NEW VOICES

OF APPLES, CARS, AND COFFEE – AGAINST THE COMMISSION'S REMEDY TO UNLAWFUL TAX RULINGS

Riccardo Fadiga*

Advance pricing agreements (APAs) are the most effective tool for undertakings to reduce the uncertainty regarding the fiscal liability arising out of transactions regulated by transfer pricing. Multinationals rely on APAs to gain confidence in complicated operations and attain better efficiency. In several recent decisions, the European Commission established that APAs can give rise to unlawful granting of State aid, if they provide for transfer pricing methodologies that do not accurately reflect market conditions. However, the Commission does not describe any method to establish the lawfulness of the adopted pricing methodology objectively. Therefore, this article argues that recovery of such alleged unduly granted aid violates the principle of protection of legitimate expectations, which is a fundamental principle of EU law. As such, recovery should be deemed unlawful.

Keywords: transfer pricing, advance pricing agreements, arm's length principle, legitimate expectations, state aid

TABLE OF CONTENTS

I. INTRODUCTION – THE COMMISSION'S INVESTIGATIONS INTO UNLAWFUL TAX RULINGS AND THE *APPLE*, *FIAT*, AND *STARBUCKS* DECISIONS 210

II. JUDICIAL REVIEW OF FISCAL MEASURES – BACKGROUND AND JUSTIFICATIONS 212

III. AT ARM'S LENGTH – THE ISSUE OF ASSESSING 'MARKET-BASED CONDITIONS' 218

* Integrated Master of Arts in Law student at Bocconi University School of Law, Milano. Contact at riccardo.fadiga@studbocconi.it or riccardo.fadiga@gmail.com. The author wishes to extend his thanks to Andrea Pezza for his invaluable support and to the two anonymous reviewers for the helpful comments on the earlier drafts of this article.

IV. LEGITIMATE EXPECTATIONS WITHIN THE EU STATE AID FRAMEWORK 223
V. CONCLUSIONS 229

I. INTRODUCTION – THE COMMISSION'S INVESTIGATIONS INTO UNLAWFUL TAX RULINGS AND THE *APPLE*, *FIAT*, AND *STARBUCKS* DECISIONS

Since 2014, the European Commission has launched a number of investigations in advance pricing agreements ('APAs'). APAs are measures granted by national tax authorities that specify the methodologies applicable to determine the allocation of profits within the recipient's corporate group. Their purpose is to grant certainty to the recipient about future tax liability, avoiding the possibility that institutions could, at a later time, object to the recipient's chosen method of allocation of profits. However, the Commission has held that some Member States have employed APAs improperly, with the intent and result of granting State aid within the meaning of Article 107(1) TFEU. This approach is exemplified in the *Apple,*[1] *Fiat,*[2] and *Starbucks*[3] decisions (hereinafter 'the contested decisions').

The facts leading up to these decisions are nearly identical in all three cases. A multinational company represented by one or several subsidiaries seated in a Member State requests an APA. A ruling is granted by the competent national tax authority. The company applies the agreed-upon methodology and liquidates its fiscal obligations accordingly.

In all three of these decisions, the Commission found that the agreements entailed the reduction of the undertakings' taxable base. In fact, according to the Commission, the profit allocation methodologies described in the

---

[1] *State aid implemented by Ireland to Apple* (SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L 187/1 (hereinafter '*Apple* decision').

[2] *State aid which Luxembourg granted to Fiat* (SA.38375 (2014/C ex 2014/NN)) Commission Decision 2016/2326 [2015] OJ L351/1 (hereinafter '*Fiat* decision').

[3] *State aid implemented by the Netherlands to Starbucks* (SA.38374 (2014/C ex 2014/NN)) Commission Decision 2017/502 [2015] OJ L 83/38 (hereinafter '*Starbucks* decision').

agreements were unreflective of actual market conditions, therefore amounting to State aid within the meaning of Article 107(1) TFEU. Consequently, the Commission ordered that the States recover amounts of monies equivalent to the difference between the amount paid and the one which would have been paid under normal market conditions.

The inherent purpose of tax rulings is to establish certainty regarding the tax liability of their recipients. However, by claiming to have the competence to review them *ex post*, the Commission frustrates their very objective. Because such procedures are an expression of the issuing authority's exercise of fiscal sovereignty on behalf of their respective State, the Commission's decision violates the principles of fiscal sovereignty, legal certainty and legitimate expectations.

Currently, the Commission's competence in reviewing APAs has not been fully explored, due to the short timeframe in which it has been developed and the number of perspectives from which the legitimacy of such a practice needs to be assessed (e.g. legal certainty, legal clarity, issues of tax harmonization and of control of harmful tax practices, etc.).[4] Compatibility with the principle of legitimate expectations is fundamental to reaching a comprehensive understanding of the issue. Hence, this article establishes a framework within which to assess the compatibility of the remedies proposed by the Commission in the contested decisions with the principles of legitimate expectations and legal certainty. This article argues that the recovery of any sum larger than what was established in the APA is irreconcilable with these fundamental principles of European Union law. More specifically, this article further argues that, in the appeals against the decisions described above,[5] the Court of Justice of the European Union

---

4 However, for conclusions similar to those reached in this article, see Liza Lovdahl Gormsen and Clement Mifsud-Bonnici, 'Legitimate Expectation of Consistent Interpretation of EU State Aid Law: Recovery in State Aid Cases Involving Advanced Pricing Agreements on Tax' (2017) 8(7) Journal of European Competition Law & Practice423. For further reading, see Gary Clyde Hufbauer and Zhiyao Lucy Lu, 'Apple's Tax Dispute with Europe and the Need for Reform' (2016) PB16-16 Peterson Institute for International Economics <https://piie.com/system/files/documents/pb16-16.pdf> accessed on 11 December 2017.

