Confédération Fiscale Européenne *CFE ECJ Task Force**

Opinion Statement ECJ-TF 1/2020 on the General Court Decisions of 24 September 2019 in *The Netherlands v. Commission (Starbucks)* (Joined Cases C-760/15 and T-636/16) and *Luxembourg v. Commission (Fiat Finance and Trade)* (Joined Cases T-755/15 and T-759/15), on State Aid Granted by Transfer Pricing Rulings

This CFE Opinion Statement, submitted to the EU Institutions on 28 January 2020, discusses the General Court decisions of 24 September 2019 in *The Netherlands v. Commission (Starbucks)* (Joined Cases C-760/15 and T-636/16) and *Luxembourg v. Commission (Fiat Finance and Trade)* (Joined Cases T-755/15 and T-759/15), on State aid granted by transfer pricing rulings.

1. Executive Summary

The decisions in *The Netherlands v. Commission (Starbucks)* (Joined Cases C-760/15 and T-636/16) (hereinafter *Starbucks NL*)[1] and *Luxembourg v. Commission (Fiat Finance and Trade)* (Joined Cases T-755/15 and T-759/15) (hereinafter *Fiat*),[2] decided by the General Court (GC) on 24 September 2019, are the first in a series of expected decisions concerning the legality of the European Commission's decisions considering certain transfer pricing rulings granted by Member States to multinational enterprises (hereinafter MNEs) to constitute State aid.[3]

The GC reached different verdicts in the two cases. Whereas in *Starbucks NL* it annulled the Commission's decision, in *Fiat*, it upheld it, ordering Luxembourg to recover the aid. Despite the different outcomes, the decisions have several commonalities in terms of how the GC interpreted the applicable European law on State aid in respect of tax matters. Therefore, they may provide an indication of how the GC will decide similar pending cases. In addition, the decisions are of paramount importance in understanding: (i) the role and limits of the Commission in reviewing rulings granted by Member States; (ii) the role of the OECD's arm's length concept and of the OECD Transfer Pricing Guidelines (2017) (the OECD Guidelines)[4] in assessing the Treaty on the Functioning of the European Union's (TFEU) (2007)[5] prohibition of State aid; and (iii) the level of evidence that has to be provided by the parties in these procedures.

The importance of these two decisions cannot be emphasized enough. Although the Commission has apparently decided not to appeal the *Starbucks NL* decision, the appellants in *Fiat* will do so, thus seeking a final resolution from the Court of Justice of the European Union (ECJ). The latter is not bound to follow the GC and may decide the matter on points on law in a way that deprives the current decision of its jurisprudential value.[6] It follows that the GC would have to follow the ECJ's reasoning in future decisions as to the interpretation of EU law on State aid.

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1. NL: GC, 24 Sept. 2019, Joined Cases T-760/15 and T-636/16, *Netherlands v. the Commission*, para. 190, ECLI:EU:T:2019:669 [hereinafter *Starbucks NL*].
2. LU: GC, 24 Sept. 2019, Joined Cases T-755/15 and T-759/15, *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v. European Commission*, [2019] ECLI:EU:T:2019:670.
3. There was an earlier decision of 14 Feb. 2019 on a similar topic, BE: GC, 14 Feb. 2019, Joined Cases T-131/16 and 263/16, *Magnetrol International and Belgium v. Commission*, ECLI:EU:T:2019:91. However, the GC dismissed the case, as the Commission had failed to provide evidence that all situations covered by the Belgium "excess profit tax" regime would necessarily lead to a benefit. The GC decision was appealed and is now pending before the Court of Justice as Case C-337/19.
4. The *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (10 July 2017), Primary Sources IBFD [hereinafter *OECD Guidelines* (2017)].
5. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), Primary Sources IBFD.
6. In the past, there have been other occasions of divergent opinions between the CJEU and the GC, including on State aid in tax matters, such as in the *Gibraltar* decisions (*see* ES: GC, 18 Dec. 2008, Joined Cases T-211/04 to T-215/04, *Commission and Spain v. Government of Gibraltar and United Kingdom*, [2008] II-03745, Case Law IBFD and ES: ECJ, 15 Nov. 2011, Joined Cases C-106/09 P and C-107/09 P, *European Commission (C-106/09 P) and Kingdom of Spain (C-107/09 P) v. Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland*, ECLI:EU:C:2011:732, Case Law IBFD).

