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EU STATE AID AND THE TAX ALLOCATION OF MULTINATIONALS' PROFITS

HUGO LÓPEZ AND AITOR NAVARRO*

Abstract

This contribution examines the impact of the EU prohibition of State aid over the tax allocation of multinationals' profits. All EU Member States apportion the taxable profit of multinational groups in accordance with transfer pricing regulations based on the arm's length standard, namely, following a market valuation rationale. Although apparently neutral, such a standard may lead to prohibited aid both at the level of its regulatory design and its enforcement. These issues have been recently exacerbated due to the assessment of the "tax rulings" cases, i.e. State aid proceedings opened against the granting of individual, unpublished rulings by certain Member States to some of the largest multinationals operating in the EU, recently reviewed by the ECJ. Unlike most of the scholarly literature, which has focused on the specific issues raised in these cases, this article aims to comprehensively analyse the issues raised by the said regulations when confronted with the EU State aid regime, in line with the latest jurisprudence in this field. The examination starts by defining the aim and contradictions of the arm's length standard, which is necessary to build a proper reference framework against which deviations resulting in a selective advantage may be detected. Such derogations potentially resulting in prohibited aid may arise when assessing the scope of these regulations, the existence of specific regimes deviating from the arm's length standard rationale, and in the context of individual administrative acts (e.g. tax rulings) deviating from the content of the applicable transfer pricing regulations.

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1. Introduction

The prohibition of State aid envisaged in the Treaty of the Functioning of the European Union (TFEU) aims to prevent EU Member States from distorting competition and, therefore, constitutes a fundamental component of the internal market framework.[1] In contrast with this, precisely what characterizes the operation of entities that form part of a multinational enterprise (MNE) is that the transactions they carry out with one another are not necessarily subject to market forces and the spontaneous price formation that preside over those carried out by stand-alone entities.[2] This peculiarity leads to especially acute distortions from a tax perspective, as the corporate income taxes of the EU Member States principally follow the separate entity principle, for which every single entity is regarded as a separate taxpayer – including those that form part of a group.[3] To determine their taxable base, the transactions undertaken by stand-alone entities reflect market prices, as each party bargains to achieve the best possible outcome according to their self-interest. In opposition to it, entities operating within a group may enter into agreements that do not reflect market outcomes, as the parties do not respond to their interest but to the group's interests. If MNEs were allowed to agree on non-market outcomes, the result would be an unabridged power shift of profits from high-tax to low-tax jurisdictions simply by adopting prices allowing this behaviour. Ultimately, it would entail broad powers for MNEs to decide their taxable base, which would threaten the stability of corporate income tax.

To mitigate the described phenomenon, all EU countries – and virtually all countries worldwide – have adopted what are known as transfer pricing rules, which follow the arm's length standard. This requires transactions to be priced in accordance with what stand-alone parties would have agreed to under similar circumstances. Although these regulations are significantly homogenous across countries due to successful standardization efforts promoted by the Organisation for Economic Co-operation and Development

1. See Arts. 107–109 TFEU. For a broader perspective highlighting the manifold goals of State aid, see Piernas López, "The transformation of EU State aid law ... and its discontents", 60 CML Rev. (2023), 1623–1654.

2. For an overview of the implications on business incentives, tax and corporate law, see Schön, "Transfer pricing – business incentives, international taxation and corporate law" in Konrad and Schön (Eds.), *Fundamentals of International Transfer Pricing in Law and Economics* (Springer, 2012), pp. 47–67.

3. See an account of the debate in Hey and Schnitger, "General report" in Hey et al., *Group Approach and Separate Entity Approach in Domestic and International Tax Law* (IFA Cahiers de Droit Fiscal International, 2022), pp. 12–54. On the matter of separate entity taxation, as well as the issues it creates and existing solutions, see Devereux et al., *Taxing Profit in a Global Economy* (OUP, 2021).

(OECD),[4] their content is defined by the domestic legislation of each country and can, therefore, be prone to disparities at a comparative level.[5] Moreover, transfer pricing regulations are usually complex, and their enforcement often implies subjective judgement due to the open nature of the arm's length mandate. Therefore, disparities also arise in the enforcement aspect.

Overall, even if transfer pricing regulations based on the arm's length standard may seem *prima facie* to be a relatively neutral allocation key, the prospects of finding a deviation in the design and enforcement of transfer pricing rules leading to a selective advantage precluded by State aid are significant. The 1998 Commission Communication on the application of the State aid rules to measures relating to direct business taxation[6] and the 1999 Primarolo Report[7] identified harmful tax regimes existing in EU Member States and their dependent territories. These reports addressed issues of the compatibility of transfer pricing regulations with the State aid regime, especially concerning special regimes, administrative decisions, or tax rulings.[8] The last of these are significantly relevant to this article. They refer to individual decisions by tax authorities clarifying how specific tax regulations apply to particular transactions on arrangements. They are meant to provide legal certainty to taxpayers, but if their content deviates from the applicable regulations, they may entail the granting of selective advantages favouring individual undertakings over other competitors.

After the economic downturn of 2008, the political turmoil created by a series of public media scandals involving leaks of information on tax avoidance[9] and the launch of the initiative by the OECD to counter base erosion and profit shifting (BEPS) prompted the European Commission to

4. The OECD has long promoted the adoption of standardized transfer pricing regulations conforming to the arm's length standard at the domestic law level that are in accordance with the recommendations posed in its Transfer Pricing Guidelines. This document is updated regularly, with the latest version being *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD, 2022).

5. The European Commission launched a proposal in Sept. 2023 to harmonize the content of transfer pricing rules under a single interpretation of the arm's length standard. See European Commission, Proposal for a Council Directive on transfer pricing, COM(2023)529 final. On the prospects of harmonization, see Doeleman, "In principle, (im)possible: Harmonizing an EU arm's length principle", 32 EC Tax Rev. (2023), 93–102.

6. Commission Notice on the application of the State aid rules to measures relating to direct business taxation, O.J. 1998, C 384/03.

7. Code of Conduct (Business Taxation) Report, SN 4901/99, 23 Nov. 1999.

8. The ECJ addressed the matter in Joined Cases C-182/03 & C-217/03, *Forum 187*, EU:C:2006:416.

9. On the impact of these leaks on the actions of policymakers, see Oei and Ring, "Leak-driven law", 65 *UCLA Law Review* (2018), 532–619.

act.[10] Since 2014, the Directorate General for Competition has reviewed more than 1,000 rulings,[11] resulting in the opening of State aid proceedings, including secret rulings cases dealing with the application of transfer pricing regulations.[12] These benefited MNEs in Belgium[13] and others such as Apple in Ireland,[14] Fiat[15] and Amazon[16] in Luxembourg, as well as Starbucks[17] and Nike[18] in the Netherlands.

These cases touch upon core concepts of the prohibition of State aid in the EU and reflect a renewed effort by the European Commission to amplify its reach in corporate taxation matters. Yet, so far, the European Court of Justice (ECJ) has rejected the approach adopted by the Commission, signalling the willingness to reduce the impact of State aid in this field, which still belongs to the core sovereignty of the Member States.

In this regard, most of the literature analyses the specificities of the said cases primarily in the context of an analysis focused on the tax rulings

10. See an overview of the use of the prohibition of State aid as a means to resolutely contend with harmful tax competition in the described context in Kyriazis, "Fiscal State aid law as a tool against harmful tax competition in the EU: déjà vu?", 41 *YEL* (2022), 279–313.

11. DG Competition, "Working Paper on State Aid and Tax Rulings" (2016) para 6, available at <competition-policy.ec.europa.eu/document/download/cc11b513-0d4b-4617-bbb2-9c8a7cdb59c5_en?filename=specific_aid_instruments_working_paper_tax_rulings.pdf> (all websites visited 4 August 2024).

12. See a description of the facts of these cases in Lyal, "Transfer pricing rules and State aid", 38 FILJ (2015), 1017–1043. In the following footnotes, the reference to the Commission decision declaring the existence of aid is included, along with the reference to the latest stage in the judicial proceedings, whether that is the General Court decision, an A.G. Opinion, or the ECJ decision.

13. These cases refer to what is known as the excess profits scheme to the benefit of several MNEs. See Commission decision of 11 Jan. 2016 on the excess profit exemption State aid scheme SA.37667 (2015/C) (ex 2015/NN) implemented by Belgium, notified under document C(2015) 9837, O.J. 2016, L 260; Case T-131/16 RENV, *Belgian Excess Profits Scheme*, EU:T:2023:561.

14. Commission Decision (EU) 2017/1283 of 30 Aug. 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple (notified under document C(2017) 5605), O.J. 2016, L 187; Joined Cases T-778/16 & T-892/16, *Apple*, EU:T:2020:338; Opinion of A.G. Pitruzzella in Case C-465/20 P, *Apple*, EU:C:2023:840.

15. Commission Decision (EU) 2016/2326 of 21 Oct. 2015 on State aid SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat (notified under document C(2015) 7152), O.J. 2015, L 351; Joined Cases C-885/19 P & C-898/19 P, *Fiat*, EU:C:2022:859.

16. Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon (notified under document C(2017) 6740), O.J. 2017, L 153; Case C-457/21 P, *Amazon*, EU:C:2023:985.

17. Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks (notified under document C(2015) 7143), O.J. 2015, L 83; Joined Cases T-760/15 & T-636/16, *Starbucks*, T:2019:669.

18. Decision C(2019) 6 final on State aid SA.51284 (2018/NN); Case T-648/19, *Nike*, T:2021:428.

themselves as constituting State aid.[19] Differing from such a granular approach, the objective of this article is to offer a systematic analysis of transfer pricing regulations based on the arm's length standard under the lens of the EU prohibition of State aid. The purpose is to present an exhaustive view of the issues that arise from this cross-over, covering not only a critical review of the arguments already assessed by the Court of Justice but also aspects not yet dealt with by case law or scholarship.

The structure of the contribution is as follows. After briefly describing the main features in the methodology for assessing State aid matters (section 2), the aim and contradictions that the arm's length standard poses will be scrutinized as a basis to build a proper framework of reference (section 3). Further, the definition of such a framework will be determined by adopting a triple standpoint, specifically a subjective, a formal, and a substantive perspective (section 4). The adequate delineation of the reference framework will allow detecting derogations leading to selective advantages contrary to the State aid rationale in a number of scenarios. These range from the scope of transfer pricing regulations to specific regimes and individual acts by tax authorities potentially deviating from the arm's length rationale (section 5). Section 6 concludes.

