# Opinion Statement ECJ-TF 1/2020 on the General Court decisions of 24 September 2019, in Cases C-760/15 & T-636/16, *The Netherlands v. Commission (Starbucks)*, and Cases T-755/15 and T-759/15, *Luxembourg v. Commission (Fiat Finance and Trade)*, on State Aid granted by transfer pricing rulings

## Prepared by the CFE ECJ Task Force
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**The CFE Tax Advisers Europe note that these decisions are the first of a series of expected judgments concerning the legality of the EU Commission´s decisions considering as prohibited State Aid some transfer pricing rulings granted by Member States to Multinational Enterprises. The General Court reaches different verdicts. Whereas in Starbucks, it annulled the EC's decision, in Fiat it upholds, ordering Luxembourg to recover the aid.**

**Despite the different outcomes, the judgments have several commonalities as to how the General Court has interpreted the applicable European law on State Aids to tax matters. Therefore, they may provide an indication of how the Court will decide similar pending cases. In addition, the judgments are of paramount importance to understand: i) the role and limits of the Commission in reviewing rulings granted by Member States; ii) the role of the OECD's arm's length concept and of the OECD TP Guidelines in assessing the Treaty on the Functioning of the European Union prohibition of State Aid, and; iii) the level of evidence that has to be provided by the parties in these procedures. However, the importance of these two judgments should not yet be over-emphasised. Although the Commission has apparently decided not to appeal on *Starbucks*, the appellants in *Fiat Finance* will do so, thus asking for a final resolution by the Court of Justice of the European Union.**

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This is an Opinion Statement prepared by the CFE ECJ Task Force[1] on Cases T-760/15 and T-636/16, *The Netherlands v. Commission (Starbucks)*[2] and on Cases T-755/15 and T-759/15 *Luxembourg v. Commission (Fiat Finance)*,[3] decided by the General Court (GC) on 24 September 2019.

These are just the first of a series of expected judgments concerning the legality of the EU Commission´s (hereinafter EC) decisions considering as prohibited State Aid some transfer pricing (hereinafter TP) rulings granted by Member States to Multinational Enterprises (hereinafter MNEs)[4].

The GC reaches different verdicts. Whereas in *Starbucks*, it annulled the EC's decision, in *Fiat* it upholds, ordering Luxembourg to recover the aid. Despite the different outcomes, the judgments have several commonalities as to how the GC has interpreted the applicable European law on State Aids to tax matters. Therefore, they may provide an indication of how the GC will decide similar pending cases. In addition, the judgments are of paramount importance to understand: i) the role and limits of the Commission in reviewing rulings granted by Member States (hereinafter MS); ii) the role of the OECD's arm's length concept and of the OECD TP Guidelines in assessing the Treaty on the Functioning of the European Union (TFEU) prohibition of State Aid, and; iii) the level of evidence that has to be provided by the parties in these procedures.

The importance of these two judgments should not yet be over-emphasised. Although the Commission has apparently decided not to appeal on Starbucks, the appellants in Fiat Finance will do so, thus asking for a final resolution by the Court of Justice of the European Union (ECJ). The latter is not bound to follow the GC and may decide the matter on points on law in a way that deprives the current judgments of their jurisprudential value.[5] That being the case, the GC conversely would have to follow the ECJ's reasoning in future decisions as to the interpretation of EU law on State Aid.

In the meantime, however, these GC judgments are the best guidelines that MNEs and Member States have (and will have in the near future) as concerns the admissibility of their TP rulings in light of the EU State Aid rules.

Given the length of the two judgments and amount of covered topics, this statement will only focus on issues considered of interest for understanding the GC's reasoning and impact.

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Unlike the usual format of the Opinion Statements (OS) of the CFE ECJ Task force, this Statement does not address the issue on the basis of a single decision but rather by taking into account the first two decisions of the General Court (GC) regarding a long series of final decisions by the EU Commission considering that rulings granted by certain EU Member States to their residents (MNEs) on transfer pricing issues were prohibited State Aid.

[2] ECLI:EU:T:2019:669.

[3] ECLI:EU:T:2019:670.

[4] There was an earlier judgment of 14 February 2019 on a similar topic, *Magnetrol International and Belgium vs Commission*, Joined Cases T-131/16 and 263/16, ECLI:EU:T:2019:91. However, the GC dismissed the case the EC had failed to provide evidence that all situations covered by the Belgium "excess profit tax" regime would lead necessarily to a benefit. The judgment of the GC was appealed and is now pending before the Court of Justice as C-337/19.

[5] In the past there have been other occasions of divergent opinions between the CJEU and the GC, including on State Aid in tax matters, such as in the Gibraltar judgments (on which see GC, 18 December 2008, Joined Cases T-211/04 and T 215/04, ECLI:EU:T:2008:595 and CJEU, 15 November 2011, Joined Cases C-106/09 P and 107/09 P, ECLI:EU:C:2011:732.