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

Given the length of the two decisions and the number of topics covered, this statement will only focus on issues considered to be of interest in understanding the GC's reasoning and the impact of the cases.

2. Background and Decision of the GC

2.1. Starbucks

2.1.1. Issues

The GC was asked to annul a Commission decision on an advance pricing agreement (hereinafter APA) granted by the Netherlands to Starbucks Manufacturing EMEA BV (hereinafter SMBV), a Netherlands subsidiary of the Starbucks corporation (US), which was indirectly controlled through a subsidiary, Alki, a tax resident of the United Kingdom.

SMBV was basically a manufacturer, buying beans and roasting coffee and distributing it alongside related products to Starbuck shops in Europe, the Middle East and Africa.[7] It concluded a roasting agreement with Alki by which it obtained the use of the intellectual property needed for the roasting and distribution of the coffee, in exchange for the payment of royalties.

In 2008, SMBV and the Netherlands concluded an APA for the determination of SBMV's tax base that was valid for 10 years. It established that: (i) the method for determining the base would be the transactional net margin method (hereinafter TNMM),[8] by reference to a certain percentage of the operating costs;[9] (ii) the amount allowed to be deducted as a royalty paid to Alki would be computed as the difference between SMBV's total revenue, on the one hand, and SMBV's cost base increased by SMBV's remuneration (tax base), on the other.[10]

In 2015, the Commission decided that the APA amounted to State aid, and ordered the recovery of the corresponding aid.[11] The core of the discussion was the requirement of selectivity. The Commission followed the traditional three-step analysis to determine whether the measure was selective. First, the reference system must be identified. Second, it should be determined whether a given measure constitutes a derogation from that system insofar as it differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. Finally, it must be established whether the contested measure is justified by the nature or general scheme of the system.[12]

The reference system was the general corporate tax system of the Netherlands, which had the objective of taxing all companies subject to tax in the Netherlands. This meant that integrated and standalone companies "were in a comparable legal and factual situation, in the light of that objective and were therefore subject to corporate income tax without distinction".[13]

The measure (APA) deviates from the reference system in so far as it is "a tax measure which results in an integrated company charging prices that did not reflect those which would have been charged in conditions of free competition, that is prices negotiated by independent undertakings negotiated under comparable circumstances at arm's length" and that confers "an advantage on that group company in so far as it resulted in a reduction of its taxable base and thus its tax liability under the ordinary corporate income tax system".[14] Thus, the Commission had to "verify whether the methodology accepted by the Netherlands tax administration via the APA for the purposes of determining SMBV's taxable profits in the Netherlands departed from a methodology that result[s] in a reliable approximation of a market-based outcome and, therefore, from the arm's length principle".[15] The Commission considered that the "arm's length principle necessarily formed an integral part of its assessment, under article 107(1) TFEU, of the tax measures granted to integrated companies, independently of whether a Member State had incorporated that principle into its national legal system".[16]

Following this reasoning, the Commission concluded that there was prohibited State aid and ordered the recovery of the "difference between the tax that should have been paid on the basis of that price and the amount actually paid under the APA".[17]

2.1.2. Decision

The Court decided to "annul the contested decision in its entirety".[18]

For the purposes of this article, the CFE finds it useful to focus on the following two issues analysed by the GC decision, namely (i) the infringement of the Member States' fiscal autonomy; and (ii) the existence of prohibited State aid granted through the APA.

7. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 14.
8. The ruling referred to "cost-plus" but, in practice, as the GC concluded, the APA was applying the TNMM – *see The Netherlands v. Commission* (T-760/15 and T-636/16), para. 187.
9. Which excluded a significant part of the effective costs, such as the cost of the green beans, the cost of the cups, napkins et seq. and the logistics and distribution ensured by third parties, as well as the royalties – *see The Netherlands v. Commission* (T-760/15 and T-636/16), para. 15.
10. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 188.
11. Id., para. 19.
12. Id., para. 34.
13. Id., para. 36.
14. Id., para. 38.
15. Id., para. 38. The expression "reliable approximation of a market-based outcome" is likely the most repeated expression in both decisions. *See The Netherlands v. Commission* (T-760/15 and T-636/16), paras. 38, 46, 50, 53, 54, 57, 140, 152, 196, 199, 201, 202, 212, 213, 395, 416, 418, 425, 428, 474, 512, 532 and 555 and *Luxembourg v. Commission* (T-755/15 and T-759/15), paras. 25, 43, 121, 132, 176, 204, 207 and 412.
16. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 38.
17. Id., para. 64.
18. Id., para. 561.