2. Methodology to identify State aid

Article 107(1) TFEU *prima facie* requires four conditions to qualify a particular measure as unlawful State aid: first, there must be an intervention by the State or through State resources; second, the intervention must be liable to affect trade between the Member States; third, it must confer a selective advantage on the beneficiary; fourth, it must distort or threaten to distort competition.[20]

Notwithstanding, the ECJ has redefined the analysis through a relatively consolidated line of decisions that places emphasis almost exclusively on the

19. Remarkable exceptions are Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (Kluwer Law International, 2021) and Miladinovic, *Selectivity and the Arm's Length Principle in EU State Aid Law* (IBFD, 2023), both adopting an in-depth, comprehensive analysis of the impact of State aid in transfer pricing regimes following the arm's length standard.

20. Note that several exceptions exist to the plain classification as State aid measures complying with said criteria including but not limited to those listed in Arts. 107 and 108 and the exceptions granted by the Commission. For an overview, see Bacon, *European Union Law of State Aid*, 3rd ed. (OUP, 2017); Hancher, Piernas López, and Szyszczak, *Research Handbook on European State Aid Law* (Edward Elgar, 2021); Quigley, *European State Aid Law and Policy (and UK Subsidy Control)* (Hart Publishing, 2022).

issue of selectivity.[21] Specifically, the methodology set by the Court would rely on determining whether the contested national measure favours certain undertakings over others "which, in the light of the objective pursued by that regime, are in a comparable factual and legal situation and which accordingly suffer different treatment that can, in essence, be classified as discriminatory".[22] Usually, the ECJ requires the identification of a reference framework, specifically the "normal" system of rules applicable in the Member State concerned defined in line with the declared aim of the regulations under scrutiny.[23] As this constitutes the starting point of the analysis, the Court has declared that an error made by the Commission in that determination necessarily vitiates the whole analysis.[24]

Afterwards, it must be demonstrated that the contested measure constitutes a derogation from such a framework insofar as it differentiates between operators who, in the light of the objective pursued by that system, are in a

21. See an exhaustive account of the method followed by the ECJ in Schön, "State aid in the area of taxation" in Hancher (Ed.), *EU State Aids* (Sweet & Maxwell, 2021), pp. 441–486.

22. See Joined Cases C-20/15 P & C-21/15 P, *World Duty Free*, EU:C:2016:981, para 54; Case C-374/17, *A-Brauerei*, EU:C:2018:1024, para 35; Case C-562/19 P, *Commission* v. *Poland*, EU:C:2021:201, para 28; Joined Cases C-885/19 P & C-898/19 P, *Fiat*, para 67; Case C-885/19 P, *Amazon*, para 33. An in-depth analysis of the convergence between non-discrimination in the fundamental freedoms and the State aid analysis may be found in Szudoczky, *The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation: Primary Law, Secondary Law, Fundamental Freedoms and State Aid Rules* (IBFD, 2014). See also Martín Jiménez, "Level playing field versus Member States' direct tax policies: The State aid (r)evolution" in Pistone (Ed.), *European Tax Integration: Law, Policy and Politics* (IBFD, 2018), at sec. 8.4. See also Lyal, "State aid, tax integration and State sovereignty" in Panayi, Haslehner and Traversa (Eds.), *Research Handbook on European Union Taxation Law* (Edward Elgar, 2020), pp. 410–429, at pp. 415–416. An early, critical view of this stance may be found in Schön, "Taxation and State aid law in the European Union", 36 CML Rev. (1999), 911–936.

23. Therefore, the beneficial character of a measure can only be asserted in the context of the regulations under scrutiny. See e.g. Joined Cases C-20/15 P & C-21/15 P, *World Duty Free*, para 60; Joined Cases C-885/19 P & C-898/19 P, *Fiat*, para 69; Joined Cases C-451/21 P & C-454/21 P, *Engie*, EU:C:2023:948, paras. 107–108. See López López, "General thought on selectivity and consequences of a broad concept of State aid in tax matters", 9 EStAL (2010), 807–819. Yet, Monsenego, op. cit. *supra* note 19, at sec. 2.1, highlights that in some cases the Court did not require the identification of a reference framework to ascertain the existence of State aid. Plus, there are cases in which the outcomes were not influenced by the adequate identification thereof. Similarly, see the Opinion of A.G. Kokott in Joined Cases C-236/16 & C-2 37/16, *ANGED*, EU:C:2017:854, para 88, referring to the analysis undertaken by the ECJ of the *Gibraltar* and *World Duty Free* cases.

24. See Joined Cases C-451/21 P & C-454/21 P, *Engie*, para 110. See also Joined Cases C-885/19 P & C-898/19 P, *Fiat*, para 71.

comparable factual and legal situation.[25] Therefore, the fundamental query lies in determining whether the measure under examination "introduces, between operators that are, in the light of the objective pursued by the general tax system concerned, in a comparable factual and legal situation, a distinction that is not justified by the nature and general structure of that system".[26] If that is the case, the measure at hand amounts to a selective advantage and would thus be, in principle, contrary to the prohibition of State aid. Notwithstanding, if it is demonstrated that the existence of the measure is justified due to the nature or general structure of the system of which those measures form a part, the measures will not be contrary to EU law.[27]

The State aid regime has a significant impact on the design of tax systems in EU countries, as the selective non-collection of taxes has the same effect as granting subsidies.[28] Targeted tax measures, especially those conferring benefits, may fall under State aid scrutiny. Thus, the State aid regime constitutes a powerful tool for the European Commission to further the negative harmonization of income taxation in the EU by establishing boundaries for Member States on their policy choices in this field.[29] Plus, the open-ended configuration of State aid prohibition enabled the Commission to pursue an extension of its boundaries to an extent that was inconceivable years ago, often with the acquiescence of the ECJ.[30] This raised concerns about the

25. *De facto* selectivity would also be covered, see Joined Cases C-106/09 P & C-107/09 P, *Gibraltar*, EU:C:2011:732, para 101; Case C-374/1, *A-Brauerei*, paras. 32–33. For an overview, see Ismer and Piotrowski, "The selectivity of tax measures: A tale of two consistencies", 43 *Intertax* (2015), 559–570.

26. Joined Cases C-20/15 & C-21/15, *World Duty Free*, para 60.

27. An early reference on the assessment of justification may be found in Case C-88/03, *Azores*, EU:C:2006:511, para 81. See also Joined Cases C-20/15 P & C-21/15 P, *World Duty Free*, paras. 35 and 36; Joined Cases C-885/19 P & C-898/19 P, *Fiat*, para 68. An in-depth analysis of the justification stage may be found in Miladinovic, op. cit. *supra* note 19, at sec. 6.5. Critical on the justification stage of the analysis, see Biondi, "State aid is falling down, falling down: An analysis of the case law on the notion of aid", 50 CML Rev. (2013), 1719–1744, at 1737–1738. Comparing justification on State aid against the fundamental freedoms analysis, see Ismer and Piotrowski, "Relationship of fiscal State aid and the fundamental freedoms" in Panayi, Haslehner and Traversa, op. cit. *supra* note 22, pp. 450–472, at pp. 457–459.

28. See e.g. Case C-143/99, *Adria-Wien Pipeline*, EU:C:2001:598, para 38.

29. For an overview, see Szudoczky, "A European tax law agenda in direct taxation" in Parada (Ed.), *A Research Agenda for Tax Law* (Edward Elgar, 2022), pp. 163–182. For a critical assessment, see Fantozzi, "The applicability of State aid rules to tax competition measures: A process of 'de facto' harmonization in the tax field" in Schön (Ed.), *Tax Competition in Europe* (IBFD, 2003), pp. 121–132. See also Mehta, "Tax harmonisation and State aid – a warning for the future", 6 EStAL (2007), 257–266.

30. The lack of clarity in the delimitation of this requirement is highlighted, among others, in López López, op. cit. *supra* note 23, and Schön, "Tax legislation and the notion of fiscal aid: A review of 5 years of European jurisprudence" in Richelle, Schön, and Traversa (Eds.), *State Aid Law and Business Taxation* (Springer Berlin Heidelberg, 2016), pp. 3–26.

infringement on the national sovereignty on tax matters, and therefore on the question of federalism and the distribution of competences between the EU and the Member States in the matter.[31] The tax rulings decisions are the latest development of this trend.

The methodology described will be employed to systematically analyse the compliance of transfer pricing regulations based on the arm's length principle against the prohibition of State aid.[32] Specifically, the determination of the reference framework must follow from an objective examination of the content, the structure and the specific effects of the applicable rules under the national law of the Member State concerned.[33] Therefore, in the next section (section 3), the aim and design of domestic transfer pricing regimes based on the arm's length standard will be examined. Only through a proper understanding of its basic tenets can a reference framework be appropriately built (section 4) and possible deviations from it be assessed (section 5).

3. Aims and contradictions of the arm's length standard

The first step of the analysis requires the building of a reference framework from which any derogation leading to a selective advantage could be detected. To do so, the aim of the applicable rules must be addressed. Hence, this section is devoted to determining the objective of transfer pricing rules based on the arm's length standard, which is the income allocation reference adopted in all EU Member States.[34]

The arm's length standard implies adjusting profits derived from transactions undertaken by related entities that form part of a group to reflect the outcome that unrelated parties would have agreed to for tax purposes under the same circumstances. To calculate such market remuneration, a

31. See Englisch, "Sliding scales of review in State aid control of fiscal aid measures" in De Pietro, Peters, and Kemmeren (Eds.), *A Journey through European and International Taxation: Liber Amicorum in Honour of Peter Essers* (Kluwer Law International, 2024), pp. 271–290. See, in the context of the tax rulings cases, Schön, op. cit. *supra* note 21, p. 475.

32. In this regard, the present contribution assumes the current status of the ECJ case law as is. For an elaborated critique and an alternative approach inspired in the "internal consistency test" developed by the US Supreme Court to identify discriminatory State tax rules and applied to the tax rulings cases, see Mason, "Identifying illegal subsidies", 69 *American University Law Review* (2019), 479–564.

33. Joined Cases C-20/15 & C-21/15, *World Duty Free*, para 62; Joined Cases C-885/19 P & C-898/19 P, *Fiat*, para 72; Case C-457/21 P, *Amazon*, para 38; Joined Cases C-451/21 P & C-454/21 P, *Engie*, para 111; Case C-831/21 P, *Fachverband Spielhallen*, EU:C:2023:686, para 38; Case C-558/22, *Esperia*, EU:C:2024:209, para 84.