5 Each of the decisions has already been appealed before the Court, in all cases by both the company and the State interested. Against the *Apple* decision (n 2): Case T-778/16

(hereinafter 'the Court') should hold the remedy proposed by the Commission to be unlawful, and therefore order that any sum larger than what was agreed in the tax rulings cannot be recovered.

After this introduction, section II of the article goes over the underpinnings of the use of transfer pricing to manipulate profit allocation in order to reduce tax liability, and explains the main workings and consequences of APAs. It also details how the Commission has extended its competence to such measures under the EU State aid rules. Section III describes the issue of assessing correspondence to 'normal market conditions', while section IV examines how EU case law has construed the principle of the protection of legitimate expectations. Section V reviews in detail the aforementioned cases and draws conclusions on their reciprocal compatibility and issues therein, in light of the arguments put forward in the earlier sections.

II. Judicial Review of Fiscal Measures – Background and Justifications

To maximise profits, corporate groups that have subsidiaries in different jurisdictions (hereinafter 'multinational enterprises' or 'MNEs') have an interest in attributing the highest possible amount of profit to subsidiaries in low-tax jurisdictions, therefore reducing the group's overall tax burden. MNEs achieve this by manipulating the price charged for commercial transactions between various companies of the same corporate group (hereinafter 'transfer pricing'). Transfer pricing manipulation contributes to taxable base erosion[6] and constitutes an unfair advantage for those undertakings that can artificially allocate profits between associate

Ireland v Commission (2017/C 038/48) OJ C 38/35, and Case T-892/16 *Apple Sales International and Apple Operations Europe v Commission* (2017/C 053/46) OJ C 53/37; against the *Fiat* decision (n 3): Case T-755/15 *Luxembourg v Commission* (2016/C 059/55) OJ C 59/48, and Case T-759/15 *Fiat Chrysler Finance Europe v Commission* (2016/C 059/56) OJ 59/49; against the *Starbucks* decision (n 4): Case T-760/15 *Netherlands v Commission* (2016/C 059/58) OJ C 59/50, and Case T-636/16 *Starbucks and Starbucks Manufacturing Emea v Commission* (2016/C 462/32) OJ C 462/25. All of these cases are still pending.

[6] OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris. Available at <http://dx.doi.org/10.1787/tpg-2017-en>, pp 16 and 34 ff.

companies in different jurisdictions.[7] This practice differs from legitimate tax planning, which is expressly safeguarded in some jurisdictions.[8]

EU Member States[9] allow their tax authorities to review intra-group transactions with the aim of establishing whether the pricing schemes adopted genuinely reflect the value of the transaction. The tax authorities can then adjust the price that they take into account for the purpose of calculating the tax liability. This possibility creates uncertainty about the final tax burden resulting from a cross-border operation, which, in turn, leads to sub-optimal strategic decisions[10] and potentially to costly disputes affecting taxpayers and tax authorities.[11]

To reduce this uncertainty, the tax authorities of most Member States offer the possibility of entering a binding agreement which defines *ex ante* the tax

---

7 *Ireland Alleged Aid to Apple* (SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision C 2017/5605 [2014] OJ C/369/22, para 150.

8 Eg, the Belgian Supreme Court acknowledged the taxpayers's right to freely choose the 'route of less taxation' in landmark *Brepols* case (Supreme Court of Belgium, Court de Cassation/Hof van Cassatie, 6 June 1961, Brepols, Pas 1961, I, p 1082.). In Luxembourg, the provisions of Article 22bis of the Luxembourg Income Tax Law, implementing the neutrality regime of Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [1990] OJ L225/1, ('Merger Directive'), constitute without question a tax planning tool, and their use does not constitute tax evasion or avoidance.

9 In 2017, Thomson Reuters submitted their yearly questionnaire to legal experts in 38 different countries with questions regarding their respective jurisdiction's approach to topical issues. 14 EU Member States were interviewed: Austria, Belgium, Bulgaria, Croatia, Cyprus, France, Germany, Ireland, Italy, Luxembourg, Portugal, Spain, The Netherlands, and the UK. Thomson Reuters publishes their questionnaire results at <https://uk.practicallaw.thomsonreuters.com/Browse/Home/International/TransferPricingGlobalGuide> accessed on 12 December 2017 (hereinafter 'Thomson Reuters data').

10 John T Jost, Grainne Fitzsimons and Aaron C Kay, 'The Ideological Animal', in Jeff Greenberg, Sander L Koole and Tom Pyszczynski (eds), *Handbook of Experimental Psychology* (Guilford 2004) 263–83.

11 European Commission, 'Communication on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU' COM (2007) 71 final.

burden resulting from a planned operation, called an APA.[12] The content of such measures are agreed upon by the applicant and the tax authority through procedures which include a variable degree of negotiation between the two parties.[13]

The EU Joint Transfer Pricing Forum ('JTPF')[14] found that APAs are beneficial to both taxpayers and tax administrations in that they *(i)* are an efficient tool for dispute avoidance;[15] *(ii)* benefit the tax administration, in that they avoid the need for audits to establish correct transfer pricing, and only leave the correct application of the agreement to be verified;[16] and *(iii)*

---

[12] Of course, APAs engender their own tax avoidance issues. They can give rise, *inter alia*, to double non-taxation. Such situation can arise for instance when two distinct agreements are obtained at different conditions in different jurisdictions, if the tax authorities concerned are reciprocally unaware of the proceedings occurring at the cures of the other.