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2.1.2.1. *Infringement of the Member State's fiscal autonomy*

The GC considered that the examination in the light of the arm's length principle specific to EU law forms part of its analysis of the selective advantage.[19] And, "[w]hen national tax law does not make a distinction between integrated undertakings and standalone undertakings for the purposes of their liability to corporate income tax, that tax law is intended to tax the profits arising from the economic activity of such integrated undertaking as though it had arisen from transactions carried out at market prices".[20] Furthermore, article 107(1) of the TFEU "allows the Commission to check whether that pricing corresponds to pricing under market conditions".[21]

Arm's length is described as a "useful tool",[22] a "benchmark"[23] and a "methodology"[24] to check whether the taxable profit of an integrated undertaking pursuant to a tax measure corresponds to a "reliable approximation of a taxable profit generated under market conditions".[25]

As for the OECD Guidelines, they do not bind the Commission but are not deprived of relevance, as they have a "practical significance in the interpretation of issues relating to transfer pricing" given that they (i) "are based on important work carried out by groups of renowned experts"[26] and (ii) "reflect the international consensus achieved with regard to transfer pricing".[27]

As concerns the legal basis for the arm's length standard, the GC followed the Commission's reasoning that the arm's length principle: (i) necessarily formed an integral part of the examination, under article 107(1) of the TFEU, of tax measures granted to group companies and (ii) was "a general principle of equal treatment in taxation, which fell within the application of Art. 107 TFEU".[28]

The GC recognized that the arm's length standard does not lead to a precise result and that, as a consequence, there would be an advantage "only if the variation between the two comparables goes beyond the inaccuracies inherent in the methodology used to obtain that approximation".[29]

2.1.2.2. *Aid granted through an APA*

Regarding the amount that could be deducted as royalties paid to Alki, the GC considered that: (i) a methodological error in the application of the arm's length standard was not sufficient to prove that there was a non-market based outcome;[30] (ii) the Commission provided no evidence that the comparable uncontrolled price (hereinafter CUP) method should have priority over the TNMM or that the latter "necessarily leads to a result that is too low".[31] Furthermore, it considered that the Commission failed to provide reasons why the amount of royalties paid to Alki should have been zero.

Concerning the acquisition of green beans, the GC concluded that the Commission failed to provide evidence that the method used for determining the price paid was part of the APA or, if this was the case, that it represented an advantage.[32]

The GC considered that the Commission had failed to provide evidence why choosing the SMBV as the tested party for the purposes of the application of the TNMM led to a reduction of the taxable profit and dismissed the claim. It also stated that the Commission had failed to show that eventual methodological errors in the determination of the functions and SMBV's profits (namely the choice of profit level indicator and the choice of adjustments) led to an advantage.

2.2. *Fiat*

2.2.1. *Issues*

The case concerned a ruling granted by Luxembourg to Fiat Chrysler Finance Europe, formerly Fiat Finance and Trade (hereinafter FFT), a Luxembourg subsidiary of the FIAT/Chrysler group. FFT provided treasury services and financing to the group (except for those entities located in Italy).

In 2012, Luxembourg granted FFT a ruling with a five-year duration. This ruling established that: (i) the tax base for the intra-group activity could be set using the TNMM; and (ii) when applying such a method, FFT could segment its equity capital. Accordingly, its tax base would be composed of two amounts: (i) "a 'risk remuneration', calculated by multiplying FFT's hypothetical regulatory capital of EUR 28,500,000, estimated by applying the Basel II framework by analogy, by the pre-tax expected return of 6.05%, estimated using the Capital Asset Pricing Model (CAPM)"; (ii) "a 'functions remuneration', calculated by multiplying what is designated as FFT's capital used to perform the functions, estimated as EUR 93,710,000, by the market interest rate applied to short-term deposits, estimated to be 0.87%".[33]

In October 2015, the Commission decided that the ruling amounted to State aid[34] and ordered the recovery of the corresponding aid.