# I. Background and judgment of the GC

## I.1 Starbucks

### I.1.1 Issues

1. The GC was asked to annul an EC decision on an Advance Pricing Agreement (hereinafter APA) granted by the Netherlands to Starbucks Manufacturing EMEA BV (hereinafter SMBV), a Dutch subsidiary of the Starbucks corporation (US), which was indirectly controlled through a subsidiary, Alki, a tax resident of the UK.
2. SMBV was basically a manufacturer, buying beans and roasting coffee and distributing it alongside with related products to Starbuck shops in Europe, the Middle East and Africa.[6] It concluded a roasting agreement with Alki by which it obtained the use of the intellectual property needed for the roasting and distributing coffee, in exchange for the payment of royalties.
3. In 2008, SMBV and The Netherlands concluded an APA for the determination of SBMV's taxable base, with a duration of 10 years. It established that: i) the method for determining the base would be the transactional net margin method (hereinafter TNMM),[7] by reference to a certain percentage of the operating costs[8]; ii) the amount allowed to be deducted as royalty paid to Alki was computed as the difference between the SMBV's total revenue on the one hand, and SMBV's cost base increased by SMBV's remuneration (taxable base), on the other.[9]
4. In 2015, the EC decided that the APA amounted to State Aid, and ordered the recovery of corresponding aid.[10] The core of the discussion was on the requirement of selectivity. The EC followed the traditional three-step analysis to determine whether the measure was selective: i) reference system; ii) derogation; iii) valid justification.[11]
5. The reference system was the general corporate tax system of the Netherlands, which had the objective of taxing all companies subject to tax in the Netherlands. This meant that integrated and standalone companies "were in a comparable legal and factual situation, in the light of that objective and were therefore subject to corporate income tax without distinction".[12]
6. The measure (APA) would deviate from the reference system in so far as it was "a tax measure which results in an integrated company charging prices that did not reflect those which would have been charged in conditions of free competition, that is prices negotiated by independent undertakings negotiated under comparable circumstances at arm´s length" and that "conferred an advantage on that group company in so far as it resulted in a reduction of its taxable base and thus its tax liability under the ordinary corporate income tax system".[13] Thus, the EC had to "verify whether the methodology accepted by the Netherlands tax administration via the APA for the purposes of determining SMBV´s taxable profits in the Netherlands departed from a methodology that result[s] in a reliable approximation of a market-based outcome and, therefore, from the arm's length principle"[14]. The EC

[6] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 14.

[7] The ruling referred to "cost-plus" but in practice, as the GC concluded, the APA was in practice applying TNMM) - *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 187.

[8] Which excluded a significant part of the effective costs such as the cost of the green beans, the costs of the cups, napkins and similar and the logistics and distribution ensured by third parties or the royalties – *The Netherlands v. Commission* (T-760/15 & T-636/16), at para. 15.

[9] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 188.

[10] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 19.

[11] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 34.

[12] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 36.

[13] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 38.

[14] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 38. The expression "eliable approximation of a market-based outcome" is likely the most repeated expression on both judgments. See *The Netherlands v. Commission* (T-760/15 & T-636/16), paras. 38, 46, 50, 53, 54,

considered that the "arm's length principle necessarily formed an integral part of its assessment, under Art. 107(1) TFEU, of the tax measures granted to integrated companies, independently of whether a Member State had incorporated that principle into its national legal system".[15]

7. Following this reasoning, the EC concluded that there was prohibited State Aid and ordered the recovery of the "difference between the tax that should have been paid on the basis of that price and the amount actually paid under the APA".[16]

### I.1.2 Judgment

8. The Court decided to "annul the contested decision in its entirety".[17]

9. For the purposes of this OS, we find it useful to focus on the following two issues analysed by the GC judgment, namely i) the infringement of the MSs fiscal autonomy; ii) the existence of prohibited State Aid granted through the APA.

#### I.1.2.1 Infringement of the MS's fiscal autonomy

10. The GC considered that the examination in the light of the arm's length principle specific to the EU forms part of its analysis of the selective advantage.[18] And, "[w]hen national tax law does not make a distinction between integrated undertakings and standalone undertakings for the purposes of their liability to corporate income tax, that tax law is intended to tax the profits arising from the economic activity of such integrated undertaking as though it had arisen from transactions carried out at market prices".[19] Furthermore, Art. 107(1) TFEU, "allows the Commission to check whether that pricing corresponds to pricing under market conditions".[20]

11. Arm's length is described as a "useful tool"[21], a "benchmark"[22] and a "methodology"[23] to check whether the taxable profit of an integrated undertaking pursuant to a tax measure corresponds to a reliable approximation of a taxable profit generated under market conditions".[24]

12. As for the OECD TP Guidelines, they do not bind the EC but are not deprived of relevance as they have a "practical significance in the interpretation of issues relating to transfer pricing" given that they i) "are based on important work carried out by groups of renowned experts"[25], and; ii) "reflect the international consensus achieved with regard to transfer pricing"[26].

13. As concerns the legal basis for the arm's length, the GC followed the Commission's reasoning that the arm's length principle: i) necessarily formed an integral part of the examination, under Art. 107(1) TFEU, of tax measures granted to group companies", and that; ii) was "a general principle of equal treatment in taxation, which fell within the application of Art. 107 TFEU"[27].