[13] For instance, the German tax authority (see file ref: IV B 4 – S 1341 – 38/06 of the Federal Ministry of Finance of Germany, dated 5 October 2006) tends to determine unilaterally the content of the APA on the basis of the information filed by the applicant, while the French tax authority has a full-fledged negotiation process in place (see <www.impots.gouv.fr/portail/international-professionnel/advance-pricing-arrangement> accessed on 12 December 2017).

[14] The JTPF (formerly Joint Forum on Transfer Pricing) is a standing meeting venue between tax authorities and business representatives instituted by the Commission in order to: examine issues with transfer pricing, APAs and similar tools; consider the scope for improving and rendering more uniform transfer pricing methodologies within the OECD guidelines; and examine necessary improvements to the Arbitration Convention. European Commission, 'Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee - Towards an Internal Market without tax obstacles - A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities' COM (2001) 582 final, p 14, and 61, 43. On page 3 of this Communication, the Commission notes that various problems affect intra-group transactions and therefore stand as obstacles to the realisation of uniform tax conditions within the common market. The Commission suggests the development of APA programs as a possible solution. However, at that moment there seems to be no certainty regarding the methodologies and consequences of such programs. The institution of the JTPF seems to be aimed at fixing precisely this lack of specific knowledge.

[15] Commission Communication (n 11) 3.

[16] Ibid 14.

benefit the taxpayer, in that they enjoy *ex ante* certainty concerning the transfer pricing methodology to be applied to the covered transaction.[17] Through APAs, enterprises can assess the consequences of the covered transaction without the uncertainty engendered by the possibility of a review of the pricing scheme by the national tax authorities. At the time of writing, 23 EU Member States provide for formal procedures for requesting APAs or similar ahead-of-time clearances.[18]

Because States have an interest in corporations shifting their reported taxable base to their jurisdiction, States have an incentive to employ APAs more favourably towards more economically relevant MNEs. In light of this, the European Commission reviewed some of these rulings to ascertain that such a favour does not amount to State aid within the definition of Article 107(1) TFEU. The main objection to the legitimacy of reviewing fiscal measures at the European level is that levying taxes is a capacity at the core of national sovereignty.[19] At the current state of harmonization in the Union, national fiscal policies are subject to negative integration – i.e., States are 'at liberty to determine the conditions and the level of taxation' across their domestic economies, provided that they do so consistently with EU law.[20]

However, with regards to tax measures, the Court has stated that they can 'amount to State aid within the meaning of Article 107(1) TFEU', inasmuch as they 'place the recipients in a more favourable financial position than other

---

[17] Commission Communication (n 11) 14.

[18] EU Joint Transfer Pricing Forum JTPF/015/2016/EN, *Statistics on APAs in the EU at the End of 2015*, Brussels, October 20th, 2016, combined with Thomson Reuters, *Regional Q&A on Transfer Pricing*, at <https://uk.practicallaw.thomsonreuters.com/qacompare/report/country/07202ac840c34a2ab6a62cb2d2f4ad91?transitionType=Default&contextData=(sc.Default)#/report/Croatia> accessed on 3 July 2017.

[19] Cf, Sjaak JJM Jansen, *Fiscal Sovereignty of the Member States in an Internal Market: Past and Future* (Kluwer Law International 2011); George Melo, 'Taxation in the Global Arena: Preventing the Erosion of National Tax Bases or Impinging on Territorial Sovereignty (A Critique of the OECD's Report: Harmful Tax Competition: An Emerging Global Issue)' (2000) 12(1) Pace International Law Review 183.

[20] Case C-298/05, *Columbus Container Services* EU:C:2007:754, paras 28 and 43-57. Cf Case C-265/04, *Bouanich* EU:C:2006:51, paras 22-43.

taxpayers'.[21] Consequently, tax measures can be reviewed on the grounds of incompatibility with the Treaty,[22] provided that they fit the criteria established by the case law for classifying a measure as State aid, which are: *(i)* there must be intervention by the State or through state resources; *(ii)* the intervention must be liable to affect trade between Member States; *(iii)* it must selectively confer an advantage on the recipient; and *(iv)* it must distort or threaten to distort competition.[23]

With regard to the criterion *(i)* – state intervention – the Court has progressively denied that the resources concerned must be granted in the form of a positive direct transfer.[24] In particular, the Court has included within this definition the waiving of credit,[25] and specifically of tax revenue.[26] The application of an APA which confers an advantage through favourable conditions (i.e. reducing the recipient's tax liability) satisfies this condition in full.

Both the Commission and the Court have broadly interpreted the criterion *(ii)* – an intervention affecting intra-EU trade –, establishing that it is fulfilled by any sort of economic activity. In particular, and dispelling all doubts on the qualification of preferential tax measures as affecting trade, the Court has stated that 'the grant of aid by a Member State, *in the form of a tax relief*, to some of its taxable persons must be regarded as likely to have an effect on

---

[21] Case C-105/14, *Taricco* EU:C:2015:555, para 61, which is the latest in an extensive series of consistent judgments.