19. Id., para. 137.
20. Id., para. 149.
21. Id., para. 151.
22. Id., paras. 151, 152, 157, 163, 169 and 199. In the French language version, the GC uses the expression "*un outil permettant d'effectuer cette vérification*".
23. Id., para. 151.
24. Id., paras. 152, 154 and 196.
25. Id., para. 152.
26. The French language version mentions only "experts".
27. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 155.
28. Id., paras. 139 (for the position of the Commission), 162 and 168. This would not be a "general principle of equal treatment" but merely "a tool enabling [the Commission] to check that intra-group transactions are remunerated as though they had been negotiated between independent companies".
29. Id., paras. 152 and 427.
30. Id., paras. 204 and 205.
31. Id., para. 212.
32. Id., para. 374 et seq., in particular para. 380.
33. *Luxembourg v. Commission* (T-755/15 and T-759/15), para. 11.
34. Commission Decision of 21 October 2015 SA.86375 (2014/Cex2014/NN), C(2015) 7152 final.

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The Commission followed the three-step analysis and a reasoning quite similar to that described previously.[35] It all boiled down to determining whether the ruling "departed from a methodology that led to a reliable approximation of a market-based outcome and, thus, from the arm's length principle".[36] The Commission considered that this was not the case because: (i) first, and for the purposes of applying the TNMM, the ruling should have opted for the accounting equity (capital) instead of the hypothetical regulatory capital; (ii) second, because the hypothetical regulatory capital was underestimated; (iii) third, because several deductions from FFT's remaining capital should not have been allowed; (iv) fourth, because "the choice of a beta of 0.29 when using the CAPM to determine the return on capital to be applied to FFT's hypothetical regulatory capital resulted in a profit allocation to FFT that was not in line with the arm's length principle".[37]

2.2.2. Decision

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

For the purposes of this opinion statement it is useful to focus on the two following arguments analysed by the GC in this case, namely (i) tax harmonization in disguise; and (ii) the existence of prohibited State aid.

2.2.2.1. Tax harmonization in disguise

As in *Starbucks NL*, the GC concluded that "Article 107(1) TFEU allows the Commission to check whether the pricing of intra-group transactions, accepted by the national authorities for determining the taxable base of an integrated undertaking, corresponds to prices that would have been charged at arm´s length".[38]

There are, however, a couple of additional clarifications. First, the GC rejected FFT's claim that "the Commission's position on the arm's length principle departed from its previous practice in taking decisions", since "that practice in other cases cannot affect the validity of a contested decision, which can be assessed only in the light of the objective rules of the FEU treaty".[39] Second, it rejected FFT's claim that the arm's length principle used by the Commission differed from the OECD one, namely because it did not allow for appropriate adjustments.[40] The GC noted that the OECD Guidelines do not bind the Commission, that the Commission had not ruled out the possibility of making adjustments[41] and that FFT had not provided evidence why the exclusion of adjustments would render the arm's length principle specific to EU law, as used by the European Commission, an incorrect method.[42] Third, the Commission's decision did not infringe legal certainty[43] and legitimate expectations.[44]

2.2.2.2. Existence of State aid

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

In this case, the GC focused on the segmentation of the capital. It considered that, in applying the TNMM, all equity capital should have been considered since (i) capital is, by nature, fungible;[45] (ii) segmentation is neither authorized nor prohibited, and thus, needs to be tested;[46] (iii) "the total capital is exposed to risk and is available to support FFT's solvency";[47] (iv) the total capital is considered by the borrowers;[48] and (v) the segmentation is artificial, inappropriate, and does not correspond to the functions performed.[49] This allowed for the conclusion that the ruling led to a non-market-based outcome, regardless of any further considerations on the return rate on the capital.

