the measure, State-origin, distortion of competition, hindrance to the EU internal market) it will be caught by the Commission being in breach with the prohibition of State aid through the procedure ex art. 108 TFEU ([172]).

This leads up to highlight a particular problematic aspect which is peculiar to the instrument of tax rulings, and which especially concerns the element of selectivity. Indeed, the fact that tax rulings consist in measures facilitating the taxpayer companies to which they are addressed in tax matters may lead to the logical conclusion that tax rulings shall always be *prima facie* deemed to be caught under art. 107(1), for they always meet the criterion of selectivity by their very nature. This is, by the way, the approach initially adopted by the European Commission, which therefore concluded that the mere international dimension of the companies addressed by a tax ruling would suffice to apply arts. 107 and 108 TFEU.

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[170] Claudia Scardino, *Tax ruling: dalla Commissione il via al pacchetto trasparenza*, FiscoOggi, (18th March 2015).

[171] European Parliament, Directorate-General for Internal Policies, Policy Department A – Economic and Scientific Policies, *'Tax Rulings' in the EU Member States* (2015), at 26.

[172] It is interesting to observe that, as SANTACRUZ (*supra*), also ARENA identifies the attributability of the measure to the State to be a further condition implicitly laid down by art. 107(1) TFEU (Amedeo Arena, *op cit.* (2017) at 939).

For instance, in *Åland* ([173]) the Commission held that foreign ownership was a sufficient ground for activation of the provision concerned, while in *Trieste* ([174]) it came to the same conclusion according to intra-European transactions ([175]). On one hand however, as we will see, the ECJ has finally rejected such *modus operandi* in *Autogrill* and *Banco Santander* ([176]), while on the other it shall still be borne in mind that selectivity alone may not be a ground for the application of art. 107(1) as tax rulings are, in general, only *likely* to be prohibited under the prohibition of State aid and not unlawful *per se*. In fact, as it has been pointed out by BOBBY, one should not forget the distinction within the element of "selectivity" and the element of "advantage", which according to the author has often been quite ignored in the Commission's practice ([177]). Indeed, although art. 107 refers to the existence of a "selective advantage", such notion shall be considered to be composed by two fundamental and distinct elements.

On one hand, selectivity has to be considered in accordance with the effects of the tax ruling concerned. It follows that the measure will be unlawful only if it is concretely referred to a certain company or group of companies. On the other hand, in order to be unlawful under art. 107(1), selectivity must still be bound to a direct or indirect advantage flowing from the tax ruling itself, so that the mere fact that a ruling is referred to selected undertakings shouldn't be considered in breach of the State aid prohibition unless it provides them with an unjust favourable market position with respect to their competitors.

While arguing that the EU Commission has applied the two concepts in an *"overly simplistic"* way ([178]), BOBBY has identified different approaches which have been adopted by the Commission. For what concerns general regimes, he argues, the Commission usually separates the two elements, while it "collapses"

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[173] Commission Decision 2410/2002/EC of the 10th July 2002.
[174] Commission Decision 2003/230/EC of the 11th December 2002.
[175] See also: Commission Decision 2003/775/EC of the 17th February 2003; Commission Decision 2003/515/EC, 17th February 2003; Commission Decision 2003/884/EC, 11th December 2002; Commission Decision 2004/76/EC, 13th May 2003; Commission Decision 2003/12/EC, 5th September 2002; Commission Decision 2003/502/EC, 16th October 2002; Commission Decision 2003/81/EC, 22nd August 2002.
[176] See Chapter II.
[177] Christopher Bobby, *A Method inside the Madness: Understanding the European Union State Aid and Taxation Rulings,* Chicago Journal of International Law vol. 18, No.1 (2017), at. 186 ff.
[178] *Ibidem*, at 207.

them when it comes to cases concerning individual agreements, which have to be considered tax rulings as such ([179]). This confirms, in fact, the result of the already mentioned historical conception of the European Commission, thus considering a tax ruling as being a selective measure *per se*. After all, however, while the issue of the inherent selectivity of tax rulings according to art. 107(1) TFEU is of extremely important relevance for the application of the rule concerned, it must be stressed that tax benefits provided through tax rulings of the Member States' national authorities are normally selective in practice, for it should never be forgotten that their final aim consists in *"establishing in advance the application of the ordinary tax system to a particular case in view of its specific facts and circumstances"* and that *"for reasons of legal certainty, many national tax authorities provide prior administrative rulings on how specific transactions will be treated fiscally"* ([180]).

Moreover, according to ARENA, a particular feature of tax rulings which differentiates them from general tax law schemes consists in the "advantage of the first move" ([181]). Indeed, for tax rulings are generally obtained after a request of the interested taxpayer, this gives the possibility to obtain a measure which better fits its own interests ([182]).

According to what has been stated, a general conclusion may be drawn. In fact, the attitude of the Commission and of EU law in general towards tax rulings has many peculiar patterns, which are almost always linked to the administrative dimension and the case-related pragmatist nature of the instrument at stake. Nevertheless, the main framework under which the EU institutions catch such rulings which may adversely affect the competitive structure of the internal market, and thereby the latter's effectiveness, still remains the one drafted by the general rules about State aid prohibition laid down in the TFEU. This means, in principle,

[179] *Ibidem*, at 208.
[180] Kelyn Bacon, *European Union Law of State Aid* (Oxford: Oxford University Press, 2017), at 76.
[181] In fact ARENA refers to the s.c. "vantaggio della prima mossa" (Amedeo Arena, *op cit.* (2017) at 930);
[182] Amedeo Arena, *op cit.* (2017) at 930; however ARENA further explains that tax rulings also have disadvantages in following terms: *"la richiesta di una decisione anticipate comporta anche degli svantaggi di tipo strategico: innanzitutto, implica che le autorità fiscali esaminino certamente una determinata fattispecie, laddove la probabilità che la stessa sia soggetta a un successivo* […] *accertamento è generalmente piuttosto bassa; poi, il quesito del contribuente può indurre il fisco a soffermarsi su aspetti problematici dell'operazione che avrebbero potuto non essere rilevanti in occasione di un controllo a posteriori"* (*ibidem*, at 931).

that tax rulings shall be deemed unlawful according to the same reasonings which apply to illegal State aid ex art. 107 in general. Therefore, basically, when they establish a derogative rule with respect to the general tax regime in force having the effect to provide an unfair benefit to one or more selected taxpayers, thereby enhancing harmful tax competition in the Union, this will determine their unlawfulness. Thus, again, insofar the conditions for the application of art. 107(1) are met in practice. It follows that, given that it constitutes an attitude of the Commission to easily recognize selectivity as being a feature inherent to tax rulings, this does nevertheless not mean that the tax ruling as such is likely to be considered incompatible with the internal market. In fact, as long as a tax ruling does not favour the taxpayers to whom it has been addressed according to the criterion of the "selective advantage", the measure will not be caught by the prohibition.

Consequently, for instance, once it has been cleared that they shall not be considered unlawful *per se*, tax rulings may be also used as a remedy to hinder that illegal State aid may be granted through a misleading exploitation of the general rules on taxation applicable to a whole sector. In fact, tax rulings may not only provide benefits, but they may also eliminate in principle the selective advantages flowing from general provisions of law through an exceptional different interpretation or application of the general rule itself, which would otherwise favour certain undertakings in the market.

2.2. Types of Rulings.

According to what has been observed in the previous paragraph, Tax Rulings might be considered administrative measures having a very flexible nature, also because of their very broad definition ([183]). Due to the relatively wide character

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[183] In fact, the very flexible nature of the notion of tax rulings is moreover demonstrated by the different definitions of the instrument concerned in the national legal order of the Member States. French-speaking countries (Luxembourg, Belgium and France) use the terms *décisions anticipées* or *rescrits fiscaux*, while German-speaking Member States refer to tax rulings with the term *Auskunft*. Finally, In Italy tax rulings fall within the general domestic framework of the s.c. *Diritto di interpello* (although at EU level they are identified as *ruling fiscali*) while the term used in the United Kingdom is *"non-statutory advance clearances"* (European Parliament, Directorate-General

of the notion, in general, tax rulings may be classified in different categories. First of all, we may distinguish, formal and informal tax rulings. While the formers are the result of an administrative procedure established under provisions of law, the latter are instead issued *"without any legal or administrative framework"* ([184]). This is the case of the "opinions" or "interpretations" and any other legal arrangement established as an administrative practice in the single Member States which does not fall within any clearly predefined legal procedural path. Although the spectrum of the forms which a ruling may concretely adopt is quite extended, two particularly important categories of instruments falling within the notion of formal tax ruling may be identified.

The first consists in the already mentioned advance tax rulings, thereby understanding *"a statement provided by the tax authorities* […] *regarding the tax treatment of a taxpayer with respect to his future transactions and on which he is – to a certain extent – entitled to rely"* ([185]). As a general rule, advance tax rulings, which by the way constitute the 'form' of ruling which is the most frequently provided ([186]), do bind the administrations which have delivered them with respect to the addressed taxpayer ([187]), who may obtain the ruling from the competent administration after a procedure initiated through the submission of a request ([188]).

The selectivity of advance tax rulings relays on the assumption that the application for the obtainment of the ruling might be submitted only by the interested taxpayer and only with reference to its own activities and transactions. This means that, on one hand, virtual requests may not be submitted, while a tax ruling will be exclusively applicable to the legal situation to which it is referred to.

for Internal Policies, Policy Department A – Economic and Scientific Policies, *'Tax Rulings' in the EU Member States* (2015), at 27).

[184] *Ibidem,* at 28.

[185] *Ibidem*.

[186] According to the EP's study: *"tax rulings are normally issued either before the transaction has been undertaken or before a tax return has been submitted for the period covering the transaction"* (European Parliament, *Ibidem,* at 28).

[187] On the implications about tax rulings concerning the principle of legitimate expectations see § 2.6

[188] The competent administration may be any body of public law which is entitled to deliver the ruling by a provision of law. It may be the national administration as well as a local or international authority. As the EP's Policy Department's studies demonstrate, *"mostly, there is an autonomous service or committee within the central tax administration that issues rulings or gives binding advice to the local or central tax authorities"* (European Parliament, *Ibidem,* p .26).

Such case-related dimension of tax rulings, which is strictly connected to their lack of precedential force, combined with their administrative and authoritative nature, entails that once it has been submitted, the validity of a tax ruling is likely to be overruled by a legislative reform of the provisions of law to which it is referred and connected ([189]).

An advance tax ruling has a limited duration, for normally it expires within the period of five years. After the expiration period, the ruling's binding effect upon the administration ceases to exist and the authorities may therefore change their approach towards the situation previously constituting the object of the tax ruling itself. Obviously, the lawfulness and the intensity of such a change ultimately depends on the degree of discretion which tax law provisions recognize upon the competent tax administration in interpreting the rules established by law themselves.

Finally, the Member States' national law may provide rules concerning transparency, for instance imposing upon the administration the duty to publish the rulings which have been adopted or providing mechanisms for a proper exchange of information between different administrations ([190]).

Along with advance tax rulings, there is another important category of rulings: namely the s.c. "advance pricing agreements" (APAs). According to the EU Guidelines of 2007, *"an APA is an arrangement between tax administrations over the way in which certain transfer pricing transactions between taxpayers will be taxed in the future"* ([191]). So, if it is unclear what category of legal acts advance tax rulings shall be considered exactly to fall in, the same cannot be stated for the APAs for, as the term itself suggests, they have the nature of a negotiated act ([192]).

[189] In fact, the nature of tax rulings being fundamentally a decision of the national tax administration, the general principle of administrative law affirming the prohibition to exercise public powers in a way which is inconsistent with the rule of law attributing administrative discretion still applies to tax rulings as to every instrument issued by the administration, thereby affecting all those rulings which might have been delivered *contra legem* (European Parliament, *Ibidem*, at 29).

[190] In fact, transparency and exchange of information are an important aspect which will be analysed in the final chapters of this essay, for those elements constitute two fundamental prerequisites for a well-functioning monitoring activity of the European institutions over illegal tax rulings.

[191] European Commission, *EU APA Guidelines*, COM(2007), §13, at 5.

[192] Nevertheless, a change of approach seems to be imminent at EU level. The Commission has in fact proposed to amend Directive 2011/16/EU by inserting following definition of advance pricing agreement: *"any agreement, communication or any other instrument or action with similar effects,*

In fact, APAs may be multilateral, bilateral or even unilateral ([193]).

The reason why APAs have a huge importance when it comes to the matter of tax rulings is explainable through the fact that, as the definition itself suggests, they are concerned with "transfer pricing" practices, thereby understanding the price determination for sales of goods and services between companies which are legally connected. It follows that the "transfer price" is nothing else than the price established between the parties for the transaction itself; in legal terms: the object of the performance which constitutes the buyers' obligation in an agreement or contract on a transfer pricing transaction. Transfer pricing has an important relevance with respect to taxation matters for it might easily be used as a method for profit allocation by the companies which compose a group. Given that EU law recognizes a group being a unitary corporate entity, so that intragroup activities may not be considered to be in breach of art. 101 TFEU, transactions between two entities of a same transnational group may be artificially set up in order to materially transfer the profits of one undertaking to another. Thus, with the aim for the group to benefit from the lower tax rate possibly imposed by the law of the State of the seller company; thereby inevitably enhancing regulatory tax competition between the Member States of the European Union. More precisely, the tax advantages which might flow from transfer pricing practices at international level might be summarized as follows ([194]).

The freedom to set the price of the transaction, which shall always be recognized in the light of the general principle of private autonomy, allows the

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including one issued in the context of a tax audit, given by or on behalf of, the government or tax authority of one or more Member States, including any territorial or administrative subdivision thereof, to any person that determines in advance of cross-border transactions between associated enterprises, an appropriate set of criteria for the determination of the transfer pricing for those transactions or determines the attribution of profits to a permanent establishment" (European Commission, *Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation*, COM(2015) 135 final).

[193] According to the 2007 Guidelines, *"although there may be circumstances where the taxpayer has good reasons to believe that a unilateral APA is more appropriate than a bilateral, bilateral APAs are preferred over unilateral APAs. Where a unilateral APA may reduce the risk of double taxation to some degree, care must be taken that unilateral APAs are consistent with the arm's length principle in the same way as bilateral or multilateral APAs".*

[194] See: Shivangi Agarwal, *Transfer Pricing: Meaning, examples risks and benefits*, LinkedIn publishing, (15th October 2016) available at: <https://www.linkedin.com/pulse/transfer-pricing-meaning-examples-risks-benefits-shivangi-agarwal/>.

companies involved to amortize the costs of income taxation by imposing a higher transfer price when it comes to the transfer of goods and services in the State in which taxation regimes are comparatively more advantageous. By contrast, by under-pricing the object of the transactions, the group may instead minimalize the connected duty costs, as this entails a consequent reduction of the associated tax base upon which custom tariffs and other levies might be calculated. Clearly however, this second aspect has a minor relevance when it comes to intracommunity transfer pricing, for the trade barriers between the Member States in the form of levies shall be abolished in principle according to arts. 30 TFEU and the VAT is subject to approximation at EU level ([195]).

Although they may enhance harmful tax competition and tax avoidance, transfer pricing practices are not only perfectly legal in principle, but they even constitute a typical policy of multinational companies in the carrying out of their business ([196]). In fact, there are mainly two beneficial aims which may be pursued through transfer pricing arrangements.

The first consists in the avoidance of double taxation. This might be done mainly through exemptions on one hand, or through tax credits for the taxes which have already been paid in the country of transfer on the other.

The second use, instead, pursues the avoidance of abuses, allocating profit in such a way to secure that the profits allocated in the different States in which a multinational company operates are not too low.

The same legitimacy *a priori* may be in principle affirmed with respect to APAs too, provided however that they do neither define the taxable profits nor the exact amount which will be subject to taxation. They only affirm in advance the principles and the criteria according to which the tax base related to the transaction at stake will be defined, thereby providing such legal certainty which is useful to

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[195] Nevertheless, from a business point of view, there might be also difficulties related to transfer pricing practices. Such risks may have internal dimension (*e.g.* the incompatibility of the transfer pricing strategies of the firms concerned, organizational inefficiency and additional labour costs) or an external character (*e.g.* Currency, Market and Credit risks) (Shivangi Agarwal, *Ibidem*).

[196] In particular, it is of common usage among US based multinational firms to exploit their subsidiaries abroad to by-pass the 35% levy applicable to profits in the United States (*e.g.* in 2016, *Microsoft*'s profits earned abroad amounted to 68% of the company's total earnings, whereas non-US sales amounted to 46% of the total sales 'only') (*Ibidem*).

the companies addressed in drafting their business strategies ([197]).

Nevertheless, the freedom to establish the transaction's price entails that the companies of a group may completely ignore any price-related economic consequence as well as any other business evaluation related to the concerned transaction itself at such an extent that, at least potentially, *"a subsidiary may* [finally be able to] *show zero profit and therefore pay zero tax"* ([198]). Such observation perfectly shows how deeply transfer pricing and profit shifting policies may alter the competitive structure of the international and EU market and incredibly enhance harmful tax competition, provided that the instrument of tax rulings gives the opportunity to national administrations to provide tax benefits without requiring the expense of time and resources which legislative procedures normally impose. For this reason, at both national and international (and EU) level, some legal solutions have been elaborated to hinder as much as possible a misleading use of the transfer pricing practices in international trade.

2.3. The application of the "arm's length" principle in the field of transfer pricing transactions and practices.

Despite a unitary aim consisting in limiting the damages to a competition-based market which may derive from transfer price strategies, the approaches adopted to counter a harmful application of transfer pricing methodologies vary from national context to national context. Western countries and all the Member States of the European Union generally adopt the s.c. "arm's length" principle, although this is differently interpreted when it comes to different national jurisdictions.

According to this principle, indeed, the prices established for intragroup transactions shall be considered not to be artificial as long as they reflect the prices which would have been genuinely produced by the market if the transaction concerned would have been concluded between independent undertakings. Thus,

[197] The Model Tax Convention of the OECD allows the conclusion of APAs at art. 25(3).
[198] Phedon Nicolaides, *State Aid Rules and Tax Rulings*, European State Aid Law Quarterly No. 3 (2016), at 418.

again, in the assumption that transfer pricing policies (and the connected APAs) are not harmful *per se*, but only insofar the transfer price is manipulated, in order to gain an economic advantage which would not have existed if the parties to the contract were not legally and economically bound. In simple words, therefore, a transfer pricing transaction is not illegal nor harmful as long as the buyer company pays the seller a price which reflects the *"normal commercial value"* of the tangible or intangible property concerned in the contract ([199]). The principle has been *de facto* codified at international level by the OECD Model Tax Convention ([200]). In fact, art. 9(1) of the mentioned document states that, in the case in which a transfer pricing agreement is concluded between undertakings of the same group, *"and* […] *conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly"* ([201]). In the meanwhile, the OECD Guidelines on transfer pricing ([202]) dictate some important mechanisms which are useful for tax administrations to determine the net profit. In particular, the OECD foresees five different methods. As BOBBY suggests, we may distinguish between those 'traditional methods' (the 'CUP' ([203]) method, the resale price method, and the cost-plus method), which are mainly used to compare the terms and conditions of transfer pricing transactions between undertakings of a group to those established in equivalent contracts concluded between independent firms, and 'transactional profit' methods (the TNMM method and the transactional profit split method), which are by contrast used to compare *"the profitability of the subsidiary at issue with similar subsidiaries or independent operators"*([204]). The framework established by the OECD is of primary importance

[199] European Parliament, Directorate-General for Internal Policies, Policy Department A – Economic and Scientific Policy, *EU State Aid Law and National Tax Rulings*, 2015 at 14

[200] OECD, *Articles of the Model Convention with respect to taxes on income and on capital.*

[201] OECD, *Articles of the Model Convention with respect to taxes on income and on capital,* Art. 9(1).

[202] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, (2017).

[203] "Comparable Uncontrolled Price".

[204] Christopher Bobby, *op. cit.* (2017) at 202.

because of the fact that it constitutes the main reference for the national tax administrations in the exercise of their powers when it comes to transfer pricing cases ([205]). Nevertheless, a deeper reading of art. 9 of the Model Tax Convention postulates that for every good or service sold and purchased through a transfer pricing transaction, a 'natural' market price does actually exist. Therefore, in this case, domestic law and practice assumes its centrality over international instruments again, although the domestic legal framework also constitutes the starting point for the European Commissions' legal intervention concerning transfer pricing practices, as we will later see. Therefore, the approaches adopted by national tax administrations may vary considerably from case to case ([206]). For instance, some Member States (Germany) adopt the s.c. *Maßgeblichkeitsprinzip* (the "authoritative principle"), according to which the tax base will be determined through commercial bookkeeping and accounting. However, it is still possible for the Member States to attribute domestic legal value to the principles and mechanisms proposed by the OCED itself, mainly through transposition in law provisions.

Definitely, however, once a market price for a certain good or service exists, or it is otherwise possible to determine price which would have been adopted by the concerned undertakings if they were not legally interrelated (the s.c. "arm's length price"), the application of the arm's length principle postulates that if the price payed by the buyer entity has been established in a 'fictional' way by the parties, then the profits which have been shifted through the transfer pricing transaction shall concur to determine the effective tax base regardless of the fact that they have been artificially transferred to the seller company. According to the 2016 European Commission's Working Paper on Tax Rulings, in fact, *"the OECD Guidelines provide a useful guidance to tax administrations and multinational enterprises on how a transfer pricing methodology produces an outcome in line with the market*

[205]European Commission, DG Competition, *Working Paper on State Aid and Tax Rulings* (June 2016).

[206] According to the EP's study on national Tax Rulings, "*other Member States allow for separate tax accounting where commercial accounts and tax accounts can use rather different methods of valuation, depreciation, timing of recognition of profits and losses, etc."* (European Parliament, Directorate-General for Internal Policies, Policy Department A – Economic and Scientific Policy, *EU State Aid Law and National Tax Rulings* (2015) at 14).

conditions" ([207]).

Thus cleared, the following question shall be answered: how does an Advance Pricing Agreement conflict in principle with the arm's length principle?

As it has been said, an APA does not determine the taxable profit in advance, but it does only communicate the set of criteria which the administration will adopt when it will calculate the tax base for the concerned transaction and the shifted profit in the future. However, given that APAs have a binding effect not only towards the future contracting private entities, but with respect to the administrations which have concluded them, an APA will *de facto* determine the method according to which the administration will decide if the future transaction will effectively be at arm's length. Therefore, anticipating the Commission's particular approach to the matter at issue, it may be concluded that *"a tax ruling which endorses a transfer pricing methodology for determining a corporate group entity's taxable profit that does not result in a reliable approximation of a market-based outcome in line with the arm's length principle confers a selective advantage upon its recipient"* ([208]). Therefore, such a ruling will thereby consequently activate a possible application of art. 107 TFEU *ex officio* if the duty to notify the aid measure ex art. 108 has not be fulfilled.

Before continuing the analysis according to how tax rulings fall in breach with the State aid rules, it is important to highlight the fact that advance tax rulings and advance pricing agreements do not exhaust the list of possible existing tax rulings, for any administrative measure subject to a well-defined procedure issued in taxation matters is likely to be labelled as a formal tax ruling. Moreover, also legally unframed measures provided by public authorities as those which are labelled in the EU framework as *"other tax arrangements"* ([209]) surely constitute examples of tax rulings, along with those having an informal nature. In fact, this

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[207] The same applies either in the case of overpricing to shift the profits in the State having lower income taxation rates or, *mutatis mutandis*, in case of under-pricing to circumvent higher import tariffs or indirect taxation.

[208] European Commission, *Notice on the Notion of State Aid* (2016) § 171.

[209] The European Parliament uses the term to refer itself to those 'those arrangements' provided by local tax administrations and taxpayers in circumstances other with respect to those which have been analysed in detail, *e.g.* the arrangement adopted before the filing of a tax return, during a mediation procedure concerning taxation matters or even during a pending judicial proceeding (European Parliament, *Idem, 'Tax Rulings' in the EU Member States* (2015), at 32)

means that the number of different combinations which may contextually fall within the same notion of tax rulings, and thereby possibly in breach with art. 107(1) TFEU, is potentially extremely large, if not virtually infinite.

2.4. Tax Rulings in the framework of the State aid enforcement action of the European Commission.

2.4.1. The investigative powers and procedure of the European Commission.

The institution which is competent to determine if tax rulings are effectively in breach of art. 107 TFEU is obviously the European Commission. Currently, as highlighted in the Directorate-General for Internal Policies of the European Parliament on State Aid and national Tax Rulings, the Commission is investigating into individual tax rulings granted by following States: Austria, Belgium, Cyprus, Czech Republic, Denmark, Finland, Germany, Hungary, Italy, Lithuania, Malta, Portugal, Romania, Slovakia, Spain and Sweden ([210]). For what concerns the pending investigations, they will be addressed in the final chapter of this essay ([211]).

As the Commission's syndicate is still related to the compatibility of the measures according to the rules of State aid, the aforementioned scheme drawn by arts. 107 and 108 TFEU applies in general to tax rulings as for any measure which fits the requirements for their application.

Particular remarks may be made with respect to the burden of proof. As it has been observed, rulings are generally selective, for they are necessarily referred to the undertakings which applied for them. On the other hand, it has also been observed that rulings are considered not to be harmful *prima facie*. By combining these two statements it becomes clear what the point is.

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[210] European Parliament, *Idem, EU State Aid Law and National Tax Rulings* (2015).

[211] Indeed, as we will see, the Member States which have been recently addressed and which are still targeted in a particular way by the EU Commission's monitoring activity are the English-speaking States (especially Ireland as it will be highlighted in the following pages when dealing with the *Apple* case) and the States of Benelux, with particular attention paid to the rulings conceded by the Grand-duchy of Luxembourg, whose reputation of being a "tax heaven" is of common knowledge.

Indeed, it is necessary to find out if the benefit flowing from the ruling concerned may be enjoyed by taxpayer companies in general or if it rather consists in a "concession" of the authority towards the undertaking involved, thereby becoming a breach of art. 107 TFEU. Accordingly, it is in principle up to the Commission to demonstrate that the requirement of selectivity is met ([212]). To do so, the Commission may exercise its powers and it becomes therefore important to expose the practice which the Commission adopts in carrying out its monitoring tasks. In fact, according to Reg. 659/1999 as upgraded by Reg. 734/2013 ([213]), the European Commission follows a s.c. "two-step approach" ([214]). First, the Commission requests the Member States to inform it about the rulings which have been granted by their tax administrations and to submit any relevant attached documentation ([215]). This is of huge relevance because the practice of the Member States' authorities and the methodologies used in order to calculate the tax base with reference to the situation standing behind a ruling constitute the starting point for the Commission's investigations, given that the role of the Commission is not to interfere in national administrative *consuetudo* but rather to be the grantor of the legal order provided by the Treaties. As it will be explained in the following pages, this happens especially with respect to the investigations on tax rulings concerned with intracommunity transfer pricing operations.

Secondly then, the Commission individuates certain rulings from those

[212] According to LUJA, *"should the Commission provide evidence that a ruling contains a benefit by diverting from the normal tax system it will also have to check whether that benefit would not be available* prima facie *to others without such a ruling"* (European Parliament, *Ibidem*, at 18).

[213] Indeed, art. 5(1) Reg. 659/1999 reads as follows: *"Where the Commission considers that information provided by the Member State concerned with regard to a measure notified pursuant to Article 2 is incomplete, it shall request all necessary additional information. Where a Member State responds to such a request, the Commission shall inform the Member State of the receipt of the response"*; art. 6(1) states: *"the decision to initiate the formal investigation procedure shall summarise the relevant issues of fact and law, shall include a preliminary assessment of the Commission as to the aid character of the proposed measure and shall set out the doubts as to its compatibility with the common market. The decision shall call upon the Member State concerned and upon other interested parties to submit comments within a prescribed period which shall normally not exceed one month. In duly justified cases, the Commission may extend the prescribed period".* Reg. 734/2013 has introduced new rules in order to render the investigations more effective, *inter alia* providing the possibility for the Commission to request private actors to submit the necessary information.

[214] European Parliament, *Ibidem,* at 12.

[215] Clearly, once the Commission has shown that the ruling is selective, it is up to the interested national tax administration to show that the ruling does not provide any selective advantage liable to put the addressed companies in a stronger position with respect to the competitors.

which have been notified to it, reviewing them in detail in a phase which is called "preliminary investigation". With respect to this, according to the mentioned document, *"even though it is not clear what the Commission's criteria for selection are when choosing from the longlist, it does not seem to be an entirely random process"* ([216]). In fact, *"there is a clear focus on multinationals, in particular those who were already under public scrutiny via the press, NGOs or in national parliaments"* ([217]). It follows that the Commission pays particular attention to corporate activities, and thereby to issues involving transfer pricing issues, although this does not exhaust the spectrum of situations which may be treated under the umbrella of counter-State aid enforcement. Indeed, the fact that rulings are generally provided by the authorities of the Member States to the companies which require them individually, it is impossible to determine the contempt of rulings *a priori* and, therefore, the Commission is not in the position to adopt a precise and perpetual approach applicable to every kind of rulings regardless of their individual object or addressee. Nonetheless, we may proceed in analysing some common features which exist in the Commission's practices whenever it approaches tax rulings dealing with similar situations. This happens when it comes to the matters of deliberate mismatches and transfer pricing arrangements, which constitute the situations on which the Commission focuses the most.

2.4.2. Mismatches between national tax laws in the EU framework.

A situation which is quite peculiar in the spectrum of those subject to a possible application of the State aid rules is the one involving mismatches. The term "mismatch" here indicates the circumstance in which a same legal situation is treated differently in two different national legal orders. More precisely, the legal order of one or more Member States as long as the EU internal market in concerned.