[22] *Ex multis*, the Court stated that '[a]lthough both tax legislation and the implementation of tax arrangements are matters for the national authorities, the fact remains that the exercise of that competence may, in certain cases, prove incompatible with Article [107(1) TFEU]' (Case C-83/98, *France v Ladbroke Racing and Commission* EU:C:2000:248, para 4). This formulation can be found in the summary that the Court gave of the judgment given by the Court of First Instance, which the General Court confirmed by dismissing the appeal in full.

[23] Joined Cases C–341/06 P and C–342/06 P, *Chronopost and La Poste v UFEX and Others* EU:C:2008:375, para 122, and Case C-451/03 *Servizi Ausiliari Dottori Commercialisti* EU:C:2006:208, para 56.

[24] Case C-30/59 *SMNEnkolenmijnen v High Authority* EU:C:1961:2.

[25] Joined Cases C-6/69 and C-11/69, *Commission v France* EU:C:1969:68.

[26] Case C-387/92, *Banco Exterior de España* EU:C:1994:100.

trade.'[27] A similar reasoning goes towards the fulfilment of the criterion *(iv)* – distortion of competition.[28]

Therefore, the decisive criterion used to assess the legitimacy of a tax measure is that of *(iii) selective advantage*. This concept is made up of the two separate notions: selectivity and advantageousness.

As for the notion of selectivity, a measure must be liable to benefit one or more undertakings, while not being available to others in order to fall under the State aid provisions. *De jure* selectivity can be excluded in any jurisdiction where a State-sanctioned procedure to request tax rulings/APAs is in place – i.e., in the vast majority of Member States[29] – because, indeed, such procedures make APAs theoretically available to all undertakings that request it. On the other hand, to exclude *de facto* selectivity, it must be proved that the same benefit available to some undertakings could have been obtained by others on the basis of criteria that are public, objective, and verifiable.[30] According to this three-step test adopted by the Commission,[31] unless a tax ruling is equipped with proof that its contents result directly from the basic or guiding principles of that tax system, the measure is selective. In other words, as Member States have failed so far to produce the abovementioned criteria, but rather conduct APA negotiations behind closed doors, such measures are liable to be more beneficial to those applicants who wield more bargaining power.

---

[27] Case C-494/06 P, *Commission v Italy and Wam* EU:C:2009:272, para 51 (emphasis added) and the case law cited therein.

[28] Case C-372/97, *Italy v Commission* EU:C:2004:234, para 44.

[29] JTPF/015/2016/EN (n 19).

[30] DG Internal Policies, '"Tax rulings" in the EU Member States', IP/A/ECON/2015-08, PE 563.447, p 17. The issue of verifying such conditions has been tackled repeatedly by the Commission; see, eg, EU Commission, 'Notice on the application of State aid rules to measures relating to direct business taxation' [1998] OJ C 384/3; EU Commission Notice on the Notion of State aid as referred to in Article 107(1) TFEU (2016/C 262/01) OJ C 262/1, para 101. In the context of investigations on discriminatory fiscal schemes, the Court established a rigorous three-step test for assessing selectivity in Case C-143/99, *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke* EU:C:2001:598, and later in Joined Cases C-78/08 to C-80/08, *Paint Graphos and Others* EU:C:2011:550.

[31] Case C-143/99, *Adria-Wien Pipeline* (n 31).

The second part of the notion of *selective advantage,* that of the advantage itself, refers for the purpose of Article 107(1) TFEU to any economic benefit that an undertaking would not have obtained under normal market conditions.[32] The criterion used to distinguish whether a measure falls within this definition is the Market Economy Investor Principle ('MEIP'). This principle states that the only economic resources that a State can lawfully transfer to a private operator are the resources that would have been 'contributed in circumstances that would be acceptable to a private investor operating under normal market economy.'[33] Mitigations of charges that would otherwise have been part of the budget of the recipient are assimilated to a resource transfer.[34]

Therefore, if the economic situation in which APA recipients find themselves after the agreement is more advantageous than if they had not concluded an APA, then such a measure entails an advantage within the definition of Article 107(1) TFEU.[35] This is held to be the case where multinational corporations price their intra-group transactions in a manner that does not reflect the conditions that apply between companies acting independently on the market ('market-based conditions'). How such conditions are determined is described in the following section.

III. At Arm's Length – The Issue of Assessing 'Market-Based Conditions'

To determine whether a measure entails an undue advantage for its recipient, a benchmark must be established against which to test the economic consequences of a measure *vis-à-vis* 'market-based conditions'. To this end, the so-called 'arm's length' principle has been developed. This section briefly

[32] Case C-39/94, *SFEI and Others* EU:C:1996:285, para 60; Case C-342/96, *Spain v Commission* EU:C:1999:210, para 41.

[33] *OECD Transfer Pricing Guidelines*, (n 7) at 3.2.

[34] Case C-387/92, *Banco Exterior de España* EU:C:1994:100.

[35] For a further analysis of the notion of selectivity in APAs, see Saturnina Moreno González, 'State Aid, Tax Competition and BEPS: Comments on the European Commission's Decisions on Transfer Pricing Rulings' [2016] University of Leicester School of Law Research Paper No 17/00 <https://ssrn.com/abstract=2947870> accessed 11 December 2016.

outlines its origin and formulation, and discusses the consequences of its application in the contested decisions.

The arm's length principle was established in 1933 in a study conducted by the League of Nations' fiscal committee,[36] and today enjoys worldwide recognition.[37] The principle is included within a plethora of soft law instruments.[38] Most prominently, Article 9 of the OECD Model Tax Convention provides the most accepted formulation:

> [any time] conditions are made or imposed between [...] two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.[39]

Most Member States have developed or are developing their legislations according to this formulation, sometimes expressly referring to the OECD rules.[40] The CJEU has employed the arm's length principle to determine the

---

[36] Mitchell B Carroll, 'Taxation of Foreign and National Enterprises', *Volume 4 Methods of Allocating Income* (League of Nations 1933).