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57, 140, 152, 196, 199. 201. 202. 212, 213, 395, 416, 418, 425, 428, 474, 512, 532 and 555. and *Luxembourg v. Commission* (T-755/15 & T-759/15), paras. 25, 43, 121, 132, 176, 204, 207 and 412.

[15] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 38.

[16] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 64.

[17] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 561.

[18] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 137.

[19] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 149.

[20] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 151.

[21] *The Netherlands v. Commission* (T-760/15 & T-636/16), paras. 151, 152, 157, 163, 169 and 199. In the French language version the GC uses the expression "un outil permettant d'effectuer cette verification".

[22] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 151.

[23] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 152, 154, 196.

[24] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 152.

[25] The French language version mentions only "experts".

[26] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 155.

[27] *The Netherlands v. Commission* (T-760/15 & T-636/16), paras. 139 (for the position of the EC), 162 and 168. This would not be a "general principle of equal treatment" but merely "a tool enabling [the Commission] to check that intra-group transactions are remunerated as though they had been negotiated between independent companies".

14. The GC recognised that arm's length does not lead to a precise result and that, as a consequence, there would be an advantage "only if the variation between the two comparables goes beyond the inaccuracies inherent in the methodology used to obtain that approximation".[28]

#### I.1.2.2 Aid granted through an APA

15. As concerns the amount that could be deducted as royalties paid to Alki, the GC considered that: i) a methodological error in the application of the arm's length was not sufficient to prove that there was a non-market based outcome[29]; ii) the EC provided no evidence that the comparable uncontrolled price (hereinafter CUP) method should have priority over the TNMM or that the latter "necessarily leads to a result that is too low".[30] Furthermore, it considered that the EC failed to provide reasons why the amount of royalties paid to Alki should have been zero.
16. Concerning the acquisition of green beans, the GC concluded that the EC failed to provide evidence that the method used for determining the price paid was part of the APA or, if this was the case, that it represented an advantage.[31]
17. The GC considered that the EC had failed to provide evidence why choosing the SMBV as the tested party for the purposes of the application of the TNMM led to a reduction of the taxable profit and dismissed the claim. It also stated that the EC had failed to show that eventual methodological errors in the determination of the functions and SMBV's profits (namely the choice of profit level indicator and the choice of adjustments) lead to an advantage as it would not be a reliable approximation of a market-based outcome.

## I.2 Fiat Finance and Trade

### I.2.1 Issues

18. The case concerned a ruling granted by Luxembourg to Fiat Chrysler Finance Europe, formerly Fiat Finance and Trade (hereinafter FFT), a Luxembourg subsidiary of the FIAT/Chrysler group. FFT provided treasury services and financing to the group (except for those located in Italy).
19. In 2012, Luxembourg granted FFT a ruling with a duration of five years. This ruling established that: i) the taxable base for the intra-group activity could be set using the TNMM; ii) when applying such method, FFT could segment its equity capital. Accordingly, its taxable base would be composed by two amounts: i) "a 'risk remuneration', calculated by multiplying FFT's hypothetical regulatory capital of EUR 28,500,000 estimated by applying the Basel II framework by analogy, by the pre-tax expected return of 6.05%, estimated using the Capital Asset Pricing Model ('CAPM')"; ii) "a 'functions remuneration', calculated by multiplying what is designated as FFT's capital used to perform the functions, estimated as EUR 93,710,000, by the market interest rate applied to short-term deposits, estimated to be 0.87%"[32].
20. In October 2015, the EC decided that the ruling amounted to State Aid[33] and ordered the recovery of the corresponding aid.
21. The Commission followed the three-step analysis and a reasoning quite similar to the one described previously.[34] It all boiled down to determining whether the ruling "departed from a methodology that

[28] *The Netherlands v. Commission* (T-760/15 & T-636/16), paras 152 and 427.
[29] *The Netherlands v. Commission* (T-760/15 & T-636/16), paras. 204 and 205.
[30] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 212.
[31] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 374 et seq and particularly 380.
[32] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 11.
[33] Commission Decision of 21 October 2015 SA.86375 (2014/Cex2014/NN), C(2015) 7152 final.
[34] *The Netherlands v. Commission* (T-760/15 & T-636/16), paras. 22, 23 and 24.

led to a reliable approximation of a market-based outcome and, thus, from the arm's length principle".[35] The EC considered that this was not the case because: i) first, and for the purposes of applying TNMM, the ruling should have opted for the accounting equity (capital) instead of the hypothetical regulatory capital; ii) second, because the hypothetical regulatory capital was underestimated; iii) third, because several deductions from FFT's remaining capital shouldn't have been allowed; iv) fourth, because "the choice of a beta of 0.29 when using the CAPM to determine the return on capital to be applied to FFT's hypothetical regulatory capital resulted in a profit allocation to FFT that was not in line with the arm's length principle".[36]

### I.2.2 Judgment

22. Unlike in the Starbucks case, the GC dismissed the request for annulment of the Commission's decision.

23. For the purposes of this OS, we find it useful to focus on the two following arguments analysed by GC in this case, namely i) tax harmonisation in disguise; ii) existence of prohibited State Aid.