The Directorate-General for Internal Policy of the European Parliament suggests four concrete examples of mismatches which the European Commission

[216] European Parliament, *Idem*, *EU State Aid Law and National Tax Rulings* (2015), at 12.
[217] *Ibidem.*

may be called up to face ([218]). The first situation is indicated as "debt versus equity" and it refers to the case in which the law of a Member State classifies an intragroup transaction as being a loan, while the law of the other Member State involved considers it to be equity. The first Member State will allow the deduction of the interests while the second Member State will instead consider the payment exempted, considering it to be a dividend.

Secondly, there is the s.c. "tax transparency of hybrid entities", where the mismatch is due to the presumption of the Member State in which profit has been shifted that profit has been already subject to taxation at the legal entity level, while the State from which profit has been transferred assumes that they will be taxed at participant level instead.

Then, the "attribution of assets to permanent establishment" consists in assigning assets to activities taxed abroad while liabilities continue to be taxed by the home-State authorities. Finally, through the "group allocation of costs and profits", the law allows companies to organize their profit allocation in order to factually obtain that all the national authorities involved will consider the taxation of their profits to fall within the competence of another Member State or, possibly, when the law provides that the profits should be assigned in the State which offers the most friendly conditions.

Contrary to rulings concerned with transfer pricing, in the light of the suggested examples mismatches are normally based on a passive behaviour of the Member States with respect to the taxable transaction or profit. In fact, it may be highlighted that in all the described situations the advantage is realized through an exploitation of the general tax schemes coming from the taxpayers themselves, while public authority intervention is limited in providing the related legal framework even before the taxable transaction existed, normally through the exercise of legislative powers. On the other hand, it might certainly not be claimed that the suggested mismatches are unlikely to adversely affect competition in the internal market, for their concrete effect is to reduce the overall tax burden for the interested taxpayers.

However, a real breach of art. 107(1) may not be found in mismatches *per*

[218] *Ibidem*, at 14-15.

se for following reasons. On one hand, the requirement of selectivity seems to crumble. Generally, indeed, mismatches are generated through the combined effect of two different general taxation regimes. Therefore, mostly there is no actual intention of the legislator to favour *'certain firms'* rather than others, nor to indirectly support domestic undertakings, for the law is generally assumed to be accessible to all the addressed market players operating in the internal market. Surely, this does not entail that selectivity does never exist when it comes to general regimes establishing mismatches, but only that it is unlikely to be individuated with respect to general schemes if they were not drafted with the precise intention to provide a discrimination. On the other hand, although the criterion of State resources may be deemed satisfied in principle, there is a lack of a fundamental pre-condition for application of art. 107(1): the attributability to the State ([219]).

Indeed, mismatches are formed by the combination of law provisions of two different Member States, and therefore *"genuine mismatches in legal classification cannot be attributed to a single State in order forSstate aid to apply"*, and the principle of *tempus regit actum* seems not to be applicable to solve the problem as well ([220]). In fact, the individuation of the State which has *de facto* created the mismatch by introducing the rule which collides with a foreign already existing provision is not relevant in the light of the State aid rules. When it comes to general legal regimes, indeed, the Member States remain free to determine their national general tax schemes insofar they do not discriminate between domestic and foreign taxpayers. The ECJ case-law on this point will be analysed in the next Chapter of the essay ([221]). For now, it may suffice to say that the only effective solution to this effort consists in a better coordination between European legislators, also through harmonization at EU level as we will see.

Nonetheless, it must be observed that there are indeed mismatches which escape the above-described concepts, and which may consequently classify as State aid *strictu sensu* by their very nature. This is the case of the s.c. "deliberate mismatches", thereby understanding those mismatches which are deliberately set

[219] *Ibidem*, at 15.
[220] *Ibidem*.
[221] See Chapter III.

up by a Member State in order to secure indirect aid to certain taxpayer companies.

As the Directorate-General for Internal Policy again suggests, deliberate mismatches may be established through two means in particular ([222]). The first consists in special legislation, which may be laid down by national legislation in order to permit certain foreign or domestic companies to benefit from a factual tax exemption when combined with the law of another Member State. The second is instead represented by possible involvement of tax rulings. In fact, national tax authorities may construct a mismatch providing *ad hoc* rulings giving a different interpretation of the general tax regime applicable *in casu*, which diverges from the one constituting its ordinary practice (*e.g.* by confirming an intragroup payment being classified as a debt, as the Directorate-General for Internal Policies suggests) ([223]). Such approach is confirmed by the Commission's practice. In *Groepsrentebox* ([224]) the Commission dealt with the issue at stake, although it finally concluded that the measure provided by the Netherlands did not constitute State aid in the meaning of art. 107 TFEU.

In 2006, the Dutch legislator provided a new tax scheme for intragroup-interest payments, which had to be added to the already existing law, providing an exemption for dividends paid by a Dutch company to a foreign one, while imposing the normal corporate tax rate of 25.5% to dividends received by a Dutch company. The measure lowered the rate down to 5% and it established that the same rule should have applied to the interest paid, thereby introducing the possibility to deduct them at the same rate. Consequently, in 2007 the Commission initiated an investigation proceeding towards the Netherlands because it suspected that the measure would confer a selective advantage to some companies. In particular, the Commission noted that the regime concerned classified as neutral from a domestic point of view, but that it was not the case with respect to cross-border business relationships. In fact, groups could benefit from a deduction of the interests in States with higher tax rates and benefitting from a rate of 5% for the interest received. allocating the profits gained in the Netherlands into a more "friendly State". However, the comments submitted by Belgium, Hungary and by the greatest Dutch

[222] *Ibidem*.
[223] *Ibidem*.
[224] Commission Decision 2009/809/EC of the 8th July 2009,

association of employers (*Verbond van Nederlandse Ondernemingen - Nederlands Christelijk Werkgeversverbond, VNO-NCW)* and, most importantly, the modifications provided by the Dutch legislator, who transformed the measure from optional to mandatory and who enlarged the field of application of the notion of "group" in the meaning of the interested act, drove the Commission to eventually conclude that there was any ongoing State aid. Thus, because *"it* [could not] *be argued that large (multinational) companies will have easier access to the scheme than small and medium-sized enterprises (SMEs) and will thus benefit disproportionally from it"* ([225]). However, the Commission endorsed the conception according to which only deliberate mismatches may fall in breach of art. 107(1) by stating that *"for purposes of State aid, this is of relevance only if the differences are caused by the measure of the Member State itself, e.g. where there is a lower tax rate only for foreign group interest income"* ([226]). Thus, because *"it is not relevant in the case of a general measure applicable to all group interest income, domestic and foreign, which leads to cross-border differences"* ([227]).

In conclusion, it must be highlighted that mismatches are situations which are secondary in practice. As we will see indeed, the Commission's recent relevant Decisions clearly show that its attention is paid to transfer pricing arrangement with a higher degree of priority.

2.4.3. The arm's length principle under EU law: relationship with national law of the Member States and the OECD Guidelines.

It has already been observed that the arm's length principle, which is foreseen by the OECD at international level, is generally recognized by national legal orders in various forms, depending on the particular principles characterizing national law. Indeed, the same principle has been imported at the EU level through the practice of the European Commission.

The premises of the Commission's methodology in approaching rulings

[225] *Ibidem,* § 1.
[226] *Ibidem,* 41.
[227] *Ibidem.*

endorsing transfer pricing are commendably highlighted by the Directorate-General for Internal Policies of the European Parliament ([228]).

First of all, the EU Institutions acknowledged that most Member States adhered to the arm's length principle, although in different forms, when it comes to the necessity to assess the "fairness" of intragroup transactions. On these grounds, when the Commission first observed the importance of the arm's length principles through a number of measures adopted in the early 2000s, it referred to its application in the national context of the Member State concerned, so that the Commission may, as a general rule, refer to the principle at stake within the limits of the national legal framework concerned *in casu*, which must recognize the applicability of the rule itself ([229]). This entails that every Member State is free to apply its own methodology of calculation in principle when it comes to the determination of the arm's length price, and the Commission shall limit itself at evaluating if the mechanisms used by national authorities (and therefore the rulings themselves) are likely to infringe art. 107(1) TFEU. Thus, without replacing national administrative practice with the calculation methods typical of its practice. In fact, we shall never forget that *prima facie* it is for the national administrations to determine the lawfulness of the prices established in intragroup transactions, while the monitoring and sanctioning powers of the Commission are rather meant to control the compatibility of the Member State's assessments with the competitive structure of the internal market of the Union. Such observation, while explaining why the starting point for the evaluation of transfer prices has to be the national legal framework of Member States in spite of EU secondary and primary law, also implies that the European Commission necessarily needs to adopt a different point of view towards transfer pricing practices with respect to that of national administrations, given that its role does not consist in testing the lawfulness of intra-private transactions, but rather to evaluate the compatibility of national law provisions and administrative practices with the purposes of the founding Treaties.

Before illustrating the approach adopted by the European Commission,

[228] European Parliament, Ibidem, EU State Aid Law and National Tax Rulings, at 12-13.
[229] Nevertheless, in the light of the mentioned case law, it should be noted that *"Member States should not use fixed margin or fixed rates to determine taxable profit but* [they should rather] *engage in a case-by-case assessment against facts*" and also provide for periodical review towards "perpetual rulings" (European Parliament, *Ibidem*, at 13).

however, it must absolutely be highlighted that, for what concerns practice, the Commission has fundamentally endorsed the OECD Guidelines on transfer pricing by stating that *"they provide a useful guidance to tax administrations and multinational enterprises on how to ensure that a transfer pricing methodology produces an outcome in line with market conditions"* ([230]). This is a statement of huge importance, for this means that *"consequently, if a transfer pricing arrangement complies with the guidance provided by the OECD Transfer Pricing Guidelines, including the guidance on the choice of the most appropriate method and leading to a reliable approximation of a market based outcome, a tax ruling endorsing that arrangement is unlikely to give rise to State aid"* under art. 107(1) TFEU ([231])!

2.4.4. The Commission's own approach towards the arm's length principle.

However important the OECD Guidelines on transfer pricing may be in practice, a fundamental clarification is absolutely needed. In fact, although recognizing the fundamental role which the Guidelines play in steering the action of the Commission in assessing the lawfulness of national tax rulings under art. 107(1), it must be observed that the European Commission has adopted its own approach towards the arm's length principle, stating that the Commission is not bound by the OECD Guidelines at all.

The corner stone of this approach is represented by *Forum 187* ([232]). In that decision, the Commission has contested the way in which the *'cost plus'* method foreseen by the OECD had been applied by the tax administration, although it did not object the lawfulness of the adoption of such methodology ([233]). In the

[230] European Commission, *Notice on the Notion of State aid as referred to in Article 107(1) TFEU,* (2016 § 173; However, as we will see, *"the Commission* [has] *convincingly* [stated] *that rulings and settlements have to be based on a reasonable and non-discretionally interpretation of the underlying tax legislation according to the objective standards"*, and therefore, while administrative practice may be lawful at national level, still it may be liable to breach art. 107(1) (Leigh Hancer, Tom Ottervanger, Piet Jan Slot, *op. cit.* (2016), 13-041).
[231] European Commission, Notice, *supra*, (2016) *Ibidem*.
[232] Commission Decision 2003/755/EC of the 15th February 2003.
[233] *Ibidem*, § 15 ff. ; see also Marco Boccaccio, *L'evoluzione della politica della Commissione su aiuti di Stato in materia fiscale*, Rivista di Diritto Finanziario e Scienza delle Finanze No. 2 (June 2017), at 224-225.

Judgement which followed the Decision, the Court implied that the effect of the exclusion of *"[the costs] from the expenditure which serves to determine the taxable income of the centres is that the transfer prices do not resemble those which would be charged in conditions of free competition",* thereby endorsing the Commission's view ([234]).

But the real breakthrough has been provided by the Commission with the *Starbucks* decision, which will be analysed in detail later ([235]). Indeed, in that decision the Commission affirmed that *"for any avoidance of doubt, the arm's length principle that the Commission applies in its State aid assessment is not that derived from Article 9 of the OECD Model Tax Convention, which is a non-binding instrument"*, for the arm's length principle "*necessarily forms part of the Commission's assessment under Article 107(1)* […] *which binds the Member States and from whose scope the national tax rules are not excluded"* ([236]).

As it will be better highlighted later, this determination has been subject to heavy criticism among commentators, especially from the US. Nevertheless, this statement radically confirms that the European Commission has indeed adopted its own praxis in the matter of transfer pricing transactions and the arm's length principle.

As pointed out by NICOLAIDES ([237]), the latter approach is mainly expressed by two documents of primary importance: The Commission's Notice on the notion of State aid and the Commission's Working Paper on tax rulings, both drafted in June 2016 ([238]). The former expresses, as we have seen, that an application of the arm's length principle in a national tax ruling which *de facto* recognizes the admissibility of a manipulated transfer price is liable to confer a selective advantage upon the companies concerned. Thus, given that an advance tax ruling or and advance pricing agreement may actually "*establish in advance* […] *how 'arm's length profits' will be set for related party transactions where*

[234] Case C-182/03 *Belgium v. Competition* [2006], ECLI-416 § 96.
[235] Commission Decision 7143/2015 of the 21st October 2015.
[236] *Ibidem*, § 264.
[237] Phedon Nicolaides, *op. cit.* (2016) at 416.
[238] European Commission, Notice, supra (2016); European Commission, DG Competition, Working Paper on State Aid and Tax Rulings, (June 2016).

uncertainty justifies an advance ruling to ascertain whether certain intragroup transactions are priced at arm's length" ([239]). The Notice expressly recognizes that *"the arm's length principle necessarily forms part of the Commission's assessment of tax measures granted to group companies under art. 107(1)*", and although the Commission itself affirmed that the national context constitutes the starting point of its action dealing with tax rulings, the arm's length principle is transposed at EU level *"independently of whether a Member State has incorporated* [it] *into its national legal system and in what form"* ([240]). Such assumption is very important in practice, for thereby the Commission still empowers itself to adopt its own approach towards tax rulings deviating from the practice common to the national authorities involved *in casu*.

In particular, the criterion to which the EU Commission attributes a certain degree of primacy in assessing if the price of the transaction is at arm's length or not is the criteria of the 'market result' for *"where a tax ruling endorses a result that does not reflect in a reliable manner what would result from a normal application of the ordinary tax system"* ([241]), then the Commission has to evaluate if there's *"an approximation of a market based outcome"* ([242]). According to the wording used by the Commission itself, such expression means that *"any deviation from the best estimate of a market-based outcome must be limited and proportionate to the uncertainty inherent to the transfer pricing method chosen or the statistical tools employed for that approximation exercise"* ([243]). Therefore, it may ultimately be affirmed that, in the eyes of the DG Competition, the arm's length principle is precisely *"used to establish whether the taxable profit or a group company for corporate income tax purposes has been determined on the basis of a methodology that produces a reliable approximation of a market-based outcome"* ([244]). Consequently, for this reason, *"a tax ruling endorsing such a methodology ensures that a company is not treated favourably under the ordinary rules of*

[239] European Commission, Notice, *supra*, (2016), §169.
[240] *Ibidem*, 172.
[241] *Ibidem*, 170.
[242] Phedon Nicolaides, *op. cit.* (2016), at 418.
[243] *Ibidem*, 171.
[244] *Ibidem*, 172.

corporate taxation of profits in the Member State concerned as compared to standalone companies who are taxed on their accounting profit, which reflects prices determined on the marked negotiated at arm's length" ([245]).

While the Notice explains in what way the arm's length criterion applies in principle to the action of the European Commission, the White Paper specifies how the arm's length rule applies to its practice, explaining in particular how the DG Competition should effectively determine the "market-based outcome". Indeed, the document concerned states that *"the arm's length principle aims to ensure that all economic operators are treated in the same manner when determining their taxable base for corporate income tax purposes, regardless of whether they form part of an integrated corporate group or operate as standalone companies on the market"* ([246]), provided, again, that the possibility for national tax administrations to grant rulings is not *"called into question"* ([247]). In fact, as it is admitted in the Working Paper, *"rulings that cover intra-group transactions between two Member States, where both companies carry out genuine economic activities on which they are taxed, have been found to be unproblematic"* ([248]). Therefore, the Commission aims at those rulings which *"manifestly deviate from a reliable approximation of a market-based outcome"* with a certain degree of priority ([249]). This especially concerns those tax rulings which are addressed to the transactions between the entities of the group and those "financing companies" which are part of the group too, because *"the only activity of such financing companies is the passing-on of funds or intellectual property (IP) rights from one group company to another"* and given that *"in some Member States with no withholding tax, there are tax rulings approving profit margins for these financing companies"* ([250]).

It is moreover interesting to see that, as it will be deeply analysed later on, the Commission has justified its adherence to the arm's length principle mentioning (and manipulating to a certain extent) the case-law of the CJEU ([251]).

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[245] *Ibidem.*
[246] European Commission, Working Paper *supra* (2016), § 3.
[247] *Ibidem*, § 5.
[248] *Ibidem*, § 13.
[249] *Ibidem*, § 14.
[250] *Ibidem*, 15.
[251] See § 3.5.

In fact, referring to *Forum 187*, the Commission's Notice provides that *"the European Court of Justice endorsed the arm's length principle for determining whether a fiscal measure prescribing a method for an integrated group company's taxable profits gives rise to a selective advantage for the purposes of Article 107(1)"* ([252]). However, NICOLAIDES argues that the Court did actually never explicitly mention the arm's length principle in the recalled judgement, as it only referred to the *"conditions of free competition"*, which are rather an element which is inherent to the latter ([253]).

2.4.5. Problems related to the Commission's approach towards the arm's length principle.

Nevertheless, the acquisition of the principles drafted at OECD level postulates that the problems related to them are automatically transferred to the EU framework. In particular, attention shall be paid to the aforementioned situation in which the sale of goods or the provision of services is imposed at a transfer price which does not have any market-based counterpart to be compared with. In this case, the Commission affirms the need to adopt an approximation; more precisely: *"the search for a 'reliable approximation of a marked-based outcome' means that any deviation from the best estimate of a market-based outcome must be limited and proportionate to the uncertainty inherent in the transfer pricing method chosen or the statistical tools employed for that approximation exercise"* ([254]). Such attitude, although reflecting the need to secure the fairness of transfer pricing transactions with respect to competitors in a quite logical way, might perhaps be subject to some observations. Indeed, as it will be underlined more in detail at the end of this chapter, the Commission's approach in the application of the State aid rules to tax rulings has been subject to some criticism, which might be more or less founded as we will see.

[252] European Commission, Working Paper, *supra* (2016) § 4.
[253] Phedon Nicolaides, *op. cit.* (2016) at 420.
[254] European Commission, Notice, *supra* (2016) § 171.

With respect to the application of the arm's length principle in the light of the OECD Guidelines, it may be observed that both the OECD and the Commission's approaches postulate, in general, that transactions between legally related undertakings, although not necessarily in breach with art. 107 and 108 TFEU, find themselves in a more advantageous position with respect to those concluded between standalone companies. Thus, because it is assumed that in the former case there is a fundamental lack of those connected risks which characterize the latter instead, clearly because of the unitary dimension of the firms being part of the same group.

In fact, it is not so. As it has been pointed out by NICOLAIDES, in intragroup transactions risks are limited rather than eliminated, for the contract itself cannot eradicate completely business risks, such as the risk of default or, most importantly, the risks related to the quality of goods and services ([255]). By the way, this is the same conclusion to which the CJEU has come in *France v. Commission*, annulling the Commission's decision on the aforementioned *IFP* case ([256]). In fact, when it comes to product quality in the context of the EU, in must be noted that the latter is, at least partially, defined or predefined through an exercise of authority, since when the product or service meets the standards drafted through the Directives of the Commission and the standard-setting bodies' determinations, then it is in principle allowed to freely circulate in the internal market. Thus, independently from the actual arm's length price.

Secondly, the Commission's approach is liable to rise doubts also with respect to the determination of the normal market conditions via approximation. Indeed, the most common definition of market reads *"an actual or nominal place where forces of demand and supply operate"* and so, the ideal negotiation ground *"where the buyers and sellers interact to trade goods, services, or contract or instruments, for money or barter"* ([257]). Provided that the concept of market does not necessarily imply that the market players have a private nature, given that even States or International Organizations and their sub-divisions may be buyers or

[255] Phedon Nicolaides, *op. cit.* (2016), at 422.
[256] Joined Cases T-479/11 and T-157/12, *IFP and France v. Commission* (2016), ECLI-320.
[257] Definition of Market, Business Dictionary, available at: <https://businessdictionary.com>.

sellers of certain products or services ([258]), the mentioned economic definition postulates that the market is a dimension which is by its very nature established through the action of the market players exercising their will to satisfy their needs, thereby imposing the economic conditions by which transactions are concluded. Indeed, there is no reason to believe that the Commission does not recognize such a notion of 'market', at least for what concerns its core elements. It seems therefore quite unreasonable that, by acting through approximation in the case in which there is no actual market price related to a certain transfer pricing transaction, the Commission may express itself *de facto* censuring a transaction as being unfair with respect to a virtual "market-based result" which does not even exist. And thus, with a market price which is factually imposed through an authoritative exercise of power, and which consequently cannot be classified as a "market-based outcome" *per se*!

Nevertheless, the reasons which justify such an approach have been already highlighted in the first chapter. In fact, the EU is based on a "social market approach" rather than a "free market ideology", in line with the ordoliberal ideals which stand behind the concept of *"Soziale Marktwirtschaft"*. For a free market itself is not the goal, but rather the mean by which the Member States and the Union's public authorities want to realize certain political and social aims, in the eyes of the Commission it would be necessary to scarify the logics inherent to market-freedom to secure a balanced market, making sure that fairness and equality of treatment is granted in order to promote a stable competition for the consumers' sake. Therefore, if the idea of the Commission determining and factually applying that arm's length price which would have been established had the market existed, although conflicting with the very concept of market on which its action is based, is on the other hand absolutely legitimate (if not even absolutely necessary) in the light if the Union's purposes resulting from art. 3 TEU.

Turning back to the issue of product quality, if it might be illogical with respect to the principles of free market economy to identify a market-based arm's length price which should be applied to the transaction *a posteriori*, a similar determination is impossible to be provided when it comes to the exact determination

[258] This is, again, the cases of States Monopolies or "economic services of general interest".

of product quality in legal terms. Although it might be limited, the existence of risks also with respect to legally related companies may give rise to problems when comparing standalone companies to non-independent ones. Such a difficulty is indeed recognized by the OECD Guidelines themselves too, where it is affirmed that *"a practical difficulty in applying the arm's length principle is that associated enterprises may engage in transactions that independent enterprises would not undertake"* given that "[transfer pricing] *transactions may not necessarily be motivated by tax avoidance but may occur because in transacting business with each other, members of a group face different commercial circumstances than would independent companies"*. In fact, it truly is this difference concerning the premises on which business strategies of group-member companies on one hand and standalone companies on the other are based which is both the starting point for the Commission's monitoring activity and the problem which may be related to its concrete action in the light of all what has been stated above, namely because there is no comparable transaction which might be used as a benchmark to find a solution *in casu* ([259]). This difficulty is even amplified by the fact that *"transactions between related companies are* [normally] *subject to higher degree of transparency, lower degree of risk and more control over quality"* ([260]).

However, it should be observed the core of the problem is not even the existence of a difference, which might be clear in both economic and legal terms in principle, but rather the fact that, as NICOLAIDES argues, neither the OECD Guidelines nor the Notice and the Working Paper seem to indicate how exactly the "market-based outcome" should be determined. Even the European Commission has failed to express its favour towards one or some of the methodologies suggested by the OECD, for the only argument which it stresses out is that tax rulings are not

([259]) Indeed, LEBOWITZ observes that if the differences between independent undertakings and related undertakings might be clear at first glance, this is not the case when it becomes necessary to deal with its consequences in depth. As the author affirms, in fact, *"related entities are economically different creatures than unrelated ones. While this notion is probably intuitive to business people, economists in the field of industrial organization have recently developed an entire subfield devoted to analysing the variety of economic relationships that exist among, as well as within, economic entities and the circumstances under which transacting within or outside a single entity (or commonly controlled group of entities) is economically more advantageous"* (Brian E. Lebowitz, *Transfer Pricing and the End of International taxation,* Tax Notes International No. 9, (1999) at 1202 in Phedon, *op. cit.* (2016), at 423.

[260] Phedon Nicolaides, *op. cit.* (2016), at 422.

considered to be in breach ex art. 107(1) TFEU *"if they do not grant a selective advantage to economic operators"* ([261]). It shall not be forgotten indeed, that the determination of the arm's length price is not the ultimate task of the Commission, which rather consists in evaluating the tax rulings granted by the Member States to the transacting companies in the light of the State aid rules. For this reason, the application of the arm's length principle does not qualify as an aim of the Commission's action, for it is instead a mean by which the Commission enforces the prohibition of State Aid ex TFEU with respect to situations involving transfer pricing operations.

On these grounds, it might be observed that the lack of any expressed preference towards the methods provided by the OECD Guidelines, as well as the silence concerning those which may conflict with the legal dimension of EU law and its principles are elements which certainly improve uncertainty in the system. Furthermore, the exclusive reference to the features of art. 107(1) provided by the Working Paper ([262]) might probably be the expression of a precise approach adopted by the Commission, considering the methods used to determine the arm's length price as falling within the framework of its discretionary powers in the enforcement of the Treaty provisions ([263]). Under this light, the problem underlined by NICOLAIDES becomes relativized because, from the Commission's point of view, what is important is to make sure that tax rulings which have the effect to hamper fairness in the common market, by "allowing" transactions which do not reflect the effective price which would have been adopted in ordinary conditions of competition, are caught according to arts. 107 and 108 TFEU. Thus, entailing that for that purposes it is not relevant in principle *"whether* [the companies concerned] *form part of an integrated corporate group or operate as standalone companies on the market"* ([264]).

[261] *Ibidem*, at 423.
[262] *Ibidem*.
[263] Indeed, the discretion of the Commission has been also recognized by commentators. *Inter alia*, GUIZZI, affirmed: "*È da rilevare che, nonostante l'affermazione del divieto degli aiuti di Stato, contenuta nel par. 1 dell'art. 107(1), le deroghe a tale principio fanno si che la valutazione della compatibilità o incompatibilità di un aiuto istituito da uno Stato sia in gran parte affidata alla discrezionalità della Commissione"* (Vincenzo Guizzi, *op. cit.*(2015), at 707).
[264] European Commission, Working Paper, *supra* (2016), § 3.

2.4.6. The "Red Flags".

According to the two-steps approach, the Commission has a wide margin of discretion in determining what rulings will be subject to its investigation activity. In order to decide what measures will be addressed by the exercise of the Commission's powers, the DG Competition uses certain criteria to assess the degree of liability of the rulings to be incompatible with art. 107(1) TFEU. Such criteria are the s.c. *"Red Flags"*.

By analysing the Commission's recent case law on tax rulings, ARENA has identified four types of such red flags ([265]).

First, the author observes that an element which is likely to raise the awareness of the DG Competition with respect to tax rulings consists in the lack of related reports when it comes to rulings endorsing transfer pricing transactions, better said: the lack of a *"transfer pricing report"*. Such instrument consists in a document which is provided by the taxpayer which has the aim to explain the methodologies used by the taxpayer himself in calculating the arm's length price applicable to the considered taxable transaction ([266]).

Secondly, another kind of red flag consists in the fact that some tax rulings may be issued with the purpose of pursuing aims of general interest. Indeed, as ARENA observes, in this case the Commission may assume that the taxpayer will accept to bear the costs which are related to the realization of such goals only if he will benefit from a favourable tax treatment in exchange ([267]).

Thirdly, then, a further element which may attract the Commission's attention is the duration of the ruling. In fact, as ARENA observes, *"the longer the period of validity of a tax ruling is, the more likely it is that the ruling itself does not respond to a correct application of the arm's length principle"* ([268]). Indeed, it

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[265] Amedeo Arena, *op. cit.*, (2017) at 942 ff.
[266] Indeed, as we will see with respect to *Amazon*, the Commission did in fact assess that doubts have arisen because of the lack of transfer pricing reports, contrary to the *Fiat* case, in which the company's tax advisor had indeed provided a report on the calculation of the tax base.
[267] Amedeo Arena, *ibidem*; ARENA further observes that: *"nella decisione di avvio del procedimento Exess Profit* […]*, la Commissione ha evidenziato che la disciplina belga sulle decisioni fiscali anticipate non sembrava essere in linea con il principio di libera concorrenza* (the arm's length principle) *nella misura in cui attribuiva vantaggi fiscali parametrati alla creazione di nuovi posti di lavoro o alla realizzazione di investimenti del Belgio"* (*ibidem*).
[268] *Ibidem*, at 942.

may happen that the transfer price which is endorsed by a ruling does actually reflect the arm's length principle at the time in which the measure is issued.

However, it is also probable that after a number of years the methodology which has been endorsed *ad quem* will not mirror he actual arm's length price anymore ([269]).

Finally, the last "red flag" criterion deals with the controversial relationship between the Commission's approach towards tax rulings and the OECD Guidelines. In fact, it has been said that even though the Commission considers itself not to be bound by the latter instrument, it has also recognized the Guidelines' high steering value, foremost with respect to the implications concerning the application of arm's length principle. Therefore, as ARENA suggests, the Commission's decisions show that it pays particular attention to those rulings which endorse arm's length calculation methodologies which fall outside the spectrum suggested by the OECD in its Guidelines ([270]).

2.4.7. Problems related to taxation on share profits.

Before coming to the analysis of the relevant Commission Decision on tax tulings, it is important to say something about share profits taxation incidentally. Indeed, although profit taxation normally applies through general provisions of law and not via administrative rulings, there are some patterns which may be relevant in the light of the issue of the present essay because of the involvement of some aspects liable to collide with the framework of art. 107(1).