34. For an overview of the regulations adopted by EU countries in this regard, see the per-country survey of the OECD, available at <www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profiles.htm>.

comparability analysis would be conducted by searching for information on comparable independent references.[35]

The arm's length standard as an allocation key for MNEs' profits serves at least two primary purposes.[36] First, it distributes the tax burden among taxpayers. By doing so, it aims at achieving comparability of MNE constituents and independent market operators to grant a certain degree of neutrality in their treatment from the perspective of the corporate tax base calculation.[37] To treat related and unrelated taxpayers alike, a mechanism must exist to compare their ability to pay. Thus, distortions are removed through the arm's length standard to convert "group monetary units" into "market monetary units"[38] to reach a level playing field from which a comparison can be ascertained.

Second, at a cross-border level, the arm's length standard defines the jurisdiction to tax MNE profits from a double perspective. On the one hand, it helps coordinate tax revenue distribution among States. This includes not only the possibility of performing an upward adjustment when the profit registered by an MNE entity does not correspond to a comparable market reference, but also a corresponding downward adjustment on the counterpart that leads to the

35. For an in-depth assessment of the comparability analysis, see Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* (Kluwer Law International, 2010), pp. 393–473. The most prevalent method in this regard consists of comparing profitability ratios under what is known as the transactional net margin method (TNMM), assuming that comparable entities would obtain comparable net margins. To perform the comparison, the most common practice consists of using databases that aggregate financial accounting information. See Lang et al., *Fundamentals of Transfer Pricing: A Practical Guide* (Kluwer Law International, 2019), pp. 126–139. See also Treidler, *Transfer Pricing in One Lesson: A Practical Guide to Applying the Arm's Length Principle in Intercompany Transactions* (Springer International Publishing, 2020), pp. 51–63; Monsenego, *Introduction to Transfer Pricing*, 2nd ed. (Kluwer Law International, 2022), sec. 2.3.1.

36. See Schön, "International tax coordination for a second-best world (Part III)", 2 *World Tax Journal* (2010), 227–261, at 230: "the application of the 'arm's length' standard fulfils two functions at the same time. It allocates income to the involved parties and it allocates taxing rights to the involved countries". See also "EU State aid law and national tax rulings", IP/A/TAXE/2015-02 (October 2015); Luja, "Will the EU's State aid regime survive BEPS?", 3 *British Tax Review* (2015), 379–390; and Haslehner, "Transfer pricing rules and State aid law" in Panayi, Haslehner and Traversa, op. cit. *supra* note 22, pp. 430–449, at pp. 445–447.

37. See OECD, cited *supra* note 4, para 1.8. See also Dodge, "Theories of tax justice: Ruminations on the benefit, partnership, and ability-to-pay principles", 58 *Tax Law Review* (2004), 399–461, at 453; Bullen, *Arm's Length Transaction Structures: Recognizing and Restructuring Controlled Transactions in Transfer Pricing* (IBFD, 2011), p. 143; Repetti and Ring, "Horizontal equity revisited", 13 *Florida Tax Review* (2012), 135–156, at 140.

38. See Schoueri, "Arm's length: Beyond the guidelines of the OECD", 69 *Bulletin for International Taxation* (2015), 690–716, at 691.

elimination of double taxation.[39] Thus, the acknowledgement of the arm's length criterion eases the task of aligning the adjustments made by involved jurisdictions. On the other hand, as stated above, it helps to mitigate profit shifting as it would impede a discretionary allocation of profits to overseas low or no-taxed entities.[40]

Yet, the mentioned aims, as unambiguous as they may seem in the abstract, lead to a series of paradoxes central to their adequate understanding and the manifold issues that arise when contrasted with the EU prohibition of State aid. Acknowledging these paradoxes will help address subsequent queries on defining the framework of reference and potential derogations leading to a selective advantage. Three aspects deserve further attention.

1. Transfer pricing aims to equate settings that are non-comparable from an economic perspective: specifically, the interactions between stand-alone parties and those of controlled entities pertaining to the same MNE.[41] Advocating for neutrality disregards the fact that, under identical conditions, MNEs tend to overcome inefficiencies caused by imperfect markets. Therefore, *ceteris paribus*, MNEs will – in several scenarios – achieve higher returns than those obtained by stand-alone entities, due to the elimination of transaction costs or the generation of synergies and economies of scale, among other factors.[42] Therefore, the arm's length standard should be suitable for approximating the tax treatment of both unrelated and related entities operating under similar circumstances, but it does not result in an unabridged levelling.[43] This

39. See Art. 9.2 of the 2017 OECD Model Tax Convention on Income and on Capital, the 2021 United Nations Model Tax Convention and the 2016 United States Model Tax Convention, as well as Art. 17 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS.

40. In fact, this was the main role of transfer pricing since its inception, as illustrated by the US second circuit case *Asiatic Petroleum Co. (Delaware) Ltd.* v. *Commissioner*, 31 BTA. 1152 (2nd Cir. 1935). See Rectenwald, "A proposed framework for resolving the transfer pricing problem: Allocating the tax base of multinational entities based on real economic indicators of benefit and burden", 22 *Duke Journal of Comparative & International Law* (2012), 425–450.

41. Similarly, see e.g. Brauner, "Cost sharing and the acrobatics of arm's length taxation", 38 *Intertax* (2010), 554–567, at 562; Burke, "Re-thinking first principles of transfer pricing rules", 30 *Virginia Tax Review* (2010), 613–629; Schön, "Transfer pricing, the arm's length standard and European Union law" in Richelle, Traversa, and Schön (Eds.), *Allocating Taxing Powers within the European Union* (Springer, 2013), pp. 73–99, at pp. 94–95.

42. For an overview, see Tavares, "Multinational firm theory and international tax law: Seeking coherence", 8 *World Tax Journal* (2016), 243–276. See also Buriak and Lazarov, "Between State aid and the fundamental freedoms: The arm's length principle and EU law", 56 CML Rev. (2019), 905–948, at 922–923.

43. Moreover, the business function of transfer prices and that of tax law fundamentally differ. This is clearly noted by Schön, op. cit. *supra* note 2, at p. 53: "The business function of transfer prices requires the management to choose transfer prices which provide incentives to

aspect will be crucial in properly defining the subjective framework of reference, i.e. to determine whether such framework should be applicable to all corporate taxpayers or just those forming part of a group.[44]

2. The purported standardization of transfer pricing regulations – essentially through OECD standards – lies in contrast to the existence of differences in local transfer pricing regulations and approaches adopted by taxpayers, tax authorities, and the courts of each Member State, even when the arm's length rationale influences their domestic regulations.[45] Although countries usually adopt rules based on the content of the OECD Transfer Pricing Guidelines, a 1:1 modelling is often not reached. Plus, even under similar regulations, the approach of tax authorities and courts in each country may differ.[46] This especially applies when transfer pricing requires not a unified outcome but a range of reasonable results depending on the availability of information to properly conduct a comparability analysis. Therefore, defining the arm's length standard and transfer pricing regulations as a uniform phenomenon would be misleading. This aspect is especially relevant when addressing the formal and the substantive framework of reference, i.e. the specific content of the arm's length standard as defined by the Member State's applicable domestic transfer pricing regulations.[47]
3. The prevention of profit shifting is one of the primary goals of transfer pricing, yet these regulations are frequently considered a catalyst for such a phenomenon. It poses substantial tax planning opportunities for those who can boldly structure their affairs favourably. After all, the taxpayer has ample discretion to contractually allocate functions, assets, and risks since it presents the facts, chooses the information to be disclosed, and prepares the relevant documentation.[48] Significant

maximize the overall profit of the firm; tax law requires business units to choose transfer prices which maximize their respective share of the overall business profit of the firm."

44. The topic is further examined *infra* at section 4.1.

45. See Gunn and Luts, "Tax rulings, APAs and State aid: legal issues", 24 EC Tax Rev. (2015), 119–125; Haslehner, op. cit. *supra* note 36, pp. 443–445.

46. It is even doubtful whether the Commission proposal for the adoption of a transfer Pricing Directive –mentioned *supra* in note 5 – would bar State aid issues, because aid could arise through a deficient enforcement of its content, providing certain undertakings with a selective advantage.

47. This topic is addressed *infra* at sections 4.2. and 4.3.

48. See Brauner, "An international tax regime in crystallization", 56 *Tax Law Review* (2002), 259–328, at 274–275; Fleming, Peroni, and Shay, "Worse than exemption", 59 *Emory Law Journal* (2009), 79–150, at 125; Benshalom, "Rethinking the source of the arm's-length transfer pricing problem", 32 *Virginia Tax Review* (2013), 425–460, at 427.

> tax planning opportunities are available through the separation of functions, assets, and risks and cost-based remuneration schemes in high-tax jurisdictions to allocate residual profits in low- or no-tax jurisdictions, the transmission of intangibles that are difficult to value, or the overvaluation of services provided from a low-tax jurisdiction, among other options.[49] Such ample discretion is pivotal in what regards the evaluation of the content of individual tax rulings on transfer pricing matters, to determine whether they are in line with applicable transfer pricing regulations or whether they constitute deviations amounting to a selective advantage.[50]

In the following sections, the described features will become a factor in building a reference framework and assessing derogations potentially leading to State aid.

4. Common denominators to define a proper framework of reference

The determination of an adequate reference framework for assessing transfer pricing rules based on the arm's length standard must contemplate three essential aspects, specifically to define: (1) which operators are comprised in the framework (subjective reach); (2) which rules define the content of the framework (formal reach); and (3) the specific content of the regulations under scrutiny (substantive reach).

These issues largely correspond to those raised by the Commission in the tax rulings cases, where a novel approach was adopted by posing the following entangled arguments. First, the Commission considered that the corporate tax system as a whole should define the reference framework. This is because related and non-related entities must be treated equally, and the arm's length standard – as the profit allocation standard of choice – is an essential tool for achieving such equalization. Second, the Commission considered that, as the arm's length standard establishes the means to ensure a level playing field, it stems directly from Article 107(1) TFEU itself and not domestic law. Third,

49. See an overview of these issues in Collier and Andrus, *Transfer Pricing and the Arm's Length Principle after BEPS* (OUP, 2017) and Torvik, *Transfer Pricing and Intangibles: US and OECD Arm's Length Distribution of Operating Profits from IP Value Chains* (IBFD, 2019). Although the OECD/G20 Base Erosion and Profit Shifting project partially addressed some of these issues, the specific impact in terms of the prevention of profit shifting seems modest, according to Zucman et al., "Global tax evasion report 2024" (2023) available at <www.taxobservatory.eu//www-site/uploads/2023/10/global_tax_evasion_report_24.pdf>.

50. This issue is analysed *infra* at section 5.3.

the arm's length standard has content that is not determined by the regulations present in domestic law but by an abstract interpretation of the arm's length standard concretized through using the OECD Transfer Pricing Guidelines.