The Commission claimed that the beneficiary of the aid was the FIAT/Chrysler group as a whole "in so far as FFT formed an economic unit with the other entities within the group and that those entities had benefited from the tax reduction granted to FFT, given that the tax reduction necessarily had the effect of reducing the pricing conditions of its intra-group loans".[50] The GC accepted that conclusion.[51]

The GC rejected the notion of taking into account any possible neutralization of the aid in the other Member State. First, because the lower taxes in Luxembourg were not lowered by higher taxes in another Member State. Second, because, even if that was the case, neutralization would not alter the fact that the group obtained a benefit in Luxembourg.[52]

The GC dismissed Luxembourg's and FFT's claim that there was no selectivity since the measure had to be examined by reference to Luxembourg law and practice. And, as no justification had been put forward to support the deviation,[53] the derogation would amount to State aid.

3. Comments

3.1. Introduction

As mentioned, this Opinion Statement will not focus on case-specific issues. The goal is to focus on critical issues

35. *The Netherlands v. Commission* (T-760/15 and T-636/16), paras. 22, 23 and 24.
36. *Luxembourg v. Commission* (T-755/15 and T-759/15), para. 25.
37. Id., paras. 28-31.
38. Id., para. 157.
39. Id., para. 170.
40. Id., para. 172.
41. Id., para. 173.
42. Id., para. 175.
43. Id., paras. 180-184.
44. Id., paras. 185-186.
45. Id., para. 223.
46. Id., para. 229.
47. Id., para. 238.
48. Id., para. 241.
49. Id., paras. 242, 246 and 250.
50. Id., para. 38.
51. Id., para. 316.
52. Id., paras. 316-318.
53. Id., para. 363.

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in the GC's reasoning, highlighting its impact on the development of EU law in this area and the impact that it may have for Member States and businesses throughout the European Union.

3.2. Application of the selectivity test

In both cases, the discussion was focused on the existence of a selective advantage. The GC followed the traditional three-step analysis test in assessing selectivity, i.e. (i) the reference system; (ii) a derogation; and (iii) justifications for the derogation.

3.2.1. Reference system

According to settled case law, the reference system is the tax regime that a Member State would normally apply to the beneficiary of the measure. The GC accepted the Commission's view that the reference system would not be the applicable domestic law provisions, but the "object" of the CIT system, which was to tax the total profit of integrated and standalone companies. This seems to be in line with the position already adopted by the Court in *Gibraltar* (Case C-106/09 P and C-107/09 P)[54] and *World Duty Free* (Case C-20/15 P and C-21/15 P).[55]

3.2.2. Derogation

In the second place, one needs to assess if the measure derogates from the reference system, differentiating "between economic operators who, in the light of the objectives intrinsic to the reference system, are in a comparable legal and factual situation".[56] For the GC, the Commission provided enough evidence of this derogation.

3.2.3. Justification

The selectivity examination requires the assessment of justifications, i.e. domestic reasons that would outweigh the EU interest underlying article 107(1) of the TFEU. The GC dismissed any examination on the basis of the burden of proof, noting that nothing had been alleged by the appellants.

3.3. The arm's length principle inherent to article 107(1) of the TFEU

3.3.1. Legal basis for the EU arm's length principle: Arm's length as a corollary of the State aid prohibition

Both GC decisions are based on the fundamental premise that insofar as domestic law does not distinguish between standalone and integrated companies, the arm's length principle may be used in the review pursuant to article 107(1) of the TFEU.[57] This line of reasoning endorses the view of the Commission based on the arguments accepted by the CJEU in *Forum 187* (Case C-182/03 and 217/03).[58] The GC did not object to the Commission's view that "the arm's length principle necessarily [forms part of the] assessment, under Art. 107 TFEU, of tax measures granted to group companies, irrespective of whether the Member State had incorporated that principle into its national legal system".[59] These assumptions allow the Commission to go beyond the intricacies of domestic TP law and create a common framework for the review of the rulings based on the general CIT principle of taxation of market income. The arm's length standard, as an approximation of this market income between associated enterprises, therefore, appears as a (new) limit to a State's sovereignty in direct tax matters.