In fact, according to VESTERDORF, the main question with respect to this kind of taxation concerns the compatibility of the s.c. "taxation on an accrual basis" for shares with the internal market ([271]). This method consists in calculating the gains which have not yet been registered into the tax base which will be subject to

[269] On this point, ARENA suggests that this is the situation concerned in *Apple* and *Amazon* because as we will see, the Commission's Decisions concerned measures confirming other measures which had already be granted in the past (*ibidem*).
[270] In fact, the author observes that *"nella Comunicazione sulla nozione di aiuto di Stato* (Communication on the notion of State Aid, § 173) *si legge soltanto che la Commissione potrebbe ‹‹tener conto delle indicazioni›› contenute in documento di soft law"* (Ibidem, at 943).
[271] Peter L. Vesterdorf, *Capital Gains Taxation of Share Profits and EU State Aid Regulation*, European State Aid Law Quarterly No. 4 (2010), at 741.

taxation. For what concerns capital gains, the accrual principle applies mainly with reference to the value of the shares resulting from their trends in the stock exchange markets. It is not clear, indeed, if the Commission has a clear practice with respect to this issue. Nevertheless, it must be underlined that transfer pricing and deliberate mismatches alike, the accrual principle applied to share profit transactions may have an adverse impact on the common market and consequently be inconsistent with the State aid rules. VESTERDORF refers to Danish law, which provides the application of the accrual methodology only with respect to companies quoted in stock exchanges, while allowing the freedom of choice between the latter principle and the s.c. "realization method" for unlisted companies ([272]). Perhaps, this provision may affect competition in the internal market because of the fact that such rule may create an inequality of treatment between listed and unlisted undertakings.

The author points out that an effective counterargument to this conclusion consists in assessing that a differential methodology in the determination of the tax base with respect to unlisted companies may be justified through concrete circumstances. In fact, it is true that the *"EU does not prevent Member States from* applying *"tax legislation that treats undertakings* […] *differently, but such different treatment must be legitimised on the basis of the nature of the general scheme of the system"* ([273]). Therefore, the mentioned system might be in breach of art. 107(1) where it allows unlisted undertakings to choose the system applicable for the calculation of their tax base, while it does not provide so with respect to the listed ones, because *"accrual basis taxation is economically less favourable to companies"* ([274]) for several reasons ([275]). However, this difference of treatment may be considered lawful if there is sufficient ground to affirm that a difference of treatment between listed and unlisted companies is justified in the light of the general scheme. For instance, this might be made affirming that *"a legislation which introduces particularly advantageous taxation with the aim of supporting*

[272]*Ibidem*, at 742.
[273] *Ibidem*, at 742.
[274] *Ibidem*, at 745.
[275] The author mentions, *inter alia*, the fact that investors may be required to pay taxes on profits which they have not realized and to the circumstance according to which the provisions concerned where meant to increase the State's resources in accordance with the larger reform of which they were part of (*Ibidem*, at 744 and 745).

unlisted companies could be [allowed] *due to considerations concerning the importance of creating new enterprises and innovation"*, or by observing that taxation on accrual basis does not fit to unlisted companies because *"it may in certain cases be difficult to assess the value of* [their] *shares or to assess values with a sufficient degree of precision"*([276]). Nonetheless, the Commission seems not to have any clearly defined approach towards the mentioned problematic, while the ECJ was contradictory in affirming the lawfulness in principle of the accrual base system under the State aid provisions on one hand, and often ruling against it on the other ([277]). Perhaps, this may be consequent to the fact that profit taxation rules differ consistently from one Member State to the other, and that therefore a meticulous case-by-case approach may seem the only way to effectively deal with the problematic at stake.

Conclusively however, for what concerns the present essay it is important to underline that a tax ruling granting a scheme such as the mentioned one may be in breach of art. 107(1) because of the possible effect of hampering effective competition in the internal market. In particular, we may observe that a certain relevance has to be recognized upon the issue of market determination, which natural framework is instead generally identified with respect to arts. 101 and 102 TFEU. Indeed, as also VESTERDORF seems to suggest ([278]), a differential treatment between listed and unlisted companies in tax matters may be extremely difficult to be considered as justifiable in respect to cases in which the undertakings involved operate on the same product market, for dissimilarities in the calculation of their respective tax bases would be surely incompatible with the Treaties by their nature of being direct competitors.

[276] *Ibidem*, at 749.
[277] *Ibidem*, at 752.
[278] *Ibidem*, at 749.

2.5. Relevant Commission Decisions on tax rulings.

2.5.1. Preliminary remarks on the Commission's decisions on tax rulings.

The aforementioned approaches are confirmed by the recent decisions of the European Commission on State tax aid. Indeed, the aim to counter unlawful national tax rulings has been set as one of the priorities of the Juncker Commission, along with the establishment of the digital internal market. The following selected case-law highlights how the Commission has concretely applied the above-mentioned criteria and principles *in casu*. As also the criticism expressed by some commentators which will be analysed in the final paragraph of this chapter seems to confirm, the decision which had a greater impact on both the civil society's opinion and the recent legal literature is undoubtably *Apple*.

Nevertheless, it is also important to illustrate other relevant decisions of the European Commission in order to better show and confirm how the Commission actually deals with cases concerning tax rulings, given the fact that Tax Rulings have become a central issue in the DG Competition's practices only since 2014, when the Juncker Commission entered in charge.

By the way, the case-law at hand demonstrates that the Member States which the investigations of the Commission have been mainly concentrated on mainly concerned the countries of the "BeNeLux", with a particular attention given to the Grand-duchy of Luxembourg, whose reputation to be (or to have been) a "tax heaven" is quite well-known among the civil society ([279]).

[279] In this regard, also see: Romano Beda, *L'Ue: «Amazon paghi le tasse non versate al Lussemburgo». Irlanda deferita alla Corte di giustizia per Apple*, Il Sole24Ore (4th October 2017); Romano Beda, *La Ue apre un'indagine su Ikea: ha evaso tasse in Olanda*, Il Sole24Ore, (18th December 2017); *EP tax avoidance fact-finding mission in Luxembourg*; Luxembourg Times, (2nd March 2017); René Höltschi, *Die heikle Besteuerung von Apple, Google und Netflix,* Neue Zürcher Zeitung (17th September 2017); *Luxembourg Leaks: « Tax ruling » : une pratique légale... jusqu'à quel point ?*, Luxemburger Wort (6th November 2011); Federica Micardi, *Più dialogo per superare le doppie imposizioni*, Il Sole24Ore (16th March 2018); Angelo Mincuzzi, *Sempre più tax ruling. Così gli Stati Ue si fanno concorrenza fiscale*, Il Sole24Ore, (15th March 2018); Werner Mussler, *Luxemburg schliesst Steuerschlupfloch*, Neue Zürcher Zeitung (27th December 2016); Werner Mussler, *Starbucks und Fiat-Tochter müssen Steuern nachzahlen, Neue Zürcher Zeitung* (21st October 2015); Michele Pignatelli, *Unilever, tasse e norme anti-scalata dietro la scelta di Rotterdam*, Il Sole24Ore, (16th March 2018); Mauro Pizzin, Tax ruling, *accordi segreti fra Stati Ue e multinazionali in crescita del 160%*, Il Sole24Ore, (7th December 2016); Reuters, *L'enquête de*

In particular, there are two important aspects which the following decisions further stress. First, despite the fact that the Commission has developed its own approach, it should be noted that the recourse to the arm's length calculation methodologies suggested by the OECD seems indeed to dominate the administrative practices of the Member States and of the EU as well. Nevertheless, as we will see, one method in particular seems to be preferred for transfer pricing practices: namely the TNMM. This is so because, contrary to other methodologies, the mechanism at hand provides more flexibility than other mechanisms, mainly because it is based on the reference to only one of the undertakings involved in the transaction, contrary to the CUP. Secondly, also in the light of the importance which the Commission has attributed to the *transfer pricing reports* ([280]), we may observe that while the Commission as a public authority plays a quasi-exclusive role, the intervention of private undertakings and entities during the proceedings has a huge importance, for it furnishes important feedbacks used by the Commission to draw its conclusions ([281]).

2.5.2. The *Apple* case: the Commission decision of aid granted by the Irish tax administration to *Apple's* European subsidiaries ([282]).

In 2014, the European Commission initiated a formal proceeding pursuing art. 108 TFEU against the Republic of Ireland. The investigation concerned two different rulings granted by Ireland to two subsidiaries of the famous American technology giant *Apple inc.*; namely: *Apple Sales International* (*ASI*) and *Apple*

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l'UE sur les "tax rulings" étendue à ses 28 membres, Les Echos – Investir, (17th December 2014); Reuters, *Les enquêtes de l'UE sur la fiscalité des multinationals*, Les Echos – Investir (30th August 2016); Andrea Telara, *Amazon e il Tax Ruling spiegato bene*, Panorama (21st August 2017).
Rochelle Toplensky and Richard Milne*, Ikea's tax arrangements investigated by EU*, Financial Times (18th December 2017); Rochelle Toplensky, *Amazon and Apple hit by EU tax crackdown*, Financial Times, (4th October 2017) and Rochelle Toplensky, Arthur Beesley, Adam Samson, *EU takes Ireland to court over Apple taxes, Financial Times* (4th October 2017).

[280] See the Red Flags illustrated by ARENA , *supra* § 2.4.6.

[281] Indeed, we can observe that the Commissions considerations are based more than once on the reports submitted by the Companies' tax advisors which have been endorsed by the contested rulings (see. *Apple*). Moreover, the same applies to the observations submitted by the companies' competitors according to art. 108 TFEU (as the one submitted by *Nestlé* in the *Amazon* Case).

[282] Commission Decision 5605/2016 of the 30th August 2016.

Operations Europe (*AOE*), which have been incorporated in Ireland. The concerned firms are the depositaries of the Intellectual Property Rights on Apple products being produced and marketed outside the American continent; thus, on grounds of a s.c. "cost sharing agreement" concluded with the main branch of *Apple inc.* based in the US, which provides the counter-obligation for the Irish divisions to inject a certain amount of capital every year into the American office to contribute to the financing of its Research and Development activities ([283]).

As said, already in 1991, the Irish tax administration addressed the two Irish-based companies with two distinct rulings, concerning the determination of the tax base applicable to the firms' profits. The content of those measures was eventually amended in 2007 through the provision of two new rulings replacing the ones of 1991. Indeed the older rulings granted to *ASI* provided that "*the net profit to be allocated to ASI's Irish branch would be calculated as 12.5 % of all branch operating costs, excluding material for resale"* ([284]), while the one recognized upon *AOE* established instead that *"the net profit attributable to AOE's Irish branch would be calculated as 65 % of that branch's operating expenses up to an annual amount of USD [60-70] million and 20 % of its operating expenses in excess of USD [60-70] million"* ([285]). In the meaning of the latter ruling, the notion of "operating expenses" applied to *"all operating expenses incurred by AOE's Irish branch, including depreciation, but excluding materials for resale and cost-share for intangibles charged from Apple-affiliated companies"* ([286]). In 2007 the situation changed. The new rulings introduced a new profit determination method. According to the one granted to *ASI "net profit to be allocated to ASI's Irish branch would be calculated as equal to [10-15] % on branch operating costs, excluding costs such as charges from Apple affiliates and material costs"* ([287]). On the other hand, the 2007 ruling addressed to *AOE* established that *"the tax base of the Irish*

[283] According to the European Commission, *"Apple Sales International [and Apple Operations Europe] contributed to fund more than half of all research efforts by the Apple group in the US to develop its intellectual property worldwide"* (European Commission, Press Release, *State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion* (Brussels, 30th August 2016)).
[284] *Ibidem*, 59.
[285] *Ibidem, 61*.
[286] *Ibidem.*
[287] *Ibidem*,

branch was equal to (i) [10-15] % of branch's operating costs, excluding costs such as charges from Apple affiliates and material costs, (ii) an IP return of [1-5] % of branch turnover in respect of the accumulated manufacturing process technology of the Irish branch and (iii) a deduction for the capital allowances for plant and buildings 'computed and allowed in the normal manner'" ([288]).

In the light of this, it is clear that in the present case the Commission was concerned with transfer pricing transactions likely to fall in breach of the State aid rules. Therefore, the Commission referred to the OECD Guidelines in order to individuate the most appropriate methodology to determine if profit allocation had applied as it would have in a situation of ordinary market conditions. Indeed, the Commission found that the Irish tax administrations chose TNMM method ("transaction net margin method"), consisting in *"one of the "indirect methods" to approximate an arm's length pricing of transactions and profit allocation between companies of the same corporate group"* ([289]). The Decision affirms that the *"TNMM approximates what would be an arm's length profit for an entire activity, rather than for identified transactions"* while, in the Commission's view, *"it does not seek to establish the price of goods sold but* [it] *estimates the profit independent companies could be expected to make on an activity, such as the activity of selling goods"* [290]. In fact, *"it does this by taking a base ("a profit level indicator"), such as costs, turnover or fixed investment, and applying a profit ratio reflecting that observed in comparable uncontrolled transactions to that base"* ([291]). Indeed, the *in casu* applicable profit level indicator which had been endorsed by both the rulings of 1991 and of 2007 was individuated in the s.c. "operative expenses".

First, the Commission contested the application of this choices. Indeed, both *ASI* and *AOE* are entitled to care about the sales of *Apple* products not only in Europe but also in any other geographical area differencing from North and South America through their dislocated "branches". The rulings concerned did endorse the allocation methods used by *Apple* consisting in transferring the profits gained

[288] *Ibidem,*
[289] *Ibidem,* 93.
[290] *Ibidem.*
[291] *Ibidem.*

abroad to their respective head offices located in Ireland. Contrary to the CUP methodology, the TNMM method applies by testing only one of the parties of the transaction; namely: the party which is considered to perform the "less complex function". On these grounds, as the rulings endorsed *Apple*'s identified the dislocated "branches" as being the "tested party", thereby implicitly affirming that the head offices' activity was the more complex one, the Commission argued that there was a wrong application of the TNMM method. Indeed, given the fact that neither *ASI* nor *AOE* had any employees or any relevant facilities on Irish territory, and that the head offices' main task was to manage the IPRs related to Apple products, it could not be asserted that the sale of products provided by the external branches really constituted the less complex activity.

Secondly, the Commission held that such choice did not *"result in a reliable approximation of a market-based outcome in line with the arm's length principle"* ([292]). Thus because of different reasons with respect to both companies individually. For what concerns *ASI,* the Commission held that the firm could not be considered a "low risk distributor", which is indeed a necessary condition for an appropriate application of operative expenses as profit level indicator granting a "market-based outcome". In fact, the Commission noted that, since *ASI* did not have any personnel nor production machineries, on one hand, it could not be considered to bear the product risk, but, on the other hand, it had to be deemed bearing the turnover risk. In fact, the used profit level indicator did not reflect such risk, for while the operation expenses remained relatively stable since 1991, the amount of *ASI'*s sales enjoyed a substantial increase in the same period ([293]). Thus, along with the observation that *ASI* also provided heavy warranties for the products sold in the EMEIA region (Europe, Middle East and Africa) and that it *"systematically relied on third parties"* for distribution, drove the Commission to conclude that the application of the chosen profit level indicator was incorrect. As regards to *AOE* on the other hand, the Commission stated that a profit level indicator including total

[292] *Ibidem*, 334.
[293] Indeed, the payments made by the Irish companies to the US branch by virtue of the cost-sharing agreement *"amounted to about US$ 2 Billion in 2011 and significantly increased in 2014"* (European Commission, Press Release, *State aid: Ibidem*, (30 August 2016)).

costs would have been more appropriate to evaluate the risks borne by the company ([294]). In fact, the Commission held that *"the acceptance by Irish Revenue of operating expense as profit level indicator in the profit allocation methods endorsed by the contested tax rulings, instead of sales for ASI's Irish branch and total costs for AOE's Irish branch, inappropriately lowers the annual taxable profit of both companies in Ireland as compared to non-integrated companies whose taxable profit reflects prices determined on the market negotiated at arm's length"* ([295]). Consequently, the Commission held that in both cases the arm's length principle was applied in a way which did not reflect the actual market-based outcome and, therefore, the rulings were *prima facie* inconsistent with art. 107(1) TFEU

Thirdly, the same has been stated for what concerns the levels of return accepted by the Irish tax administration. The arm's length return for the two branches was indeed calculated through a "comparative study" which was considered to be misleading. In fact, *"the Commission considers the use of a comparability study, which is based on a comparables database search, to be an inappropriate means for estimating an arm's length profit for ASI's and AOE's Irish branches"* ([296]). Thus because, *"for such a study to produce a reliable approximation of a market-based outcome in line with the arm's length principle, the products sold by the third parties included in the comparability study need to be comparable to the goods sold by ASI and the goods manufactured by AOE"* ([297]). In fact, by endorsing the comparative study proposed by *Apple*, the tax administration allowed *"a selection of comparables do not include any consideration of the fact that Apple sells high quality branded goods and positions its products on the market as such, while the companies selected might position themselves on the market differently"* ([298]). Indeed, *ASI*'s *liability* to for warranties on products sold presents a *"non-negligible risk"* with respect to product quality

[294] The Commission justified such a choice by referring to the fact that both Apple's external advisor and the PwC suggested to adopt a profit level indicator including reference to total costs (European Commission, *Ibidem*, 343).
[295] *Ibidem*, 345.
[296] *Ibidem*, 351.
[297] *Ibidem*.
[298] *Ibidem*.

([299]). By contrast, as regards to *AOE*, the Commission argued that there was no reason why *"the 25th percentile* [should have been] *accepted as the lower end of the range rather than requiring a narrower range to address the comparability concerns"* ([300]).

Finally, the Commission argued that *"even if Irish Revenue had been right to have accepted the unsubstantiated assumption that the Apple IP licenses held by ASI and AOE should be allocated outside of Ireland, which the Commission contests, the profit allocation methods endorsed in the contested tax rulings still produce an outcome that departs from a reliable approximation of a market-based outcome in line with the arm's length principle"* ([301]). This is because, in the Commission's view, the rulings endorsed *"a taxable remuneration which the Irish branches would not have accepted, from the perspective of their own profitability, if they were separate and independent companies engaged in the same or similar activities under the same or similar conditions"*, and that therefore the outcome of the transaction may not be considered market-based ([302]).

Consequently, using the words of present European Commissioner for Competition Margrethe Vestager, *"the Commission's investigation concluded that Ireland granted illegal tax benefits to Apple, which enabled it to pay substantially less taxes than other businesses over many years. In fact, this selective treatment allowed apple to pay an effective corporate tax rate of 1 per cent on its European profits in 2003 down to 0.005 per cent in 2014"*. In particular, the European Commission imposed Ireland to apply the normal corporation tax rate allocating every profit which had been indirectly transferred since 2003 to their "head office" to their respective "branch of origin" ([303]). The recovery period lasted until 2014 for in 2015 the two interested undertakings provided a change in their structure.

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[299] *Ibidem*.
[300] *Ibidem*, 360.
[301] *Ibidem.*
[302] *Ibidiem.*
[303] The reason why the sanction applies only to profits allocated since 2003 consists in the fact that the Commission's powers are retroactively limited for a maximum of 10 years from the year in which the first request for information was submitted to national tax authority (*in casu* this happened in 2013).

2.5.3. The *Excess profit* case: the Commission's decision on unlawful aid granted by Belgian authorities to multinational corporations ([304]).

In January 2016, the European Commission ruled against Belgium for a breach of the State aid prohibition. Indeed, according to Commissioner Vestager; *"Belgium has given a select number of multinationals substantial tax advantages that break EU State aid rules"* because it distorted competition *"by putting smaller competitors who are not multinational on an unequal footing"* ([305]). The law applicable in Belgium, namely the *Code des Impôts sur les Revenus/Wetboek Inkomstenbelastingen*, foresees that companies should be taxed on grounds of the activities registered in Belgium. However, art. 185(2) allowed Belgian authorities to issue tax rulings referred to multinational corporations in order to reduce their tax bases. Those measures had a mandatory character and could be renewed every four years.

On grounds of the doubts arising about the compatibility of some of the rulings concerned and art. 107 and 108 of the TFEU, the Commission initiated formal investigation in 2015. In particular, the Commission considered some rulings delivered according to a "excess profit" tax scheme enacted in 2005. The interested rulings applied the arm's length principle to the profits gained by multinational undertakings through intra-group transactions.

First, in the light of what has been explained, the European Commission found that the measures did qualify as exceptions with respect to the general taxation regime *"considers the Excess Profit exemption granted pursuant to Article 185(2)(b) WIB 92 to constitute a derogation from the Belgian corporate income tax system and not the mere application of it"* ([306]). Thus, because *"The Excess Profit exemption grants Belgian group entities benefitting from the contested scheme a selective advantage for the purposes of Article 107(1) of the Treaty by exempting a part of their profit actually recorded from Belgian corporate income tax"* ([307]),

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[304] Commission Decision 9837/2015/EU of the 11th January 2016.
[305] European Commission, Press Release, *State aid: Commission concludes Belgian "Excess Profit" tax scheme illegal; around €700 million to be recovered from 35 multinational* companies (11 January 2016).
[306] Commission Decision, *Ibidem*, 132.
[307] *Ibidem*, 133.

given that *"the Belgian corporate income tax system contains no principle or rule according to which profit actually recorded"*, contrary to what the rulings provided ([308]). Consequently, for they granted a selective advantage favouring "certain companies" through "State resources" thereby "distorting competition", the measures concerned surely fell within art. 107(1) TFEU. But in what way did the tax rulings grant the contested advantage?

For what concerns the requirement of selectivity, the Commission pointed out that not only group entities could enjoy the benefits flowing from the rulings at stake, thereby disfavouring standalone companies, but also that *"since the contested scheme is based on Article 185(2)(b) WIB 92, which restricts the application of the exemption and the grant of an advance ruling necessary to benefit from the exemption to entities engaged in cross-border transactions, only Belgian entities forming part of a multinational group may benefit from the Excess Profit exemption"* ([309]).

A deeper analysis was instead required for what concerns the element of the advantage, which the Commission did implicitly face separately from selectivity. Equal to the Irish tax administration in the *Apple*, in this case the Belgian authorities applied the TNMM method, but they did so according to the structure and categories inherent to Belgian law. In particular, the tax administration operated through a two-steps approach. *"Under the first step of that process, the Belgian group entity estimates its arm's length profit as a residual profit"* through the use of a one-sided method (the TNMM) ([310]). Then, *"under the second step of the process* […], *the Belgian group entity estimates the profit that a comparable standalone company would have made in comparable circumstances to arrive at an "adjusted arm's length profit" by applying the TNMM, this time with the Belgium group entity as the tested party"* ([311]). The aim of the first step consists in the calculation of the residual level of profit, while the purpose of the second relies in the determination of the adjusted arm's length profit. The difference between the two values formed the s.c. "excess profits" which were tax-exempted under the rulings ex art. 185(2)

[308] *Ibidem* 136.
[309] *Ibidem*, 138.
[310] *Ibidem*, 153.
[311] *Ibidem*, 269.

of the Belgian Code. Furthermore, the Commission found the whole system to be founded on the notion of "central entrepreneur" provided by Belgian law. In fact, Belgian authorities considered the offices established in Belgium to be the ones exercising the "most complex function" because of their higher degree of liability. By contrast, detached entities of the group established abroad had the mere legal function of being the other contracting parties to the intra-group agreements concluded by the Belgian-based companies, exercising productive and commercial activities for the group and therefore bearing a lower amount of responsibilities.

The Commission found the calculation of the arm's length profit according to the second step to be misleading. On one hand, the Commission does not put into question the legitimacy of the use of the TNMM method, considering a one-sided testing methodology to be appropriate to be applied *in casu*. Nevertheless, it observed that the Belgian group entities should have been the beneficiary of the major profits of the group, by virtue of their nature of being the "central entrepreneur" exercising the most numerous and complex managing functions for the sake of the entire multinational entrepreneurial structure. Therefore, the detached companies should on one hand transfer the greater party of their profits to the group leader undertakings in Belgium, but, on the other hand, they should have held a sufficient amount of financial resources in order to face their ordinary liability risks (product risk, entrepreneurial losses, etc.). Better said, by reference to the wording used by the European Commission, *"as a result of the transfer pricing exercise conducted under the first step, the Belgian group entity, as "central entrepreneur", is left with the residual profit from intra-group transactions"* ([312]). Consequently, *"this residual profit* […] *equals the arm's length profit of the Belgian group entity under the Belgian corporate income tax system and, in the case of the Excess Profit scheme, also equals its profit actually recorded"* ([313]).

Therefore, in the Belgian authority's approach the arm's length profits were in fact the result of the calculation inherent to the first step determining the residual ones, which were in turn the product of market-based evaluations of the interested companies indeed. It follows that, by carrying out the second step, the tax

[312] *Ibidem*, 154.
[313] *Ibidem.*

administration distorted the tax base which should have been considered for taxation. Thus because, while taxation should have been applied to the residual profits as a whole, the result of the second step entailed an undue tax exemption for those "excess profits", which in reality should have been considered belonging to the taxable gains. According to such reasoning, the Commission concluded that *"exempting any of that profit from the central entrepreneur's tax base* […] *constitutes an unjustified derogation from a market-based outcome, which is contrary to the arm's length principle, and leads to the grant of a selective advantage in favour of entities benefitting from the contested scheme since it results in a lowering of their tax liability under the Belgian corporate income tax system"* ([314]).

Belgium tried to justify such downward in the light of the economic dimension of the group. In fact, the national tax administration assessed that the part of gains concerned, represented *"profit* [flowing] *from synergies or economies of scale"* and that, as a consequence, *"such profit should not be attributed to the Belgian central entrepreneur under the arm's length principle"* ([315]). However, the Commission observed that *"what Belgium refers to as "excess profit", even if (partly) connected to synergies and economies of scale, should not be reattributed, but taxed where it arises"* because *"profit from synergies or economies of scale is not separately identified, remunerated or attributed under the arm's length principle"* and so, such consideration is not relevant for the determination of the arm's length profits.

Therefore, the Commission held that: *"assuming the arm's length principle has been properly applied following the first step, the conditions and prices under which the Belgian group entities transact with associated group entities should be reflected in its profit actually recorded"*. Indeed, the fact that through this system the companies concerned could have their tax base reduced by between 50% and 90% was not acceptable in the light of art. 107(1) TFEU. For this reason, on January the 11th 2016 the Commission decided that Belgium was breaching the State aid rules since the adoption of the rulings in 2005 and it consequently provided to

[314] *Ibidem*, 156.
[315] *Ibidem*, 157.

impose the necessary sanctions. On one hand, it ordered the tax administration to stop the application of the objected tax scheme. On the other hand, it also established that Belgium had to collect all the taxes applicable to the exempted profit since the application of the illegal rulings from around thirty-five multinational companies operating in Belgium which benefitted from the unlawful aid. The Commission estimated that the total volume of such undue payment amounted to around €700 million.

2.5.4. The *Fiat* decision on unlawful State aid granted to a subsidiary of the *Fiat-Fca* group through a ruling delivered by Luxembourg ([316]).

As ARENA observes, *Fiat* has been the first Decision of the European Commission on the incompatibility of a tax ruling with the State aid rules ([317]).

In June 2014, the Commission initiated an informal investigation proceeding against Luxembourg for suspected breach of art. 107 TFEU. The Commission's activity concerned a tax ruling in the form of an APA which the Luxembourgish tax administration (*Administration des Contributions Directes*) delivered to an undertaking of the famous automotive-manufacturing group *FCA*. In fact, within the undertakings which compose the group there is a company, *Fiat Finance and Trade S.A.*, which was based in Luxembourg. As the name of the company suggests, the object of the entity concerned consists providing *"cash management and treasury services to the Fiat S.p.A. Group in European and international financial markets"* by *"the company funds group companies and invests surplus funds in other investments and with banks. It also provides financial consultancy services"* ([318]). The 11th July 2014, one month after having started investigation, the Commission decided to rule against the Grand-duchy of

[316] Commission Decision 3627/2014/EU of the 11th June 2014.
[317] Amedeo Arena, *op cit.* (2017), at 934.
[318] *Fiat Finance & Trade* — Company card, Financial CBONDS Information, available at: <*http://cbonds.com/organisations/emitent/39713*>.

Luxembourg for contravening the Treaties by providing illegal aid to *Fiat Finance and Trade* (hereinafter *FFT*). The Luxemburgish tax ruling endorsed the arm's length principle application resulting from the transfer pricing report prepared by *FFT*'s tax advisor. The report affirmed that *"the transfer pricing study determines an appropriate remuneration on the capital at risk and the capital aimed at remunerating the functions performed by the company of EUR 2.542 million on which a range of +/- 10% is envisaged"* ([319]). The taxation rate applied to the mentioned profit was the ordinary one providing an imposition amounting to 28.8%. Moreover, the ruling had a binding effect towards the administration for a duration of 5 years, thereby entailing that no adjustment could be provided during that period. Again, the method used for the calculation of the taxable revenue was a variant of the TNMM, the CAPM (Capital Asset Pricing Model). This mechanism consists in estimating the arm's length margin to a profit indicator, which *in casu* had been individuated in equity. Thus, through a distinction between diversifiable and non-diversifiable risk. In particular, as observed by the DG Competition, *"the CAPM model considers that an efficient market would only remunerate the non-diversifiable risk component for each asset"* ([320]) in accordance with a reasoning based on the assumption that a *"rational investor would therefore invest in a diversified portfolio rather than in only one security"* ([321]), as foreseen by the economic theories ([322]). After having verified the existence of the legal requirements for the activation of art. 107(1), the Commission objected the tax ruling granted by Luxembourg under four points.

First, because the ruling allowed a deduction of the intragroup investments without any acceptable justification. In fact, there was no reason to provide such a deduction if the capital injections into other entities of the group provided by *FFT* were repaid through the participation to the profits of the former companies by benefitting from the related dividends.

[319] *Fiat, Ibidem*.
[320] *Ibidem*, § 40.
[321] *Ibidem*.
[322] In fact, the Commission explains *that "a rational investor, according to financial theory, diversifies its risk by investing in several securities (a portfolio) instead of investing in only one security. Because the share prices of different securities are not perfectly correlated, that is, they do not all fall in price at the same time, the risk of a portfolio is lower than adding the risk of the securities comprising the portfolio"* (*Ibidem*, § 39).