This section aims to deconstruct the arguments posed by the Commission in the tax rulings cases, in accordance with the defined framework prongs. Although some of the Commission's claims have already been assessed by the ECJ, it is still relevant to do so in order to build a proper foundation, on which the assessment of transfer pricing regulations based on the arm's length principle will be critically conducted afterwards.[51]

4.1. *Subjective framework: All corporate taxpayers?*

The subjective framework aims to define the undertakings comprised in the analysis. This factor must be determined in accordance with the objectives of the regulations under consideration. At the level of regulatory taxes, the framework usually comprises those agents whose behaviour is to be nudged or those causing externalities that should be internalized.[52] The *Kernkraftwerke Lippe-Ems* case may illustrate this aspect, as it referred to a German tax on using nuclear fuel to produce electricity. The claimant – a nuclear energy producer – considered that such a tax would place other energy producers in a more advantageous position. The Court dismissed such an approach because the tax was aimed at financing the rehabilitation of a radioactive waste disposal facility.[53] Thus, the reference framework comprised undertakings capable of producing the radioactive waste that had to be processed afterwards. As only nuclear fuel producers generated such waste and all were subjected to the tax, no derogation was found and therefore no prohibited aid.[54]

In contrast, the primary objective of corporate income taxes is plainly to raise revenue.[55] Such purpose may be comprehensively asserted, meaning that

51. See *infra* section 5.

52. Schön, op. cit. *supra* note 30, pp. 11–12. Issues may arise in determining whether the design of the tax fulfils the declared aim. An example is the ECJ decision on a Spanish tax on large sales areas that was announced as an environmental tax but, at the same time, seems to aim to promote small retail businesses, which may be problematic from a State aid view. See Joined Cases C-236/16 & 237/16, *ANGED*. See also Ismer and Piotrowski, "Selectivity in corporate tax matters after World Duty Free: A tale of two consistencies revisited", 46 Intertax (2018), 156–166, at 165.

53. Case C-5/14, *Kernkraftwerke Lippe-Ems*, EU:C:2015:354, paras. 78–80.

54. Yet, delineating the subjective reference framework is not always straightforward. See Case C-487/06 P, *British Aggregates*, EU:C:2008:757. For a critical view, see Martín Jiménez, op. cit. *supra* note 22, at sec. 8.3.

55. Raising revenue would be the aim of the corporate tax as a whole, yet corporate tax regulations may pursue other specific aims, e.g. the promotion of Research & Development

the subjective reference framework should *prima facie* capture all undertakings liable for corporate income taxes.[56] Notwithstanding, the arm's length standard has a more restricted reach, as it affects related-party transactions and often only those conducted at a cross-border (MNE) level. Moreover, the specific regulations in which the arm's length standard is encapsulated, i.e. transfer pricing regulations, may impact related-party transactions differently across sectors, which could lead to determining an even more restricted set of undertakings. Which subjective reference framework should be adopted for transfer pricing? Should it comprise all corporate income taxpayers or only those covered by the applicable domestic transfer pricing regime? Surprisingly, in the tax rulings cases, the ECJ left the question unaddressed. Yet this section aims to provide a normative answer to this question, in contrast with the stance taken by the Commission in the said cases.

The Commission *prima facie* opted for a comprehensive approach in the tax rulings cases. Specifically, it was considered that the general corporate income tax system of the jurisdiction under scrutiny should form the reference framework. As corporate taxes aim to tax the profits of all covered entities, the Commission included all resident entities and branches of non-resident entities located in the country in the framework.[57] Therefore, both related and non-related entities were considered to be in a similar factual and legal situation.[58] Further, the Commission asserted that the differences in determining the taxable profit of stand-alone and integrated companies do not affect such an approach, as the overall goal of the corporate income tax is to achieve the ultimate objective of determining the taxable bases of both types of companies equally.[59]

through regimes such as patent boxes or super deductions. See a survey of these regulations at Danon (ed.), *Tax Incentives on Research and Development* (IFA Cahiers de Droit Fiscal International vol. 106A, 2015).

56. Joined Cases C-20 & 21/15 P, *World Duty Free*, para 63. See Szudoczky, "Convergence of the analysis of national tax measures under the EU State aid rules and the fundamental freedoms", 15 EStAL (2016), 357–380, at 361–363. See also Ismer and Piotrowski, op. cit. *supra* note 52, at 158–159.

57. Commission final decision on Apple, cited *supra* note 14, para 228; Commission final decision on the Excess Profits scheme, cited *supra* note 13, para 121; Commission final decision on Fiat, cited *supra* note 15, para 194; Commission final decision on Starbucks, cited *supra* note 17, para 232; Commission final decision on Amazon, cited *supra* note 16, para 588.

58. Commission final decision on Apple, cited *supra* note 14, para 229; Commission final decision on the Excess Profits scheme, cited *supra* note 13, para 133; Commission final decision on Fiat, cited *supra* note 15, para 209; Commission final decision on Starbucks, cited *supra* note 17, para 236; Commission final decision on Amazon, cited *supra* note 16, para 593.

59. Commission final decision on Apple, cited *supra* note 14, para 230.

However, the present authors submit that it is misleading to define the corporate tax system as a whole as the reference framework when the arm's length standard forms part of the design of the tax.

Once an EU Member State has decided to adopt a specific profit allocation mechanism, the framework of reference should be defined in accordance with its aim. In the case of the arm's length standard, that aim would be to limit profit-shifting opportunities and achieve a certain level of parity in the treatment of both group and stand-alone undertakings.[60] These aspects concern only group undertakings; therefore, the reference framework should refer to only these types. In fact, the truth is that stand-alone and group undertakings, even after implementing the arm's length standard, are not fully comparable. As stated in section 3 above, groups still have significant opportunities for profit shifting, and they generate comparatively more profit than stand-alone entities. Plus, they must abide by the significant compliance duties associated with transfer pricing regulations and the need to document the methodology to arrive at an arm's length valuation of their transactions, which stand-alone entities do not experience. Therefore, the logical framework of reference should be formed by those entities covered by the scope of transfer pricing regulations and not all corporate income taxpayers.

In fact, the Commission contradicts its stance on the reference framework definition when conducting the specific analysis at the level of the existence of selective advantage in all tax rulings cases. Specifically, it held in all cases that a wrong application of the arm's length standard is what led to granting selective advantages.[61] Therefore, it is the reference framework, and the deviation from it envisaged in the contested tax rulings, that constitutes the selective advantage. Concisely stated, as the arm's length standard applies only to MNE groups, the reference framework cannot apply to all corporate income taxpayers because stand-alone entities are unaffected by it.[62] In other words, the Commission announces a reference framework that is abandoned when assessing the existence of a selective advantage.

In the authors' opinion, the only scenario in which the reference framework should comprise all corporate income taxpayers would arise if an EU Member State derogated its MNE profit allocation standard without replacing it. Such

60. See *supra* section 3.

61. It will be shown *infra* at section 4.3 that the understanding of the arm's length standard's content adopted by the Commission was also erroneous.

62. In fact, this was the stance of the Commission in the *Groepsrentebox* decision. See Commission Decision of 8 July 2009 on State aid C 4/2007, *Groepsrentebox*, O.J. 2009, L 288, paras. 83–97. See also Gormsen, "EU State aid law and transfer pricing: A critical introduction to a new saga", 7 JECLAP (2016), 369–382, at 377. See also Buriak and Lazarov, op. cit. *supra* note 42, at 913; Galendi, "State aid and transfer pricing: The inherent flaw under a supranational reference system", 46 *Intertax* (2018), 994–1010, at 1003.

a corporate tax would result in the effective taxation of only stand-alone entities or domestic groups. This is because MNE entities would have the possibility to divert profits to no- or low-tax jurisdictions at their own discretion. In this scenario, the very corporate income tax would be an aid in itself.[63] From a corporate tax perspective, the difference in treatment of stand-alone and related parties would be so stark that the outcome can only be described as entailing a *de facto* selective advantage in favour of group entities.

The described scenario resembles that of the ECJ decision in *Gibraltar*, which referred to replacing that territory's corporate income tax with a combination of three levies,[64] leading to a significantly more advantageous tax treatment of foreign-held entities when compared to those operating domestically. The ECJ considered that the new regime was designed in a manifestly discriminatory manner to circumvent the requirements of EU law on State aid.[65] Stated in a different manner, the new regime would amount to *de facto* selectivity even if *de jure* all three taxes covered all resident undertakings performing business in Gibraltar.[66]

The discussion above leads to the submission that a corporate income tax based on the separate entity approach that does not incorporate an allocation standard to address the differences between related and unrelated companies would amount to forbidden aid. As the ECJ affirms, even measures – or the lack thereof – not entailing a derogation and founded on criteria that are inherently of a general nature may be selective if they, in practice, discriminate between companies that are in comparable situations in the light of the objective of the tax system concerned.[67] True, this *de facto* selectivity approach applied by the Court in *Gibraltar* runs the risk of being an arbitrary State aid regime in which a significant amount of corporate tax measures could be considered prohibited aid. Yet post-*Gibraltar* cases point towards restraint by the Court in using this reasoning, which leads to the conclusion that the *Gibraltar* approach may only be adopted when the difference in treatment is exceptionally blatant.[68] This is especially valid considering later case law that shows a moderation in the approach, especially the one

63. See Case C-526/04, *Laboratoires Boiron*, EU:C:2006:528, paras. 30–48.

64. These levies consisted of a payroll tax, a business property occupation tax and a registration fee.

65. See Joined Cases C-106/09 P & C-107/09 P, *Gibraltar*, para 21.

66. Ibid., paras. 93, 101, 104.

67. See Case C-374/1, *A-Brauerei*, paras. 32–33 and Joined Cases C-885/19 P & C-898/19 P, *Fiat*, para 70.

68. Also supporting the use of the *Gibraltar* doctrine with caution, see Ismer and Piotrowski, op. cit. *supra* note 27, pp. 450–472, at p. 457; Smit, "International juridical double non-taxation and State aid", 25 EC Tax Rev. (2016), 109–112, at 112.

corresponding to progressive turnover taxes.[69] In the authors' opinion, a country that derogated from the arm's length standard without adopting any other proper income allocation method would lead to a *Gibraltar*-like scenario in which entities pertaining to an MNE would be granted a selective advantage when compared to stand-alone entities. It is only in that precise situation that it would be adequate to define the framework of reference as comprising all corporate taxpayers.

Leaving aside this unlikely scenario, the key point is that the reference framework to test transfer pricing regulations against the State aid regime should comprise entities under common control and disregard stand-alone entities, as these subjects are not comparable.