However, this premise may not be accurate for the following reasons:

- article 107(1) of the TFEU is part of the competition agenda of the TFEU and prohibits Member States from granting selective aid to undertakings. It aims to ensure free competition and, consequently, economic efficiency within the internal market;
- article 107(1) of the TFEU does not indicate how states should treat undertakings. It merely restricts states in granting selective aid insofar as such aid distorts competition. It does not allow for the extraction of substantive rules on how states have to treat their undertakings;
- article 107(1) of the TFEU, a fortiori, is not part of the tax agenda of the TFEU and does not establish rules on how Member States shall tax undertakings subject to its taxing jurisdiction. It merely prohibits them from using the tax system to grant illegal or unlawful State aid;
- a potential harm to legal certainty may arise insofar as one extracts a principle and uses it for judicial review, particularly when such a principle has no support in the case law (or even legal doctrine) at the moment the ruling was granted; and
- there is a certain *petitio principii* in the following GC's reasoning: (i) arm's length is part of the Commission's assessment, and thus it applies regardless of any domestic law provisions; (ii) nonetheless, the definition of the reference system requires taking into consideration the purpose of the domestic CIT system, and the conclusion that "that law is intended to tax the profit arising from the economic activity of such an integrated undertaking as though it had arisen from transactions carried out at market prices";[60] and (iii) finally, and even if domestic TP systems were considered in defining the reference system, they are not taken into account as sources of the content of the EU arm's length tool.

54. *Gibraltar* (C-106/09 P and C-107/09 P), para. 75.
55. ES: ECJ, 21 Dec. 2016, Case C-20/15 P, *Commission/World Duty Free Group and Others*, paras. 31, 54, 57, 58 and 60, ECLI:EU:C:2016:981, Case Law IBFD.
56. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 34 and *Luxembourg v. Commission* (T-755/15 and T-759/15), para. 22.
57. *Luxembourg v. Commission* (T-755/15 and T-759/15), para. 141 and *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 137.
58. BE: ECJ, 22 June 2006, Joined Cases C-182/03 and C-217/03, *Kingdom of Belgium and Forum 187 ASBL v. Commission of the European Communities*, [2006] ECR I-5479.
59. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 139 and *Luxembourg v. Commission* (T-755/15 and T-759/15), paras. 26 and 131.
60. *Luxembourg v. Commission* (T-755/15 and T-759/15), para. 141.

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It might appear as if the GC is assuming that the arm's length pricing leads to a "reliable approximation of a market-based outcome" or "market prices".[61] This assumption would not be entirely correct for the following reasons:

- The starting point of any transfer pricing system is to annul the pricing effects derived from conditions imposed by one group member to another; in a cross-border scenario, this prevents, for example, using intra-group pricing to increase profits in lower-taxed jurisdictions while correspondingly decreasing profits in higher-taxed jurisdictions.
- However, arm's length does not necessarily lead to an approximation of market conditions. As the OECD points out "the relationship among members of an MNE group may permit the group members to establish special conditions in their intra-group relations that differ from those that would have been established had the group members been acting as independent enterprises operating in open markets".[62] Thus, the standard takes into account situations that might not be present between independent enterprises. Moreover, "in making these comparisons [with standalone entities or transactions], material differences between the compared transactions or enterprises should be taken into account. In order to establish the degree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof), it is necessary to compare attributes of the transactions or enterprises that would affect conditions in arm's length transactions".[63]
- The arm's length result takes into account the differences between standalone and integrated companies, namely through the introduction of adjustments. Thus, as the entities or transactions are not operating similarly as independent enterprises, the arm's length principle will produce neither "market prices" nor even reliable approximations of market-based outcomes (within the limits of a reasonable interpretation of this expression).
- The residual profit may be seen as additional evidence of the previous argument. Under the profit-split method, after allocating profit to each group member according to what the market would remunerate independent companies conducting similar transactions, there is still usually a residual profit that has to be allocated taking into account the facts and circumstances. This residual profit is often the result of group-specific realities, such as synergies, economies of scale or the benefits of integrating companies that would generally not occur between standalone companies.

61. The Commission states that the "arm's length principle consisted in the notion that transactions between intra-group companies were to be remunerated as if they had been agreed to by standalone companies negotiating under conditions of free competition" – *see The Netherlands v. Commission* (T-760/15 and T-636/16), para. 38.
62. *OECD Guidelines* (2017), at para. 6 of the preface.
63. Id., at para. 1.36.