Secondly, the Commission held that the computation of the tax base resulted in a lower taxation with respect to the one which should have been applied. Indeed, the State measure did allow the method for the determination of the tax base endorsed by the report, which consisted in applying the rules indicated by the Basel II regulation with respect to "equity at risk". Indeed, the Basel II regulation provides that assets should be evaluated in accordance with their international rating and the internationally elaborated risk models applicable to them. The Commission stated that such choice was misleading because, according to Basel II, the mentioned rule shall apply only to AAA or AA- rated State bonds ([323]). The company tried to justify this mechanism by stating that *"this treatment of not allocating any capital needs to the intra-group assets would be based on the assumption that there is no risk of default for the group because "the group has interest to financially support all the group companies" and because no defaults are observed*" ([324]). The Commission did however not agree by affirming that *"although the creditworthiness of a parent company can impact the calculation of the creditworthiness of its subsidiary, banks do not exclude assets from risk weighting on that basis"* ([325]). Furthermore, it observed that *"this is even more so in the present case, considering that the creditworthiness of the Fiat Group is much lower than the creditworthiness of a highly-rated sovereign"* ([326]).

Thirdly, the European Commission argued that the low-risk indicator chosen by the report was not justified. Better said, it assessed that the report did not contain any explanation of why the *"difference between creditor interests accrued on bank deposits and debtor interests accrued on bank loans"* should have been considered amounting to 15% ([327]).

Finally, the Commission held that the report endorsed by the tax ruling wrongly referred the Basel II minimum capital requirements of 8%. Indeed, *FFT* held a minimum capital amounting to 6%, thereby altering the applicable tax base

[323] Indeed, the rationale of the Basel II criteria relies on the fact that, according to the regulation itself, *"banks are required to hold capital in proportion of their "risk weighted assets"* (*Ibidem*, 70).
[324] *Ibidem*, § 71.
[325] *Ibidem*, § 72.
[326] *Ibidem*.
[327] *Ibidem*, § 74.

provided by Basel II.

According to the Commission's points, it can be concluded that the aid was granted mainly in two ways. First of all, the selective advantage depended, as in the other cases which have been analysed in the former paragraphs, on a substantial reduction of the tax base through a mechanism which provided a different outcome if compared to the actual arm's length conditions. Secondly however, contrary to situations faced in *Apple* and *Excess profit*, in *Fiat* the interested tax ruling had endorsed a tax base determination method which did not only provide a misleading calculation of the taxable profits, but which did really apply through a wrong application of the provisions which the company claimed to have correctly applied.

Indeed, the Commission finally ruled against Luxembourg as it did two years later with respect to Belgium and Ireland. In fact, the Luxemburgish administration was under obligation to tax the profits which had been factually exempted through the endorsement provided by the ruling.

It may be observed that this case is particularly interesting under two profiles. On one hand, it shows how, due to the financial character of the activities carried out by *FFT*, the arm's length tax base could be calculated according to the same parameters applicable to banks *strictu sensu*. On the other hand, from a rather procedural point of view, as it will be better explained with respect to *Starbucks*, in this case the Commission used the powers conferred upon it by Regulation 734/2013 for the first time.

2.5.5. The *Starbucks* case: The Commission's decision on the tax ruling issued by the Dutch administration favouring *Starbucks* ([328]).

While it was investigating on the tax ruling granted by Luxembourg to *Fiat Chrysler*, the Commission initiated another proceeding towards the Netherlands, concerning tax aid granted to the famous international coffee roasting company *Starbucks*. In fact, the Commission found that the corporation benefitted from an

[328] Commission Decision 7143/2015/EU of the 21st October 2015.

aid measure in the form of a tax ruling, granting a substantial reduction of Starbucks' tax base, allowing it to pay around twenty and thirty million Euro less than due.

In 2008, the Dutch administration provided to conclude an APA with *Starbucks Manufacturing EMEA BV* (hereinafter: *Starbucks Manufacturing*), the only coffee roasting company belonging to the *Starbucks* group operating on the internal market, which in turn is incorporated in the Netherlands. The measure endorsed a transfer pricing report proposing a tax base which would have been applied to the interested firm. The method used for this calculation was again the TNMM, which was particularly applied in order to determine the price applied to transactions between *Starbucks Manufacturing* and *Alki LP.*, a British-based corporation. In particular, these exchanges concerned the transfer of technology, IPRs and know-how from the British company, which was a shareholder of the Dutch firm, to *Starbucks Manufacturing*, obtaining the payment of royalties as counter-obligation.

Starting from these premises, the Commission held that the report endorsed by the interested tax ruling actually misapplied the arm's length principle. It held so with respect to four points.

Firstly, as in *Apple*, the Commission held that the report wrongly configured *Starbucks Manufacturing* as a low-risk company. *"More specifically"*, the Commission argues that, contrary to the assessment contained in the objected report, *"information provided on SMBV's revenues demonstrates that roasting is not the main source of income of SMBV"* ([329]) for it could be observed that *"SMBV derives most of its profits recorded in the Netherlands from an activity different from roasting. Indeed, SMBV's reselling function, referred to as providing logistic and administrative services by the Netherlands and Starbucks, appears more important than its roasting activity and accounted for [80-85] % of SMBV's revenues in 2013 and 2014"* ([330]). Furthermore, it also assessed that *"SMBV's reselling function not only represents the main source of SMBV's income, but also represents the only source of SMBV's profit since 2010, considering SMBV's*

[329] *Ibidem*, § 381.
[330] *Ibidem*, § 382.

roasting activity has been loss making since that year, without prejudice to the question whether those losses on the roasting activities were caused by incorrect pricing of the green coffee beans" ([331]). Indeed, according to the latter point, the Commission also found that *Starbucks Manufacturing* contemporarily benefitted from a parallel transfer pricing agreement between it and the Swiss sister company *Starbucks Coffee Trading SARL*, which imposed transfer prices for the sale of green beans (one of the main elements of the coffee sold by Starbucks) which were intentionally increased with respect to the ordinary market price which should have been applied instead.

Secondly, the Commission held that the ruling was endorsing an inacceptable outcome considering the royalties constituting profit attributable to *Alki LP*, for the latter corporation had neither employees nor facilities and it was therefore not in a position allowing it to be operational. For this reason, *"since Alki LP is not in a position to generate active profits from the resale of non-coffee products*, […] *attributing those profits to Alki LP through the payment of royalty based on residual profits is not in line with the arm's length principle"* ([332]).

Thirdly, the Commission observed that as in the light of the report of *Starbucks Manufacturing*'s tax advisor the main activity of the interested company was misidentified, consequently, the TNNM method had to be considered to have been wrongly applied too. More precisely, in the Decision the Commission affirmed that "*it acknowledges that the* [methodology used] *is not backed by a sufficient comparability analysis and that the exercise is simply meant to replicate and duplicate the tax advisors' analysis if the functions would have been correctly identified"* ([333]). In fact, *"since the tax advisor's misidentification of SMBV's main functions and its inappropriate selection of operating expenses as profit level indicator in the application of the TNMM confirm that the methodology proposed by it in the transfer pricing report and accepted by the SMBV APA for determining SMBV's tax base in the Netherlands does not result in a reliable approximation of a market-based outcome in line with the arm's length principle"*, it was clear that

[331] *Ibidem*, § 383.
[332] *Ibidem*, § 389.
[333] *Ibidem*, § 400.

the APA granted by the Dutch tax administration, *"by accepting that methodology, should be considered to confer a selective advantage on SMBV for the purposes of Article 107(1) of the Treaty"* ([334]).

Finally, although the Dutch tax administration provided to submit the results of simulations carried out to proof that the calculation method for the working capital adjustment was quite logical, the Commission found that basically, on one hand, *"the Netherlands* [took] *a range that is based on information dating from after the APA"* ([335]) and that the administration did *"not explain* [the resulting] *level by presenting simulations with different interest rates and a different spread"* ([336]). Indeed, the fact that *"the transfer pricing report also accepts a considerable reduction in the cost base used to calculate the tax base in 2008"* ([337]), *"combined with the misclassification of the actual activities of SMBV"* ([338]), drove the Commission to affirm the existence of a selective advantage in the meaning of art. 107(1) TFEU.

Equally to what concerned the *Fiat* decision, on one hand the Commission imposed upon the Netherlands to collect the lacking taxation, on the other *Starbucks* represented the first testing bench for the new rules introduced by Reg. 734/2013 along with the mentioned one involving Luxembourg.

As said, however, the great importance of the case at hand relies on the fact that it really was in this Decision that the Commission officially affirmed the subsidiary character of the OECD Guidelines and that the existence of the arm's length principle in the framework of EU law is a direct consequence of the applicability of art. 107(1) in matters of transfer pricing transactions ([339]).

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[334] *Ibidem*, § 407.
[335] *Ibidem*, § 404.
[336] *Ibidem*, § 403.
[337] *Ibidem*, § 406.
[338] *Ibidem*.
[339] *Ibidem*, § 264.

2.5.6. The *Amazon* case: the Commission's decision on the Luxemburgish ruling favouring Amazon EU ([340]).

On October the 4th 2017, the European Commission ruled against Luxembourg for breaching of art. 107(1) TFEU by granting tax benefits to the worldwide operating delivery company *Amazon* of around €250 million. The multinational firm mainly operates in Europe through two companies incorporated in the Grand-duchy of Luxembourg: namely *Amazon EU* (hereinafter *AEU*) and *Amazon Europe Holding Techonolgies* (hereinafter *AEHT*). Both companies where in the meanwhile subject to the direction of their head holding *Amazon.com* based in the United States and belonging to the latter's group. Contrary to what has been observed with respect to the two sister companies in *Apple* and to the *Alki LP* in *Starbucks*, *AEU* had effectively more than five-hundred employees operating in Europe, where the company was responsible for carrying out the retail activities for the group, which implied buying products from producers and manufacturers, selling them to costumers and consumers and finally deliver them to the ultimate buyer. The fact that the contracts of sale concluded through *Amazon*'s websites all over Europe did indicate *AEU* as the purchaser's counterparty, all the profits flowing from the sales were automatically shifted into Luxembourg. By contrast, *AEHT* did not have any employees nor facilities in the mentioned Member State, for its activities mainly consisted in providing intermediation between *Amazon.com* and its European branches. Like *Apple Sales International* in *Apple, AEHT* is the holder of the IPRs concerning Amazon's activities as a group, which could be exercised and managed on grounds of a "cost-sharing" agreement concluded between the subsidiary and the US company *Amazon.com*. The agreement foresaw that *AEHT* had to contribute to the costs supported by *Amazon.com* for the development of intellectual property in order to get those Rights in exchange, in order to make the group's retail activities in Europe possible.

In the meanwhile, Luxembourgish general tax law provided that *AEU* only had to be taxed in Luxembourg, for *AEHT* was a holding company in the form of limited partnership, and thereby it had to be subject to taxation at the level of its

[340] Commission Decision 6740/2017/EU of the 4th October 2017.

partners. Moreover, since 2003 Luxembourg's tax administration granted *AEHT* with a tax ruling endorsing the calculation method applied to the transactions with *Amazon.com* to determine the tax base at arm's length. Again, the firm chose to use the TNNM methodology. In particular, the ruling permitted *AEU* to transfer around three quarters of its actual profits to the holding company *AEHT*. These shifts were provided mainly through intra-group transactions between the former and the latter company, which in turn did not play any role in the management of the group's activities in Europe for all relevant determination were in reality taken by *AEU*. In order to justify this, Luxembourg and Amazon argued that *"the contested tax ruling concerns transfer pricing and, since only multinational corporate groups are confronted with pricing cross-border intra-group transactions, companies belonging to such groups are in a different factual and legal situation to independent companies"* ([341]). The Commission pointed out that *"with that argument, Luxembourg and Amazon advocate for a reference system limited to Article 164(3) LIR* ([342])*, the provision of Luxembourg tax law that was considered to lay down the arm's length principle for the purposes of pricing cross*-border *intra-group transactions during the relevant period"* ([343]).

The Commission, as it is imaginable, did not agree with such position; and thus because of four main reasons. First, as it affirms that the fact that *"a group company might resort to transacting with associated companies and, in those situations where it does, it must resort to transfer pricing does not mean that group companies are in a different factual and legal situation to other taxpayers for corporate income tax purposes in Luxembourg"* ([344]). On these grounds, it secondly affirmed also that *"the fact that profit has been generated from an intra*-group *transaction that is subject to Article 164(3) LIR does not mean it is subject to special exemptions or a different tax rate"* and *"consequently, the different manner in*

[341] *Ibidem*, § 590.
[342] According to the Decision, art. 164(3) of the Luxemburgish *Loi des impôts sur le revenue* (LIR) is the provision concretizing the arm's length principle in the legal order of Luxembourg, providing that: *"Taxable income comprises hidden profit distributions. A hidden profit distribution arises in particular when a shareholder, a stockholder or an interested party receives either directly or indirectly benefits from a company or an association which he normally would not have received if he had not been a shareholder, a stockholder or an interested party."* (*Ibidem*, § 241).
[343] *Ibidem*, § 590.
[344] *Ibidem*, § 591.

which the taxable profit is necessarily arrived at in the case of controlled and uncontrolled transactions has no bearing for the determination of the reference system in the present case" ([345]). Therefore, the Commission concluded that as Luxembourgish law did not draw any distinction between corporate taxpayers with respect to their geographical origin and *"since the profit of all corporate taxpayers is taxed in the same manner under the Luxembourg corporate income tax system* […], *all corporate taxpayers should be considered to be in a similar factual and legal situation"* ([346]). Thirdly, the Commission assessed that since Luxemburgish tax law applied in an equal way to all the market players generating profits in Luxembourg without any distinction between controlled and standalone companies, the ruling endorsing a different calculation methodology for the interested companies establishes an artificial differentiation fulfilling the requirement of selectivity under art. 107(1) TFEU, as this had been justified on grounds of their nature of being member-firms of a group. Fourthly, the Commission assessed that it was actually a purpose of the mentioned art. 164(3) LIR *"to align the tax treatment of transactions concluded between associated group companies with the tax treatment of transactions concluded between independent companies, so that the former are treated no more favourably than the latter under the Luxembourg corporate income tax system"* and that therefore the provision could not be used to confirm Amazon's positions and those of the tax administration ([347]). Fifthly, the selective advantage granted to the endorsing tax ruling did indeed distort competition in the internal market *"since both types of companies are taxed on their total taxable profit at the same corporate income tax rate under the general Luxembourg corporate income tax system, any measure allowing the former to reduce its taxable base upon which that tax rate is applied grants it a favourable tax treatment in the form of a reduction of its corporate income tax liability as compared to the latter"* ([348]). Sixthly and finally then, the Commission highlighted that, on one hand, contrary to what *Amazon* and Luxembourg claimed the Commission never affirmed that *"the reference system must be limited to integrated*

[345] *Ibidem*, § 592.
[346] *Ibidem*, § 593.
[347] *Ibidem*, § 595.
[348] *Ibidem*, § 596.

companies only" in its former Decisions and that, on the other hand, the Commission itself is not bound by its practice, for the only criteria which should be pursued when dealing State aid cases are those which are provided by art. 107 TFEU, which existence should be determined by the Commission itself through its own discretion.

Conclusively, the Commission fined Luxembourg with the obligation to recover *"the difference between what* [AEU] *paid in taxes and what it would have been liable to pay without the tax ruling"*.

2.6. Criticism and comment to the European Commission's new approach in investigating on national tax ruling issued by EU Member States.

Before concluding our overlook on the Commission's practice in the field of Tax Rulings, it is important to highlight that the approach resulting from the analysed case law has been subject to heavy criticism by many commentators ([349]). Indeed, as observed by BOBBY, *"*[certain] *scholars have argued that the State aid reviews of advanced pricing agreements* [and advance tax rulings] *create legal uncertainty for a significant number of tax assessments"* while *"other professionals argue that, while the results may not be uncertain, they are unsatisfactory and for that reason conceptual reform is necessary"* ([350]).

It is moreover important to state that most of the critics arose among commentators from the United States. In fact, according to FAULHABER, this is so for three main reasons ([351]). First, this is because *"many of the companies*

[349] Indeed, ARENA admits that: *"occorre segnalare che alcune delle decisioni della Commissione in materia di tax rulings non si sono soffermate sulla portata derogatoria delle decisioni fiscali controverse, limitandosi ad analizzare il ≪vantaggio selettivo≫ da esse attribuito ai destinatari* […] *Tale iter argomentativo è stato fortemente contestato* […]*"* (Amedeo Arena, *op cit.*, 2018, at 946-947).
[350] Christopher Bobby, *op. cit.* (2016), at 198.
[351] Lilian V. Faulhaber, *Beyond Apple: State Aid as a Model of a Robust Anti-Subsidy Rule*, Georgetown Journal of International Law No. 48 (2017), at 381 ff.

[targeted by the Commission] *were based in the United States, so some U.S. observers argued that they were discriminatory, while others expressed surprise that the state aid prohibition could apply to U.S. companies"* ([352]). Secondly, then, the author holds that another reason for this is explainable through reference to tha fact that while *"the Commission had previously found entire ruling regimes to constitute impermissible State aid, these investigations seemed notable because they focused on individual rulings provided to specific companies"* ([353]). Finally, the third reason consists in the fact that *"the investigations that have resulted in decisions attracted attention because of the significant amount of money at stake"* ([354]).

In fact, the instrument to which those critics mainly refer is an official act of the US administration: namely the White Paper of the U.S. Treasury Department on the Commission's case law on State aid and transfer pricing ([355]). Indeed, HRUSHKO seems to endorse the assessment of the American authority where it states that the Commission's approach towards tax rulings in its recent case-law is considered to be 'unfair'([356]). In fact, along with BOBBY, the author stresses out the profiles under which the U.S. Department of Treasury came to the aforementioned conclusion.

First, indeed, it is argued that the *"Commission's approach is new and departs from prior EU Case Law and Commission Decisions"* ([357]). Indeed, the White Paper affirms on one hand that *"it appears that the Commission has collapsed the concepts of "advantage" and "selectivity," which are distinct requirements under State aid law"* and, on the other hand, that *"under the Commission's new approach, an economic advantage provided to a multinational company, but not to a standalone one, would a fortiori meet the selectivity*

[352] *Ibidem*, at 392-
[353] *Ibidem.*
[354] *Ibidem*.
[355] U.S. Department of the Treasury, *The European Commission's Recent State Aid Investigation of Transfer Pricing Rulings* (24th August 2016).
[356] Nina Hrushko, *Tax in the World of Antitrust Enforcement: European Commission's State Aid Investigations into EU Member States' Tax Rulings*, 43 Brooklyn Journal of International Law No. 327 (2017), at 327 ss, at 343.
[357] U.S. Department of Treasury, White Paper, *supra* (2016) at 1.

requirement" ([358]).

Thus said, we may provide following observations. Under the first profile, as previously stated referring to BOBBY, it is true that in cases concerning specific rulings rather than general law schemes the Commission seems indeed to collapse the two notions concerned ([359]), which is something which has been considered as unfair by American commentators.

Nevertheless, the latter critique does not seem convincible, and even ARENA considers this argument not to be "*entirely persuasive"* ([360]). In fact, it must be stated that art. 107(1) TFEU, which is the rule applied by the Commission in the cases we have seen, does indeed not explicitly contemplate the objected distinction, for it refers to the unlawfulness of any kind of *"advantage"* granted to *"certain undertakings"* through State resources and hampering competition. This means that, although *prima facie*, the approach adopted by the Commission does not seem manifestly in breach with the wording of the article ([361]). Moreover, as again observed by ARENA, the case-law and policies of the European Commission show that criterion of the "selective advantage" is not new at all, for it is part of the concerns Institution's practice since the nineties at least ([362]).

Under the second profile instead, while also the ECJ has risen doubts about the liability of the cross-border character to satisfy alone the criterion of selectivity, it must be highlighted that in the cases at stake, the rulings were granted to specific undertakings only. In fact, referring to *Apple*, *"we may observe that the Irish tax administration* […] *had issued rulings to non-resident companies in relation to the allocation of profits to their Irish branch in nine cases* [including] *the following nine companies: Company [A]*, Company [B], Company [C1], Company [D], Company [E], Company [F], Company [G1], Company [G2] and Company [G3]"*

[358] *Ibidem*, at 6.
[359] Cristopher Bobby, *op. cit.* (2016) *supra*.
[360] Amedeo Arena, *op. cit* (2017), at 946 ff.
[361] Indeed, as we will see in the following Chapter, although it might be probable that the ECJ will draw such a distinction between 'advantage' and 'selectivity', it does not seem that the Court has addressed the issue contested by the U.S. Department in explicit terms, for it did normally argue that the Commission has failed to show the existence of selectivity when it comes to the annulment of the Commission's decisions (see. Ch. 3).
[362] Amedeo Arena, *op. cit.* (2017) at 948.

([363]) and that the rulings which were at stake were *"issued by Irish Revenue in 1991 and 2007 in favour of ASI and AOE"* ([364]). Furthermore, although it cannot be contested that the approach adopted by the Commission in the cases at stake is new as also FAULHABER observes, this does not mean that the approach itself should be considered unlawful or unfair, provided that art. 108 TFEU grants the Commission a wide margin of discretion in providing its assessments and conclusions ([365]).

Secondly, the US Department's White Paper argues that *"the Commission's new approach as inconsistent with international norms and undermines the international tax system"* ([366]). In fact it is observed and also HRUSHKO seems to agree, that even though the OECD Guidelines constituted its starting point, the fact that the Commission has adopted its own approach according to the arm's length principle may hamper the efforts which the international community has suffered in order to secure legal certainty in tax matters at international level, given that *"this allows the Commission to ignore national law when making a determination whether a transfer pricing tax ruling has violated the arm's length principle"* ([367]).

According to this point, it should be borne in mind that, if it's true that the OCED constitutes one of the most important forums worldwide for political and economic cooperation between the members of the international community, the organization does exercise its powers mainly through non-binding recommendations. Thus, contrary to the instruments on which the EU is based, which have the form of real ordinary Treaties of General International Law being legally binding towards the States which are parties to them according to the Vienna Convention on the Law of the Treaties of 1969. Indeed, it should equally not be forgotten that the preamble to OECD Convention itself states that the Contracting States are *"determined to pursue these purposes in a manner consistent with their obligations in other international organisations or institutions in which they*

[363] *Apple*, *supra*, § 2.
[364] *Ibidem*, § 4.
[365] Lilan V. Faulhaber, *op. cit.* (2017), *supra.*
[366] White Paper, *supra*, at 1.
[367] Nina Hrushko, *op. cit.*, at 349-350.

participate or under agreements to which they are a party" ([368]). In fact, this will has been implemented in art. 1 of the Convention itself, where it is stated that the Organization promotes its aims *"on a multilateral, non-discriminatory basis in accordance with international obligations"* ([369]). Definitely therefore, while the Member States of the European Union have politically agreed to find common solutions at international level to prevent the spread of harmful tax competition internationally, this does not mean that this implies a derogation from the prohibition set forth by art. 107(1) TFEU, which is ultimately for the European Commission to be applied in the framework of the Union.

Moreover, even the claim according to which the European Commission has frustrated the legitimate expectations of the taxpayers with respect to an application of the arm's length principle which is radically in line with the OECD Guidelines seems not to be acceptable. In fact, as it has been said, the Commission has affirmed the adoption of its own approach and the OECD Guidelines subsidiary nature already in 2003 in *Forum 187*.

Thirdly, the U.S. Treasury Department affirms that *"the Commission is seeking to recover amounts related to tax years prior to the announcement of this new approach"*, thereby breaching the principle of the prohibition of retroactive enforcement and the principle of the legitimate expectations of the taxpayers, and therefore acting in a way which is in turn *"inconsistent with EU legal principles"* ([370]). Indeed, the U.S. department rightly argues that the Union recognizes the principle of legal certainty, so that *"*[EU] *rules* [shall] *enable those concerned to know precisely the extent of the obligations imposed on them, and that those persons be able to ascertain unequivocally what their rights and obligations are and take steps accordingly"* ([371]).

However, it should be recalled that, according to the most well-established case-law of the European Court of Justice, *"the Community constitutes a new legal order of international law for the benefit of which the states have limited their*

[368] Convention on the Organization for Economic Cooperation and Development (Paris14th December 1960).
[369] *Ibidem*, art. 1 *lit.* c).
[370] U.S. Department of Treasury, White Paper, *supra* (2016) at 1
[371] *Ibidem*, at 14.

sovereign rights" ([372]). This means that while the Commission may certainly not be bound by the Member States' administrative *consuetudo,* on the other hand national administrations of EU Members are by contrast subject to the provisions of the Treaties ([373]). Moreover, the U.S. Department of the Treasury seems not to withstand the fact that there is another important legal principle which is considered to be inherent to the legal order of the Union. This is the principle of the *effet utile*. According to the latter, indeed, national law must *"not render practically impossible or excessively difficult the exercise of rights conferred by Community law"* ([374]) and that national courts are obliged to *"ensure the full effectiveness of Community law by guaranteeing effective protection for the rights of individuals"* ([375]). This means that the rules flowing from EU law have to be interpreted in a way which permits them to be effective. Indeed, if retroactive recovery would be precluded, this would impede the realization of the goals which are inherent to art. 107 TFEU itself: namely the safeguard of the internal market before State action trying to hamper competition in the market by favouring certain sectors to provide an undue advantage to domestic economy.

Anyway, for what concerns the proclaimed breach of EU law through retroactive recovery, it is true that arts. 107 and 108 should only apply to the aid existing only after the entry into force of the TFEU. However, the Commission has rightfully assessed that the rulings caught mainly consisted in measures which existed before 2009 but which had been confirmed annually and were still in force after the ratification of the Treaty of Lisbon ([376]).

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[372] Case 26/63, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration* (1962), ECLI:EU:C:1963:1, § 3.
[373] With respect to the issue of the taxpayers' legitimate expectations, ARENA highlights that: *"la Commissione* […] *ha replicato di essere venuta a conoscenza di tali decisioni fiscali soltanto durante le audizioni di Palle innanzi al Senato degli Stati uniti nel maggio 2013 e di aver tempestivamente inviato una richiesta d'informazioni al riguardo al governo irlandese* […] *inoltre, nei procedimenti Apple e Fiat, la Commissione ha respinto i rilievi relativi alla novità della materia oggetto del procedimento, ricordando che già nella Comunicazione delle misure di tassazione diretta del 1998 aveva ipotizzato che i Tax Rulings potessero costituire aiuti di Stato"* (Amedeo Arena, *op. cit.* (2017), at 957-958).
[374] Case C-453/99, *Courage Ltd v Bernard Crehan and Bernard Crehan v Courage Ltd and Others* (2001), § 29.
[375] Joined cases C-46/93 and C-48/93, *Brasserie du Pêcheur SA v Bundesrepublik Deutschland and The Queen v Secretary of State for Transport, ex parte: Factortame Ltd and others* (1996), ECLI:EU:C:1996:79, § 72.

[376] see Amedeo Arena, *op. cit.* (2017), at 956.

In the light of what has been exposed, it may be argued that commentators such as BOBBY or HRUSHKO as well as the U.S. Department of Treasury have identified some critical issues, which will probably constitute a point on which the ECJ will dedicate attention when dealing with the judgements connected with the analysed Decisions of the Commission.

Nevertheless, it is also true that the latter seem to have engaged in critics having the character of partiality, at least in part. In fact, the point of view which has been exposed seems not to take into account the fact that the Commission is the executive body of a supranational organization, which is something which in turn imposes legal concerns and peculiarities which may not wholly be faced through the typical legal categories of national contexts involving full sovereignty of the State ([377]).

[377] Accordingly, ARENA concludes that "*in definitiva, anche se le norme sugli aiuti di Stato si rivolgono agli Stati Membri, imputet sibi chi conclude accordi con il fisco troppo vantaggiosi per essere incompatibili con l'art. 107, par.1, TFUE"* (*Ibidem*, at 959).

CHAPTER III

The jurisprudential approach of the CJEU in tax matters.

3.1. Preliminary remarks: the role of the CJEU in the enforcement of the rules on State aid.

In Chapter II it has been explained that although falling within the general framework of art. 107(1) TFEU, which also applies to general tax schemes providing unlawful aid, tax rulings have their own special characters and features. This became evident with respect to the illustrated decisions, where the Commission had to assess the existence or non-existence of elements and situations which are typical of the nature of tax rulings; first of all: the nature of the transfer pricing transactions which were considered by the rulings at issue as being at arm's length. However, these particular aspects seem not really to be at stake when it comes to the relevant case-law of the Court of Justice of the European Union.

Indeed, as it has been said more than once, this is explainable through reference to the different role which the Court plays if compared with the Commission, according to the institutional structure provided by the Treaties.

As it is well-known, the Commission is the executive body of the Union, which is competent for enforcing EU law along with the national Courts of the Member States. In fact, as it has been observed, when it comes to the matter of State aid, the authoritative role of the Commission is even strengthened, because of its quasi-exclusive prerogatives recognized upon it by art. 108 TFEU. It follows that the decisions of the European Commission are by their very nature strictly related to the facts of the cases, which also requires it to apply all its technical expertise not only with respect to the applicable treaty law but also in the field of financial and fiscal auditing, tax advising etc.

The CJEU, by contrast, is not called upon to apply EU law but rather to interpret it and to secure the uniform application of both Primary and Secondary EU Law in the whole territory of the Union. This uniformity, which by virtue of its very nature characterizes the case-law of the ECJ, has necessarily influenced the overall approach of the Court when it comes to matters of taxation. Indeed, as we will see, the principles established and affirmed by the CJEU applicable to the cases involving tax rulings have been elaborated while dealing with situations which, once brought before the Court, did not actually concern tax rulings, but rather general law provisions. By the way, as it has been often affirmed in the previous pages of this essay, the legal framework applicable to both tax rulings and general tax laws providing selective advantages is and remains the one of arts. 107 and 108 TFEU. Accordingly, the principles which the Court applies and finds with respect to the application of the mentioned articles shall, ultimately, apply equally to both instruments. Thus, clearly, insofar State aid is actually deemed to exist in the case concerned.