4.2. *Formal framework: Domestic regulations or Article 107 TFEU?*

The framework of reference to assess the compatibility of tax measures with the prohibition on State aid has traditionally been built upon applicable domestic regulations. This is understandable, as the founding treaties do not grant competencies in income taxation matters to the EU. Aside from specific harmonized areas and the need to abide by the fundamental freedoms and the prohibition of State aid, Member States enjoy discretion to design their income taxes, hence, it is impossible to adopt a supra-national reference.[70] Yet, the Commission, in the tax rulings cases, adopted Article 107(1) TFEU itself as a framework from which it derived an abstract arm's length standard "independently of whether a Member State has incorporated this principle into its national legal system and in what form".[71] The Commission based its

69. Case C-75/18, *Vodafone Magyarország*, EU:C:2020:139; Case C-323/18, *Tesco*, EU:C:2020:140; Case C-562/19 P, *Commission* v. *Poland*; and Case C-596/19 P, *Commission* v. *Hungary*, EU:C:2021:202. See Mason and Parada, "The legality of digital taxes in Europe", 40 *Virginia Tax Review* (2020), 175–218. See also Piernas López, op. cit. *supra* note 1, at 1638–1640; Bernatt and Grzejdziak, "Selectivity of State aid and progressive turnover taxes – Leaving the door (too) wide open?: *Commission* v. *Poland*", 59 CML Rev. (2022), 187–202.

70. According to the ECJ, in the absence of EU rules governing the matter, it falls within the competence of the Member States to designate bases of assessment and to spread the tax burden across the various factors of production and economic sectors, as well as the choice of tax rate, the determination of the basis of assessment and the taxable event. See Joined Cases C-106/09 P & C-107/09 P, *Gibraltar*, para 97; Joined Cases C-236/16 & C-237/16, *ANGED*, para 50; Joined Cases C-105/18 to C-113/18, *UNESA*, EU:C:2019:935, para 68; Case C-562/19 P, *Commission* v. *Poland*, para 38; Case C-596/19 P, *Commission* v. *Hungary*, para 44; Case C-831/21 P, *Fachverband Spielhallen*, para 39. This is so, as long as the contested rules comply with the underlying structure of the national tax regime as designed. See Schön, op. cit. *supra* note 21, at p. 474.

71. Commission final decision on the Excess Profits scheme, cited *supra* note 13, para 150; Commission final decision on Fiat, cited *supra* note 15, para 228; Commission final decision on Starbucks, cited *supra* note 17; para 264. Such a blunt statement was replicated in

stance on the *Forum 187* case, referred to the Belgian tax regime for coordination centres.[72] The ECJ stated in that decision that a reduction in the taxable base resulting from a tax scheme – be it a legal provision or a tax ruling – that enables a taxpayer to achieve non-arm's length prices confers a selective advantage.[73] Ultimately, the position of the Commission entails adopting the very prohibition of State aid rules as a benchmark to determine whether aid exists. Most likely due to the circular character of this argument, the Commission complemented this view by deriving a purported general principle of equal treatment in taxation from Article 107(1) TFEU as the arm's length standard specification of that principle.[74]

Why would the Commission adopt such an innovative stance in the tax rulings cases? A plausible answer lies in the assessment of the *Apple* case. The need to refer to Article 107 TFEU as the legal anchor of the arm's length standard was due to the lack of its explicit adoption in Irish tax legislation during the relevant years under scrutiny.[75] Being aware of this, and perhaps in order to preserve coherence in its argumentation, the Commission replicated such reasoning in all the tax rulings cases.[76]

Ironically, such a stretch in the argumentation may cost the Commission a chain of defeats as the ECJ has already dismissed the point in the *Fiat* and the *Amazon* decisions. Specifically, the Court considered that, by referring exclusively to Article 107 TFEU, the Commission applied an arm's length

Commission Notice on the notion of State aid as referred to in Art. 107(1) of the Treaty on the Functioning of the European Union, O.J. 2016, C 262/01, para 172.

72. Joined Cases C-182/03 & C-217/03, *Forum 187*, paras. 96–97. See the critiques posed in Haslehner, op. cit. *supra* note 36, at pp. 440–441, and Kyriazis, *Fiscal State Aid Law and Harmful Tax Competition in the European Union* (OUP, 2023), pp. 158–163. See also Joris and De Cock, "Is Belgium and *Forum 187* v. *Commission* a suitable legal source for an EU 'at arm's length principle'?", 16 EStAL (2017), 607–616.

73. Commission final decision on Apple, cited *supra* note 14, para 249; Commission final decision on the Excess Profits scheme, cited *supra* note 13, para 145; Commission final decision on Fiat, cited *supra* note 15, paras. 222–223; Commission final decision on Starbucks, cited *supra* note 17, paras. 258–259. Similarly, see Commission final decision on Amazon, cited *supra* note 16, para 403. See Gormsen, *European State Aid and Tax Rulings* (Edward Elgar, 2019), pp. 45–47.

74. Mason refers to this as the "sui generis" arm's length principle. See Mason, "Tax competition and State aid", *YEL* (2023), 1–24, at 14, and references quoted therein.

75. Interestingly, the Commission could have opted to build an argumentation line labelling the lack of a defined profit allocation method as amounting to *de facto* State aid, due to the ambiguous and indeterminate character of the Irish profit allocation rules. The chances of success before the ECJ would have been higher than basing the framework of reference on Art. 107 TFEU. Plus, such an approach would have permitted the Commission to adopt the domestic transfer pricing regulations as a reference framework in the rest of the tax rulings cases.

76. See Joined Cases T-778/16 & T-892/16, *Apple*, para 235. See Buriak and Lazarov, op. cit. *supra* note 42, at 914.

standard that cannot be found in the Luxembourg income tax regulations.[77] According to the Court, only the national provisions are relevant for the purposes of analysing whether particular transactions must be examined in the light of the arm's length standard.[78] Furthermore, without harmonization in that regard, the criteria for determining an arm's length outcome falls within the discretion of the Member States, as there are significant differences between their specific application of transfer pricing methods.[79] Additionally, it is interesting to note that, in the *Fiat* case, the Court mentioned the principle of legality in taxation as an EU general principle underpinning the significance of the distribution of competences in this regard.[80] It is especially a counterargument to the purported principle of equality that the Commission invoked to derive the arm's length standard from Article 107(1) TFEU, which would have resulted in a blatant case of competence creep.[81] Ultimately, the Court once again recognizes that States can still exercise their tax autonomy to attract investment.[82]

The Commission's argument ultimately implied that separate entity taxation requires the use of the arm's length standard to allocate income in any case. It is submitted that such an assumption is not correct. Other income allocation systems may be adopted, such as formulary apportionment or the use of fixed margins.[83] Additionally, it is interesting to note that the Commission has recently issued a proposal to adopt a single set of rules to determine the tax base of groups of companies in the EU coupled with a mechanism to distribute such a base among the Member States on a formulaic

77. Joined Cases C-885/19 P & C-898/19 P, *Fiat*, para 91; Case C-885/19 P, *Amazon*, para 42.

78. Ibid., *Fiat*, para 96; Case C-885/19 P, *Amazon*, paras. 43–44.

79. Ibid., para 95.

80. See also mentions at Joined Cases C-451/21 P & C-454/21 P, *Engie*, para 119, and Case C-566/17, *Związek Gmin Zagłębia Miedziowego*, EU:C:2019:390, para 39. See Monsenego, op. cit. *supra* note 19, at sec. 2.2.1, and Dourado, "The FIAT case and the hidden consequences", 51 *Intertax* (2023), 2–4, at 4.

81. See Prechal, "Competence creep and general principles of law", 3 REALaw (2010), 5–22. See also Nanetti and Mameli, "The creeping normative role of the EC Commission in the twin-track struggle against State aids and harmful tax competition", 11 EC Tax Rev. (2002), 185–190; Buriak and Lazarov, op. cit. *supra* note 42, at 919–920; Peters, "Tax policy convergence and EU fiscal State aid control: In search of rationality", 28 EC Tax Rev. (2019), 6–17, at 16; Monsenego, op. cit. *supra* note 19, at sec. 2.2.3.1.

82. Mason, op. cit. *supra* note 74, at 16.

83. See an overview of the literature on other allocation systems in Greil, "The arm's length principle in the 21st century – a literature overview", 6 *Journal of Tax Administration* (2021), 148–198.

basis.[84] Therefore, although it is clear that Member States have chosen to resort to the arm's length standard, policy options should not be restricted in this regard. Yet, this is precisely what occurs when defending the derivation of the arm's length standard from Article 107(1) TFEU itself.[85]

The described approach led the ECJ to base its reasoning on *Fiat* and *Amazon* exclusively on the grounds of an erroneous definition of the reference framework. This way of proceeding led the Court to avoid pronouncing its opinion on any of the other arguments raised by the Commission. These included the subjective aspect of the reference framework analysed in the previous subsection or the valuation analysis prepared to challenge the (non-) arm's length remuneration obtained by Fiat and Amazon per the issued tax rulings. Stated differently, the settling of an incorrect framework of reference by the Commission led the ECJ to exclusively base its decision upon that factor, instead of assessing the relevant substantive aspects of the said cases.[86]

As a result of the foregoing discussion, the conclusion must be that the reference framework must always be the domestic legislation implementing the arm's length standard and not an abstract arm's length standard deriving from Article 107(1) TFEU.

4.3. *Substantive framework: What content for the arm's length standard?*

The concept of a substantive framework refers to the need to analyse thoroughly the specific content of the regulations adopted in the domestic regulations under scrutiny. This is especially relevant in the context of the arm's length standard; to treat arrangements conducted by related parties as if they were adopted by non-related parties is an open mandate that must be concretized, and there are several ways of doing so.[87] In the following sections, several examples will illustrate this aspect, especially those referred to as the adoption of safe harbours to alleviate complexity or the use of tax rulings to enhance certainty. Yet, it is not only the specificities that are problematic – so is the reach of the arm's length standard itself.