[37] OECD *Transfer Pricing Guidelines* (n 7) at 1.14 – 1.15.

[38] OECD, *Model Convention with Respect to Taxes on Income and on Capital (Condensed Version)*, OECD 2014, pp 29-30; OECD *Transfer Pricing Guidelines* (n 7); Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises [1990] OJ L 225/10.

[39] OECD *Model Convention with Respect to Taxes on Income and on Capital* (n 39) 29-30.

[40] Eg, Austria has published the OECD's TPC in the official gazette and they have the status of aids to official interpretation; Ireland's transfer pricing legislation specifically provides for construing regulation in accordance with the TPC; the Spanish Tax Authority has made specific reference to fostering the application of the principles laid out in the OECD Guidelines in their latest General Guidelines; etc. (see Thomson Reuters at <https://uk.practicallaw.thomsonreuters.com/Document/I479cef161fa911e798dc8b09b4f043e0/View/FullText.html> accessed on 3 July 2017). The Guidelines are often referred to even outside the OECD: *inter alia,* they are accepted by means of praxis in Bulgaria and implemented into legislation in Croatia (Thomson Reuters at <https://uk.practicallaw.thomsonreuters.com/w-007-8395> and <https://uk.practicallaw.thomsonreuters.com/w-007-3438> for Bulgaria and Croatia respectively, accessed on 3 July 2017).

existence of selective advantage in fiscal measures[41] which is present if the measure endorsed a method for determining a corporate group's taxable profit that does not result in a reliable approximation of a market-based outcome.[42] To reach a quantitative conclusion on the pricing scheme assessment based on the arm's length principle, several methods can be applied. These methods are described in the OECD Transfer Pricing Guidelines, and establish the accounting techniques that should be used to assess a 'correct' value for the transaction.[43] Different jurisdictions favour different methods.[44] In general, the methods described by the OECD entail either approximating the price of a transaction or comparing it with a comparable, independent operation.

These principles and methods played a cardinal role in the Commission's conclusions that the measures in the contested decisions amounted to State aid. Between 2013 and 2014, the Commission reviewed the tax ruling practices of all Member States, focusing in particular on tax rulings that 'endorse transfer pricing arrangements proposed by the taxpayer for determining the taxable basis of an integrated group company'.[45] It assessed the tax liability resulting from the application of the pricing schemes described in the rulings *vis-à-vis* the results that could be obtained by an independent operator in the market; this comparison led to the finding that several arrangements entailed reductions in tax liability equivalent to State aid.

In stipulating the APAs under review, all the tax authorities involved had considered the arm's length principle. Irish tax law formally recognises the

[41] Joined Cases C-182/03 and C-217/03, *Forum 187* EU:C:2006:416.

[42] The Commission thusly summarised the Court's position in its DG Competition Working paper on State aid and tax rulings, 2016, available at <http://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf>, accessed on 13 December 2017.

[43] While a quantitative or technical definition of such methods lays outside the scope of the article, an in-depth description is included in the OECD *Transfer Pricing Methods* paper of July 2010, available at <www.oecd.org/ctp/transfer-pricing/45765701.pdf>, accessed on 13 December 2017, which, in turn, references paragraphs 2.13-2.145 of the *Transfer Pricing Guidelines* (n 7).

[44] Thomson Reuters data (n 10).

[45] Working paper on State aid and tax rulings (n 43).

application of the 'arm's length principle' as laid down in Article 9 of the OECD Model Tax Convention.[46] The Luxembourg tax administration confirmed that 'the transfer pricing analysis hereafter has been realized in accordance with the Circular 164/2 of the 28 January 2011 and respects the arm's length principle'.[47] The Dutch administration explicitly accepted that the remuneration determined by Starbucks constituted an arm's length remuneration.[48]

The Commission also made specific reference to the principle, using it as a guideline for its assessment of whether the APAs under review were reflective of actual market conditions. The Commission asserted that 'the OECD's framework {describing the arm's length principle} serves as a focal point and exerts a clear influence on the tax practices of OECD member countries.'[49] In particular, the Commission stated that the investigations were started on the grounds that the results obtained through the rulings' calculations were not compliant with the arm's length principle,[50] and did not correspond to conditions that a prudent independent operator acting under normal circumstances would have accepted.[51]

As means of justification for such claims, the Commission stated in its *Fiat* decision that the method selected for the transfer pricing assessment, known as the Transactional Net Margin Method ('TNMM'), was not reliable. This claim explicitly contradicts what was determined by the national tax authorities. Instead, the Commission argued that the Luxembourg authorities ought to have applied the Comparable Uncontrolled Price ('CUP') method.[52]

---

[46] See, *Apple* decision (n 2), para 78.

[47] See, *Fiat* decision (n 3), para 54.

[48] See, *Starbucks* decision (n 4), para 42.

[49] *Apple* decision (n 2), para 79. See also, almost verbatim: *Fiat* decision (n 3), para 87; *Starbucks* decision (n 4), para 66.

[50] *Apple* decision (n 2), para 149; *Fiat* decision (n 3), para 130; *Starbucks* decision (n 4), para 287.

[51] *Apple* decision (n 2), para 146; *Fiat* decision (n 3), paras 131-137; *Starbucks* decision (n 4), para 256.