Moreover, reference to the ECJ case law is also important in the light of another fundamental aspect. Indeed, we see that those situations, principles and features which are generally linked to cases dealing with selective measures ex art. 107(1) TFEU (*e.g.* the arm's length principle) may be relevant in other legal contexts too. Indeed, the claims against the Commission's decisions are only one of the means by which one can bring a case before the ECJ. This means that, besides the cases expressly dealing with State aid concerns, the Court also had the possibility to establish principles relevant to the matter of tax rulings in cases submitted to it through the mechanism of prejudicial review.

In the next paragraphs we may come to the analysis of the role of the Court and its approach in detail.

3.2. Differences between the approaches of the Commission and of the CJEU on selectivity.

Once the essential features of the Commission's approach towards administrative rulings in tax matters has been clarified, it is time to face another non-negligible topic, which leads us up to the conclusion of our insight on the matter of taxation and unfair competition. This aspect consists, of course, in the approach adopted by the CJEU, which has been already described in the very first pages as the ultimate grantor of the uniform application and interpretation of EU law, and thereby of a correct functioning of the legal system preventing Member states to provide unlawful aid. In this respect, it is important to highlight once more that the Court of Justice of the European Union is empowered to exercise its functions of judicial body of the Community according to the former art. 177 EC Treaty, which content is now provided by art. 234 TFEU. Indeed, while according to art. 108 TFEU it is for Commission to catch illegal State aid through its decisions, the interpretation and the decisions concerning the validity of the acts provided by the EU Institutions is a matter which falls within the competences of the CJEU ([378]).

Indeed, as we will observe, while the main channel allowing the Court to decide upon cases concerning State aid consists in the challenges against the decisions of the Commission themselves, the CJEU also made important statements on legal principles which are relevant in the field of tax aid in expressing itself on cases brought before her through referrals for preliminary rulings delivered by national Courts.

With respect to the case-law which will be analysed, a fundamental clarification is then required. In fact, it should be noted that the Court has not yet produced a relevant case-law in matters of Tax Rulings specifically. Thus, clearly because the “new approach” has become part of the practice of the European Commission in the field of tax aid in recent times only. Therefore, the CJEU did not have the opportunity yet to express itself specifically on the arguments adopted by the Commission while catching national rulings under art. 107(1) TFEU. Moreover, it should not be forgotten that although rulings are clearly characterized by some peculiar features and aspects, the legal framework under which they may be found unlawful still is the one provided by the rules on State aid contained in the TFEU, which are applicable to (tax) aid measures in general. For this reason, it is important to observe that the principles of law applicable to Tax Rulings flowing from the jurisprudence of the CJEU have been elaborated by the Court mainly through judgements referred to general tax aid measures, mostly provided by law schemes rather than by administrative arrangements.

By engaging in a deeper analysis with respect to the content of its

[378] Art. 234(1) *lit. b)* TFEU

judgement, it must be stated at first glance that the CJEU has generally endorsed the Commissions point of view concerning the interpretation of the notion of aid, particularly with respect to the requirement of selectivity ([379]).

First, in *Air Liquide Belgium*, the Court has acknowledged the necessity to verify the existence of aid in accordance with the four-prong test linked to the conditions set forth by art. 107(1) TFEU as it did in other cases, *e.g.* in *Altmark*: namely, again, the use of State resources, the existence of a benefit, selectivity and the distortion of competition ([380]). Indeed, in the same case, the Court also recognized that selectivity must necessarily be estimated with respect to the general regime according to which the contested measure is granted ([381]). It follows that the CJEU has generally confirmed the correctness of the Commission's practice with respect to the determination of selectivity. In fact, the Court held that the requirement for aid to be referred to '*certain undertakings'* could be determined on the grounds of advantages granted to entire sectors, as it was established in *Wietersdorfer & Peggauer* ([382]). By the way, in *Commission v. Germany* the Court did the same with respect to "regional selectivity", regardless of the fact that the measure was provided through legislative provisions, which have to be considered as a regulatory instrument having a general character by their very nature ([383]). Moreover, as it is suggested in *Commission v. Italy*, even temporary measures or measures being accessible over time have been caught being in breach of the State aid rules by the CJEU ([384]). Furthermore, it should be observed that the Court's general endorsement is not only limited to issues relating to the substantial profiles inherent to the State aid rules, but also to more procedural aspects. In fact, in

[379] In this respect, by mentioning the ECJ case-law which will be illustrated in the coming pages, AERENA seems to confirm that: *"nel caso degli aiuti fiscali, la CGUE ha delineato un'analisi in tre fasi per valutare il requisito della selettività: i) individuazione del del regime fiscale applicabile nello Stato Membro* […]*; ii) prova che la misura costituisce una deroga al sistema di riferimento, in quanto distingue fra soggetti in una posizione analoga rispetto agli obiettivi di tale sistema; iii) eventuale giustificazione della misura"* (Amedeo Arena, *op. cit.* (2017), at 944).

[380] Joined Cases C-393/04 and C-41/05 *Air Liquide Industries Belgium* (2006,) ECLI:EU:C:2006:403, § 28; Case C-280/00 *Altmark Trans v. Regierungspräsidium Magdeburg* (2003) ECLI:EU:C:2003:415, § 74.

[381] *Ibidem*, § 32.

[382] Case C-143/99 *Adria-Wien Pipeline v. Wietersdorfer & Peggauer Zementwerke* (2001) ECR I-8365, § 40.

[383] Case C-156/98 *Germany v. Commission* (2000) ECR I-6857, § 23.

[384] Case T-211/05 *Italy v. Commission* (2009) ECR II-2777, paragraphs 120 and 121.

Commission v. Netherlands, the CJEU confirmed that the burden of proof related to the existence of aid primarily relies upon the Commission, which has the task to assess whether the advantage is granted to a specific group of companies or not ([385]).

In accordance with such examples, it must however be stated that while the CJEU's general approach is constructed according to the same assumptions which guide the Commission's investigation activities pursuing art. 108 TFEU, it would be wrong to hold that the CJEU mainly acts as a mere passive validator of the Commission's determinations. In fact, there are several aspects according to which the Court's view on State aid rules substantially differs from the Commission's practice which has been deeply analysed in the previous chapters. In fact, this is quite inherent to the role of the Court itself according to art. 234 TFEU *lit. b),* being the judicial controller of the activities carried out by the Commission, which is by contrast the executive organ of the Union.

The divergences between the two Institutions' approaches are exemplified at best by the two s.c. "Spanish Goodwill" cases, namely *Autogrill* and *Banco Santander* ([386]). Indeed, in these cases, the Court made important statements with respect to the determination of selectivity *in casu*. Both judgements were based on claims brought respectively by the two mentioned Spanish firms challenging two different decisions of the European Commission finding a breach of art. 107(1) TFEU. In particular, the European Commission found that Spanish law provided indirect aid by allowing Spanish-based companies to deduct the goodwill flowing from participations in companies abroad consisting in the possession of more than 5% of their shareholdings. In fact, the Commission held that the measure granted a selective advantage to Spanish firms investing abroad by putting those companies investing at domestic level in a disfavoured position. The Court did however overrule the Commission decision by adopting the following reasoning.

By reference to its former case-law, it has been affirmed that the determination of selectivity necessarily entails a comparison to be made. In fact, according to the Court, in order to determine if a State measure effectively granted

[385] Case C-279/08 *Commission v Kingdom of the Netherlands* (2011), ECLI:EU:C:2011:551.
[386] Case T-219/10 *Autogrill España v. Commission* (2014) ECLI:EU:T:2014:939; Case T-399/11 *Banco Santander de Santusa v. Commission* (2014) ECLI:EU:T:2014:938.

a selective advantage to '*certain companies*', there must be an element which allows to assess that the addressees of such aid are indeed selected undertakings with respect to undertakings in general. By the way, this is fundamentally the same which had already been stated in *Commission v. Portugal*, where the Court held that the application of art. 107 TFEU *"requires assessment of whether, under a particular statutory scheme, a State measure is such as to 'favour certain undertakings or the production of certain goods' in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question , such comparison may be made"* ([387]). Once such necessity has been highlighted it is still questionable how can such comparative determination be carried out in practice.

Indeed, as specified in the case at hand, the starting point for this assessment is the "reference framework", thereby understanding the general legal (tax) regime of which the measure may be considered to be part of. In particular, according to the Court, *"in order to determine whether a tax measure is selective, it is* […] *appropriate to examine whether, within the context of the reference framework, that measure constitutes an advantage for certain companies in comparison with others which are in a comparable factual and legal situation"* ([388]).

In fact, here the Court seems to confirm the general rule applicable to art. 107(1) explained before, according to which State aid must necessarily consist in a derogation from the general scheme provided by law; thus, especially in tax matters, where the Member States are free to choose their internal tax regimes in accordance with the limits of set forth by arts. 110 and 113 TFEU.

However, while the criterion of selectivity still remains linked to the extent of the application of such general legal structure *in casu*, the Court affirms that this is not enough to determine the existence of an advantage. Indeed, according to the Court, *"even when, within the reference framework,* […] *a difference in treatment appears between comparable factual and legal situations, according to settled case-law, the concept of State aid does not refer to State measures which differentiate between undertakings and which are, therefore, prima facie selective*

[387] Case C-88/03 *Portugal v Commission* (2006) ECR I-7115, § 54.
[388] *Autogrill*, § 31.

where that differentiation arises from the nature or the overall structure of the system of charges of which they are part" ([389]). The statement is of huge importance for thereby the Court recognizes that for the purposes of art. 107(1) the mere fact that a measure is addressed to only those taxpayers (or subjects in general) which fulfil certain condition does not mean that the measure itself does *per se* qualify as aid. In fact, it is necessary that the advantages which flow from such measure are referred to the addressed companies on grounds of exclusivity. As the CJEU explains, *"it is in relation to this common or 'normal' tax regime that it is necessary* […] *to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it differentiates between economic operators who, in the light of the objective assigned to the tax system of the Member State concerned, are in a comparable factual and legal situation"* ([390]). It follows that in the opinion of the Court, the requirement of selectivity shall be considered as fulfilled when following two elements exist.

First, the measure must be referred to a set or a group of '*certain companies*' engaged in an economic activity, which means that the measure must draw a distinction between its addressees and the "remaining" companies to which it does not apply. If this condition is fulfilled, however, contrary to what the Commission held in the decision subject to the Court's ruling in the case concerned, this is not enough for the assessment of a breach of art. 107(1) ([391]). Secondly, in fact, the differentiation must also concern companies which are in a 'comparable factual and legal situation' with respect to the 'reference framework' in which the measure is provided. This means that any law or tax ruling which may be granted by the authorities of a Member State to certain undertakings operating on its territory does not infringe the State aid rules as long as the measure itself or the result granted by it remains accessible to all the market players fulfilling the requirements for the measure's application without any distinction.

On these grounds, it seems that the Court again confirms what has been

[389] *Ibidem*, § 32
[390] *Ibidem*, § 33.
[391] In *Autogrill*, the Spanish firm challenged Decision 2011/5/EC of 28th October 2009, which found the measure provided by the Kingdom of Spain being in breach of art. 107(1) TFEU.

explained when analysing the instrument of tax rulings, it is to say that 'beneficial' rulings granted to companies in order to prevent a distortion of competition through a misapplication of the general tax scheme as well as those potentially referred to any undertaking do not fall within the prohibition of art. 107(1) TFEU and are therefore perfectly lawful. Getting back to the case, the Court held that the Commission wrongly assessed that Spain was granting illegal aid to *Autogrill* for *"the application of the method of analysis* [used by the Commission] *does not, in this case, lead to the conclusion that the measure at issue is selective"* ([392]) because *"the measure at issue applies to all shareholdings of at least 5% in foreign companies which are held for an uninterrupted period of at least one year"*([393]). Therefore, as the Court argues, "*the Commission cannot, in itself, establish that the measure at issue favours 'certain undertakings or the production of certain goods' within the meaning of* [art. 107(1) TFEU]*, since that measure is available, a priori, to any undertaking"* ([394]). The same conclusions drawn by the Court in *Autogrill* are provided in *Banco Santander* in almost equal terms.

There are, indeed, further aspects which make the two Spanish Goodwill cases very important judgements for the determination of the Court's point of view in matters of harmful tax competition in the framework of State aid. These aspects will be analysed with respect to the CJEU's approach towards mismatches. For now, it is important to highlight two clear and important differences between the latter's practice and that of the Commission.

Firstly, it will surely be remembered that with respect to the Commission's investigation activities commentators have highlighted the unclear way in which the latter conceives the criterion of selectivity. By mentioning BOBBY, indeed, it has been said that the Commission has a tendency to collapse the two elements composing the element at stake, namely "selectivity *strictu sensu*" and the existence of an economic "advantage", which together give rise to the concept of "selective advantage". By the way, this aspect has been subject to heavy criticism by some commentators, as we have seen. By contrast, it is clear from the aforementioned

[392] *Autogrill*, § 52.
[393] *Ibidem*, § 53.
[394] *Ibidem*, § 52.

reasoning, that the Court does not (or should not) conceive such a confusion ([395]). In fact, in both *Autogrill* and *Banco Santander* the judges held that first, it should be assessed if, by comparison of the market players with respect to the reference legal framework, the measure considered does in fact address *'certain undertakings'* exclusively. Secondly, only after the measure is found to be selective, then it should be considered if the *"measure at issue provides that a tax advantage is to be granted on the basis of the conditions"* laid down by the measure itself ([396]).

In spite of this, it is important to highlight what the Court recently affirmed in *World Duty Free Group* ([397]). In fact, in this judgement, the Court has for the first time stated that one of the conditions contemplated in art. 107(1) TFEU consists indeed in the "selective advantage", *de facto* collapsing the notions of "advantage" and "selectivity", which is typical of the Commission's approach in the matter of tax rulings. Nonetheless, although this might constitute the first milestone for a progressive change in the CJEU's practice, the Court itself has recognized the exceptional character of such consideration. Indeed, in its ruling, the Court held that *"[it cannot] be required of the Commission, in order to establish the selectivity of such a measure, that it should identify certain specific features that are characteristic of and common to the undertakings that are the recipients of the tax advantage, by which they can be distinguished from those undertakings that are excluded from the advantage"* ([398]). In fact, according to the Court, *"all that matters in that regard is the fact that the measure, irrespective of its form or the legislative means used, should have the effect of placing the recipient undertakings in a position that is more favourable than that of other undertakings, although all those undertakings are in a comparable factual and legal situation in the light of the objective pursued by the tax system concerned"* ([399]).

Nonetheless, such affirmation should be considered more a clarification of

[395] In fact, also major commentators seem to agree that *"in order to identify a tax advantage, one has to inquire whether the taxpayer is relieved of ‹‹charges normally included in the budget of an undertaking››"* while, on the other hand *"in order to find selectivity one has to identify a system of reference and to determine ‹‹whether a given measure constitutes a derogation from that system››"* (Leigh Hancer, Tom Ottervanger, Piet Jan Slot, *op. cit.* (2017) 13-031).
[396] *Ibidem*, § 59.
[397] Case C-20/15, *Commission v. World Duty Free Group SA and others* (2016), EU:C:2016:2981.
[398] *Ibidem*, § 78
[399] *Ibidem*, § 79

what the Court has already stated in *Autogrill* and *Banco Santander*, rather than an overruling of the latter cases.

Secondly, with respect to the substantive approach adopted by the Commission, we may draw an important conclusion in accordance to something which has already been observed in the paragraph dedicated to the latter's practice in matters of tax rulings. Indeed, contrary to what the Commission's practice shows, the Court does not hold that the mere fact that the undertakings which are addressed by a ruling operate internationally may not satisfy the requirement of selectivity. Indeed, in *Gibraltar* the CJEU has definitively affirmed once and for all that *"the criteria forming the basis of assessment which are adopted by a tax system must also, in order to be capable of being recognised as conferring selective advantages, be such as to characterise the recipient undertakings, by virtue of the properties which are specific to them, as a privileged category, thus permitting such a regime to be described as favouring 'certain' undertakings or the production of 'certain' goods within the meaning of* [art. 107 TFEU]*"* ([400]). This also means that, consequently, if on one hand *nulla quaestio* on the existing of selectivity when a ruling or equivalent measure is granted to individual undertakings, the selective character of aid is something which is substantially for the Court to be determined at last ([401]).

3.3. The CJEU and the criteria of competition distortion and State resources.

The determination of selectivity apart, reference to the case law of the CJEU is also fundamental to provide further important clarification. In fact, the Court seems to have developed a clear approach not only towards selectivity but also with

[400] Joined Cases C-106/09P and C-107/09 of 16 March 2009, *Commission v. Gibraltar and the UK* and S*pain v. Commission* (2019), ECLI:EU:C:2011:732, para. 104

[401] This aspect has been acknowledged by commentators with a certain criticism. Indeed, LUJA stated as follows: *"even though the author agrees with the General Court that the Commission should identify a category of undertakings based on their specific characteristics to establish selectivity either de jure or de facto, the need to be engaged in foreign takeovers and hence be internationally active may still be a satisfactory criterion to establish such (de jure or de facto) selectivity*" (European Parliament, *Ibidem, EU State Aid Law and National Tax Rulings* (2016), *supra* at11)

respect to the other requirements set forth by art. 107(1) TFEU.

In fact, it shall be remembered first that one of the key elements set forth by art. 107(1) is the liability of a measure to distort competition in the internal market or trade between the Member States of the Community. From another perspective, however, this also clearly means that the Court does not acknowledge the absolute importance of a competition-based free market by itself in abstract terms. Consequently, with reference to the concept of competition governing the Internal Market which has been highlighted in the first chapter of this essay, the competition which the Court intends to safeguard is only the one existing between the market players acting in the framework of the single market of the EU. Therefore, it follows that neither the Court nor the Commission are called up to protect competition with respect to market players which are not established in the territory of the Union as long as their behaviour does not seem to be a serious threat to intra-EU competition.

On the other hand, a deeper reasoning is required when it comes to the feature of State resources. The case which better highlights the Court's approach towards the criterion at hand with respect to the issue of taxation is undoubtedly *Sloman Neptun* ([402]). Contrary to the cases which have been analysed in the previous chapter, the proceeding concerned consisted in a preliminary review delivered to the CJEU by the German Court of Bremen for Labour Affairs (Arbeitsgericht Bremen). The litigation was started in 1991 by Filipino seafarers against the German shipping company they were working for, *Sloman Neptun AG*. In fact, according to paragraph 21 of the *Flaggenrechtsgesetz*, the companies which are registered in the Register foreseen by the *Gesetz zur Einführung eines zusätzlichen Schiffregisters für Seeschiffe unter der Bundesflagge im internationalen Verkehr* (hereinafter: "Register law") could not apply German law to labour contracts between them and their non-German employees not residing in the Federal Republic of Germany ([403]). In fact, the workers challenged the contract applying

[402] Joined Cases C-72/91 and C-73/91, *Sloman Neptune Sloman Neptun Schiffahrts AG V. Seebetriebsrat Bodo Ziesemer der Sloman Neptun Schiffahrts* (1993), ECLI:EU:C:1993:97.

[403] More precisely, the mentioned rule stated as follows: *"For the purposes of Article 30 of the Introductory Law to the Bürgerliches Gesetzbuch (Civil Code) and subject to the provisions of Community law, the contracts of employment of crew members of a merchant ship registered in the ISR who have no permanent abode or residence in Germany shall not be governed by German law merely on account of the fact that the ship is flying the Federal German flag. If, in respect of the*

Filipino law before the competent authority, the Seebetriebsrat, alleging that it was in breach of the principles of German labour law, with particular reference to the principle of the equality of treatment. The authority did indeed affirm that such a breach had occurred. Therefore, the final decision was challenged before the Court of Bremen which submitted the case to the CJEU, demanding for a judgement on the compatibility of the aforementioned provision with the rules on State aid. In fact, applying Filipino law to the contract concerned did not only entail the application of a lower payment rates, but also lower tax rates with respect to labour contributions. Therefore, the Court was requested to express itself on the liability of such dynamic to entail State aid in the meaning of the Treaty ([404]).

Indeed, the Court finally recognized that "a system established by a Member State, such as that applicable to the International Shipping Register (ISR), which *"enables contracts of employment concluded with seafarers who are nationals of non-member countries and have no permanent abode or residence in that Member State to be subjected to working conditions and rates of pay which are not covered by the law of that Member State and are considerably less favourable than those applicable to seafarers who are nationals of that Member State, does not constitute State aid within the meaning of Article 92(1) of the EEC Treaty"* ([405]).

From the description of the case, reference to the framework of the Treaty rules on State aid seems questionable. Indeed, the point is that the case at stake should have been better faced with reference to the rules concerning the Free movement of workers ex arts. 45 to 48 TFEU. Nevertheless, this choice would have been incoherent with the well-established jurisprudential approach of the CJEU

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contracts of employment referred to in the first sentence, collective agreements are entered into by foreign trade unions, they shall have the effects provided for in the Law on collective agreements only if it has been agreed that they are to be subject to the wage bargaining rules applicable within the field of application of the Grundgesetz and that jurisdiction should be conferred on the German courts. In case of doubt, wage bargaining agreements entered into after the entry into force of this subparagraph shall relate to the contracts of employment mentioned in the first sentence only if expressly provided for therein. The provisions of German social insurance law shall remain unaffected" (CGEU, *Report for the hearing – Joined Cases C-72/91 AND C-73/91* (1993), I-890, at2).

[404] It could be interesting to discuss if the register could be considered to be a 'ruling', given that the notion embraces every kind of administrative measure endorsing a certain advantage. Nevertheless, in this case, it may be argued that the 'selective advantage' should have been considered more the effect of a provision of a general law scheme referring to the register rather than of the register itself.

[405] *Sloman Neptun*, Costs.

confirmed in *Demirkan* according to which the rights conferred by the Treaties upon EU nationals may not be conferred in the same way to citizens of third States without an explicit will of the High Contracting Parties or the Community legislator, for "*the development of economic freedoms for the purpose of bringing about freedom of movement for persons of a general nature which may be compared to that afforded to European Union"* may not be automatically extended to extra-EU countries ([406]).

On the other hand, the aforementioned fact that the application of the law of the country of origin would have implied a substantive reduction of the weight of tax obligations borne by the employers listed in the register contemplated by German law actually establishes such legal circumstances which could collide with art. 107(1) TFEU, provided that the existence of the register itself could have been a sufficient ground to prove the existence of selectivity.

Therefore, the Court had to establish the existence of a breach of nowadays art. 107 TFEU using the same categories which it always applied when dealing with State aid. In particular, the ECJ had to clear if the reduction of the tax burden indirectly granted to *Sloman Neptun* could be considered to fulfil the requirement of State resources. In fact, as it has been anticipated, the Court held that it was not so.

The ECJ observed that *"as* [it] *held in its judgment in Case 82/77 Openbaar Ministerie of the Netherlands v. Van Tiggele ([1978] ECR 25, paragraphs 23-25), only advantages which are granted directly or indirectly through State resources are to be regarded as State aid within the meaning of Article 92(1)* [now art. 107 TFEU] *of the EEC Treaty"* ([407]). In fact, *"the wording of this provision itself and the procedural rules laid down in* [art. 107(1) TFEU] *show that advantages granted from resources other than those of the State do not fall within the scope of the provisions in question"* ([408]). Consequently, *"aid granted through State resources serves to bring within the definition of aid not only aid granted directly by the State, but also aid granted by public or private bodies designated or established by the*

[406] Case C-221/11 *Demirkan v. Germany* (2013), ECLI:EU:C:2013:583., § 53.
[407] *Sloman Neptun,* § 18.
[408] *Ibidem.*

State" ([409]).

With respect to this point, the Court assessed that, even though the German Government itself recognized that the rationale of the rule at stake consisted in *"*[ensuring] *the international competitiveness of German merchant vessels by reducing staff costs"* ([410]), the consequent distortion of competition was not realized through a misuse of State resources in the meaning of art. 107. In fact, the Court held that the State could not be considered to suffer a loss in the form of tax revenue liable to fall within the prohibition of aid. Indeed, the Court observed that *"the system at issue does not seek, through its object and general structure, to create an advantage which would constitute an additional burden for the State or the abovementioned bodies, but only to alter in favour of shipping undertakings the framework within which contractual relations are formed between those undertakings and their employees"* ([411]). Accordingly, *"in so far as* [the advantages] *relate to the difference in the basis for the calculation of social security contributions, mentioned by the national court, and to the potential loss of tax revenue because of the low rates of pay, referred to by the Commission, are inherent in the system and are not a means of granting a particular advantage to the undertakings concerned"* ([412]). It follows that the measure does not infringe art. 107 TFEU.

In the light of this conclusion, it may be affirmed that the reasoning pursued by the Court demonstrates that, contrary to what concerns selectivity, the ECJ fundamentally endorses the approach adopted by the Commission with reference to the criterion of State resources. Indeed, when the Court states that *"the low rates of pay* […] *are inherent in the system"*, it substantially confirms the necessity of aid having a derogative character with respect to the general scheme of law, which means general foreign Labour law *in casu*.

[409] *Ibidem.*
[410] *Ibidem*, § 8.
[411] *Ibidem*, § 21.
[412] *Ibidem*.

3.4. Further aspects of the Court's general approach towards State aid.

As we have seen, the *Sloman Neptun* judgement particularly concerned the application of the criteria of State resources. Nevertheless, there are two further aspects which the Court addressed in that case which are of fundamental importance: the procedural relationship between the CGEU and the Commission and the relationship between national and community policies.

With reference to the first profile, as it has been already mentioned above, the proceeding at hand consisted in a preliminary ruling of the ECJ activated by a national Court. Indeed, this is quite unusual because the general framework according to which unlawful aid measures should be a caught still is the one drawn by art. 108 TFEU, establishing the primary role of the European Commission in finding out the breaches of art. 107 TFEU. Indeed, the CJEU seems to have acknowledged such aspect too, where it states that *"it is important to note that, as the Court has consistently held* […], *the intention of the Treaty in providing through* [art. 108 TFEU] *for aid to be kept under constant review and supervision by the Commission, is that the finding that an aid may be incompatible with the Common Market is to be determined, subject to review by the Court, by means of an appropriate procedure which it is the Commission's responsibility to set in motion"* ([413]). Nevertheless, in the case concerned the Court held that it could express itself on the request concerning State aid anyway.

Indeed, the judges observed that in *Steinike* ([414]) the ECJ held that *"cases may come before national courts which give them cause to interpret and apply the concept of aid contained in* [107 TFEU] *in order to determine whether or not State aid introduced without observance of the preliminary examination procedure provided for in* [108 TFEU] s*ought to have been subject to this procedure"* ([415]). It follows that therefore *"the question submitted must be viewed as seeking to ascertain whether a system established by a Member State, such as that applicable to the ISR, which enables contracts of employment concluded with seafarers who are nationals of non-member countries and have no permanent abode or residence*

[413] *Ibidem*, § 11.
[414] Case 78/76 *Steinike und Weinlig v. Federal Republic of Germany* (1977), ECLI:EU:C:1977:52.
[415] *Sloman Neptun*, § 12.

in that Member State to be subjected to working conditions and rates of pay which are not covered by the law of that Member State and are considerably less favourable than those applicable to seafarers who are nationals of that Member State, is to be regarded as State aid within the meaning of [art. 107(1) TFEU] *and whether Article 117 of the Treaty* [of the European Economic Community] *precludes the application of a system of that kind"* ([416]).

In the light of this, it may be concluded that the Court considers art. 108 TFEU to have a kind of "double" function with respect to the issue of access to the ECJ. In fact, if on one hand it is really by virtue of the rule concerned that the Commission may play the primary role in the enforcement of art. 107 TFEU, art. 108 also constitutes the ground for its limitation. In fact, it is through art. 108, or better said through a claim concerning a Member State's breach of art. 108 and its obligation to notify aid, that national Courts may refer State aid cases directly to the ECJ in the absence of any pending investigation and without any existing decision of the Commission in that regard.

According to the second issue, we may observe that the second question which the Arbeitsgericht submitted to the ECJ in *Sloman Neptun* concerned the compatibility of the *Seebetriebsrat*'s decision with the social goals of the Union contained in the former art. 117 EC Treaty whose content is nowadays provided by art. 151 TFEU. In fact, according to that rule, it constitutes a goal of the European Union *inter alia* to secure *"promotion of employment"* and *"improved working conditions"* ([417]). In fact, the German tribunal considered that that the rule at hand *"is not merely intended to set out a programme, but* [it] *imposes on the Member States an obligation to achieve the social objectives of, and freedom of competition within, the Community"* ([418]). However, the ECJ did not agree with such conception. Indeed, the Court stated that although art. 151 constitutes *"an important aid, in particular for the interpretation of other provisions of the Treaty and of secondary Community legislation in social matters"* ([419]), it should be

[416] *Ibidem*, § 13.
[417] Art. 151(1) TFEU.
[418] *Sloman Neptun*, § 23.
[419] *Ibidem*, § 26.

affirmed that the rule at stake *"is essentially in the nature of a programme"* and that consequently *"it relates only to social objectives the attainment of which must be the result of Community action, close cooperation between the Member States and the operation of the Common Market"* ([420]). It follows that, as the Court affirms, *"the attainment of those objectives must* [ultimately] *be the result of a social policy to be defined by the* [national] *competent authorities"* ([421]). On these grounds, the ECJ recognized that *"neither the general trends of the social policy defined by each Member State nor special measures such as those referred to in the orders for reference are open to review by the Court"* ([422]) and that therefore the *"Member States are free to take their own decisions in that regard which* prevents *the obligation […] of the Treaty from conferring rights on individuals which the national courts would be under a duty to safeguard"* ([423]).