An example may illustrate this point. The arm's length standard requires tax authorities to perform upward adjustments to the value of related-party transactions in order to reflect what independent parties would have agreed in identical circumstances. Such an adjustment, in principle, entails an increase in the taxable base. Yet, all EU Member States additionally recognize the

84. See Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT), COM(2023)532 final.

85. See Miladinovic, op. cit. *supra* note 19, at sec. 3.4.

86. Substantive matters are dealt with *infra* at section 5.

87. See Haslehner, op. cit. *supra* note 36, at p. 435. See also Mason, "Tax rulings as State aid – part 4: whose arm's-length standard?", 155 *Tax Notes* (2017), 947–966.

possibility of performing downward adjustments on the taxable base of the counterpart in the transaction to eliminate double taxation in the event that another country previously performed an upward adjustment.[88] Now, assume that an EU Member State decided to allow undertakings covered by transfer pricing regulations to perform downward adjustments without the need to demonstrate that there was a previous upward adjustment at the level of the foreign counterpart. In theory, there would be compliance with the arm's length standard because such a downward adjustment aims to reflect the profit that independent parties would have obtained in identical circumstances. Yet, this could amount to the non-taxation of a portion of the profit corresponding to the synergy gains, i.e. the profit that related parties obtain due to operating in an integrated manner. Group entities would have significant incentives to overstate that synergy gain as much as possible, to benefit from the said downward adjustment regime aiming at equating their profit to the (lower) profit obtained by independent parties in comparable scenarios.[89] Such a regime would clearly make it more attractive for MNEs to establish their headquarters in that country. In such a context, it is submitted that no prohibited aid should arise as long as the described downward adjustment reflects what independent parties would have reasonably agreed and the possibility to perform it is extended to any entity pertaining to a group.[90] This conclusion stems from two interrelated arguments. First, the downward adjustment would aim to equalize the taxable base of related and stand-alone entities, therefore granting equal treatment to both pairs of subjects in that respect. This applies even when it may imply the non-taxation of said synergy gains. Second, from a cross-border perspective, when countries define their tax jurisdiction, they are not bound to address instances of non-taxation; neither are there are any EU law requirements to do so.[91]

88. In fact, this downward adjustment mechanism is envisaged not only in domestic law but also in the EU Member States' tax treaty network. There are mechanisms in place to solve disputes relating to the calculation of the amount of these adjustments, specifically the 1990 Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC) that all Member States have signed, and Council Directive 2017/1852 on tax dispute resolution mechanisms in the EU. For an in-depth analysis of these instruments, see Pit, *Dispute Resolution in the EU* (IBFD, 2018).

89. On the concept of synergy gains and its relevance for state aid purposes, see Galendi, "State aid and transfer pricing: The inherent flaw under a supranational reference system", 46 *Intertax* (2018), 994–1010.

90. See Mason, op. cit. *supra* note 32, at 551, who stresses the need to offer domestic groups the possibility to disregard synergy gains in order to treat all classes equally, specifically cross-border transactions, domestic group transactions, and those for stand-alone entities.

91. See Schön, op. cit. *supra* note 30, at p. 5; Kokott, "Tax harmonisation through the prohibition of State aid?", 21 EStAL (2022), 462–467. See also Galendi, op. cit. *supra* note 89, at 1000. The Commission probably considered this aspect when the Transfer Pricing Directive proposal was elaborated because a uniform content for the arm's length principle adopted

This hypothetical situation was partly discussed in the context of the Belgian excess profits scheme case.[92] Belgium had incorporated the usual formulation of the arm's length standard into its domestic corporate income tax law, along with a rule allowing for a downward adjustment to eliminate double taxation. To be applicable, such a rule required an arm's length upward adjustment in the residence country of a group entity with which the Belgian entity conducted a transaction.[93] The downward adjustment was conditional upon the approval by an Advance Ruling Commission through a tax ruling.[94] Notwithstanding, it was discovered that this Commission granted downward adjustments without verifying whether a previous upward adjustment had been made on the related foreign counterpart.[95] Plus, it considered aspects not contemplated in the applicable law, such as the MNE's investment level in Belgium, employment created, or the existence of centralized activities therein.[96] Given the described disregard of the applicable transfer pricing regulations, it was easily concluded that these tax rulings constituted a selective advantage and, thus, unlawful aid.

Yet, if Belgium had adopted a downward adjustment in its domestic law applicable to all entities covered by its transfer pricing regulations and not conditional on the issuance of a tax ruling contingent on the meeting of other requirements – as proposed in the example above – it is submitted that such a rule would not amount to State aid. The Commission would probably disagree with this stance, as it maintained in the excess profits scheme case that "such taxation represented a lowering of the tax burden of the beneficiaries of the scheme, in comparison with the burden that would have arisen from normal taxation, under the Belgian corporate income tax system, which would have covered all profits actually recorded".[97]

This article contends that such an interpretation is misleading. Granting a downward adjustment to reflect an arm's length outcome would equalize the calculation of the taxable profit of resident entities pertaining to an MNE with those profits obtained by domestic parties operating independently in the

EU-wide would curtail the possibility of introducing the described measure into domestic law. Such content corresponds to the latest version of the OECD Transfer Pricing Guidelines. See Proposal for a Council Directive on transfer pricing, cited *supra* note 5, Art. 14(1).

92. Case T-131/16 RENV, *Belgian Excess Profits Scheme*.

93. Art. 185(2)(b) of the CIR 92: "when profit is included in the profit of one company which is already included in the profit of another company and the profit so included is profit which should have been made by that other company if the conditions agreed between the two companies had been those which would have been agreed between independent companies, the profit of the first company is adjusted in an appropriate manner."

94. See Memorandum to the Law of 21 June 2004.

95. Case T-131/16 RENV, *Belgian Excess Profits Scheme*, paras. 77, 85.

96. Ibid., para 130.

97. Ibid., para 86. See also Buriak and Lazarov, op. cit. *supra* note 42, at 915.

market. In other words, the jurisdiction to tax MNE profits of such a country would be constrained to taxing only those profits that an independent party would have obtained, meaning that the profits generated due to group dynamics would be disregarded for these purposes. As stated, such a self-standing downward adjustment would be plausible from a symmetry perspective. If the aim of the arm's length standard is to equalize the treatment of related and non-related parties, performing downward adjustments would be as reasonable as performing upward adjustments. Consequently, the Commission's argument that entities pertaining to an MNE are obtaining an advantage because independent operators cannot perform a downward adjustment in their taxable base would be incorrect. It is precisely MNE operators who must conduct such a downward adjustment for their taxable base in order to be equated to that of independent operators.

Overall, this section has shown that the reference framework should be defined by applicable domestic transfer pricing regulations applicable to groups of companies, defined as companies pursuing a common interest. In the next section, possible derogations from such a framework will be analysed to delineate which instances amount to selective advantages and, thus, to prohibited aid.

5. Derogations from the arm's length standard potentially resulting in State aid

This section assumes that adopting the arm's length standard in the domestic transfer pricing regulations of any Member State defines the reference framework of the analysis and that any derogation from it may lead to State aid. Specifically, as the concrete implementation of the arm's length rationale depends on the domestic regulations and their enforcement depends on each Member State, it may well be that specific rules or administrative practices result in a derogation leading to a selective advantage and thus prohibited aid. The following subsections will analyse such instances.

5.1. *The scope of transfer pricing regulations as a selectivity problem*

The first aspect that should be reviewed when addressing derogations from an arm's length reference framework is the scope of this income allocation system defined by domestic law. In principle, it would be assumed that these regulations apply whenever a community of interest between the parties excludes the achievement of their individual interests in favour of a common interest. Only then would the risk that non-market transactions pose to the tax system manifest itself because of the distortion in determining the taxable base through profit shifting that this would allow.[98] Suppose a country chooses the arm's length standard as an allocation method but configures the definition of related parties in an underreaching manner. In that case, there may be transactions by parties sharing a common interest resulting in non-market outcomes. These would, therefore, enjoy a selective advantage derived from the existence of privileged entities that could engage in profit shifting, compared to those covered by transfer pricing regulations.

In this respect, three different aspects should be evaluated. First, the applicability of transfer pricing regulations only in cross-border transactions as a State aid problem. In most EU countries, transfer pricing regulations concern only cross-border transactions, probably because the risk of profit shifting leading to low or no taxation is higher when compared to domestic transactions for which the income would still be taxable as the recipient is resident in the same country and, therefore, that country may exert its taxing powers. Notwithstanding, in a purely domestic scenario, to be able to conduct non-market transactions could result in profit shifting and lead to a tax advantage that would not have arisen had transfer pricing rules been applicable. Domestic transactions with related loss-making entities or entities enjoying special tax regimes leading to lower effective tax rates would be similar to cross-border profit shifting. A selective advantage benefiting domestic groups could arise if there is no obligation to value these domestic transactions at arm's length. However, countries could react to this specific form of "domestic profit shifting" with special anti-avoidance rules, tailored to prevent a tax advantage from arising. If such rules are adopted, the exclusion of domestic groups from the scope of transfer pricing regulations could be justified by stating that the risk of domestic profit shifting is minimal or non-existent compared to cross-border instances. At the same time, simplification is achieved given the demanding requirements of transfer pricing regulations in terms of compliance. Moreover, from a different perspective, it may be affirmed that restricting the scope of transfer pricing rules to cross-border transactions only, without adopting measures to combat profit shifting at the domestic level, could lead to a selective advantage in favour of domestic groups and therefore to potential State aid.

Second, the rules determining when undertakings are considered related, i.e. forming part of the same group of companies, may also be scrutinized from a State aid perspective. Each Member State defines this critical aspect of transfer pricing regulations without any standardized reference at hand,

98. See the discussion *supra* in section 3.

because the OECD does not offer guidelines on this matter.[99] The logical way of defining the "related companies" concept would be to refer to the existence of a common interests, either due to common control, the exertion of influence in the management, or any other *de facto* possibility in which two entities operate not to forward their own interest. This is the case of, for example, the transfer pricing regulations of Luxembourg[100] and the Netherlands,[101] which, therefore, do not pose issues from a State aid perspective in this regard. In contrast, other Member States offer a closed definition, usually entailing a list of scenarios in which control is assumed to exist but risking leaving out other scenarios in which control may be exerted. Such an approach might be problematic for State aid in cases where common control exists, but the entities are not considered related due to the said closed definition. Here, a selective advantage could arise in the form of being outside the scope of transfer pricing regulations.

Third, several countries establish exemptions from documentation duties for small- and medium-sized enterprises or when transactions do not reach certain thresholds. Formal duties are indeed the cause of significant compliance costs to groups captured by transfer pricing regulations. Hence, enjoying relief from those could be regarded as amounting to a selective advantage. For instance, there is a transaction-based threshold in Cyprus. Transfer pricing documentation duties are only effectuated if related party transactions exceed the sum of EUR 750,000 in aggregate per category of transaction per fiscal year.[102] In Ireland, the threshold is revenue-based; no transfer pricing documentation is required if the consolidated group revenue of the previous fiscal year is EUR 50 million or less.[103] Yet, this difference in treatment may be justified due to simplification concerns to alleviate SMEs from the heavy compliance burden that entails documenting the methodology to arrive at market prices, so that the said thresholds would not constitute a prohibited aim.

99. However, see the definition of related parties enshrined in Proposal for a Council Directive on transfer pricing, cited *supra* note 5, Art. 5.