#### I.2.2.1 Tax harmonisation in disguise

24. As in Starbucks, the GC concluded that "Article 107(1) TFEU allows the Commission to check whether the pricing of intra-group transactions, accepted by the national authorities for determining the taxable base of an integrated undertaking, corresponds to prices that would have been charged at arm´s length".[37]

25. There are, however, a couple of additional clarifications. First, the GC rejects FFT's claim that "the Commission's position on the arm's length principle departed from its previous practice in taking decisions", since "that practice in other cases cannot affect the validity of a contested decision, which can be assessed only in the light of the objective rules of the FEU treaty".[38] Second, it rejected FFT's claim that the arm's length principle used by the Commission differed from the OECD one, namely because it did not allow for appropriate adjustments.[39] The GC noted that the OECD Transfer Pricing Guidelines do not bind the EC, that the EC had not ruled out the possibility of making adjustments[40] and that FFT had not provided evidence why the exclusion of adjustments would turn the arm's length principle used by the Commission into an incorrect method.[41] Third, the EC's decision did not infringe legal certainty[42] and legitimate expectations.[43]

#### I.2.2.2 Existence of State Aid

26. Luxembourg claimed that there was no advantage and rebutted the (five) methodologic errors identified by the Commission regarding the amount of capital to be remunerated (namely the profit level indicator) and the rate of return of that capital.

27. In this case, the GC focused on the segmentation of the capital. It considered that, in the application of the TNMM, all equity capital should have been considered since i) capital is, by nature, fungible;[44] ii) segmentation is neither authorised nor prohibited, and thus, needs to be tested;[45] iii) "the total capital

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[35] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 25.
[36] *Luxembourg v. Commission* (T-755/15 & T-759/15), paras. 28-31.
[37] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 157.
[38] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 170.
[39] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 172.
[40] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 173.
[41] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 175.
[42] *Luxembourg v. Commission* (T-755/15 & T-759/15), paras. 180-184.
[43] *Luxembourg v. Commission* (T-755/15 & T-759/15), paras. 185-186.
[44] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 223.
[45] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 229.

is exposed to risk and is available to support FFT's solvency";[46] iv) the total capital is considered by the borrowers;[47] v) the segmentation is artificial, inappropriate, and does not correspond to the functions performed.[48] This allowed concluding that the ruling led to a non-market based outcome, regardless of any further considerations on the return rate on the capital.

28. The EC claimed that the beneficiary of the aid was the FIAT/Chrysler group as a whole "in so far as FFT formed an economic unit with the other entities within the group and that those entities had benefited from the tax reduction granted to FFT, given that the tax reduction necessarily had the effect of reducing the pricing conditions of its intra-group loans".[49] The GC accepted that conclusion.[50]

29. The GC rejected to take into account any possible neutralisation of the aid in other MS. First, because the lower taxes in Luxembourg were not lowered by higher taxes in another Member State. Second, because, even if that was the case, neutralisation would not alter the fact that the group obtained a benefit in Luxembourg.[51]

30. The GC dismissed Luxembourg's and FFT's claim that there was no selectivity since the measure had to be examined by reference to Luxembourg law and practice. And, as no justification had been put forward to support the deviation,[52] the derogation would amount to State Aid.

# II. Comments

## II.1 Introduction

31. As mentioned, this Opinion Statement will not focus on case-specific issues. The goal is to focus on critical issues in the GC's reasoning, highlighting its impact on the development of EU law in this area and the impact that it may have for MS and businesses throughout the EU.

## II.2 Application of the selectivity test

32. In both cases, the discussion was focused on the existence of a selective advantage. The GC followed the traditional three-step analysis test to assess selectivity considering: i) the reference system; ii) a derogation; iii) justifications for the derogation.

### II.2.1 Reference system

33. According to settled case-law, the reference system is the tax regime that a Member State would normally apply to the beneficiary of the measure. The GC accepted the EC's view that the reference system would not be the applicable domestic law provisions, but the "object" of the CIT system, which was to tax all the profit of integrated and standalone companies. This seems to be in line with the position already adopted by the Court in *Gibraltar*[53] and *World Duty Free*.[54]

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[46] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 238.
[47] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 241.
[48] *Luxembourg v. Commission* (T-755/15 & T-759/15), paras. 242, 246 and 250.
[49] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 38.
[50] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 316.
[51] *Luxembourg v. Commission* (T-755/15 & T-759/15), paras. 316-318.
[52] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 363.
[53] Judgment of 15 November 2011, *Commission and Spain / Government of Gibraltar and United Kingdom* (C-106/09 P and C-107/09 P, ECR 2011 p. I-11113) ECLI:EU:C:2011:732, para. 75.
[54] Judgment of 21 December 2016, *Commission / World Duty Free Group* (C-20/15 P and C-21/15 P) ECLI:EU:C:2016:981, para 31, 54, 57, 58 and 60.