3.5. The approach of the CJEU towards the arm's length principle.

As said, the principles arising from the case-law of the CJEU which are in principle applicable to Tax Rulings have been elaborated mainly through Court judgements concerning aid measures having a legislative character, and therefore not addressed to Tax Rulings precisely. Nevertheless, it is also important to remind that the Court had the possibility to express itself also on transfer pricing cases which were brought before the ECJ. Indeed, for what concerns the *Apple* case for instance, it seems that in 2019 the Court will have the possibility to express itself on the concerned decision ([424]). On one hand because both the Irish Government and Apple have expressed the will to initiate a litigation before the Court in Luxembourg to demonstrate the compatibility of the tax ruling involved with EU law; on the other hand, because the Commission itself has threatened the same for

[420] *Ibidem*, §25.
[421] *Ibidem*, § 26.
[422] *Ibidem*, §27.
[423] *Ibidem*, § 28.
[424] Indeed, the legal proceeding concerning the aforementioned *Starbucks* Decision is now pending before the Court.

alleged delays in the recovery of aid ([425]).

Moreover, we have already seen that the Court factually endorsed the Commission's interpretation of the arm's length principle in *Forum 187* ([426]). Indeed, in the latter case, although NICOLAIDES has observed that the Court did actually not explicitly refer to the arm's length principle, the ECJ referred to the principle according to which the tax base related to a transfer pricing transaction should be determined in accordance with the *"conditions of free competition"* which may have existed in the absence of a group ([427]).

However, in spring 2018, the Court provided to pronounce itself again the issue of transfer pricing. Thus, giving a judgement of great importance. In fact, on May the 31st 2018 the Court submitted its decision on *Hornbach-Baumarkt v. Finanzamt Landau* ([428]). The facts of the case involved a German DIY company *Hornbach-Baumarkt AG* which completely owned two Dutch-based firms: namely *Real Estate Groeningen BV* and *Real Estate Wateringen BV* (hereinafter respectively *Groeningen* and *Wateringen*). In 2002 *Hornbach-Baumarkt* graciously provided comfort letters containing a guarantee statement for both *Groeningen* and *Wateringen* on grounds of which a bank decided to grant the financing of those companies which suffered negative equity. In particular *Hornbach-Baumarkt* promised to communicate every change in its participation in the Dutch companies. For this reason, the German tax authority of Landau decided that it was necessary to respectively rise *Hornbach-Baumarkt*'s tax base taking into account those guarantees in accordance with the provisions German tax law ([429]). As a consequence, the German company objected the such re-computation and, after the objections were rejected, it brought an action against the tax office before the Tribunal or Rhineland Pfalz. More precisely, *Hornbach-Baumarkt* claimed that since German law provided that the re-calculation of the tax base had to be carried out only for transnational guarantees, the situation at hand entailed an unequal

[425] Staff and Reuters, *Ireland expects Apple EU tax appeal to be heard in autumn*, The Guardian, (24th April 2018), available at <https://www.theguardian.com/world/2018/apr/24/ireland-apple-eu-tax-appeal-autumn>.
[426] Case C-182/03, *supra*.
[427] Phedon Nicolaides, *op. cit.* (2016), at 420.
[428] Case C-382/16, *Hornbach-Baumarkt AG v. Finanzamt Landau* (2018), ECLI:EU:C:2018:366.
[429] In particular, this was provided by paragraphs 1 and 4 of the *Aussensteuergesetz* (AStG).

treatment with respect to wholly internal operations, as it also did not provide any possibility for the company to justify the fact that no price was corresponded in exchange of the guarantees, which *de facto* entailed an implied transfer of profits from the German company to the Dutch ones. More precisely the company held that since "*the income of a resident taxpayer, reduced due to the fact that it agreed on non-arm's-length terms with a related party, is the subject of a correction only if that party is established outside Germany"*, German law was breaching EU law ([430]).

The ECJ approached the case by referring to its former judgements. In fact it observed that a national tax treatment differentiating domestic and transnational situations might deter a taxpayer *"from acquiring, creating or maintaining a subsidiary in a Member State other than its Member State of residence or from acquiring or maintaining a substantial holding in a company established in that other Member State because of the tax burden imposed, in a cross-border situation, on the agreement entered into on non-arm's-length terms"* ([431]). On the other hand, however, the Court also recognized that that it held that *"allowing companies resident in a Member State to transfer their profits, in the form of unusual or gratuitous advantages, to companies with which they have a relationship of interdependence and which are established in other Member States may well undermine the balanced allocation of the power to tax between the Member States and that legislation of a Member State providing that the resident company is to be taxed in respect of such advantages which it has granted to a company established in another Member State allows the former Member State to exercise its tax jurisdiction in relation to activities carried out in its territory"* ([432]). On these grounds, the ECJ further affirmed that that *"such national legislation pursues legitimate objectives which are compatible with the Treaty and constitute overriding reasons in the public interest and that such legislation must be regarded as appropriate to ensure the attainment of those objectives"* ([433]).

Consequently, referring to the situation contemplated in the case brought

[430] *Hornbach-Baumarkt*, § 33.
[431] *Ibidem*, § 35.
[432] *Ibidem*, § 44.
[433] *Ibidem.*

before her, the Court observed that *"the same applies with respect to the national legislation at issue in the main proceedings, given that a resident company granting advantages to a company established in another Member State with which it has a relationship of interdependence under conditions which are not market conditions, could allow the resident company to transfer profits in the form of advantages to its non-resident subsidiary and may well undermine the balanced allocation of the power to tax between the Member States"* ([434]). It follows that *"by taxing the resident company of the Member State concerned, on the basis of the value corresponding to the presumed amount of the remuneration for the advantage granted gratuitously to a company established in another Member State with which it has a relationship of interdependence in order to take account of the amount which the parent company would have had to declare in respect of those profits if the transaction had been concluded in accordance with market conditions, the legislation at issue in the main proceedings allows the first Member State to exercise its powers of taxation in relation to activities carried out in its territory"* ([435]). Therefore, the Court finally concluded that EU law does not prevent national legislation to foresee that *"a company resident in a Member State which granted to a company established in another Member State with which it has a relationship of interdependence advantages under terms that depart from those that would have been agreed on by unrelated third parties under the same or similar circumstances, must be calculated as it would have been if the terms which would have been agreed with unrelated third parties had been applicable, and be corrected, despite the fact that such a correction is not made in respect of taxable income when the same advantages are granted by a resident company to another resident company with which it has a relationship of interdependence. However, it is for the national court to determine whether the legislation at issue in the main proceedings affords the resident taxpayer the opportunity to prove that the terms were agreed on for commercial reasons resulting from its status as a shareholder of the non-resident company"* ([436]).

[434] *Ibidem*, § 45.
[435] *Ibidem*. § 46.
[436] *Ibidem*, Costs.

The just exposed judgement has been welcomed by commentators with quite heated reactions ([437]), due to the relatively great importance which this decision has with respect to the interpretation of the arm's length principle. In accordance with this point, we may distinguish to important profiles which require further explanation.

First, it is important to stress that even though the case was concerned with transfer pricing practices, the ECJ did not face the dispute through the categories underpinning State aid. Indeed, the question which the *ad quem* Court submitted to the ECJ did not concern the interpretation of the arm's length principle in the light of art. 107(1) TFEU, but it rather consisted in demanding the Court to assess whether German law was in breach of the freedom of establishment contemplated in art. 49 TFEU or not. Indeed, this permits us to make an important clarification.

It has been said that a tax ruling endorsing a transfer price which is not at arm's length, thereby artificially altering the tax base attributable to a taxpayer with respect to the one which should have resulted from the application of general national tax law, may breach art. 107(1) TFEU once it is established that the requirements set forth by it are fulfilled. However, nothing has been said with respect to the situation in which a tax administration actually refuses to grant a ruling to a certain requesting company. In fact, this is a question that could have only been answered by the CJEU for, in the absence of a ruling, it is not possible for the Commission to act under art. 108 TFEU as there is actually no element on which it may investigate. The ECJ, indeed, gave an answer to this problem in the case concerned, where it observed that *"a difference in the tax treatment of taxpayers based on the place where the companies with which an agreement on non-arm's-length terms have been made have their registered office is liable to constitute a restriction of freedom of establishment, within the meaning of Article*

[437] *E.g.* see: Kelly Stricklin-Coutinho, *Kelly Stricklin-Coutinho comments on International Tax Review's "European Court's Hornbach-Baumarkt ruling gives clarity on arm's-length principle" – C-382/16*, 39 Essex Chambers (18th June 2018), available at <https://www.39essex.com/kelly-stricklin-coutinho-comments-on-international-tax-reviews-european-courts-hornbach-baumarkt-ruling-gives-clarity-on-arms-length-principle-c-382-16/>; Cathya Djanogly, *Hornbach-Baumarkt v Finanzamt Landau*, Tax Journal (5th June 2018); *Commercial purpose: a new standard in EU law?*, Tax Journal, 21st June 2018; Chris Lallemand, *Transfer pricing of cross border assurance facilitating external borrowing for negative equity subsidiaries*, Mazars – Blog (6th June 2018), available at <http://blogs.mazars.com/letstalktax/tag/hornbach-baumarkt-ag/>.

43 EC (nowadays art. 49 TFEU)*"* ([438]). Thereby, the Court indirectly recognized that, if on one hand the granting of a ruling or any other tax measure may in principle be likely to be unlawful under art. 107(1) TFEU, on the other hand, the refusal of a ruling may be illegal as well, provided that it could collide with other duties and rights conferred upon the Member States and their nationals by the Treaties themselves.

Secondly, the judgement at stake put an accent on the consequences related to the harmful effects that a lack of regulatory intervention may have on tax competition. In fact, with respect to the previous point, the Court nonetheless highlighted that "*the need to maintain the balanced allocation of the power to tax between the Member States may be capable of justifying a difference in treatment where the system in question is designed to prevent conduct liable to jeopardise the right of a Member State to exercise its power to tax in relation to activities carried out in its territory"* ([439]). Accordingly, by reference to *SGI* ([440]), the Court held that such necessity could justify a State measure as the one concerned under the label of *"overriding reasons in the public interest"* ([441]). In fact, the Court affirmed that *"it must therefore be held that national legislation such as that at issue in the main proceedings, which seeks to prevent profits generated in the Member State concerned from being transferred outside the tax jurisdiction of that Member State via transactions that are not in accordance with market conditions, without being taxed, is appropriate for ensuring the preservation of the allocation of powers of taxation between the Member States"* ([442]).

Moreover, as a further condition for a limitation of the application of art. 49 of the TFEU consists in the measure being proportionate to its legitimate purposes ([443]). In particular, the Court held *"that for the purposes of assessing the*

[438] *Hornbach-Baumarkt*, § 35.
[439] *Ibidem*, § 43.
[440] Case C-311/08, *Société de Gestion Industrielle SA v. État Belge* [2010], EU:C:2010:26
[441] *Hornbach-Baumarkt*, § 44.
[442] *Hornbach-Baumarkt*, § 47;
[443] In fact, by assessing the proportionality of German law in casu, the ECJ observed that *"national legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents an artificial arrangement, entered into for tax reasons, is to be regarded as not going beyond what is necessary to attain the objectives relating to the need to maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance where, first, on each occasion on which there is a suspicion that a transaction goes*

proportionality of legislation such as that at issue in the main proceedings, it is necessary, moreover, to distinguish between, on the one hand, the possibility of relying on the reasons why advantages were granted gratuitously between companies in the same group, and, on the other hand, the assessment of the substance of those advantages" ([444]). At the end, we have seen that the Court has found the measure to fulfil the requirement of proportionality indeed ([445]). This is because, in the meaning of the Court, *Hornbach-Baumarkt* actually had the possibility to submit its observations to the tax administration, but it substantially failed to show that the conclusion of a non-arm's length transaction could be linked to a "commercial justification", which existence should however be determined by the national court *ad quem*.

This conclusion entails another important consequence. In fact, this conception represents a sort of counter-trend or divergence in comparison to the practice of the Commission related to the arm's length principle. Therefore, if on one hand the Commission generally considers a ruling which endorses an infra-group transaction and which is not at arm's length being in breach of art. 107(1) TFEU simply because it is liable to hamper competition in the internal market *per se*, the ECJ seems to affirm that further analysis is required. Indeed, the Court observed that national legislation may hinder cross-border infra-group transactions which are not carried out at arm's length in order to secure the efficiency of its jurisdiction in tax matters. Nevertheless, the Court observed that such an impediment shall take into account the fact that there could be a commercial

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beyond what the companies concerned would have agreed under market conditions, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that transaction […] second, the corrective tax measure must, where required, be confined to the part which exceeds what would have been agreed between the companies in question under market conditions" (*Ibidem*, § 49).

[444] *Ibidem*, § 52.

[445] In fact, the Court held that *"there may be a commercial justification by virtue of the fact that Hornbach-Baumarkt AG is a shareholder in the foreign group companies, which would justify the conclusion of the transaction at issue in the main proceedings under terms that deviated from arm's-length terms* [because] *since the continuation and expansion of the business operations of those foreign companies was contingent, due to a lack of sufficient equity capital, upon a provision of capital, the gratuitous granting of comfort letters containing a guarantee statement, even though companies independent from one another would have agreed on remuneration for such guarantees, could be explained by the economic interest of Hornbach-Baumarkt AG itself in the financial success of the foreign group companies, in which it participates through the distribution of profits, as well as by a certain responsibility of the applicant in the main proceedings, as a shareholder, in the financing of those companies"* (*Ibidem*, § 56.).

explanation for a non-arm's length transaction and that therefore such a transaction may be objectively justified. In fact, as the ECJ affirmed in *SGI*: *"national legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents an artificial arrangement, entered into for tax reasons, is to be regarded as not going beyond what is necessary to attain the objectives relating to the need to maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance where, first, on each occasion on which there is a suspicion that a transaction goes beyond what the companies concerned would have agreed under fully competitive conditions, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that transaction"* ([446]).

3.6. The approach of the CJEU towards mismatches.

With regard to mismatches, it has been illustrated how such situations are established and under what profile they are likely to be caught in breach of art. 107(1) TFEU. In particular, it has been affirmed that, contrary to the specific situation in which they are created deliberately, mismatches may not be deemed to violate the State aid rules because of the lack of the necessary requirement of the attributability of the aid-granting measure to one of the Member States concerned. In fact, as the Directorate General for Internal Policies of the European Parliament suggested, *"even if a state would change its national qualification across-the-board and thereby create a mismatch, such actions would still not be attributable to that Member State as long as this is the new general interpretation of the law within that Member State"* ([447]). However, there is an exception indeed.

To highlight this kind of circumstances we should refer again, as it has been anticipated in the previous pages, to the two *Autogrill* and *Banco Santander* judgements. In fact, with reference to the latter Court ruling, we have seen how the

[446] *SGI*, § 71.
[447] European Parliament, v. supra, *EU State Aid Law and National Tax Rulings*. *Supra* (2016) at 15.

Court stated that *"in order to classify a domestic tax measure as 'selective', it is necessary to begin by identifying and examining the common or 'normal' regime applicable in the Member State concerned* [as] *it is in relation to this common or 'normal' tax regime that it is necessary, secondly, to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it differentiates between economic operators who, in the light of the objective assigned to the tax system of the Member State concerned, are in a comparable factual and legal situation"* ([448]). It has also been observed that the ECJ did not held that Spanish law was breaching art. 107(1) primarily because of its general nature, which renders it virtually applicable to all the players which satisfy the requirements for its application.

However, this also implicitly entailed that if the measure would have been selective, then this would have probably implied a breach of the State aid prohibition, given that all the other criteria of the four-prong test seem to have been fulfilled *in casu*. Indeed, by arguing that the Commission had failed *"to establish the measure at issue is selective in nature"*, the Court observed that *"while the assessment of the condition set out in* [107(1) TFEU] *and relating to the effect on trade between Member States involves examining whether the undertakings or the production of certain goods of a Member State are placed at an advantage compared to the undertakings or the production of certain goods of other Member States, the condition relating to selectivity, set out in the same paragraph of that article, can be assessed only at the level of a single Member State and emerges only from an analysis of the difference in treatment between the undertakings and the production of certain goods of that State"* ([449]). This means that State aid is not considered to be granted by measures which treat differently undertakings which are taxed in the Member State concerned and those which are subject to taxation abroad when it simply facilitates the acquisition of companies established in the latter.

Nevertheless, the Court also affirmed that *"it cannot be inferred from the*

[448] *Banco Santander* (v. supra), § 37.
[449] *Autogrill*, § 71.

case-law on which the Commission relies that the EU courts have already classified a tax measure as selective without it being established that the measure at issue favoured a particular category of undertakings or the production of certain goods, to the exclusion of other undertakings or the production of other goods" ([450]). In fact, referring to *Commission v. France* ([451]), the judges confirmed that *"the Court of Justice ruled that a preferential rediscount rate for exports, granted by a State in favour only of national products exported and for the purpose of helping them to compete in other Member States with products originating in the latter, constituted aid* […] *and that interest rate rebates on loans for export* […] *and a tax deduction which benefits only undertakings which have export activities and which make certain investments referred to by the measures at issue* […] *satisfied the condition of selectivity"* ([452]). In this light, it shall be noted that the Court only held that the Commission failed to show that the conditions provided by Spanish law fulfilled the requirement of selectivity, but it did confirm the principles which it always affirmed in its case law: namely the fact that selectivity exists when the measure addresses a clearly defined category of certain undertakings only. Consequently, when it comes to mismatches, a measure which creates them, even though it shall be deemed to be legal *prima facie*, may still be caught by the Commission (and by to Court) to be in breach of art. 107(1) TFEU as long as the requirements of the four-prong test are fulfilled in accordance with the case-law of the ECJ.

In fact, as the latter itself observed by stating that it is not possible to confirm *"that the EU courts classified a tax measure as selective without the identification of a particular category of undertakings or the production of certain goods which could be distinguished on account of their specific characteristics"*, it should be concluded that the Court did not address mismatches as being a situation which shall be treated differently in comparison with other general measures providing State aid. Therefore, the same reasonings and rationales which the Court always applies when dealing with State aid cases in general shall be ultimately applied to the specific situations concerning mismatches as well.

[450] *Ibidem*, § 77.
[451] Joined Cases 6/69 and 11/69, *Commission v. France* (1969), ECR 523, § 20.
[452] *Autogrill*, § 78.

3.7 The CJEU's approach towards taxation on profits.

Finally, it is important to highlight an important aspect concerning the Court's approach followed in cases on share profits. In fact, as pointed out by VESTERDORF, the legality of taxation on accrual basis is assumed to be lawful under EU law, also when this is applied to share profits.

However, the author suggests that *"it appears* [that the CJEU] *has not ruled on that question, although it has ruled on the conformity with the TFEU of accrual-based taxation in cases where shareholders move to another country"* ([453]). In fact, *"in such a situation, a country may want to tax not realised share profits* in order *to not forgo tax on share profits and to avoid tax evasion"* ([454]).

Moreover, while the ECJ generally ruled against accrual basis taxation regimes insofar they were combined with provisions imposing a duty upon the shareholders *"to provide a guarantee or security"*, nothing seems to prove that the Court considers the adoption of such regimes at national level to be illegal under EU law ([455]).

By the way, as VESTERDORF further observes, *"it cannot be deduced from ECJ practice that a Member State is precluded from applying tax on an accrual basis with regard to shareholders moving from that Member State if the Member State in question does not apply a general accrual-based tax on share profits"* ([456]). This is in fact coherent with the reasoning which the Court has generally adopted. In fact, it should not be forgotten that, also with respect to what has been suggested in the paragraph concerning the approach of the Court towards mismatches, the ECJ usually uses the categories which are inherent to the applied Treaty law and its case-law when dealing with cases in practice, thereby referring to the rules applicable to the general legal framework in which the situation of the judgement itself is considered to fall.

It follows that, in a way which is consistent with the Court's observations

[453] Peter L. Vesterdorf, *op. Cit.*, at 752.
[454] *Ibidem*.
[455] *Ibidem*.
[456] *Ibidem*.

and reasonings adopted in *Hornbach-Baumarkt*, nothing should be in principle liable to impede the Member States to adopt taxation regimes on accrual base when it comes to transnational or intra-Member States transactions in order to prevent tax evasion or, more precisely, to secure that the interested Member State may exercise its tax jurisdiction on the transactions themselves. Thus, without being considered in breach of the rules concerning the free movement of capital (arts. 63 to 66 TFEU) or the freedom of establishment (art. 49 TFEU).

Nonetheless, it should be stressed that this should lawfully apply insofar the conditions of art. 107(1) TFEU are not met in *casu*, for there will be obviously a breach of EU law which will be justifiable only with reference to the grounds for justification provided ex paragraphs 2 and 3 (or the other explained grounds for exception) of the provision itself.

Consequently, however, although it seems that neither the Court nor the Commission have already directly addressed the issue, it seems unlikely that an accrual basis taxation applied on the grounds of a differentiation between listed and unlisted companies could be found acceptable under the principles and objectives which are compatible with those of the Union. In fact, although VESTERDORF observes that *"the Commission and, as the case may be, the European Court of Justice are called up to decide on the matter they will find that, given the wide ranging national sovereignty with regard to taxation, a system such as the one in the case dealt with here can be upheld even if, in some aspects, it can be argued that it does not totally conform to EU law on State aid"*, it should be observed that on one hand, such a legislation would inevitably hamper competition in the internal market and, on the other hand, as the author himself recognizes "*the kind of legislation in question could constitute an infringement of EU law on free movement of capital"* ([457]).

[457] *Ibidem*, at 753; in particular, it is moreover interesting to notice that VESTERDORF *inter alia* observes that, *"the area of gambling and gambling duties seems to present itself as a taxation area highly in need of clarification, something that would also seem to be best achieved by way of harmonisation rather than by ECJ decisions"* (*Ibidem*).

CHAPTER IV

Present and future developments in the matter of Tax Rulings at EU level.

4.1. The latest and current investigations: The Commission's new approach continues to be applied.

Despite the criticism towards the European Commission's new approach in the matter of tax aid, new investigations have been started in recent times and are whether still ongoing or have been closed only during the last months. Indeed, on October the 3rd 2017, the Commission has opened another formal proceeding against the Grand Duchy of Luxembourg for alleged aid granted to *McDonald's* through the use of tax rulings. In fact, on the grounds of the US-Luxembourg Double Taxation Treaty ([458]), the companies paying taxes in one of the two States should be exempted in the other. In fact, in March 2009, the Luxemburgish tax administration issued a first tax ruling confirming that the European branch of *McDonald's* was exempted from taxation for it was deemed to pay taxes in the US, provided that the company had to submit the evidence of such payment every year. However, the assumption on which the ruling was based was wrong, for *McDonald's Europe Franchising* did not actually pay any taxes to the US government. For this reason, Luxembourg submitted a second ruling in September 2009 allowing the company not to submit proofs anymore while confirming its exemption. Thus, although it had been confirmed that *McDonald's* did not pay any taxes in the US. This was realized because, before the American tax administration, the company claimed that, in the US, *McDonald's Europe Franchising* does not have any 'permanent establishment', while it has a sufficient volume of activities and facilities in Luxembourg, entailing that it's 'permanent establishment' has to be considered being located in the latter State. Therefore, it should be subject to

[458] Washington Convention between the Grand-Duchy of Luxembourg and the United States of America on Double Taxation: Taxes and Income Property (1964), 106, the text is available at: <https://www.irs.gov/pub/irs-trty/luxem.pdf>

taxation in Luxembourg pursuing art. III(1) of the Double Taxation treaty ([459]). On the other hand, while the US administration endorsed such point of view, the Luxemburgish tax authorities did not so, thereby exempting *McDonald's Europe Franchising* form taxation assessing that its US branch was the one which should actually be taxed because of the fact that this is the one which registered the most profits. The European Commission is therefore investigating if Luxembourg did provide illegal aid under art. 107 TFEU through the second 2009 ruling ([460]). On the 19th September 2018, however, the European Commission found that the ruling did not breach art. 107 TFEU because *"it could not be established that the interpretation given by the second tax ruling to the Luxembourg – US Double Taxation Treaty was incorrect, although it resulted in the double non-taxation of the royalties attributed to the US branch"* ([461]).

McDonald's is nevertheless not the only recent case involving rulings granted by Luxembourg. Indeed, in 2008 the Luxemburgish tax administration granted different tax rulings concerning financial transactions (loans) concluded between four Luxembourgish-based companies belonging to the *GDF Suez* group. For those loans are granted on a zero-interest base and they are automatically converted into company shares attributed to the lender companies, the rulings *de facto* exempt the taxation at both the lender's and the borrower's level, because of the fact that profits respectively result in the form of a zero-interest loan and dividend equity. Therefore, the Commission has initiated an investigation on an alleged violation of the State aid rules also for what concerns the tax rulings at hand ([462]). Indeed, on the 20th June of this year, the Commission concluded, contrary to what concerns *Mc Donald's*, that Luxembourg did provide unlawful aid to the

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[459] Indeed, art. III(1) of the above-mentioned Convention affirms that *"the industrial or commercial profits of an enterprise of one of the Contracting States shall be taxable only by that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein"*.

[460] For further information see: European Commission, Press Release, *State aid: Commission opens formal investigation into Luxembourg's tax treatment of McDonald's* (Brussels, 3rd December 2015).

[461] In this respect, see: European Commission, Press Release, State aid: *Commission investigation did not find that Luxembourg gave selective tax treatment to McDonald's* (Brussels, 19th September 2018).

[462] see: European Commission, Press Release, *State aid: Commission opens in-depth investigation into Luxembourg's tax treatment of GDF Suez (now Engie)* (Brussels, 19th September 2016).

companies concerned, because *"this tax treatment derogates from the reference framework, which is the Luxembourg corporate income tax system"*, thereby constituting *"an unjustified discrimination vis-à-vis other undertakings subject to the same reference framework in Luxembourg, which would be taxed on the totality of their profit"* ([463]).

In the meanwhile, the Commission has further opened a formal investigation towards the Netherlands. The proceeding concerns rulings covering certain transactions between the Dutch-based firm *Inter IKEA Systems*, where all the worldwide profits from IKEA shops are registered, and another foreign company. In fact, following a Decision of the Commission issued in 2006, Luxembourg had to repeal its exceptional tax scheme which granted a *de facto* exemption for the transactions involving the licence fee payed by *Inter IKEA Systems* to the Luxemburgish-based company *I.I. Holding*¸ holding intellectual property rights which had to be used by *IKEA* to set up its franchise concept. Consequently, *Inter IKEA Systems* decided to buy such intellectual property. To do so, it obtained a loan from its parent company based in Lichtenstein. The transaction was subject to a new ruling issued in 2011 by the Dutch tax administration, which allowed deduction for the loan-related interest payments from *Inter IKEA Systems* to the foreign-based parent company, thereby *de facto* permitting the Dutch company to shift a great amount of its total profits into Lichtenstein at a significantly reduced tax rate. As a consequence, the Commission started the investigation proceeding in 2017 ([464]).

Finally, the Commission also targeted the new British CFC rules (Controlled Foreign Company). In fact, in 2013 the UK legislator introduced an exception in its general tax regime applicable to multinational companies, allowing financing incomes obtained from foreign off-shore companies to British-based undertakings to escape tax imposition in Britain. As a result, a multinational firm operating in the UK may consistently reduce its tax burden. Consequently, the Commission started a formal proceeding in 2017 for alleged existence of a breach

[463] Commission Decision 3839/2018/EU of the 20th June 2018, § 166; see also: Commission, Press Release, *State aid: Commission finds Luxembourg gave illegal tax benefits to Engie; has to recover around €120 million* (Brussels, 20th June 2018).
[464] see: European Commission, Press Release, *State aid: Commission opens in-depth investigation into the Netherlands' tax treatment of Inter IKEA* (Brussels, 18th December 2017).

of art. 107(1) TFEU ([465]).

The illustrated pending cases may lead us up to the conclusion that the criticism promoted foremost by US commentators and scholars did not prevent the European Commission to carry on with its "new approach". Indeed, it may be highlighted that the *modus operandi* of the Commission in the ongoing investigations is absolutely in line with the previously analysed decisions. Indeed, it seems that the DG competition continues to pay particular attention to the same Member States which had been already targeted: namely the ones of the BeNeLux and those located in the British Isles, with reference to the *Apple* case already involving the Irish Tax Revenue. Moreover, the same might be stated with respect to the Commission's interest for transfer pricing transactions, for all *Suez*, *IKEA* and *British CFC* concern taxation applied to infra-group transactions. Conclusively, the adherence to the "new approach" seems also to be confirmed by the fact that, excluding only the latter case concerning a legislative exception to a general tax regime, the proceedings which have been started by the European Commission do target tax rulings granted by national administrations, thereby confirming its tendency shown in the Decisions formerly illustrated in Chapter II.

4.2. Important attempts for harmonization in the matter of tax rulings.

It is clear from our insight concerning the legal treatment of tax rulings under EU Law that there is no systematic regulatory framework in which this instruments fall. Indeed, the lack of any legislative act at Community level concerning the tools at stake implies that the only provision with respect to which tax rulings may be confronted with is indeed art. 107 TFEU, which in turn means that any ruling must be evaluated individually by the Commission in order to determine if it has indeed the effect to grant illegal aid or not. On the other hand, "tax ruling systems" may exist at national level, but again, they clearly differ from State to State ([466]). In fact, the real obstacle for a systematic treatment of tax rulings

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[465] See: European Commission, Press Release, *Commission opens in-depth investigation into UK tax scheme for multinationals* (Brussels, 26th October 2017).

[466] By the way, we may distinguish the Member States in accordance to their approach to tax rulings into two categories. On one hand, there are national legal orders which have a long tradition in

under the action of the Commission consists in the fact that in the Union there are currently twenty-eight different legal tax regimes and, consequently, as many different administrative practices on tax rulings.

In order to face such difficulty and to find an appropriate solution to the problem, the EU is currently evaluating the opportunity to embrace two distinct approaches.