[52] *Fiat* decision (n 3), paras 132-139.

The two different methods, selected respectively by the Commission and by Luxembourg, are both described in and endorsed by the OECD Guidelines.[53] The OECD does not prescribe a rigorous hierarchy between the methods, although the CUP method is presented as preferable in some cases, provided that adequate benchmarks to assess the transfer pricing scheme *vis-à-vis* comparable transactions are available. Nonetheless, all methods are presented as equally valid, and there is no rule mandating States to choose one method over the other. This notwithstanding, the Commission stated that the 'methodological choice' of the Luxembourg tax authorities is the reason why the tax rulings must be regarded as State aid.[54]

The same line of reasoning applies for the arguments used in the *Starbucks* decision. In response to the Netherlands' argument noting the absence of a 'best method rule',[55] the Commission simply argued that the factor determining the validity of a method is that it results 'in a reliable approximation of an arm's length price'.[56] Furthermore, in the *Apple* decision, no quantitative analysis whatsoever is cited.

The Commission bases its reasoning in these decisions on the OECD Guidelines. Therefore, it cannot contradict the validity of the other methodologies described therein – among which are those selected by the Member States. The Commission, then, rather than contesting the methodological choices operated by States, challenges the results that they obtained on the grounds that they are not consistent with the arm's length principle. However, by doing so, the commission is carrying out an *ex post* analysis which compromises the capability of such methods of ensuring a degree of legal certainty. Indeed, if there is no method that can be applied objectively and automatically, taxpayers are prevented from being able to rely on any one of them. Nonetheless, being able to rely on APAs is necessary so that such measures can fulfill their purpose of attaining legal certainty. Therefore, the Commission's claim frustrates the interest of both the

---

[53] OECD *Transfer Pricing Guidelines* (n 7) ch 2.

[54] *Fiat* decision (n 3), para 266.

[55] *Starbucks* decision (n 4), para 175.

[56] Ibid, para 284.

Member States and their taxpayers, as it renders APAs insufficient to guarantee certainty, and therefore fruitless.

The Commission provides no alternative solution to the issue: it has refrained from defining a 'safe' methodology, i.e. a methodology to which the Commission itself would not have grounds to object. Rather, through the motivations advanced in the contested decisions, the Commission claims competence to review the States' decisions on a case-by-case basis.

In conclusion, the Commission criticises the methodological choices operated by the national tax authorities without clear basis, as the OECD defines no strict hierarchy between the methods it described. Subsequently, because it cannot outright reject the application of a method prescribed by the OECD, it criticises the results obtained through that method. However, by proposing to judge the outcome of the process irrespectively of the correctness of the methods employed, the Commission is defying the very purpose of the OECD specification of acceptable methods of calculation. Finally, the Commission does not propose an alternative solution conducive to the establishment of a clear and certain legal framework with respect to the application of the arm's length principle.

IV. Legitimate Expectations within the EU State Aid Framework

The circumstances outlined above impinge decisively on the right to legal certainty and on the Member States' fiscal sovereignty, and, most evidently, on the principle of legitimate expectations. This section will address this latter issue.

The principle of legitimate expectations requires that institutions refrain from penalising or otherwise burdening persons, on the grounds of a conduct that such persons have kept while under a legitimate expectation of lawfulness, provided that the institutions themselves elicited such expectations. In relation to this article, the consolidation of a legitimate expectation with regard to the tax liability entailed by the covered

transaction, is the very object of obtaining an APA, as the Commission itself acknowledged in 2012.[57]

Therefore, the fact that a European institution could claim for itself the competence to review APAs is clearly problematic *vis-à-vis* the necessity of safeguarding legitimate expectations. In the case at hand, protecting the essential object of APAs, in light of their nature of acts originating from a national tax authority on a subject in which national sovereignty should be uncontested.

The Court of Justice holds the principle of legitimate expectations to be 'one of the fundamental principles of the Community.'[58] In its own words, the Court has 'consistently held' that 'any trader in regard to whom an institution has given rise to justified hopes may rely on the principle of the protection of legitimate expectation.'[59] With specific regard to the framework established for the recovery of unduly granted State aid, the Council established that the Commission 'shall not require recovery of the aid if this would be contrary to a general principle of Union law.'[60]

Therefore, it appears clear that if the conclusion of an APA is found to be liable of engendering expectations that are legitimate within the meaning of the principle described above, the Commission should refrain from recovery even where it finds that such measure amounts to State aid. Accordingly, the Court has specified the principle's indemnifying contents with regard to European institutions: it held that in case an institution gives specific assurances with regard to their future conduct, such assurances grant the

---

[57] European Commission, (IP) COM/2012/0516 final, paras 23-24.

[58] Case T-43/98, *Emesa Sugar v Council* EU:T:2001:279, para 87. See also Joined Cases C-104/89 and C-37/90, *Mulder and Others v Council and Commission* EU:C:2000:38, para 15; Case 316/86, *Krücken* EU:C:1988:201, para 22; Case 112/77, *Töpfer* EU:C:1978:94 para 19.

[59] Case 265/85, *Van Den Bergh En Jurgens v Commission* EU:C:1987:121, para 44, citing Case 78/77, *Lührs v Hauptzollamt Hamburg-Jonas* EU:C:1978:20.