### II.2.2 Derogation

34. In the second place, one needs to assess if the measure derogates from the reference system, differentiating "between economic operators who, in the light of the objectives intrinsic to the reference system, are in a comparable legal and factual situation".[55] For the GC, the EC provided enough evidence of this derogation.

### II.2.3. Justification

35. The selectivity exam requires the assessment of justifications, i.e. domestic reasons that would have a dimension of weight that would be higher than the EU interest underlying Art. 107(1) TFEU. The GC dismissed any examination on the basis of the burden of proof, noting that nothing had been alleged by the appellants.

## II.3 The arm's length inherent to Art. 107(1) TFEU

### II.3.1. Legal basis for the EU arm's length principle: arm's length as a corollary of the State Aid prohibition

36. Both GC judgments are based on the fundamental premise that insofar as domestic law does not distinguish between standalone and integrated companies, arm's length may be used in the review pursuant Art. 107(1) TFEU.[56] This line of reasoning endorses the view of the EC based on the arguments accepted by CJEU in the Forum 187 case.[57] The GC did not object to the EC's view that "the arm's length principle necessarily [forms part of the] assessment, under Art. 107 TFEU, of tax measures granted to group companies, irrespective of whether the Member State had incorporated that principle into its national legal system".[58] These assumptions allow the EC to go beyond the intricacies of domestic TP law and to create a common framework for the review of the rulings based on the general CIT principle of taxation of market income. Arm's length, as an approximation of this market-income between associated enterprises, therefore, appears as a (new) limit to a State's sovereignty in direct tax matters.
37. However, this premise may not be accurate for the following reasons:

    a) Art. 107(1) TFEU is part of the competition agenda of the Treaty and prohibits MS from granting selective aid to undertakings. It aims to ensure free competition and, consequently, economic efficiency within the internal market.

    b) Art. 107(1) TFEU does not indicate how states should treat undertakings. It merely restricts states to grant selective aid insofar as it distorts competition. It does not allow the extraction of substantive rules on how states have to treat their undertakings.

    c) Art. 107(1) TFEU, a fortiori, is not part of the tax agenda of the Treaty and does not set rules on how MS shall tax undertakings subject to its tax jurisdiction. It merely prohibits them from using the tax system to grant illegal or unlawful State Aid.

    d) A potential harm to legal certainty may arise insofar as one extracts a principle and uses it for judicial review particularly when such principle has no support in the case law (or even legal doctrine) at the moment the ruling was granted.

    e) There is a certain petitio principii in the following GC's reasoning: i) arm's length is part of the EC's assessment, and thus it applies regardless of any domestic law provisions; ii) nonetheless, the definition

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[55] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 34 and *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 22.

[56] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 141 and *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 137.

[57] *CJEU, 22 June 2006, Joined Cases C-182/03 and 217/03, Forum 187 ASBL*.

[58] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 139 and *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 26, 131.

of the reference system requires taking into consideration the purpose of the domestic CIT system, and the conclusion that "that law is intended to tax the profit arising from the economic activity of such an integrated undertaking as though it had arisen from transactions carried out at market prices"[59]; iii) finally, and even if domestic TP systems were considered for the definition of the system of reference, they are not taken into account as sources of the content of the EU arm's length tool.

38. The GC may appear to assume that the arm's length pricing leads to a "reliable approximation of a market-based outcome" or "market prices"[60]. This assumption would not be entirely correct for the following reasons:

a) The starting point of any transfer pricing system is to annul the pricing effects derived from conditions imposed by one group member to another; in a cross-border scenario, this prevents, for example, using intra-group pricing to increase profits in lower-taxed jurisdictions while correspondingly decreasing profits in higher taxed jurisdictions.

b) However, arm's length does not necessarily lead to an approximation of market conditions. As the OECD points out "the relationship among members of an MNE group may permit the group members to establish special conditions in their intra-group relations that differ from those that would have been established had the group members been acting as independent enterprises operating in open markets."[61] Thus, the standard takes into account situations that not might not be present between independent enterprises.

c) Moreover, "in making these comparisons [with standalone entities or transactions], material differences between the compared transactions or enterprises should be taken into account. In order to establish the degree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof), it is necessary to compare attributes of the transactions or enterprises that would affect conditions in arm's length transactions." [62]

d) The arm's length result takes into account the differences between standalone and integrated companies, namely through the introduction of adjustments. Thus, as the entities or transactions are not operating similarly as independent enterprises, the arm's length will produce neither "market prices" nor even reliable approximations of market-based outcomes (within the limits of a reasonable interpretation of this expression).

e) The residual profit may be seen as additional evidence of the previous argument. In the profit-split method, after allocating profit to each group member according to what the market would remunerate independent companies operating similar transactions, there is still usually a residual profit that has to be allocated taking into account facts and circumstances. This residual profit is often the result of group-specific realities such as synergies, economies of scale or benefits of integration between integrated companies that would generally not occur between standalone companies; allocation of the residual profit cannot be seen as a situation that would occur between standalone companies.

[59] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 141.