Firstly, the EU institutions have shown a certain interest for the proposal made by ROMANO in June 2015: namely, the adoption of a common tax ruling procedure ([467]). In fact, the mentioned expert stressed *"that little attention has been given to the coordination, harmonization or unification of the tax procedural issues of tax rulings today"* ([468]). In particular, the Union should provide to set up a special body having the task to deal with national tax rulings. In particular, this "European Ruling Committee" should have following competences: on one hand, it should be *"entrusted with powers of guidance and coordination"*; on the other hand, it should have even the power to issue rulings in second instance if this might be necessary to protect the integrity of the internal market and of EU law ([469]). However, this new body should not replace the European Commission in the exercise of this functions accorded by art. 108, for it rather should have the aim to assist the existing European Institutions in *"increasing the level of certainty, consistency, uniformity and transparency so to reduce harmful tax competition, including illegal state aids, and to enhance the competitiveness of the European market"*, as ROMANO affirmed ([470]).

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adopting tax rulings (indeed, Finland adopts such instruments since the 1940s.; other States are Bulgaria, Germany, Denmark, Spain, France, Hungary, Italy, Luxembourg, the Netherlands, Portugal and the United Kingdom). On the other hand, there are States like Greece or Belgium, where tax rulings have been introduced only recently in administrative practice (In Lithuania, Greece and Slovakia this happened in 2014, while in Slovenia tax rulings may be adopted since 2007). Moreover, there are States (like Luxembourg or Belgium) where tax rulings have been mostly informal in the past, while formal issuing procedures have been introduced only recently (European Parliament, *supra*, *'Tax Rulings' in the EU Member States,* at 38).

[467] European Parliament, supra, 'Tax Rulings' in the EU Member States, at 3; See also: Carlo Romano, *Advance tax rulings and principles of law: towards a European tax rulings system?,* (Amsterdam: IBFD, 2002).

[468] European Parliament, *supra, 'Tax Rulings' in the EU Member States,* at 37

[469] *Ibidem.*

[470] European Parliament, Directorate-General for Internal Policies, Policy Department A: Economic and Scientific Policies, Workshop on Tax Rulings (2015), in European Parliament, *supra, 'Tax Rulings' in the EU Member States*, at 37, footnote 117.

Besides the option of establishing such 'European System of Tax Rulings', there is another project which seems on one hand more realistic, but on the other it also implies more radical reform efforts. Indeed, at the beginning of this essay it has been observed that in the 1990s the Commission abandoned its intentions to foster full harmonization in the matter of direct taxation, due to the pressure of both the European Parliament and the Council. In fact, even if this will shock Member States individually because of the consequent compression of their sovereign right to tax still recognized by EU law today, this may be the only efficient solution not only for what concerns the problematics arising in accordance with national tax rulings, but also to harmful tax competition in the common market in general.

Indeed, the Commission and the European Parliament have proposed to establish a Common Consolidated Corporate Tax Base (CCCTB). In particular, the tax base should be mandatorily applicable to EU-resident standalone and group companies while parent companies having at least 75% of the shares of EU-based subsidiary firms should have the possibility to apply for admission to the harmonized regime ([471]). Indeed, there are different reasons why such project should be deemed essential ([472]).

First, the adoption of a common tax base for corporate profit would solve one and forever the problem related to intra-community transfer pricing practices. In fact, if the tax base applicable to the gains of EU-active companies would be the same for every national context in the Union, then profit-shifting between EU-based firms would become useless and, consequently, the problems related to the fairness of intragroup transactions would only concern the shifts between EU-resident and third State companies.

Secondly, it would allow an easier coordination between the tax administrations of the Member States and, most importantly, it would extremely facilitate the Commission's action and anti-evasion enforcement.

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[471] See: Bend Roland Killmann e Arijo Von Eijsde e Gerard Meussen, General Part, in M. Lang, P. Pistone, J. Schuch, C. Staringer, *Procedural Rules in Tax law in the context of European Union and Domestic Law* (The Netherlands: Wolters Kluwer, 2010).

[472] See: European Parliament, Directorate-General for international policies, Policy Department A: Economic and Scientific policy, *International Taxation and Tax Rulings: Policy Issues at Challenging Times*, at 17.

However, it shall be observed that the project at hand might be subject to reasonable objections ([473]). In fact, the adoption of a common tax base would postulate that the Member States have found an agreement not only on the quantification of the actual base, but also with respect to the wording used by the provisions establishing the CCCTB, which is a matter of extreme difficulty ([474]).

Moreover, clearly, in the light of the criticism expressed towards the Commission's new approach in the recent decisions on rulings, further problems may arise for what concerns the coordination between the CCCTB at European level and the international and third States' tax practices.

Finally, it may be observed that the elaboration of the CCCTB and the establishment of a new European rulings authority are indeed the two most important options which are being evaluated by the EU Institutions, but, in the meanwhile, this does not mean that these are the only ones. In fact, there are two other relevant proposals. These consist in the establishment of a "residual profit split system" on one hand and the elaboration of a "destination-based cash-flow tax system" on the other, which construction is ongoing since December 2013 under the supervision of a group of experts chaired by Prof. Michael P. Dervereux ([475]).

For what concerns the former, it must be stated that it actually consists in a reform of the existing system, thereby qualifying as a path being less intrusive if

[473] It must be however noted that *"some of the criticism levelled at this proposal* [may rise doubts]. *For example, it has been argued that a formula-based allocation does not reflect a true allocation of profits".* Nevertheless, it should be observed that *"this criticism is misguided because it assumes not only the existence of "a true allocation of profits", but a supposition that the existing system somehow captures this true allocation, even if imperfectly"* (European Parliament, *supra, International Taxation and Tax Rulings: Policy Issues at Challenging Times* (2015) at 17).

[474] Indeed, the project of the CCCTB is not that recent at all. In fact, the resistance of the MSs has been the most important factor for failure till now. In fact, it has been affirmed that "*it is generally recognized that the existence of twenty-seven different tax administrations under twenty-seven different procedural rules, increasing compliance costs and the administrative burden, may equally hinder the proper functioning of the internal market. It is therefore safe to assume that the perceived benefits of the CCCTB would be significantly reduced if each group falling under the CCCTB regime were still required to deal with twenty-seven tax administrations under twenty-seven different procedural rules. The feasibility of the CCCTB is therefore, amongst other things, dependent on the existence of an appropriate procedural and administrative legal framework, including enforcement rules. It is for that reason that the European Commission published a working document on 13 November 2007 which discusses possible elements of the administrative framework CCCTB. This document proposes a 'one-stop shop' approach for the administration of the CCCTB"* (P. Pistone, J. Schuch, C. Staringer, *op. cit.* (2010), at 44).

[475]see European Parliament, *supra, International Taxation and Tax Rulings: Policy Issues at Challenging Times* (2015), at 17.

compared with the harmonized corporate tax base. The project at hand should make it possible to reduce the harmful effects which transnational infra-group transfer pricing transactions might have on the internal market by establishing a *"mark-up method with allocating residual profit on the basis of the location of the costumers"* ([476]). Referring to the latter alternative instead, it is all about revisiting the principles governing the VAT applying them to direct taxation on transnational basis, so that *"exports would be zero-rated, while imports would be taxed"*, implying that the transactions will be taxed in the State in which the sold product will be consumed ([477]).

4.3. The efforts for a higher degree of transparency.

Great efforts have been made at EU level to grant more transparency in the field of taxation, as this was deemed necessary to secure the integrity of the internal market from the thread of harmful tax competition. Indeed, we have already seen that in 1997 the Council adopted the Code of Conduct on Business Taxation, which has been an important soft law instrument which managed to regulate the phenomenon at stake at political level until now.

Besides the Code, in 2012 the Commission has adopted an Action Plan to counter tax evasion and fraud, containing more than thirty measures improving transparency.

Another important achievement has been reached through the reform of the on Administrative Cooperation through Directive 2014/107/EU. The legislation at hand now imposes upon the Member States to exchange a large spectrum of financial and fiscal information between each-other automatically, thereby fulfilling with the principle of the new OECD /G20 global standard for information exchange between States.

Moreover, we may observe that further significant results have been

[476] *Ibidem,* at 18.
[477] *Ibidem.*

achieved through the reform of the "Parent-Subsidiary" Directive 90/434/EEC in order to counter abusive tax practices of group companies, the agreement between the EP and the Council on the introduction of the fourth Anti-Money Laundering Directive 2015/849/EU, the proposal for the amendment of Directive 77/799/ECC and through the creation of the Platform for Tax Good Governance and the launch of the VAT Forum for dialogue between authorities.

The Action Plan of 2012 further included the establishment of a European TIN (Tax Identification number) and the upgrade of EUROFISC to direct taxation, for the instrument concerned had been conceived for indirect taxation only ([478]).

Nonetheless, all those steps which have been undertaken are not felt to be enough.

In fact, according to the Commission, *"the European Parliament, the Council and many actors from the civil society all called for urgent and effective action to increase tax transparency, particularly in the field of taxation"*, where further action seems to be necessary to prevent harmful tax competition ([479]). To these ends the Commission proposed a new Tax Transparency Package, containing short-term measures meant to counter tax avoidance by improving transparency.

The assumption on which such action is based is that the problems related to harmful tax competition in the internal market may be solved only by a better cooperation between the Member States. Indeed, as ARENA observed, the main reason why national tax administrations of the Member States targeted by the Commission's investigations decided to adopt rulings consists in the fact that tax ruling are generally 'secret' measures, and by way of their non-publication they could easily escape the awareness of the other Member States and the Commission

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[478] EUROFISC consists in *"a network of national EU Member State analysts working in different areas of fraud risk […] it was set up in 2010 to improve the capacity of Member States to combat organised VAT fraud, especially carousel* fraud […] managed *by EU Member States, Eurofisc allows them to exchange early warnings on businesses suspected of being involved in carousel fraud. The European Commission contributes with administrative and logistical support without having access to operational data"* (European Commission, Press Release, *Questions and Answers on the VAT proposal for administrative cooperation* (Bussels, 30 November 2017)).

[479] European Commission, *Communication from the Commission to the European Parliament and the Council on tax transparency to fight tax evasion and avoidance*, COM(2015) 136 Final (Brussels, 18th March 2015), at 7.

([480]).

In fact, as it has been suggested in the first Chapter of this work, administrative cooperation between European national authorities is indeed a field which requires better efforts for coordination, as also the Commission has pointed out that *"national administrations often lack the necessary information about the impact of other countries' tax regimes and practices on their own tax systems"* ([481]).

Therefore, the Tax Transparency Package includes many measures. First, the Commission intends to rationalize the automatic exchange of information on incomes related to savings and interests. Indeed, it must be highlighted that the amendment provided by Directive 2014/107/EU to the Directive on Administrative Cooperation has factually frustrated the reform of the Savings Tax Directive 2003/48/EC of 2014, for it covered a huge part of the latter's scope. Indeed, the Package has the purpose to provide the absorption of the Savings Tax Directive into the Administrative Cooperation Directive.

Secondly, the Commission wants to extend the applicability of the transparency requirements which are now foreseen for banking companies and for the payments to the public for logging and extractive industries having a large dimension also to multinational companies in all sectors, in order to grant information access to national administrations ([482]). To this end however, the Commission will have to balance the need for tax transparency with other rights and aims recognized at Community level such as data protection the protection from *inside trading* practices as well as with the international standards.

Thirdly, the Package is concerned with the challenge of revising the Code of Conduct for Business Taxation of 1997 because of its relative obsolescence. Indeed, the Code does not fit the needs for fairness related to the most innovative mechanisms of tax aids and incentives, for it was designed more than twenty years

[480] More precisely, ARENA states that: *"il successo dei tax rulings in alcuni Paesi europei avvalora l'ipotesi che amministrazioni finanziarie di tali Paesi si siano servite del carattere riservato delle proprie decisioni fiscali anticipate per concedere a determinati contribuenti risparmi d'imposta ben più consistenti di quelli riconosciuti abitualmente dal fisco americano."* (Amedeo Arena, *op. cit.* (2017), at 932).
[481] *Ibidem*, at 4
[482] In fact, both the Capital Requirement Directive 2013/36/EU reflecting Basel II and Basel III and the Accounting Directive 83/349/EEC provide the mechanism of CBCR (country-by-country reporting).

ago.

Fourthly, tax transparency measures aimed at better calculating the existing tax gap are provided. Indeed, the Commission defines the latter as *"the difference between tax that is due and the amount actually collected by national authorities"* ([483]). Such measures include mechanisms to secure a better cooperation between the Member States and the Commission and EUROSTAT and the establishment of the FISCALIS project group, which has the aim to calculate the tax gap and to promote greater transparency on national tax laws.

Fifthly, the Package also aims at promoting the worldwide standards of good governance concerning taxation, especially with reference to the BEPS project of the OECD.

Finally and most importantly however, the Tax Transparency Package heavily focuses on tax rulings. In fact, even though it recognized that that tax rulings have to be considered legal *prima facie*, the Commission has assessed that information exchange duties on State aid in general do not suffice. Thus, in the light of the purpose to prevent unlawful aid to be granted through administrative rulings. Therefore, the Commission intends to introduce rules obliging national tax administrations to automatically exchange information with the authorities of the other Member States on existing and delivered tax rulings as well. Thus, mainly focusing on those rulings having a cross-border character, thereby emphasizing and confirming the Commission's special interest for rulings endorsing infra-group transfer pricing transactions. In order to accelerate the process, rather than by drafting a new act, the Commission suggested to introduce such obligation into the already existing legal framework, providing a further amendment to Directive 2011/16/EU on Administrative Cooperation.

According to this point, it is important to remind that on October the 27th 2015, the European Parliament has adopted a resolution calling for: 1) the extension of such obligation to every kind of existing and future administrative or legislative tax arrangement, regardless of its binding or non-binding nature and of its cross-border or internal character and time limit; 2) the possibility for the Commission to

[483] European Commission, *COM(2015)*, *supra*, at 6.

accede the information in the same way as Member States; and 3) the shortening of the deadlines for the related procedures ([484]).

The provisions concerning the automatic exchange of information have been finally implemented in the Directive on Administrative Cooperation through Directive 2015/2376/UE which entered into force on January the 1st 2017.

Another important aspect concerning this Directive consists in the introduction of two important definitions. On one hand, in fact, "advance cross-border rulings" are defined as *"any agreement, communication, or any other instrument or action with similar effects, including one issued, amended or renewed in the context of a tax audit"* which: a) *" is amended or renewed by, or on behalf of, the government or the tax authority of a Member State, or the Member State's territorial or administrative subdivisions"*; b) *"is issued, amended or renewed, to a particular person or a group of persons, and upon which that person or a group of persons is entitled to rely"*; c) *"concerns the interpretation or application of a legal or administrative provision concerning the administration or enforcement of national laws relating to taxes of the Member State, or the Member State's territorial or administrative subdivisions, including local authorities"*; d) *"relates to a cross-border transaction or to the question of whether or not activities carried on by a person in another jurisdiction create a permanent establishment"*; e) *is made in advance of the transactions or of the activities in another jurisdiction potentially creating a permanent establishment or in advance of the filing of a tax return covering the period in which the transaction or series of transactions or activities took place"* ([485]). On the other hand, an "advance pricing agreement" is considered to be *"any agreement, communication or any other instrument or action with similar effects, including one issued, amended or renewed in the context of a tax audit"* which: a) is issued by the authority of a Member State; b) is referred to a particular person or group which rely on the agreement; and c) *"determines in advance of cross-border transactions between associated enterprises, an*

[484] See European Parliament, Legislative Train Schedule, *Deeper and Fairer Internal Market with a Strengthened Industrial Base / Taxation* (20 July 2018) available at: <http://www.europarl.europa.eu/legislative-train/theme-deeper-and-fairer-internal-market-with-a-strengthened-industrial-base-taxation/file-automatic-exchange-of-information-on-tax-rulings>.

[485] Reg. 2015/2376/UE, art. 1 lit. b)

appropriate set of criteria for the determination of the transfer pricing for those transactions or determines the attribution of profits to a permanent establishment" ([486]).

On the 13th of March 2018 the ECOFIN reached an agreement for a further amendment of the Directive on Administrative Cooperation as a reaction to the recent *Panama Papers* scandals. The new rules will concern the introduction of a new set of criteria which will make it possible for national authorities to evaluate the risk of tax evasion or avoidance related to the entry into force of new rulings (*e.g.* the use of cross-border losses or preferential tax arrangements to artificially decrease the tax burden for certain taxpayers). Moreover, a common database will be introduced to allow national tax authorities a more effective gathering of information and awareness about new foreign rulings. These modifications will enter into force on July the 1st 2020.

Finally, reacting to the *LuxLeaks* scandal, on the 25th of May 2018, the ECOFIN adopted Directive 2018/822/EU which entered into force on June the 25th. The Directive again amends Dir. 2011/16/EU providing automatic information for cross-border aggressive planning. Moreover, it also imposes upon the Member States to adopt and publish all the legislative and administrative arrangements in order to comply with the Directive concerned.

4.4. Further action at international level against harmful tax competition: State aid and the WTO.

Besides the framework of the European Union, some commentators have rightfully pointed out that a better coordination to counter harmful tax competition is needed at international level. Indeed, it should be reminded that harmful tax competition is surely a problem which particularly affects systems of economic integration such as the European Union. Nevertheless, its negative effects on trade are felt at international level too. Moreover, it may be concluded that in the light of

[486] *Ibidem*; it is moreover interesting to observe that the provision concerned also contains a definition of "cross-border transaction" as the transaction fundamentally concluded between to subject non being simultaneously based in the Member States concerned by the transaction and which has a cross-border impact.

the recent case-law of the European Commission on tax rulings, the OECD Guidelines seem to be an instrument which is not sufficiently effective in impeding States to engage in tax competition having harmful effects. It might be appropriate for the whole international community to further adopt hard law arrangements to better secure trans-national cooperation in tax matters. Thus, also in order to circumvent the weakness of the solutions provided by the OECD, given that they mainly consist in soft law tools.

Indeed, as it has been said, FAULHABER argues that *"many American lawmakers were surprised to discover the European Union prohibition on State aid"*, for such rules represent a new model which shall be observed with special interest by the international community ([487]). In particular, these provisions shall be used as a guidance for a reform of the WTO anti-subsidy rules.

Indeed, the heavy criticism which has been mentioned in Chapter II also hugely depends on a proclaimed lack of political legitimacy of the European Commission in the enforcement of the State aid rules. In fact, as FAULHABER affirms, *"although State aid is prohibited in a treaty signed by only twenty-eight countries* (the TFEU), *it can affect third-countries"* ([488]). Indeed, although we have highlighted the limits of the legal arguments used by American commentators to criticize the Union's action in Chapter II, it is true that the Commission's decisions, especially *Apple* and *Amazon*, factually had a great impact on American economy, for costs of aid recovery are ultimately borne by the American based-group company and by U.S. investors. Therefore, FAULHABER stresses out that the framework in which a fairer international solution to the problem of State aid shall be found should be to one of the WTO.

In this respect, the mentioned author affirms that *"governments and commentators have long called for more robust anti-subsidy rules, arguing that the WTO's anti-subsidy regime is too weak to achieve the* […] *goal of liberalizing trade"* ([489]). In fact, the GATT of 1994 surely contains rules which are indirectly addressed to subsidies in arts. II, III, and VI. Nonetheless, these provisions are rather concerned with the counter-measures which the State parties to the agreement

[487] Lilian V. Faulhaber, *op. cit.* (2017), at 384.
[488] *Ibidem*, at 403.
[489] *Ibidem*, at 384.

may adopt against subsidies granted by a foreign State, while art. XVI only contemplates an obligation to notify aid measures.

On the other hand, it is true that the legal order of the WTO also includes the Agreement on Subsidies and Countervailing Measures (SCM), which specifically addresses subsidies *inter alia* providing limits and prohibitions, but those rules are still felt do be generally too weak to properly secure fairness in international trade.

In fact, on one hand, the dispute settlement mechanism provided by the Dispute Settlement Understanding (DSU) factually only grants the possibility for the State which is harmed by another Member State's breaches of the WTO agreements to impose adequate countermeasures, while recovery is never admitted ([490]). On the other hand, furthermore, *"the definition of impermissible subsidies is* […] *narrower in the WTO context than in the* [EU] *State aid context"* for *"the WTO only includes limited categories of subsidies in its anti-subsidy rules"* ([491]). In fact, the under the WTO rules, *"even though Article 1 of the SCM Agreement states that a financial contribution includes ‹‹government revenue that is otherwise due [that] is foregone or not collected››",* favourable tax measures do not seem to be prohibited in principle ([492]).

Accordingly, FAULHABER identifies four main areas in which the anti-subsidy-regime World Trade Organization should be reformed following the paradigm represented by art. 107 and 108 TFEU.

First, indeed, the notion of subsidy inherent to the WTO framework should be extended in a way similar as the notion of aid is understood in the legal order of the EU. In fact, given that the limits of the European notion of State aid are *"do to the explicit limits laid out in art. 107"* and that these exception have been *"interpreted* […] *narrowly"* by both the Commission and the CJEU *"so as not to allow them to overtake the prohibition"*, FAULHABER suggests to apply the same

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[490] In fact, it should be noted that *"in the WTO, a country is encouraged to eliminate the subsidy or the harmful aspect of the subsidy, but GATT 1994 and the SCM Agreement provide for the possibility that the subsidy will be mantained and countervailing duties will be imposed"* (*ibidem,* at 398).
[491] Indeed, FAULHABER further observes that *"under the GATT 1994, only export subsidies on manufactured goods are explicitly prohibited, and the SCM Agreement only prohibits export subsidies and subsidies to prioritize domestic inputs"* (*ibidem*, at 395-396).
[492] *Ibidem*, at 396.

mechanism to the WTO providing a broader definition of subsidy ([493]).

Secondly, an important mechanism provided by the model of arts. 107 and 108 TFEU which should be transplanted in the WTO framework is the one concerning State aid enforcement. In fact, besides the aforementioned problem consisting in the fact that the only guarantee provided by the DSU mechanism consists in the possibility for the harmed States to impose effective countermeasures without foreseeing any obligation to recover the aid, it must be highlighted that also the fact that the activation of the dispute solution mechanism entirely relies upon the will of the Member States concerned to refer to the WTO Dispute Settlement Body a factual impediment to effective enforcement too. Indeed, the fact that EU law permits the Commission as a supra-national organ to initiate an investigation proceeding on suspected State aid *ex officio* really constitutes an innovation which is unknown to traditional international organizations based on the principle of sovereign equality such as the WTO.

Thirdly, another element which in the opinion of FAULHABER should inspire a possible reform of the WTO anti-subsidy regime consists in the notification procedure ex art. 108 TFEU.

Finally, as said, a fourth consideration about the review of the WTO rules concerned is the one related to recovery.

However interesting such a step forward might be, it seems highly doubtful that the criticism levelled by certain scholars with respect to the Commission's "new approach" towards State aid and tax rulings will actually trigger the discussed possible reforms. Indeed, as FAULHABER herself admits *"it is, of course, unlikely that the WTO members will support a move from the current anti-subsidy regime to a much more robust regime modelled on the State aid prohibition"* for many of them *"have an interest in maintaining the current system, where no outside force can investigate their subsidies, where only individual countries have the right to*

[493] Indeed, the authoress reminds that *"The CJEU has gone so far as to say that the ‹‹concept of [State] aid in more general than the concept of subsidy››"* and that the fact that the enforcement WTO anti-subsidy enforcement actually relies on the Member State entails that *"the actual breadth of this definition* [of subsidy] *remains unclear"* and that *"it is not certain that aid such as a tax ruling would ever be considered to be a subsidy"* (*Ibidem*, at 401-402).

challenge one another, and where the scope of subsidies remains vague enough for countries to believe that their aid measures fall outside that scope" ([494]).

4.5. Possible developments after 'Brexit': what will be the future of State aid prohibition in the new relationships between the United Kingdom and the European Union?

After the results of the 'Brexit' referendum held in June 2016, the United Kingdom of Great Britain and Northern Ireland will officially leave the European Union on March the 29th ([495]). In fact, this means that the UK will not be bound anymore by the Treaties on which the EU is founded and by secondary legislation adopted by the EU Institutions. Thus, in the absence of an agreement explicitly providing the contrary.

Furthermore, the European Union's position on this seems to be quite clear: *"any future free trade agreement must ensure a level playing field, notably in terms of competition and State aid, and in this regard encompass safeguards against unfair competitive advantages through, inter alia, tax, social, environmental and regulatory measures and practices"* ([496]). Thus, clearly, with respect to tax aid too.

According to this statement, it seems very difficult that the EU will ever allow British undertakings and manufacturers to have access to the internal market without obtaining appropriate guarantees from Britain. In fact, it seems absolutely reasonable to hold that British undertakings have a great interest in continuing to have access to the European common market, for the UK exports towards Europe represent the 55% of Great Britain's total exports ([497]). However, as said, the European Union will probably not grant any access to the internal market if the British government will not ensure that UK undertakings will not benefit from any kind of aid. In this respect, there several options on the table which the British

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[494] *Ibidem*, at 404-405.
[495] See *inter alia*: Rachel Russell, *Brexit date 2019: When does Britain leave the EU?*, Express (19th July 2018), available at: <https://www.express.co.uk/news/politics/991323/brexit-date-2019-when-does-Britain-leave-EU-news>
[496] European Council, *Guidelines following the United Kingdom's notification under Article 50 TEU* (29 April 2017).
[497] See: Observatory of Economic Complexity, United Kingdom, available at: https://atlas.media.mit.edu/en/profile/country/gbr/#Destinations.

Government is currently evaluating.

A first solution may indeed consist in the UK joining the EFTA, thereby automatically falling within the already established legal framework of benefits and duties applicable to Iceland, Norway, Lichtenstein and Switzerland. In that case, the EFTA *mirror legislation* on State aid would apply to the United Kingdom, entailing that the authoritative functions of the European Commission acting under art. 108 TFEU will be replaced by those of the EFTA Surveillance Authority (ESA). However, as PERETZ observed, this solution might be *"politically difficult"* ([498]). In fact, not only the UK access to the EFTA would disappoint the majority of the pro-Brexit British voters, but it will probably also have to face the hostility of the organization's present members ([499]).

Therefore, Whitehall is also evaluating the possible adoption of a national legal regime on State aid prohibition. Indeed, one of the options which is on the table, as suggested by the Law Society of Scotland, consists in the institution of an authority *ex novo* which should have competence in the field of anti-State aid enforcement. Nevertheless, as highlighted by the Convention of Scottish Local Authorities (COSLA), the institution of a British national State aid prohibition regime *"by way of* [the establishment of] *an agency that is dependent from central government risks being at odds with the constitutional nature of the UK*" ([500]).

For these reasons, other possibilities seem to be preferred. Indeed, CHARITA suggested that *"governmental action to supply funding would suffice"* in matters of State aid ([501]). However, while the COSLA stressed out again that there may be incompatibility profiles with the British constitutional order, it is

[498] George Peretz, Select Committee on the European Union, Internal Market Sub-Committee *Corrected oral evidence: Brexit: competition*, Q33 (12th October 2017), available at: http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-internal-market-subcommittee/brexit-competition/oral/71322.html

[499] In this regard, also see: John Springfield and Charles Grant, *Can Britain join Norway in the EEA?*, Center for European Reform (9th June 2016), available at: <https://www.cer.eu/insights/can-britain-join-norway-eea>.

[500] Convention of Scottish Local Authorities (COSLA), Brexit: competition, Written Evidence to the European Committee of the House of Lords (CMP0033) (19th September 2017), available at: http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/eu-internal-market-subcommittee/brexit-competition/written/70450.html

[501] Anca Charita, Written evidence to the European Union Committee of the House of Lords (CMP 0013) (14th September 2017).

possible to assume that the EU would hardly allow British access to the common market in the absence of an independent authority, thereby hindering that the British Government could misuse the national State aid regime, on which the Union will surely not have any kind of control in turn ([502]).

Therefore, there are perhaps two remaining options. On one hand, the possibly existing new British rules on State aid could be enforced directly by national courts ([503]). On the other hand, the solution which presently seems the most acceptable consists in empowering the already existing British anti-trust authority, the Competition and Market Authority (CMA), to exercise anti-State aid functions for it is considered to already have the necessary expertise ([504]).

However, it may be concluded that whatever the British government's final determination will be, given the titanic consequences which the UK's withdrawal from the Union will legally have, it seems unlikely that any system which Britain will choose will properly function without any agreement, of political nature at least, with the European Union.

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[502] COSLA, *v. supra*.

[503] Berwin Leighton Paisner LLP, Written evidence to the European Union Committee of the House of Lords (CMP0025) (15th September 2017).

[504] See: House of Lords, European Union Committee, 12th Report on session 2017-2019, *Brexit*: *Competition and State aid* (2nd February 2018), at 50 ff.

CONCLUSIONS

By ending the present insight into the problematic of harmful tax competition related to the use of *ad hoc* rulings by national authorities of the Member States in the framework of the European Union, we may come to different conclusions. In fact, it has been pointed out that the need on which the whole analysed legal system of provisions and powers is based consists in the construction (and the preservation) of a supranational internal market founded on fair competition between the forces of the market. In fact, the rules on State aid have been introduced in the Treaties of the EU in a complementary relationship with the general provisions contained in arts. 101 and 102 TFEU. Thus, under the assumption that the distortions of competition in the market may not only flow from the behaviour of private players but from the action of public authorities of the Member States as well. Indeed, this is absolutely coherent with the model of Social Market Economy which has inspired the establishment of the European internal market, it is to say an economic environment in which not only private undertakings, but also public authorities may act on the market and participate in economy.

Indeed, as said in the first Chapter, competition among States is far the most ancient form of competition, finding in the use of force the ultimate mean for its self-realization in the past centuries. On the other hand, competition between State-actors, or better-said, between legislators, and thereby consequently between legal orders, generally adopts the form of the s.c. "regulatory competition", thereby understanding that kind of behaviours of national administrations and legislators which aim at attracting foreign companies and investments through favourable treatments and laws. The economic effects of the latter phenomenon are even amplified in a geographical, legal and potical framework as the EU internal market, for it is founded the free movements of goods, services, workers and capital and on the elimination of national barriers to trade.

Indeed, there are various matters in which such kind of competition is more likely to be generated; it is to say the ones which are susceptible to influence the costs borne by the undertakings in their productive activity, such as Labour law.

