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Client briefing

COMPETITION AND EU LAW

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CJEU annuls European Commission's decision in the Fiat State aid case and clarifies the selectivity requirement in cases of tax rulings on non-harmonised taxes

The Court of Justice of the European Union has annulled a General Court judgment and European Commission decision that considered the tax ruling issued to Fiat as State aid incompatible with the internal market, on the grounds that the Commission erred in analysing the "selective advantage" requirement of the aid. The selectivity criterion requires determining whether the measure constitutes an exception to the "normal" national tax system or *de facto* generates discrimination. For tax measures in non-harmonised matters, such as those in the Fiat tax ruling, the identification of the "normal" tax system must be based exclusively on national tax rules. The Commission ignored the national tax rules and independently defined what it considered should be "normal" taxation, taking into account the free-competition ("arm's-length") ***)*** **taxation principle set out in the OECD guidelines for determining transfer prices, although the Luxembourg rules took the principle into account in a different way. The CJEU has ruled that the Commission lacked authority to make this independent interpretation.**

On 8 November 2022, the Court of Justice of the European Union ("**CJEU**") ruled on the appeals brought by Fiat Chrysler Finance Europe ("**FC**"), Luxembourg and Ireland in joined cases C-885/19 P and C-898/19 P.

1. CASE BACKGROUND

In March 2012, FC requested that the Luxembourg tax authorities approve a binding private-letter ruling on transfer pricing (prices invoiced in commercial transactions between entities forming part of the same group). In September 2012, the Luxembourg authorities issued a binding tax ruling in force for five years confirming that the transfer-pricing analysis applied by the taxpayer was consistent with the arm's-length principle under Luxembourg law.

In June 2014, the European Commission ("**Commission**") opened a formal investigation to analyse whether the tax ruling constituted State aid incompatible with the internal market under Article 108 of the Treaty on the Functioning of the European Union ("**TFEU**"). In October 2015, the Commission adopted a decision declaring that it did constitute incompatible State aid and ordering its recovery ("**Decision**"). According to the Decision, the issuance of the tax ruling and the resulting reduction of the tax base applied to FC entailed an exception to the "normal" Luxembourg tax system with regard to the free competition (i.e. arm's length) principle that should govern when setting the market value of transfer prices. According

to the Commission, this afforded FC a selective advantage to the detriment of other taxpayers and competitors.

In December 2015, FC and Luxembourg appealed the Decision to the General Court ("**GC**") and requested its annulment; their claims were dismissed.

2. CJEU PROCEEDINGS

FC, Luxembourg and Ireland (the latter being particularly interested in the Commission's decisions against its own tax rulings) subsequently appealed the GC's judgment to the CJEU and requested its annulment. The CJEU has now ruled in favour of the appellants and annulled the decision, establishing clear criteria as to how national taxation should be analysed under State aid rules in cases of non-harmonised matters.

2.1 NON-HARMONISED TAX MATTERS ARE GENERALLY SUBJECT TO STATE AID RULES

The CJEU begins its analysis by recalling that tax matters that have not been subject to harmonisation in EU law – such as the direct taxation referred to in the FC tax ruling – are not excluded from the scope of application of the TFEU provisions on State aid control. Member States ("**MSs**" and, in singular, "**MS**") must refrain from granting tax measures that may constitute State aid incompatible with the internal market.

One of the conditions that must be met for a tax measure to be considered State aid is that it grants a selective advantage to its beneficiary.

2.2 THE SELECTIVE ADVANTAGE AND THE "NORMAL" REFERENCE SYSTEM ACCORDING TO THE ANNULLED DECISION

In general, determining selectivity in the case of tax measures should be carried out in three steps: (i) identifying the system of reference or comparison – i.e. the "normal" tax system applicable in the MS – and analysing the objective of its content and the purpose and specific effects of the rules applicable under national law; (ii) demonstrating that the measure constitutes an exception to that "normal" system or, even if it does not, that it causes *de facto* discrimination between operators in a comparable situation; and (iii) proving that the exception is not justified by the nature, general objectives or structure of the MS's tax system.

When analysing whether the selectivity requirement was met in this specific case and determining the "normal" reference tax framework with which the tax ruling should be compared, the Decision had considered that the arm's-length principle should be applied to determine transfer prices, as set out in the relevant Organisation for Economic Co-operation and Development ("**OECD**") Guidelines.

Under Luxembourg law, the arm's-length principle in transfer pricing did not fully mirror the OECD guidelines and made a distinction when it came to integrated companies – e.g. the Fiat group. Nevertheless, the Commission concluded that, even if Luxembourg law did not follow the exact same criteria as the OECD Guidelines, the "normal" Luxembourg system was that of the OECD Guidelines. It therefore concluded that, since the FC tax ruling followed a different approach, it counted as selective aid with respect to the "normal" system, as interpreted and defined by the Commission.

2.3 THE ARM'S-LENGTH PRINCIPLE AND THE "NORMAL" REFERENCE SYSTEM. THE TAX AUTONOMY OF MSS IN NON-HARMONISED AREAS OF TAXATION

The CJEU rejects the reasoning of the Decision and the GC on the basis of the following considerations.

- As a starting point, the CJEU establishes that, when a tax measure falls outside the areas subject to harmonisation (e.g. direct taxation and concepts such as the taxable base and taxable event), the MS has discretion, exercising its tax autonomy, to determine the "normal" tax framework, which is the starting point of the selectivity analysis. Therefore, the principle of free competition applied to the determination of transfer prices does not entail a general principle of equal treatment in taxation when it comes to non-harmonised taxes.

- Secondly, it finds that, when determining transfer prices for the payment of taxes, the national law applicable to companies in Luxembourg that form part of a group aims to reliably approximate the market price. The CJEU considered that the Commission could not dispense with an analysis of the specific arrangements for the application of that principle in Luxembourg law and a thorough identification of the national reference system.

- Thirdly, it states that the Commission lacks the power to independently define what taxation is considered "normal" under national law for an integrated company in cases of non-harmonised taxes. The methods set out in the OECD guidelines for determining the market value in transfer pricing may guide MSs when they choose the applicable methods for their national law. However, the sole relevant factor when determining what constitutes the "normal" reference system for assessing whether a tax measure is selective is what is ultimately stipulated in national law – not the OECD guidelines or any other methods not enshrined in national law. Any conclusion to the contrary would contravene the principle of tax legality and the taxpayer would no longer be able to predict and calculate the tax due and the time at which the tax becomes due.

3. FINDINGS

The CJEU has annulled the Commission's decision in the Fiat tax ruling based on the specific facts of the case. Specifically, due to the Commission's incorrect analysis when assessing the selectivity of the measure and its failure to take due account of the applicable framework in the case of a tax matter that is not subject to harmonisation and in which the MSs retain fiscal and regulatory autonomy. It should nevertheless be taken into consideration, and the CJEU reiterates this point in its judgment, that this does not exclude the possibility of other measures – such as the tax rulings of the MSs – being subject to State aid control or even being classified as State aid if the requirements of Article 107.1 of the TFEU are met.

The conclusion is clear: companies should not lower their guard in this area. Despite the success of this case, the tax rulings in force and any request submitted to tax authorities to achieve an advanced tax assessment should nevertheless be carefully scrutinised, especially in the area of transfer pricing. The rules are complex and the position of EU courts still represents a novel approach in many respects.

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