[60] The EC states that "arm's length principle consisted in the notion that transactions between intra-group companies were to be remunerated as if they had been agreed to by standalone companies negotiating under conditions of free competition" - *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 38.

[61] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, (OECD), Primary Sources IBFD, para. 6 of the preface.

[62] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, (OECD), Primary Sources IBFD, para. 1.36.

### II.3.2 Nature of the arm's length approach

39. The CG describes arm's length as a "tool"[63], a "benchmark"[64] and a "methodology"[65]. From a legal theory perspective, this lack of a precise characterisation leaves room for uncertainty on how arm's length can be interpreted and applied and whether interpretation and application can follow the same rules that domestic courts have been following until now.

### II.3.3 Value of the OECD TP Guidelines

40. The GC starting point is that the "tool" it is using is specific, and distinct from Art. 9 of the OECD MC[66] and, a fortiori, of the OECD TP Guidelines. The GC clarified that the Guidelines do not bind the EC. However, the Guidelines have a certain "practical significance in the interpretation of issues relating to transfer pricing" since they i) "are based on important work carried out by groups of renowned experts", and; ii) "reflect the international consensus achieved with regard to transfer pricing"[67]. In our view, it would have been better if the CG could have been more precise in this respect.

41. The OECD TP Guidelines are recommendations of the OECD Council[68], addressed to OECD members without binding them. A fortiori, the Guidelines per se do not bind private parties. Domestic transfer pricing rules may refer directly to the Guidelines (case in which the Guidelines will have the value that is conferred by domestic law) or the legal system may consider them as relevant sources of interpretation, as the orientations that were taken into account by the States when designing their domestic TP rules. However, the fact is, without intermediation by the domestic legislature, the Guidelines are deprived of any binding legal value.

42. This reasoning cannot be transposed immediately into the EU context. First, because not all EU MS are OECD members.[69] Second, because the EU is not an OECD member and thus, its recommendations have not even the value of recommendations.[70] Third, because there is no EU legal act attributing value to the OECD TP Guidelines. Fourth, because it cannot be said that the EU's arm's length used for the EC's review under Art. 107(1) TFEU was built on the basis of the elaborated and precise OECD TP Guidelines. Art. 107(1) TFEU maintains the same wording since 1957 and the Guidelines were issued by the OECD much later.

43. It is quite difficult to acknowledge legal status of the OECD TP Guidelines for the purposes of State Aid investigations, taking simultaneously into account that i) arm's length is specific; ii) EU primary law has no reasonable link with the OECD TP Guidelines, and; iii) secondary EU law does not remit to them (neither directly nor indirectly).

44. Finally, even if one ignored the above issue, one is still faced with the question of knowing which version of the Guidelines should be taken into account: i) the existing version at the moment when the domestic measure is adopted, or; ii) the existing version at the moment the EC decision is taken or that the court's judgment takes place. In *The Netherlands v. Commission*, the GC acknowledges that the EC used the

[63] *The Netherlands v. Commission* (T-760/15 & T-636/16), paras. 151, 152, 157, 163, 169 and 199 and *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 130, 143, 144, 151, 155, 159, 162, 207.

[64] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 151 and *Luxembourg v. Commission* (T-755/15 & T-759/15), paras. 143 and 296.

[65] *The Netherlands v. Commission* (T-760/15 & T-636/16), paras. 152, 154, 196 and *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 132, 146, 420, 427.

[66] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 161 and *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 149.

[67] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 155 and *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 147 and 176.

[68] Art. 5(b) of the Convention on the Organization for Economic Co-operation and Development of 14 December 1960, available at: https://treaties.un.org/Pages/showDetails.aspx?objid=0800000280110c0a&clang=_en.

[69] At present Bulgaria, Croatia, Cyprus, Malta and Romania are not OECD Member countries.

[70] Based on Art. 220 TFEU and in conformity with the Supplementary Protocol No. 1 to the OECD Convention, the European Commission has a special status before the OECD. Such status allows for its involvement in various aspects of the work of the OECD through a representative that does not have the right to vote and does not officially take part in the adoption of legal acts submitted to the OECD Council.

1995 and 2010 version of the OECD TP Guidelines[71] and did not seem to censor the use of a later version. In our view, and taking into consideration the GC's view as concerns the burden of proof (as mentioned infra) it seems reasonable to consider that only the version that was known at the moment the domestic measure was adopted should be taken into account when a ruling is assessed on the basis of Art. 107(1) TFEU.