100. Art. 56 of the Luxembourg Income Tax Law (*Loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu*).

101. Art. 8b of the Dutch Corporate Income Tax Act of 1969 (*Wet op de vennootschapsbelasting 1969*).

102. Art. 33(9)(a) of the Cyprus Income Tax Law of 2002, N118(I), as amended (*ο περι Φορολογίας του Εισοδήματος Νόμος*).

103. See Part 35A-01-01 of the Tax and Duty Manual, section 8.6, to be read alongside s. 835g, Part 35A of the Taxes Consolidation Act 1997, as inserted by the Irish Finance Act 2010 and as amended by the Finance Act 2019 to 2023.

5.2. *Specific regimes within transfer pricing regulations that deviate from the arm's length standard rationale*

The content of the domestic transfer pricing regulations is substantially similar in each Member State due to standardization resulting from a general adoption of the recommendations posed in the OECD Transfer Pricing Guidelines. Yet, specific domestic deviations exist, and some may risk contravening the arm's length rationale. This also deserves attention from a State aid perspective. An example is the *Forum 187* case that referred to the Belgian coordination centres regime assessed by the ECJ in 2003. The Court considered that a regime allowing for the application of a flat margin rate over a restricted set of costs was not representative of the remuneration that stand-alone entities would obtain under comparable circumstances. Thus, it amounted to prohibited aid due to its derogation from the reference framework drawn by the Belgian transfer pricing regulations based on the arm's length standard.[104]

In fact, adopting regimes that entail fixed valuation references by definition poses derogation issues in relation to the arm's length standard, which requires reflecting what stand-alone companies would have agreed in identical circumstances through a detailed case-by-case analysis.[105] There are two noteworthy examples. First, several Member States recognize the possibility of using a fixed cost-plus reference to determine the profit derived from rendering low value-added services that are established at a 5% mark-up.[106] This possibility is contemplated in the OECD Transfer Pricing Guidelines as a simplification measure.[107] Second, the OECD is currently working on a proposal to standardize the remuneration of related party distributors that perform routine marketing and distribution activities, known as Amount B.[108] The determination of the appropriate fixed returns would result from benchmarking analyses that would be updated regularly to reflect market outcomes as much as possible.

104. Joined Cases C-182/03 & C-217/03, *Forum 187*, paras. 95–97.

105. See Rubini, *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (OUP, 2009), p. 250. For an opposing view, see Monsenego, op. cit. *supra* note 19, at sec. 6.2.1.

106. This is true, e.g. for Austria, Denmark, Ireland, Italy, Germany, and the Netherlands. See the answer to query 16 of the per-country reports referred to in *supra* note 34, posing the question "Do you have any simplified approach for low value-adding intra-group services?".

107. See OECD, cited *supra* note 4, para 7.61.

108. See *OECD*, Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint, 2020 and *OECD*, Pillar One – Amount B, 2024. For an overview, see Kostić and Navarro, "Pillar One and mobility – a truly global solution?", 51 *Intertax* (2023), 840–850, at 845–849.

Clearly, these safe harbour references are selective, as only certain types of activities are covered. Yet, simplification measures are very often adopted at the cost of precision in law. Sometimes, taxation is not based on facts but on an acceptable version of them. Specifically, a company's profit is calculated through a number of accounting and tax conventions that allow it to arrive at a profit that is sufficiently acceptable.[109] In this regard, two convincing arguments would consider safe harbour measures as not entailing prohibited aid. First, if they are tailored in order to reflect arm's length outcomes as much as possible – as happens with Amount B – it could be held that a derogation does not exist, as results would be practically identical. Second, the complexity of transfer pricing and its compliance burden implies that selective measures may be justified to enhance simplification, as stated above in the context of setting thresholds on transfer pricing documentation duties.[110] That said, it is clear that the more a safe harbour valuation measure deviates from the arm's length reference, the higher the risk of constituting an unjustified selective advantage and, thus, unlawful aid. To avoid such an outcome, a possible solution would be adopting safe harbour measures with the option for the tax authorities to prove otherwise and provide an arm's length value that would prevail if there is a mismatch. This way, simplification would be achieved but not at the cost of breaching the arm's length standard. Yet, in such a setting, the achievement of certainty could be compromised, as the risk of a challenge by tax authorities would still exist.

5.3. *Individual acts deviating from the content of applicable domestic transfer pricing regulations*

This subsection refers to any act by the tax authorities that results in an undertaking or a specific group thereof covered by transfer pricing regulations being treated in a way that is contrary to the demands of those regulations. The paradigm in this context would be the contested tax rulings in the *Amazon*, *Apple*, *Fiat*, *Nike*, and *Starbucks* cases.[111] According to the Commission, in those cases, a more favourable treatment to certain MNEs was granted through individual tax rulings that constituted a selective advantage, contrary to the prohibition of State aid.

Tax rulings grant certainty over the tax consequences of a covered transaction or set thereof. Rulings are meant to be a tool to foster legal certainty for taxpayers who want to secure their tax position against the risk of being audited and challenged by tax authorities in scenarios in which the

109. See Schoueri, op. cit. *supra* note 38, at 697.
110. See an in-depth analysis in Miladinovic, op. cit. *supra* note 19, at sec. 7.4.
111. See references at *supra* notes 14–18.

applicability of a rule or a principle is somewhat ambiguous. Yet, when a tax ruling endorses an outcome that does not reliably reflect what would result from a normal application of the ordinary tax system, that ruling may confer a selective advantage insofar as that selective treatment results in lowering that taxpayer's tax liability in the Member State compared to companies in a similar factual and legal situation.[112] In fact, whenever a ruling deviates from the said framework, it automatically grants a selective advantage because, by definition, tax rulings are directed towards individual taxpayers.[113] For instance, this may happen when the tax authorities of a country agree on the content of a tax ruling proposed by the taxpayer, without reviewing its content – as happened in Luxembourg for several years.[114]

To assess these cases, it is important to examine two aspects, specifically, the determination of the reference framework and the assessment of the existence of a derogation. As both aspects have been dealt with repeatedly in this article, what follows are specific queries raised in the context of the tax rulings cases.

First, regarding the definition of the reference framework, interesting arguments were raised in the rulings cases on the proper definition of the set of undertakings to be adopted as a reference. The *Fiat* case, in which the MNE presented a two-pronged argument, may be used to illustrate this point.[115] First, Fiat considered that the framework reference should be the tax treatment of other captive financial services companies, thereby challenging the above-mentioned stance of the Commission that all corporate taxpayers should conform to the framework of the analysis. Second, it was submitted that the Commission should have compared the contested tax ruling with the 21 other taxpayers whose advance pricing agreements were submitted to it. Certainly, the proposed restriction in the subjective scope of the reference framework aims to impede the comparison of taxpayers with different

112. See Case C-6/12, *P Oy*, EU:C:2013:525, para 27; Joined Cases C-649/20 P, C-658/20 P & C-662/20 P, *Lico Leasing*, EU:C:2023:60, para 57. See Commission Notice, cited *supra* note 71, para 170.

113. See Case C-15/14 P, *MOL*, EU:C:2015:362, para 60. See also Gormsen, op. cit. *supra* note 73, at p. 53.

114. Daly, "*Fiat* v *Commission*: A misconceived approach", 86 *Modern Law Review* (2023), 1489–1503, at 1492–93, elaborates on the topic as follows: "At the time of the (Fiat) ruling, Luxembourg had rudimentary tax ruling processes. There was one tax official responsible for granting rulings, Marius Kohl, or 'Monsieur Ruling'. When asked in an interview how he verified whether a company's pricing information was accurate, Mr Kohl licked his thumb and held it up in the air. During Kohl's tenure some 40 per cent of tax rulings were approved within the day of application, as Marian found when he combed through the Luxleaks rulings". The estimate was made in Marian, "The State administration of international tax avoidance", 7 *Harvard Business Law Review* (2017), 201–265, at 217–218.

115. Joined Cases C-885/19 P & C-898/19 P, *Fiat*, para 60.

characteristics. The narrower the subjective scope is, the more likely it is that no selective advantage exists if the advantageous tax treatment was granted to all members of such a defined group, as no selectivity issue would arise with such an approach. In this regard, the authors believe that the subjective framework of reference should be formed by all taxpayers covered by the arm's length standard adopted by the domestic transfer pricing regulations.[116] It is true that the methodology to determine what independent parties would have agreed in an identical setting leads to a detailed analysis of the characteristics of the economic activity of the parties. Yet, adopting a narrower group as a reference could lead to distortions in the analysis because, there is a risk that tax authorities might grant aid to taxpayers in specific sectors against the domestic requirements of the country without it being considered selective.

Yet, another nuance must be noted. The previous section acknowledged that specific rules within transfer pricing regulations may sometimes deviate from the arm's length rationale and potentially lead to selective advantages. This double layer – rules enforcing the arm's length standard and specific rules potentially deviating from it – questions how tax rulings as a third layer should be inserted. It is submitted that, from the perspective of a tax ruling, the framework of reference should be defined according to the rules to be applied. If, for instance, a tax ruling is issued confirming that a taxpayer may opt for a particular transfer pricing safe harbour, the framework should be defined by it. If the safe harbour contradicts the arm's length rationale, then the issue is the safe harbour itself and not the tax ruling concretizing its application. If that were the case, what should be challenged as potential State aid is the safe harbour itself vis-à-vis the arm's length standard enshrined in the domestic transfer pricing regulations, and not the tax ruling.