Indeed, one of these fundamental fields is clearly the one of taxation.

In this regard, although an acceptable degree of competition between national legislators may, in general, have beneficial effects with respect to companies, consumers and economy as a whole, the degeneration of regulatory competition with respect to the rules on taxation might produce the phenomenon of the s.c. "harmful tax competition", having a negative impact on the stability of national economies and bringing unfairness not only in the EU internal market, but to international trade in general as well.

For this reason, the international community has tried to elaborate some solutions, mainly at political level, in order to impede the spread of the aforementioned problem. As we have seen, important attempts for cooperation have been made in the framework of the OECD with its BEPS programme, which also have a huge relevance for what concerns the European Union. Indeed, harmful tax competition is likely to negatively influence the overall international investment and trading policies, as its effects are likely to heavily undermine international trade in the age of Globalization, in which the role of national borders as a potential obstacle to mercantile and economic exchanges has become fundamentally relativized according to the aforementioned conception of "granted liberalism", which in turn constitutes the main idea behind the rules which govern the world economy today.

In this respect, at European level, the EU institutions have undertaken important efforts in order to impede the spread of harmful tax competition within the European common market. Indeed, besides the full harmonization of the TVA, the European Institutions have provided both soft law instruments for a political cooperation in the matter of tax competition (the Code of Conduct for Business taxation) and full harmonization in certain fields of corporate taxation, provided that direct taxation still relies in principle among the exclusive competences of the Member States individually. On the other hand, the case-law of the CJEU clearly shows that the typical instrument by which national authorities install this kind of competition is represented by national laws. Nevertheless, we have seen that harmful tax competition in the EU internal market might be promoted also (and foremost as far as this essay is concerned) through administrative arrangements.

More precisely: through the granting of Tax Rulings.

In the light of what has been explained, Tax Rulings are mainly granted to the taxpayer who requested them in advance by national administrations, mainly as a unilateral statement ("Advance Tax Rulings") or in the form of agreements ("Advance Pricing Agreements"). These measures do in fact give an interpretation of the national rules on taxation, thereby *de facto* communicating to the taxpayer how the tax base for its transactions or profits concerned will be calculated. In fact, Tax Rulings often even endorse the taxpayer's own interpretation on the rules of taxation, as the analysed decisions of the European Commission clearly show.

Although Tax Rulings are not illegal in principle, they may confer to the taxpayer company to which they might be referred an unfair advantage by unduly decreasing the tax burden which should have been otherwise imposed upon it. For this reason, in the lack of a more specific legal framework, Tax Rulings might fall within the rules of the TFEU prohibiting State aid.

As it is clear from the general interpretation of both the Commission and the Court, a measure is considered to grant unlawful aid when the criteria of art. 107(1) TFEU are satisfied, namely: the selectivity of the measure, the measure being financed by the resources of the Member State and its administrations, the existence of the advantage provided towards a company and the hindrance of intra-community trade or the distortion of competition in the internal market. Thus, provided that there are no grounds for the existence of the exceptions contemplated in art. 107(2) and 107(3) and in other secondary law acts. In the meanwhile, the procedural rules for the enforcement of the State aid prohibition set forth by art. 108 TFEU individuate the European Commission as being the quasi-exclusive authority having the power to investigate and assess if a breach of art. 107(1) has occurred.

Besides the elements which constitute State aid ex art. 107(1) composing the s.c. "four-prong" test, some commentators have stressed the importance of another important feature, which is by the way fundamental when it comes to mismatches created by the combination of tax law provisions of two different member States. In fact, if an economic advantage for a company is generated by the fact that the law provisions of two Member States *de facto* exonerate the concerned taxpayer from paying taxes (the situation which is the opposite to the s.c. "double taxation"), as long as the mismatch is not proven to be deliberate, the situation concerned may not classify as aid according to art. 107(1). Thus, because it is impossible to attribute the measure to one of the Member States involved rather than to the other.

In the light of this, it is then fundamental to observe that Tax Rulings have an enormous importance when it comes to the taxation on cross-border infra-group transactions between group entities located in two different Member States (or countries in general). In fact, tax rulings are mainly used by national administrations in order to communicate the modalities according to which the tax base attributed to infra-group cross-border transactions will be calculated by the administration itself. In fact, companies belonging to the same group but based in different Member States may conclude contracts for the sale of goods or services between each other in order to shift the profit gained by one of the two undertakings into the Member State in which the other is based, thereby benefitting from lower tax rates possibly provided by the laws of another State. Indeed, although this s.c. "transfer pricing" practices are not to be considered illegal, the fact that the companies pursue the interest of the group may advantage them in comparison with other standalone competitors, for they may establish favourable or even symbolic "transfer prices" (the price of the transaction) in order to reduce the costs related to the shifting of profits. To impede that fair competition between group and non-group companies might be hampered, the international community (or, better said, the industrialized countries) has recognized the necessity to apply the "arm's length" principle to the transactions concerned. According to this principle, the transfer price should reflect a market-based outcome; better said, the price should coincide with the price which would have been applied between the companies if they would have been standalone companies. This means that the rightful price does always factually consist in the market price related to the product or service concerned.

In this respect, it has also been observed that, by interpreting the market price, and thereby the actual tax base which should have applied to certain transactions, the European Commission or the otherwise competent authorities would incur in a paradox applying an adjusted and virtual market price to a transaction in the lack of any actually existing market related the object of the same transaction. Nevertheless, it has also been observed that, if such a dynamic might be controversial from a free-market perspective, it should not be forgotten that the model which inspires the EU is the paradigm of Social Market Economy (the s.c. German *Soziale Marktwirtschaft*) in which competition is not conceived as an aim by itself but rather as a mean to achieve social goals and objectives; consumer protection first. Under this light it becomes clear that authoritative intervention in economy through virtual interpretations and applications of principles and laws is justified by the need to secure such achievements.

In fact, it is clear from the decisions of the European Commission that the Commission itself mainly focused on transfer pricing transactions whenever it came to the enforcement of the State aid rules with respect to national tax rulings. Indeed, although the possibility to breach art. 107(1) through administrative tools had been recognized already in 1998 (and even earlier, although implicitly, in *De Gezamenlijke Steenkolenmijnen*), the Commission started to set up investigations into national tax practices in the matters of rulings since 2014, under the "State Aid Modernization" programme (SAM), constituting the s.c. "new approach" of the European Commission in State aid law enforcement. In fact, the relevant recent Decisions of the Commission (*Apple*, *Excess Profit*, *Fiat*, *Starbucks* and *Amazon*) clearly demonstrate that the European Commission, while recognizing the high value of guidance of the OECD Guidelines on transfer pricing, has adopted its own interpretation of the arm's length principle. Thus, according to the Commission itself, flowing directly from art. 107 TFEU rather than from the OECD Guidelines, which do not have any imperative character under EU law.

The findings and reasonings of the Commission adopted in the aforementioned Decisions have, indeed, attracted heavy criticism from commentators and Governments, mainly from the US. Indeed, those critiques are summarized at best by the White Paper of the US Department of Treasury of 2016, which individuates three main critical issues. First, it is argued that the Commission wrongly applied EU law, by allowing retroactive recovery of the measures which have been caught in breach with art. 107(1) TFEU. Secondly, by introducing its own interpretation of the arm's length principle, it has been stated that the

Commission has breached the general principles of law and the principle of legitimate expectations, damaging the taxpayers. Thirdly, then, it has been said that the Commission wrongly collapsed the two notions of advantage and selectivity.

From a general point of view, it has been observed that those critiques are not really convincing. In fact, it is not a coincidence that these arguments have been brought mainly by US scholars and Institutions, given that the undertakings which have been affected the most by the Commission's new approach. Therefore, it may not seem absurd to hold that the criticism at stake are quite biased; although this shall not mean that they are not founded.

In fact, as it has been said with respect to *Autogrill* and *Santander*, it is true that the CJEU, which has the competence to secure the uniform application and interpretation of the Treaties and EU law in general, has generally recognized the separation between selectivity and advantage. On the other hand, however, in *World Duty Free Group* the Court has also explicitly referred to the notion of "selective advantage", which does not distinguish between the latter concepts. Most importantly then, the Court did also never explicitly impose upon the Commission the duty to separate the two elements, for in the mentioned cases it simply assessed that the Commission had failed to demonstrate the fulfilment of the requirement of selectivity with respect to the contested measures. On these grounds, it will be important to observe what the Court will hold in its judgements concerning the Decisions issued by the Commission since 2014, for some of the parties concerned (e.g. Ireland in *Apple*) have already announced that they will sue the CJEU, alleging the unlawfulness of the Commission's conclusions. Indeed, the Court will perhaps have to decide once and for all if art. 107(1) allows the applicability of the notion of "selective advantage", thereby understanding a unitary conception of the two elements of selectivity and advantage ([505]).

[505] In fact, Arena further observed that: *"spetterà ai giudici dell'Unione pronunciarsi in ordine al principio di libera concorrenza (arm's length principle) come declinato dalla Commissione* […] *La CGUE dovrà, poi, determinare se le agevolazioni fiscali concesse attraverso i tax rulings contestati possono ritenersi finanziate mediante risorse statali anche quando, in ipotesi, aumentino il gettito fiscale complessivo* […]*, l'annullamento delle decisioni negative sarebbe probabilmente percepito come il riconoscimento, da parte della CGUE, dell'insindacabilità dei poteri sovrani degli Stati membri nel settore della tassazione diretta* […] *La conferma della validità delle decisioni della Commissione relative ai tax rulings, invece, sarebbe senza dubbio accolta da forti critiche a livello nazionale, accompagnate peraltro dalla consapevolezza che*

Furthermore, the Court's case-law is also extremely important from another perspective. As implicitly affirmed in *Hornbach-Baumarkt*, the lack of a breach art. 107(1) does not entail that a measure is not likely infringe other Treaty provisions being equally binding upon the Member States, as also less recent Court rulings show (e.g. *Denkavit*). In fact, if the granting of a Ruling may, in principle, imply a breach of the State aid prohibition whenever the elements for the application art. 107(1) exist *in casu*, the refusal to grant a ruling may on the other hand be found in conflict with other principles of EU law, *e.g.* the freedom of establishment ex art. 49 TFEU the free movement of capital ex art. 66 ff. TFEU.

Finally, the *Hornbach-Baumarkt* judgement is also important in the light of the fact it constitutes an example of how the Court recognized the relevance of the arm's length principle and of transfer pricing practices not only in situations concerning illegal State aid, but under EU law in general.

The described legal framework has indeed proven to be flexible and effective. Nevertheless, this is not enough. Indeed, harmful tax competition continues to be a relevant threat to the integrity and fairness of infra-European and extra-European trade.

As it has been suggested, a general international and supra-European solution is perhaps needed. In fact, the European State aid prohibition law has been criticised, although mainly referring to the s.c. "new approach" of the European Commission in matters of Tax Rulings. However, by doing so, commentators have more or less explicitly acknowledged that while the system at stake might rise doubts from a theoretical point of view, it has on the other hand granted an efficient enforcement of the European treaty rules on State aid. For this reason, in order to impede that national unilateral tax measures may alter competition in international trade, commentators have suggested to introduce a more robust anti-subsidy mechanism within the framework of the World Trade Organization, based and inspired by the European experience concerning art. 107(1) ff. TFEU. Nevertheless, it has been pointed out that such a reform has very few possibilities to be actually carried out, for the members of the WTO are interested in maintaining the *status*

determinate misure di concorrenza fiscale sleale non sono più al di fuori della portata della Commissione" (Amedeo Arena, *op. cit.* (2017), at 964-965).

quo, impeding further limitations of their economic sovereignty. On the other hand, problems also concern the legal framework under which unfair or illegal Tax Rulings are caught under EU law. Indeed, *tout court* reliance on arts. 107 and 108 TFEU is not sufficient for an effective protection of the competitive environment of the internal market with respect to harmful national tax arrangements. Therefore, steps for further harmonization have been undertaken.

There are two main important proposals on the table. On one hand, it has been suggested that it could be necessary to introduce a new body, a "European Ruling Committee", having the aim to secure better cooperation and to grant the Union with a more effective overlook on the rulings that might be issued by national tax administrations of the Member States. However, the powers of the body concerned should remain limited, for the role of the ultimate enforcer of the State prohibition shall continue to belong to the European Commission, as being the Institution having the highest degree of expertise and legitimacy. On the other hand, if such a solution would certainly improve the efficacy of the existing State aid law enforcement mechanism, this would not solve the problem of harmful tax competition in the internal market of the European Union.

For this reason, an even more radical reform should be deemed necessary. In particular, in 2016 the European Institutions have dusted off a project which had been already conceived in the early 2000s. The latter consists in introducing the s.c. "Common Consolidated Corporate Tax Base" (CCCTB), thereby harmonizing the tax base for business profits. In fact, this arrangement would not only facilitate the Commission's assessments on the unlawfulness of tax rulings and legislations, but it would definitely neutralize the harmful effects of cross-border infra-group transfer pricing transactions.

However, as the Directive on the CCCTB should be adopted pursuing art. 115 TFEU, the inherent rule-making power entirely relies on the Council of the European Union, acting through the extra-ordinary legislative procedure which requires unanimity. On these grounds, it is extremely unlikely that the Governments of the Member States may find an agreement on the percentage amount of the tax base and even on the terminology which may be used. Thus, because of the relevant differences which may exist from Member State to Member State in the field of tax law and, furthermore, because of the likely resistance of some other Countries which economy could be factually harmed by a harmonization like the one at issue (notably Luxembourg and Ireland first).

This shows how the main obstacle to an effective solution to the problem harmful tax competition, not only internationally but also at European level, ultimately consists in the recognition of the Member States' sovereignty in tax matters. More precisely, for what concerns the EU, in the lack of any expressed Treaty provision empowering the Union to exercise its law-making powers in the field of direct taxation, excepting taxation on business profits, the full sovereignty of the Member States in matters of direct taxation-setting still constitutes a generally accepted fundamental principle of EU law, limited only by the prohibition of discrimination ex arts. 18 and 110 TFEU.

For this reason, at least according to short-term and medium-term perspective, solutions based on political and governmental cooperation rather than on legally binding arrangements seem to be the most appropriate ones. Indeed, this is the conclusion to which both the international community and the European Institutions already came in the drafting of respectively the OECD Guidelines and the EU Code of Conduct for Business Taxation. According to the same rationale, the European legislator has acknowledged that besides the lack of uniform rules for the calculation of tax bases for direct taxation, another important aspect which enhances the harmful effects of unfair national tax rulings is the lack of transparency. On these grounds, the EU Institutions have started to react in the last years, weighing down the information duties imposed upon national tax administrations. Indeed, with a series of Directives, the European Council has substantially reformed the already existing Dir. 2011/16/EU on administrative cooperation in the field of taxation. In this respect, an important innovation is represented by the amendment carried out through Dir. 2015/2376, which has introduced a definition of "advance cross-border ruling" and of "advance pricing agreement" in a hard law instrument for the first time. In fact, this extended the mandatory information regime already provided by Dir. 2011/16/EU to any kind of aid measure, including administrative arrangements.

Furthermore, it has been observed that EU law, and thereby also the principles inherent to Treaty rules, may be considered a living instrument, as subject to the continuous evolution characterizing the European political and legal dimension. Therefore, as this will probably have an impact on the European State aid rules with respect to the State concerned, particular considerations may be finally drawn with respect to the imminent withdrawal of the United Kingdom from the Union, which will entail that Britain will not be bound neither by EU Treaty law nor by secondary law if no agreement will be concluded by the 29th March 2019. However, in order to grant access to the internal market to British undertakings, which is certainly crucial for British real economy and UK exports, it might be necessary for the British legislator to introduce State aid rules on its own, as this constitutes probably one of the main concerns of the European Commission in the Brexit negotiations in the light of the need to grant fair competition in the common market. Thus, given that the possibility of the UK joining the EFTA is quite unlikely to be considered a valid option for political reasons. However, the extent and the content of the rules at issue still remains impossible to be known in advance, for there are still different proposals on the table.

Anyway, in the light of the above exposed, the fundamental conclusion which might be drawn is that the existing legal framework, as well as the recent reforms, while being absolutely useful to improve the efficiency of the whole regulatory and enforcement system, are on the other hand far from providing a solution at source to the problem of harmful tax competition. Indeed, it should not be forgotten that, while existing since the 50s in the form of the European Community of Steal and Coal, the Union particularly and strongly evolved in the last two decades only. In fact, foremost after the Treaty of Maastricht and Lisbon, the Union has been subject to fundamental and appreciable structural changes, thereby including also the joining of the Eastern European States in the early 2000s.

For this reason, it is perhaps time to acknowledge that rules drafted more than sixty years ago, although they have tried to be adapted to the development steps of the Community through various subsequent reforms of the Treaties, may not be suitable anymore to regulate a geographic dimension which has more than quintupled over time. This is of particular importance also with regard to the fact that, besides the Treaty provisions, the attempts for reform which have been undertaken in the recent years have all been carried out through the instrument of Directives, which do not have direct effect in the legal orders of the Member States, the principles established in *Francovich* apart ([506]). Indeed, Directives might have been an effective instrument to coordinate the Member States' legal policies in the Community's early decades, but they might be considered an arrangement which is on the road towards obsolescence when it comes to the need to approximate the laws of twenty-eight different States, all having distinct regimes and own legal principles, peculiarities and administrative practices.

Accordingly, it is unlikely that the efforts to secure co-ordination under the existing legal principles of EU law will lead to a permanent and definitive solution to the problem of harmful tax competition. Clearly, a radical solution necessarily requires a radical reform, which may be effectively provided only through legally binding instruments such as *ad hoc* Treaty provisions or Regulations. In fact, the only existing proposal which could have really effective chances to put an end to harmful national tax practices in the framework of the EU internal market is the one concerning the establishment of the CCCTB, as the introduction of a common tax base is really the only mean by which the negative effects which unfair cross-border transfer pricing practices have on competition may be fundamentally prevented.

Nevertheless, as said, the Member State's sovereignty in matters of direct taxation, combined on one hand with the requirement of unanimity set forth by art. 115 TFEU and with the weaker nature of the related Directives compared with the direct efficacy granted by EU Regulations on the other, represents a significant and quite insurmountable obstacle to a solution of that kind. Thus, at least in the lack of a concrete will of the Member States (or of certain Member States) to effectively cooperate to find a real and stable solution at European level. On these grounds, we may fundamentally conclude that the European Commission's "new approach" in matters of tax rulings has certainly contributed to promote the awareness about the harmful tax practices of national tax administrations, which effectiveness is often based on the flexible nature of tax rulings themselves. Indeed, trans-national cooperation might certainly increase the efficiency of the whole State aid law

[506] Case C-6/90, *Andrea Francovich and Danila Bonifaci and others v Italian Republic* (1991), ECLI:EU:C:1991:428.

enforcement system also with respect to such administrative instruments having a quite insidious character, for they have proven to be an efficient mean for national administrations to carry out “golden plating” practices. However, it should be concluded that a radical and permanent solution to the problem of harmful tax competition in the internal market might be realized only through a general and radical re-conception, on one hand, of the Treaty law on competition and State aid and, on the other, of the role of the Member States, with a further empowerment of the European Institutions in the field of direct taxation.

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State Aid and Tax Rulings: The Problem of Harmful Tax Competition.

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SUMMARY

The term "tax ruling" generally identifies administrative arrangements which determine how the tax base related to a certain transaction or income will be calculated by the concerned national tax administration.

In the framework of the European Union, tax rulings have become a precise target of the European Commission's investigations pursuing art. 108 TFEU since 2013, under the s.c. State Aid Modernization programme, representing the "new approach" of the Commission in matters of tax aid.

In fact, the most relevant legal framework in which tax rulings fall under EU law is represented by the provisions on State aid contained in the Treaty on the functioning of the European Union. While being distinct from the Treaty articles concerned with competition law *strictu sensu* (arts. 101 and 102), the rules on State pursue fundamentally the main purpose from another perspective. In fact, according to art. 3 of the Treaty, the establishment of a competition-based internal market constitutes one of the main goals of the Union. In fact, inspired by the model of the s.c. *"Soziale Marktwirtschaft*", besides the action of private market players, the European economic dimension is also characterized by the possibility for public authority not only to act as a "market regulator", but also to actively intervene in economy, although to a certain extent. For this reason, the State aid rules are meant to prevent the behaviours of the authorities of the Member States of the European Union, by favouring domestic companies and economy, from altering the

competitive structure of the single market.

Indeed, this shows that the concept on which the very economic dimension of the Union is based is the one of “competition”. Besides classical competition between private manufacturers and companies, a certain importance shall be attributed to competition between States too, for this is even the most ancient form of political and economic competition.

In an Era in which international economy has been fundamentally globalized, the most common form of competition between public authorities consists in the s.c. “regulatory competition”, thereby understanding the phenomenon according to which national legislators “compete” with each other through the use of national law to grant the most favourable economic conditions in order to better attract foreign investments in their own national context, thereby possibly generating a “race to the bottom”.

One of the main fields in which such form of confrontation realizes itself the most is certainly the field of taxation. Indeed, through the decrease of the tax burden, the legislative or administrative authorities of the States usually try to attract foreign companies, for this will better grant economic growth at national level.

Although it might also have beneficial effects, the degeneration of the concerned dynamic is likely to produce the s.c. “harmful tax competition”, having the effect to advantage some States by hampering the economy of other States, improving instability in international politics, economy and trade.

For this reason, the international community has tried to find a common solution to prevent the recourse of national administrations to internationally unfair tax practices. The most important framework in this regard is the one of the OECD, with a main reference to its BEPS programme (Base Erosion and Profit Shifting).

At European level, the urgency to find common solution is even deeper, provided that the EU itself is based on a common room in which any kind of barrier to intra-community trade has been (or should be) radically abolished. In this respect, the EU has pursued a “double path”. On one hand it tried to strengthen infra-Member State coordination through the adoption of a soft law approach, mainly represented by the Code of Conduct for Business Taxation, containing recommendations to the Member States' government to avoid potentially harmful tax practices. On the other hand, the European Institutions have harmonized the national laws concerning some particular cross-border aspects of profit taxation (*e.g.* see the s.c. "parent-subsidiary" Directive).

However, the most important legal framework when it comes to the need to counter harmful tax competition in the internal market is nowadays represented by the rules on State aid contained in the TFEU. According to art. 107(1), indeed, a measure is considered to be unlawful when the following conditions are fulfilled: i) the measure is granted through the direct or indirect use of State resources, ii) the measure is addressed to selected companies, iii) the measure confers an undue advantage to the companies concerned, iv) the advantage is liable to hamper competition or trade in the internal market. Moreover, some commentators have rightfully pointed out that a further condition for the applicability of the prohibition of aid contained in the mentioned provision consists in the attributability of the measure to the Member State.

Indeed, there are exceptions. While Art. 107(2) contains the mandatory ones, which should apply in any case, art. 107(3) contemplates the discretionary exceptions, thereby understanding those grounds for a possible exclusion of the application of art. 107(1) TFEU which are susceptible to be evaluated by the European Commission from case to case. Moreover, aids may also escape the prohibition through the s.c. *de minimis* justification, the block exemption and any other exception established through the procedure contemplated in art. 109 TFEU.

Clearly, these rules have been further developed by the case-law of the CJEU and the practice of the Commission over time.

On the other hand, art. 108 TFEU provides the procedural rules for the enforcement of art. 107(1). Indeed, the article concerned imposes upon the Member States a duty to notify to the Commission any measure implying possible unlawful aid, while it attributes to the Commission itself the role of the quasi-exclusive enforcer of art. 108 TFEU, provided that a small role may also be played by national Courts and that the Commission's decisions may ultimately be challenged before the CJEU.

The framework of the State aid rules is the one which is the most relevant when it comes to the issue of tax rulings, for since *De Gezamenlijke Kolenmijnen*, the Court of Justice of the European Union has recognized the principle of the irrelevance of the form of the aid, entailing that, on one hand, also favourable tax measures may provide illegal advantages according to art. 107(1) and that, on the other, not only legislative instruments, but also administrative arrangements may in principle provide unlawful aid.

It shall be noted that, in the framework of the EU, there is no legally binding general definition of tax ruling, thereby entailing that the notion itself has been mainly constructed through judicial and administrative practice.

However, the EU Institutions consider that the notion of "tax ruling" embraces any kind of administrative arrangement dealing with the calculation methodologies for the determination of a tax base and referred to the taxpayer which has requested it to the competent administration.

Tax rulings may be formal or informal, depending of the predetermination of an administrative procedure according to which those arrangements might be issued. The two most important categories of rulings are "Advance Tax Rulings", consisting in unilateral administrative statements, and "Advance Pricing Agreements" (APA), being instead negotiated between the taxpayer and the concerned administration.

Indeed, while tax rulings are not to be considered illegal *per se*, their aim to communicate to the taxpayer the ways and methods by which the future tax base related to a certain transaction or income will be calculated by the national tax administration may have profiles which are likely to infringe art. 107(1).

In fact, rulings may be used foremost with respect to cross-border profit shifting practices to grant illegal advantages, mainly to multinational group companies. In particular, there are three kinds of situations in which national tax rulings have proven to be crucial: namely with regard to mismatches established by two different national regimes, to taxation on share profits and to transfer pricing transactions.

Mismatches between the Member States' national legislation may indeed confer an unjust advantage to certain companies, for instance when the combination of the provisions of the two national tax regimes *de facto* exonerates a multinational group company to pay its taxes in either States. However, as the measure is not attributable to one of the Member States concerned in general, the advantage may not be considered unlawful as long as it is not proven that the mismatch has been generated deliberately.

Secondly, shar profit taxation might be relevant with respect to taxation on accrual base, adopted for instance in Denmark, when it is applied in a distinct way with respect to listed and unlisted companies.

Nevertheless, the field in which rulings have been proven to be most effective and which did attract the main attention of the European Commission is the one of transfer pricing.

Indeed, as two group companies based in different Member States transact between each other in order to shift the profits of the group in a State in which they will be taxed at lower rates, the internationally recognized practice mainly embodied by the arrangements adopted within the OECD requires the application of the s.c. “arm’s length principle”, according to which the tax base applicable to the transaction should be the one which would have resulted if the transaction would have been concluded by two independent companies. This factually entails that the “correct” transfer price which should be applied to transaction actually consists in the market price related to the product or service constituting the object of the transaction.

Doubts may arise with respect to the situation in which, in the lack of a real market price for the object of the transaction, the fair price is established authoritatively by public authority, for this would be quite illogical. However, in principle this does not give rise to theoretical problems as far as the European framework is concerned, for the determination of a virtual market price seems to be reasonable and coherent with the need to secure a balanced competition in the internal market in the light of the model of Social Market Economy.

In respect to this, it shall be observed that while the European Commission has acknowledged the adherence of the Member States’ legal orders and the practical importance of the OECD Guidelines on Transfer Pricing in the matter of the arm’s length principle, the Commission has adopted its own approach towards the latter principle. In fact, it also affirmed that the arm’s length principle does not derive from the framework of the OECD as it is rather inherent to art. 107(1) TFEU itself.

Accordingly, between 2016 and 2014 the Commission applied its own approach in the recent decisions on national tax rulings granting unlawful aid to *Apple*, *Starbucks*, *Fiat*, *Amazon* and other multinational companies (*Excess Profit*) mainly provided by the Member States of the Benelux and of the British Isles.

Some commentators (mainly from the US) have however strongly criticized the application of the Commission's new approach; thus, mainly for three reasons.

First, because it has been argued that the Commission wrongly applied EU law allowing retroactive recovery; secondly, because it is alleged that the Commission infringed the general principle of administrative law hampering the efforts which have been undertaken at international level to counter harmful tax competition; thirdly, because the Commission incorrectly collapsed the notions of selectivity and advantage.

Although founded, the mentioned criticism seems not to be really convincing. However, for what concerns the latter argument, it may be observed that the CJEU, while often endorsing the reasonings adopted by the Commission in its Decisions, seems to agree with the fact that the notions have to be conceived as two separate elements of the prohibition laid down in art. 107(1) TFEU, mainly with reference to the *Autogrill* and *Banco Santander* cases. However, also because the Court has expressly used the notion of "selective advantage" in *World Duty Free Group*, the real limits for the possibility to interpretatively collapse the two notions at stake still seem to be unclear.

On the other hand, as *Denkavit* and *Hornbach Baumarkt* show at last, it is important to stress that even if art. 107 TFEU still remains the most important treaty provision when it comes to the issue of tax rulings, the Court has recognized that such instruments may be in principle liable to collide with other principles established by EU law, such as the free movement of capital ex arts. 66 ff. and the freedom of establishment ex art. 49 TFEU.

Moreover, despite the criticism, *McDonald's*, *Engie*, *British CFC* and *Inter Ikea Systems* show that the Commission is still enforcing the State aid rules in accordance with the "new approach". However, the European rules on State aid have not proven to be a sufficient instrument to solve the problem of harmful tax competition.

At international level, some commentators have suggested to strengthen the anti-subsidies rules provided within the framework of the WTO, taking the arts. 107 and ff. TFEU as a source of inspiration. Although this might contribute to a more effective prevention of harmful tax competition at ultra-European level, this seems not to be a realistic option yet.

At EU level, steps forward have been undertaken to secure better administrative cooperation, *inter alia* extending the mandatory information exchange regime to national tax rulings through Reg. 2015/2376/EU.

On the other hand, a more radical reform needed. The best option on the table is represented by the proposal to elaborate a common tax base for business profits (the CCCTB). However, this path seems not to be viable yet, due to the related political and legal difficulties.

In this respect, it should be noted that the main obstacle to a stable and lasting solution to the problem of harmful tax competition at both international and European level is represented by the full sovereignty recognized upon the Member States in matters of direct taxation.

Lastly, it should be noted that the withdrawal of the UK from the EU following the ‘Brexit’ referendum of June 2016 will require an adaptation of the State aid rules to the coming new relationship which will be established between the Union and Great Britain. Thus, again underlining the evolving nature of the State aid rules and of EU law in general.