## II.3.4 Content of the EU arm's length "benchmark"

45. Another question regards the exact content of that "benchmark".
46. The starting point is the recognition: i) that EU law (neither primary nor secondary law) provides no indication about its content; ii) domestic TP rules are not decisive to set meaning; iii) OECD TP Guidelines are not, by themselves, binding. In terms of logical reasoning, full consideration of these premises creates issues in terms of legal certainty as one needs to extract very specific authorisations and prohibitions (e.g. adjustments) from a very general principle.
47. Adding to the complexity, the EC introduces another variable which is accepted by the Court: namely the functional or teleological control of the validity of the (OECD or domestic) TP rules, which are only considered valid if they lead to a "reliable approximation of a market-based outcome".
48. This complexity is exacerbated by the fact that the GC avoids defining or providing criteria on what is a "reliable approximation of a market-based outcome". This leaves the interpreter with a new (validity) test for which no criteria are provided.
49. Against this background, and adding to the already existing uncertainty in the TP area, a new issue emerges: what are the domestic or OECD rules that lead to a "reliable approximation of a market-based outcome"? Which paragraphs/articles can be relied upon and which paragraphs/articles shall be dismissed? Taking into account the primacy and direct effect of EU law, shall undertakings and tax authorities start to ignore provisions of their domestic TP rules on the consideration that they do not lead to a reliable approximation of a market-based outcome? And what evidence would they have to gather to substantiate their position? Are there market-based methods and non-market based methods?
50. This raises even more fundamental questions. As we know, transfer pricing works by approximation, and the use of the OECD methodologies typically leads to a range of results that are found in transactions between independent enterprises (the arm's length range). Taking into account the GC judgments, can undertakings even rely on the domestic rules or TP Guidelines, knowing that if they are strictly followed, the outcome will always be a "reliable approximation of a market-based outcome"? Or shall it always introduce a final rationality test, assessing if the arm's length range (or parts of it) are a market-based outcome (introducing a new layer in the TP analysis within the EU)? In other words, does it suffice to comply with domestic rules and OECD TP Guidelines or, in addition, shall undertakings introduce a final "approximation of a market-based" test? And, in the latter scenario, what do they need to test? Should the EC start a program on identifying which rules lead to a reliable approximations of a market-based outcome or which results are a sufficient approximation of market-based outcomes?

## II.4 Admissibility of TNMM

51. In both cases, the GC accepts the Transactional Net Margin Method (TNMM) for the determination of the taxable base. This is one of the methods suggested by the OECD Transfer Pricing Guidelines and a method that is frequently used in the practice of transfer pricing throughout Europe.
52. TNMM departs from the comparison between the net profit margin of an undertaking obtained from non-arm's length transaction and the net profit margin of undertakings operating at arm's length from

[71] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 256.

similar transactions. It then determines the net profit margin by reference to a profit level indicator such as costs, sales or assets. In order words, it takes into account the relationship between the net profit of standalone companies and a profit indicator and extrapolates the profit method that members of integrated companies would have. The determination of the profit indicator and of the margin depends on the facts and circumstances of the case.

53. TNMM is, in most jurisdictions, a subsidiary method. Whenever the information available allows for the application of more direct methods (such as CUP, cost-plus or resale-minus), said methods should be applied. The underlying assumption is that the results obtained by the use of those methods would be more accurate.

54. The GC did not attribute too much relevance to the method chosen or even to its subsidiarity. In its view, "choosing the transfer pricing method is not an end in itself, but is done with a view to the intra-group transaction for which the arm's length method level must be determined, and not the other way around".[72]

55. In our view, the GC was not directly asked about the admissibility of TNMM or whether it is able to lead to a reliable approximation of a market-based outcome. The GC acknowledges that the EC accepts the application of the method and focuses on the methodologic errors in its application, as identified by the EC. It should be noted, however, that one-sided methods such as the TNMM might inherently lead to double non-taxation, an issue that was not addressed either by the EC or by the Court.

### II.5 Evidence / Burden of proof

56. In both judgments, the GC makes an effort to clarify the burden of each of the parties. According to the GC: i) the Commission has to provide evidence of the existence of aid, and; ii) the Member State has to provide evidence of justifications for the different treatment between undertakings.[73] The GC merely reiterates its long-standing position in this issue, which is based on the general principles for the distribution of the burden of proof.

57. The GC clarifies that evidence is only allowed insofar as it pre-dates the action that led to the aid. [74] One has to "place oneself in the context of the period during which the measures at issue were taken in order to assess the economic rationality of the conduct of the Member State".[75]

58. In transfer pricing cases, the GC recognises that Member States benefit from a certain "margin of appreciation in the approval of transfer pricing"[76] which, however, does not prevent the EC to check "whether the transfer pricing accepted by a Member State corresponds to a reliable approximation of a market-based outcome and whether any variation that may be identified in the course of that examination does not go beyond the inaccuracies inherent in the methodology used to obtain that approximation".[77] This substantially increases the burden to be met by the EC, which not only has to provide evidence of aid (in this case, a deviation from the reference framework) but also that this deviation goes "beyond the inaccuracies inherent in the methodology". In future cases, the GC will likely be asked to clarify if the "inherent inaccuracies" refer to i) the precise pricing within the quartiles; ii) tolerable differences in the selection of the elements on which each method relies (comparables, profit indicator); iii) the fact that no transfer pricing methodology will ever lead to a precise market-based outcome since any method takes into account the relationship between the parties and that there are

[72] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 209.

[73] *The Netherlands v. Commission* (T-760/15 & T-636/16), paras. 194 and 195 and *Luxembourg v. Commission* (T-755/15 & T-759/15), para 202 and 203.

[74] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 243.