Second, once the framework has been defined, a derogation entailing a selective advantage must be acknowledged to classify a tax ruling as prohibited State aid. In such a context, then, ts any deviation from the framework to be labelled as a derogation? In an open-ended standard such as the arm's length, this question is a pressing one. Depending on the available information on comparable independent references, enforcing transfer pricing rules may allow only an approximated market value to be reached.[117] It is precisely this factor that leads to the uncertainty and complexity that the issuance of a tax ruling intends to curtail. For instance, the General Court warns in several of the tax rulings cases that the determination of the transfer

116. For a discussion, see *supra* section 4.1.

117. See Gunn and Luts, op. cit. *supra* note 45, at 121 and Avi-Yonah and Mazzoni, "The Apple State aid decision: a wrong way to enforce the benefits principle?", 84 *Tax Notes International* (2016), 837–845, at 840.

prices of a company belonging to a multinational group is approximate in nature. It also cautions that there are inherent inaccuracies in the very application of the methodology used to obtain a reliable approximation of market-based results.[118] Therefore, the administrative discretion inherent to any valuation assessment included in a tax ruling *prima facie* should not be problematic from the perspective of the prohibition of State aid as long as it remains within reasonable boundaries.[119] Otherwise, in the words of Advocate General Kokott, the Commission would "become a de facto supreme inspector of taxes and the Courts of the European Union, by dint of reviewing the Commission's decisions, would become de facto supreme tax courts".[120] Thus, the query to be addressed clearly seems to be challenging to answer, i.e. where to make the distinction for separating an acceptable from an unacceptable determination of the arm's length valuation? Should the Commission be able to declare any deviation from its own conception of an arm's length outcome as State aid?[121]

In the tax rulings cases, the Commission thoroughly analysed the valuation methods endorsed by the contested tax rulings and concluded in all cases that their content could not be considered a reliable approximation of market outcomes. Without wishing to comprehensively examine each and every one of the situations that are subject to valuation by the Commission and their complex singularities, the point to be highlighted is that the Commission sustains that the methodology agreed in each case was severely flawed. For instance, the purported aid granted to Apple of EUR 13 billion clearly depicts the differences in the valuation approach by the Commission compared to Apple and Ireland. These are cases that do not regard small nuances in the valuation process but instead fundamental differences in arriving at market prices. Yet, the Commission must demonstrate that the alleged methodological errors lead to an unreliable approximation of the arm's length results and that

118. Joined Cases T-755/15 & T-759/15, *Fiat*, EU:T:2019:670, para 204; Joined Cases T-760/15 & T-636/16, *Starbucks*, para 196; Joined Cases T-778/16 & T-892/16, *Apple*, para 216; Joined Cases T-816/17 & T-318/18, *Amazon*, EU:T:2021:252, para 126.

119. See Lang and Zeiler, "Discretionary power of tax authorities as a State aid problem" in Haslehner, Kofler, and Rust (Eds.), *EU Tax Law and Policy in the 21st Century* (Kluwer Law International, 2017), pp. 91–106.

120. Opinion of A.G. Kokott in Case C-451/21 P, *Engie*, EU:C:2023:383, para 96. See Rossi-Maccanico, "AG Kokott tries to bring clarity to the selectivity test for individual tax rulings", 32 EC Tax Rev. (2023), 183–188. The same concern was already expressed by Daly, "The power to get it wrong", 137 *Law Quarterly Review* (2021), 589–603. See also Mason, "The AG's Opinion in Apple: Two steps forward, one step back", 112 *Tax Notes International* (2023), 1315–1320, at 1318.

121. See Gunn and Luts, op. cit. *supra* note 45, at 121. See also De Broe, "State aid review against aggressive tax planning: Always look a gift horse in the mouth'", 24 EC Tax Rev. (2015), 290–293, at 291–292 and Avi-Yonah and Mazzoni, op. cit. *supra* note 117, at 840.

this has the effect of reducing the tax burden compared to what it would have been if an assessment had been made in accordance with the arm's length standard. For instance, in the *Starbucks* decision, the General Court criticized the Commission for limiting its analysis to questioning the methodology used in the price report and its plausibility instead of setting out the appropriate market price range.[122]

In addition, the ECJ has stressed that mere non-compliance with the methodological recommendations by the OECD on transfer pricing is insufficient to prove the existence of State aid within the meaning of Article 107 TFEU.[123] On the contrary, the Commission must demonstrate that the methodological errors it identified did not allow it to arrive at an approximation of an arm's length result. It must additionally show that the result that was reached entailed a reduction in taxable profits compated to those that would have been calculated on an arm's length basis. This is a relevant matter for determining the burden of proof that the Commission must meet when ascertaining the existence of State aid.[124]

Ultimately, the threshold to be met for a deviation to be relevant in the context of transfer pricing regulations was settled by the Court of Justice in the *Fiat* decision – a quite stringent one indeed. The terms employed are so blatant that they merit being quoted:

> "122. In particular, after having observed that a Member State has chosen to apply the arm's length principle in order to establish the transfer prices of integrated companies, the Commission must, in accordance with the case-law cited in paragraph 70 of the present judgement, be able to establish that the parameters laid down by national law are *manifestly inconsistent* with the objective of non-discriminatory taxation of all resident companies, whether integrated or not, pursued by the national tax system, by *systematically leading to an undervaluation* of the transfer prices applicable to integrated companies or to certain of them, such as finance companies, as compared to market prices for comparable transactions carried out by non-integrated companies." (emphasis added)

Consequently, the Court stipulates a fairly demanding burden of proof standard,[125] which apparently would have been met in all of the tax rulings

122. Joined Cases T-760/15 & T-636/16, *Starbucks*, paras. 426–427.

123. Joined Cases C-885/19 P & C-898/19 P, *Fiat*, paras. 95–96; Case C-885/19 P, *Amazon*, paras. 44–47. This aspect is also connected with the building of a framework of reference based on the content of the domestic law being contested, as explained *supra* in section 4.3.

124. See Parada, "Amazon and the State aid tax saga", 1 *Cahiers de fiscalité luxembourgeoise et européenne* (2022), 95–110.

125. Similarly, see Opinion of A.G. Kokott in Case C-451/21 P, *Engie*, para 92: "not any incorrect tax ruling but only those which are manifestly erroneous in favour of the taxpayer

cases if one confronts – as the ECJ did not do – the comparability analysis proposed by the Commission in isolation compared to the one admitted by the respective tax authorities of the countries involved. Once again, for the external observer, it is frustrating to see that the discussion at the ECJ level did not revolve around this aspect, which lies at the core of the existence of a prohibited aid. It instead focused on the fact that the Commission did not build the reference framework by adhering to national law.[126]

Third, it is essential to mention that, although tax rulings are the paradigm of this category of aid within transfer pricing, other forms of deviation may also be noted. For instance, an assessment by the tax authorities that results in an outcome different from that prescribed in the applicable transfer pricing rules could prima facie be considered as leading to a selective advantage. Yet, two caveats must be pointed out. First, the assessment should meet the "manifestly inconsistent" test envisaged in *Fiat* to amount to State aid. Second, if the difference in treatment stems from a tax assessment that is detrimental to the assessed group compared to other undertakings, it must be highlighted that the ECJ has not yet acknowledged the concept of "negative aid". This concept designates instances when a taxpayer is treated less favourably than the regulations require so that its competitors comparatively benefit from an advantage.[127] Plus, calculating the amount to be recovered as aid would seem impossible in such an approach. Therefore, if the tax authorities of a Member State open proceedings against a specific entity on its related-party transactions and enforce transfer pricing rules in a detrimental manner, it is doubtful whether a State aid complaint would prosper. This

constitute a selective advantage. Derogations from the applicable national reference framework are manifestly erroneous if they cannot be plausibly explained to a third party, such as the Commission or the Courts of the European Union, and are therefore equally evident to the taxpayer concerned". See also Buriak and Lazarov, op. cit. *supra* note 42, at 933; Lyal, op. cit. *supra* note 12, at 1041. This stringent standard goes along the lines of the one defined in *Engie* as regards the possible existence of State aid at the level of rule enforcement. The Court stated that if the Commission "would itself be able to define what does or does not constitute a correct application of such a provision, which would exceed the limits of the powers conferred on it by the Treaties in the field of State aid review and would be incompatible with the fiscal autonomy of the Member States". See Joined Cases C-451/21 P & C-454/21 P, *Engie*, para 155.

126. This issue was dealt with *supra* in section 4.3. The Opinion of A.G. Pitruzzella in Case C-465/20 P, *Apple*, does not consider the outcome of *Fiat* and recommends that the ECJ remand the case for further technical consideration. Yet, after that Opinion was issued, the ECJ published the *Amazon* decision, consolidating the ECJ line of reasoning explained *supra* in section 4.3. Specifically, a reference framework not based on domestic regulations but on an abstract understanding of the arm's length standard is contrary to the methodology used to address the existence of State aid. Therefore, the ECJ will most likely decide in favour of Apple and Ireland due to that error in the approach taken by the Commission. Cf. Mason, op. cit. *supra* note 120, at 1318–1319, and Daly, op. cit. *supra* note 114, at 1499.

127. See an analysis in Schön, op. cit. *supra* note 21, at 451–453, with further references to case law.

applies even when the requirement of selectivity and the existence of an advantage may conceptually be said to exist.

6. Conclusion

This article intended to offer a systematic analysis of transfer pricing regulations based on the arm's length standard under the EU State aid regime, therefore going beyond the mainstream approach consisting of the individual assessment of the "tax rulings" cases (*Apple*, *Fiat*, *Starbucks*, and the *Excess Profits* scheme). The analysis follows the methodology established by the ECJ to assess the existence of State aid in tax matters, by which a regime that deviates from a reference framework could lead to a selective advantage, potentially entailing prohibited aid.

To that effect, the article examined the aim and contradictions of transfer pricing rules based on the arm's length standard, which is the MNE profit allocation mechanism adopted by all EU Member States. It was shown that the arm's length standard distributes the tax burden among taxpayers, defines the jurisdiction to tax MNE profit by coordinating tax revenue distribution among States, and mitigates profit shifting. Yet it also involves some contradictions, the most remarkable being that it equates settings that are non-comparable from an economic perspective, specifically the interactions between stand-alone parties and those of controlled entities pertaining to the same MNE. Another conflicting aspect refers to the fact that the prevention of profit shifting is one of the main goals of transfer pricing, yet transfer pricing regulations are a catalyst for such a phenomenon. These features become relevant when building a reference framework and assessing derogations that potentially lead to State aid.

The reference framework was built from a subjective, formal, and substantive standpoint. Respectively, it was concluded that: (1) the subjective framework should comprise entities under common control and not include stand-alone entities, as these subjects are not comparable; (2) the formal framework must always be the domestic legislation implementing the arm's length standard and not an abstract arm's length standard deriving from Article 107(1) TFEU; and (3) the specific content of the regulations adopted in the domestic regulations that are being discussed must be scrutinized.

Derogations from the described reference framework were assessed from a triple perspective. First, limitations on the scope of transfer pricing regulations were reviewed through the lens of selectivity. The applicability of these rules only to cross-border transactions, the determination of the conditions defining the existence of related undertakings, and the thresholds establishing exemptions from documentation duties were examined as potentially leading to selective advantages. Second, derogations could arise in the context of specific regimes within transfer pricing regulations that deviate from the arm's length standard rationale. For instance, adopting regimes that entail fixed valuation references may pose derogation issues in relation to the arm's length standard. It was concluded that safe harbour regimes are selective, as only certain types of activities are covered. Yet, some may find justification grounds – essentially based on the need for simplification – that would render the regime not contrary to EU law. Third, derogation issues referred to individual acts deviating from the content of applicable domestic transfer pricing regulations – the paradigm being the tax rulings cases – were examined, including the question of whether any deviation from the framework must be labelled as a derogation and the "manifestly inconsistent" standard adopted by the ECJ.