[60] Article 16(1) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (Text with EEA relevance) [2015] OJ L 248/9.

recipient an actionable right with the object of being indemnified from any future divergent conduct.[61]

In light of the analysis of the contested decisions made in the previous section, it should now be apparent that the Commission has set forth a remedy that clashes with the principle of legitimate expectations, and indeed the parties argued on these grounds. In the *Apple* case, third parties argued that the Commission's approach would undermine legal certainty. They submitted that 'transfer pricing is not an exact science';[62] therefore, the only way for taxpayers to reduce uncertainty is to request an assessment by the tax authorities through an advance ruling. In light of this, the recipient should be safeguarded, at least through the exclusion of a potential recovery.[63] With regard to the expectations of lawfulness of the rulings, Ireland itself commented that a 'reasonable and diligent taxpayer' would not have been able to predict the Commission's finding of incompatible State aid within the measure: this circumstance entails that an adjustment of the conditions contained in the measure breaches the principle of legal certainty because the recipient could not have reasonably accounted for it.[64]

The Netherlands argued similarly in *Starbucks*,[65] as well as Luxembourg in the *Fiat* case.[66] Furthermore, with regard to the latter case, the ECOFIN Code of Conduct Group[67] and the OECD Forum on Harmful Tax Practices had found that the Luxembourg tax scheme was compliant with, respectively, the

---

61 Case T-203/96, *Embassy Limousines & Services v Parliament* EU:T:1998:302, paras 74 ff.

62 *Apple* decision (n 2), para 175.

63 Ibid, paras 174 ff.

64 Ibid, para 178.

65 *Starbucks* decision (n 4).

66 *Fiat* decision (n 3).

67 See n 7.

Code of Conduct[68] and the Transfer Pricing Guidelines,[69] which – Luxembourg argued – was a circumstance liable to engender the expectation of lawfulness of the rulings.[70]

The Commission rejected the argument that the expectations were legitimate on three grounds, which were that *(i)* Member States lacked standing to invoke the principle; *(ii)* the non-adherence to State aid procedure invalidated the expectations' legitimacy; and *(iii)* the expectations were not legitimate *per se*.

The Commission predominantly emphasised the motivations described at point *(i)*. It argued that Member States lack standing to invoke the principle of legitimate expectations on behalf of the recipient of the ruling. On this issue, the Commission is consistent with the Court's case law. However, it must be borne in mind that the decisions are addressed to the Member States, not to the recipients,[71] and that the obligation to safeguard the taxpayers' legitimate expectations fall upon the Member States.[72] Consequently, the

---

[68] EU Council, ECOFIN, Code of Conduct Group documents, are available at <www.consilium.europa.eu/register/en/content/out/?DOC_TITLE=code+of+conduct+guidance&DOC_SUBJECT=FISC&i=COCGGD&ROWSPP=25&DOC_LANCD=EN&ORDERBY=DOC_DATE+DESC&typ=SET&NRROWS=500&RESULTSET=1&TARGET_YEAR=2017> accessed on 11 June 2017. The Code of Conduct Group, set up by ECOFIN in 1998, deals with assessing tax measures for business taxation and overseeing the provision of information on those measures. Furthermore, it is responsible for maintaining a non-binding Code of Conduct intended to guide Member States in curbing harmful tax practices. On the matter at hand, the Group stated that 'there [is] no need for the [Luxembourg tax measure on companies engaged in intragroup financing activities] to be assessed against the criteria of the Code of Conduct', as the system was found to be compatible with the Code.

[69] OECD *Transfer Pricing Guidelines* (n 7).

[70] *Fiat* decision (n 3), para 358. Even setting aside the authoritativeness of such institutions, it is the Guidelines of the latter which are cited as a justification for the Commission's reasoning. As a result, the OECD Guidelines are said not to be liable to engender legitimate expectations, while at the same time the principles *and* methodologies employed in the decision are based on analogous OECD documents. The contradictory nature of such assessment is evident.

[71] Article 5 of the *Fiat* (n 3), *Apple* (n 2), and *Starbucks* (n 4) decisions.

[72] *Starbucks* decision (n 4).

Member States should be able to invoke any and all exceptions to the Commission's findings that they consider to be of help in effectively fulfilling such obligations. Either way, the solution to this issue does not shed light on the substantial applicability of the principle of the protection of legitimate expectations to the case at hand.

With regard to the Commission's point *(ii)*, it must be noted that pursuant to Article 108(3) TFEU, the Court has held that Member States have an obligation of notifying the intent of granting aid before doing so, which they had not done in the cases at hand. When the aid recipient does not verify that the correct procedure for granting State aid has been followed by the State, any expectation regarding such aid is illegitimate.[73] However, extending the reasoning of the Court to circumstances in which the measure under review could not be classified *ex ante* as State aid would be illogical and contradictory. In other words, where a measure is not intended to have any effect that could amount to State aid, like in the case of APAs, it cannot be held that States have a responsibility to notify them to the Commission. The opposite conclusion would be illogical, and accepting it would require subjecting all tax rulings issued by Member States to the Commission's review.

As sole justification concerning the *per se* legitimacy of the expectations' rebuttal (point *(iii)*), the Commission held that in the cases at hand, the expectations held by the taxpayers were not legitimate because they were engendered by a conduct held not by the European institutions but by national authorities. However, the notion of national authorities protecting legitimate expectations in the application of EU law, and in particular preventing the recovery of unduly granted aid is well-established. For instance, the *Elmeka* ruling concerned the legitimate expectation of being exempted from a VAT payment by reason of the (national) tax authorities' conduct. The Court stated that:

> Under the settled case-law of the Court, the principles of protection of legitimate expectations and legal certainty form part of the Community legal order. On that basis, these principles must be respected by the institutions of the Community, but also by Member States in the exercise of the powers conferred on them by Community directives [...] It follows that national

[73] Case C-5/89, *Commission v Germany* EU:C:1990:320, paras 13 ff; and Case C-169/95, *Spain v Commission* EU:C:1997:10, para 51.