[75] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 244.

[76] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 196.

[77] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 196 and *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 207.

no criteria on what is considered a reliable approximation of that market-based outcome. At this point, the GC's judgment leads to uncertainty and may give rise to unnecessary litigation.

59. The GC does not go so far as to require the EC to provide evidence of the right pricing or of the methodology that would lead to a reliable approximation of a market-based outcome. This is made particularly clear in the *Fiat Finance* judgment. After accepting the EC's claim that the tax ruling endorsed a methodology for determining FFT's remuneration that did not enable an arm's length outcome to be achieved and that resulted in a reduction of FFT's tax burden"[78], the GC considered that it was up to the appellants to "show that the Commission had wrongly concluded that the amount of tax payable by FFT was lower than that which it would pay under normal market conditions".[79]

60. The GC takes the chance to clarify its own role in these cases. As a rule, in annulment actions of the EC's decision on State Aid, the Court should "carry out a comprehensive review as to whether a measure falls within the scope of Art. 107(1) TFEU".[80] However, and as transfer pricing has an "approximate nature", the court's review is limited to "verify whether the errors identified in the contested decision, and on the basis of which the Commission found there to be an advantage, go beyond the inaccuracies inherent in the application of a method designed to obtain a reliable approximation of a market-based outcome"[81]. Thus, the judicial review is restricted to test: i) the logical coherence of the reasoning proposed by the EC (and whether there are no errors); ii) if this reasoning allows the conclusion that the pricing does not allow an approximation of a market-based outcome, beyond the "inherent inaccuracies". Mere identification of errors in the application of pricing methodologies does not suffice, for these purposes.[82]

61. A careful reading of both judgments shows that the outcome is sensitive to the way the parties formulate their arguments and to the level of evidence produced. In *Starbucks*, the GC easily dismissed the EC's claims that the royalties paid to Alki should have been zero[83], noting that there was economic value in the transacted IP. However, the dismissal would not be that easy (or would eventually not take place) if the EC would have instead argued and provided evidence that the amount of royalties had intolerably deviated from any reliable approximation of a market-based outcome since standalone companies would never define royalties by reference to the difference between, grosso modo, a company's revenues and its costs (regardless of the amount of revenue and of the costs).

# III. Open Issues

62. The GC did not object to the EC's view that Art. 107(1) TFUE combined with the consideration of the purpose of CIT tax system "allows the Commission to check whether t[he] pricing corresponds to pricing under market conditions"[84] and that the arm's length benchmark for that assessment is not derived from domestic law or the OECD TP Guidelines.

63. Despite the references to prior case law, the GC judgments are, in our view, innovative. This still leaves room for interpretation on many aspects, including the exact meaning of the expression "reliable approximation of a market-based outcome". Does it mean that the EC can challenge TP arrangements that have been made with full compliance with domestic and OECD rules and the TP Guidelines? Does it mean that the outcome of any pricing needs to be reviewed using a new layer of analysis, focusing on assessing if the outcome is market-based? In the latter case, what is the exact content of that test?

[78] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 286.
[79] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 340.
[80] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 198 and *Luxembourg v. Commission*, para. 206.
[81] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 199.
[82] *The Netherlands v. Commission* (T-760/15 & T-636/16), paras. 201 and 211 and *Luxembourg v. Commission*, para. 207.
[83] *The Netherlands v. Commission* (T-760/15 & T-636/16), para. 360 et seq.
[84] *Luxembourg v. Commission* (T-755/15 & T-759/15), para. 143.

64. From this moment on, taxpayers can no longer rely entirely on a TP ruling as it can always be challenged by the EC, in case it considers that the ruling leads to a benefit that is not arm's length.
65. From this moment on, the ultimate word in what concerns transfer pricing is, from an administrative perspective that of the EC and, from a judicial perspective, of the CJEU.
66. From this moment on, full reliance on domestic statutes of limitation is no longer possible since what is considered aid can be recovered for the previous ten years. From a very practical perspective, this means that all documentation and dossiers have to be kept for much longer than the period indicated by company or tax law.
67. From this moment on, Member States have to be much more careful in the adoption of rulings and APA's and are pushed to strengthen their domestic transfer pricing rules, reviewing them carefully in order to remove any features that may lead to results that are not "market-based".

# IV. The Statement

68. The CFE acknowledges the clarifications brought by the GC's decision as concerns the admissibility of the EC's action in checking the compatibility of MS's TP rulings with the TFEU's prohibition of State Aid particularly as concerns the burden of proof.
69. The CFE hopes that the CJEU will bring further clarity to the technical specifics of the arm´s length principle such as the admissibility of one-sided methods (such as the TNMM) and the permissible leeway used to assess MS measures in light of Art. 107(1) TFEU, as that "tool" is based only on the broad principle of MS's market-based corporate income tax systems.
70. The CFE notes that the new concepts and criteria are not sufficiently clear and leave ample room for divergent interpretations. The CFE is concerned by the impact on legal certainty that this situation creates for businesses across Europe, particularly taking into account that the recovery of aid may be requested for up to the ten previous years.