> authorities are obliged to respect the principle of protection of the legitimate expectations of economic agents.[74]

Therefore, the Court ruled that provided the tax authority that engendered the expectation was competent on the issue, the expectation was legitimate, and the unpaid VAT could not be recovered. The words of Advocate General Stix-Hackl in her Opinion made the issue even clearer: 'it is to be regarded as permissible for national legislation to protect legitimate expectations and legal certainty in an area such as the recovery of wrongly paid Community aid.'[75] In the words of Advocate General Kokott, with regard to a different case, it is '*imperative* that, when enforcing EU law, the Member States observe the principle of the protection of legitimate expectations'.[76]

In light of the above, this article must conclude that national authorities are liable to engender legitimate expectations with regard to matters on which they are competent to rule. From this conclusion must follow that the rights of the taxpayers engender a duty of refraining from the recovery of unduly granted aid.

In the specific case of APAs, the aptness of the measure with which APAs are granted to engender expectations is even more firmly evident than with other measures that unduly grant aid. The requirements that such assurances be 'precise, unconditional and consistent information' originating from 'authorized and reliable sources',[77] are not only characteristics intrinsic to APAs, but their very objective. The entire aim of the APA procedure is to provide information that is more 'precise, unconditional and consistent' than what a taxpayer can autonomously deduce from tax legislation. Therefore, in the case of APAs, the legitimacy of the expectations engendered is even less susceptible of being contested.

The Commission's unwillingness to give efficacy to the principle of legitimate expectations can be proved further by one final observation. In the

---

74 Joined Cases C-181/04 to C-183/04, *Elmeka* EU:C:2006:563, para 31.

75 Opinion of Advocate General Stix-Hackl in Joined Cases C–181/04 to C–183/04, *Elmeka* EU:C:2005:730, para 38.

76 Opinion of Advocate General Kokott in Case C-568/11, *Agroferm* EU:C:2013:35, para 46.

77 Case T-271/04, *Citymo v Commission,* EU:T:2007:128, para 138.

Fiat case, the expectations were not only engendered by the conduct of the tax authority, but also corroborated by the findings of ECOFIN and OECD.

V. CONCLUSIONS

In light of what has been discussed, it should now be apparent that a single, objectively correct result of the application of the arm's length principle, cannot be obtained. Therefore, the assessment of the lawfulness of an APA cannot be objective.

The OECD itself recognises that its own transfer pricing guidelines are 'not sufficient to meet the transfer pricing compliance requirements of today's economy'.[78] The efforts to create reliable transfer pricing documentation have been numerous, but these initiatives have, for several reasons, not fully met the needs of either taxpayers or tax administrations.[79] Therefore, it is impossible for either the taxpayers or the tax administrations to reach objectively unquestionable, 'correct' results when determining tax liability according to the arm's length principle.

Indeed, the Commission did not challenge the methodologies applied in the contested APAs – it only contested the concrete results that they had yielded.[80] Therefore, instead of requiring Member States to devise a method that the Commission accepts and that taxpayers can apply autonomously, the Commission requires Member States to obtain, through whichever method they choose, *results* that the Commission accepts.

This is not something that taxpayers can evaluate or predict exactly in advance. There is no way for even the most prudent and discriminating enterprises[81] to establish *ex ante* whether the pricing scheme it elected for a

---

[78] OECD, *White Paper on Transfer Pricing Documentation*, of 30 July 2013, available at <www.oecd.org/ctp/transfer-pricing/white-paper-transfer-pricing-documentation.pdf>, accessed on 13 December 2017, p 4.

[79] Ibid.

[80] Phedon Nicholaides, 'State Aid Rules and Tax Rulings' (2016) 3 European State Aid Law Quarterly 416, 418.

[81] As described in section 3, these are the characteristics that the Court requires the recipient of a measure to display in forming his expectations. For the application of

specific intra-group transaction will be deemed consistent with market conditions. Therefore, it is impossible for MNEs to reliably assess their fiscal liability ahead of time.

The recovery of the alleged aid granted through the contested APAs would contradict very specific case law and general principles of the Union, violating the principles of legal certainty, legal clarity, and legitimate expectations which derives therefrom.

A remedy to this state of affairs would be that the Court and the Commission seek to establish a clear methodology and framework, according to which the Member States and taxpayers would be able to determine the content of APAs in a manner that does not allow a margin of discretion. In this way, the goal of APAs of providing certainty would be restored. In the absence of such framework, and as long as the validity of the methodologies applied by national tax authorities stands uncontested, it remains unacceptable to disregard the results that they had reached, and upon which the taxpayers have formed their legitimate expectations.

Although the intent of limiting Member States' abuse of fiscal autonomy is laudable, the methods employed by the Commission are not acceptable. The Commission should be prevented from invalidating Member States' fiscal measures on the grounds of a test which is based on criteria that the Member States or the taxpayers cannot apply autonomously with certainty. On appeal, the Court of Justice should therefore hold that the implementation of the remedy ordered by the Commission in the contested decisions is unlawful, because it amounts to a violation of a fundamental principles of the Union, the protection of legitimate expectations.

---

the formula 'prudent and discriminating' see Case T-177/10 *Alcoa Trasformazioni v Commission* EU:T:2014:897, para 60.