3.3.2. Nature of the arm's length approach

The CG describes the arm's length standard as a "tool",[64] a "benchmark"[65] and a "methodology".[66] From a legal theory perspective, this lack of a precise characterization leaves room for uncertainty on how "arm's length" can be interpreted and applied and whether such an interpretation and application can follow the same rules that domestic courts have been following until now.

3.3.3. Value of the OECD Guidelines

The GC's starting point is that the "tool" it is using must be specific and distinct from article 9 of the OECD Model Tax Convention (2017)[67,68] and, *a fortiori*, the OECD Guidelines. The GC clarified that the OECD Guidelines do not bind the Commission. However, the Guidelines have a certain "practical significance in the interpretation of issues relating to transfer pricing" since they (i) "are based on important work carried out by groups of renowned experts", and (ii) "reflect the international consensus achieved with regard to transfer pricing".[69] In the CFE's view, it would have been better had the CG been more precise in this respect.

The OECD Guidelines are recommendations from the OECD Council,[70] addressed to OECD members without binding them. A fortiori, the Guidelines, per se, do not bind private parties. Domestic transfer pricing rules may refer directly to the Guidelines (in which scenario the Guidelines will have the value that is conferred on them by domestic law) or the legal system may consider them as relevant sources of interpretation. In the latter scenario, the OECD Guidelines serve as a persuasive authority and provide direction for states in designing their transfer pricing rules. The fact remains, however, that without intermediation by the domestic legislature, the Guidelines have no binding legal value.

This reasoning cannot be transposed immediately into the EU context. First, not all EU Member States are OECD members.[71] Second, the European Union is not an OECD member and, thus, the OECD guidance does not even have the value of acting as recommendations.[72] Third, there is

64. *The Netherlands v. Commission* (T-760/15 and T-636/16), paras. 151, 152, 157, 163, 169 and 199 and *Luxembourg v. Commission* (T-755/15 and T-759/15), paras. 130, 143, 144, 151, 155, 159, 162 and 207.
65. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 151 and *Luxembourg v. Commission* (T-755/15 and T-759/15), paras. 143 and 296.
66. *The Netherlands v. Commission* (T-760/15 and T-636/16), paras. 152, 154 and 196 and *Luxembourg v. Commission* (T-755/15 and T-759/15), paras. 132, 146, 420 and 427.
67. *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties and Models IBFD.
68. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 161 and *Luxembourg v. Commission* (T-755/15 and T-759/15), para. 149.
69. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 155 and *Luxembourg v. Commission* (T-755/15 and T-759/15), paras. 147 and 176.
70. Art. 5(b) of the Convention on the Organization for Economic Co-operation and Development of 14 December 1960, available at: https://treaties.un.org/Pages/showDetails.aspx?objid=0800000280110c0aandclang=_en.
71. At present Bulgaria, Croatia, Cyprus, Malta and Romania are not OECD member countries.
72. Based on art. 220 TFEU and in conformity with the Supplementary Protocol No. 1 to the OECD Convention, *supra* n. 70, the European Commission has a special status before the OECD. Such status allows for its

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no EU legal act attributing value to the OECD Guidelines. Fourth, it cannot be said that the EU arm's length standard applied in respect of the Commission's review under article 107(1) of the TFEU was developed on the basis of the precise and elaborate OECD Guidelines. The wording of article 107(1) of the TFEU has been the same since 1957 and the Guidelines were issued by the OECD much later.

It is thus quite difficult to acknowledge the legal status of the OECD Guidelines for the purposes of State aid investigations, taking into account, simultaneously, that (i) the arm's length standard is specific; (ii) EU primary law has no reasonable link with the OECD Guidelines, and; (iii) secondary EU law does not refer to them (either directly or indirectly).

Finally, even if one were to ignore the above issues, one would still be faced with the question of determining which version of the Guidelines should be taken into account: (i) the version existing at the moment the domestic measure was adopted, or (ii) the version existing at the moment of the Commission or court decision. In *Starbucks NL*, the GC acknowledged that the Commission used the 1995 and 2010 versions of the OECD Guidelines[73] and therefore did not seem to censor the use of a later version. In the CFE's view, and taking into consideration the GC's view concerning the burden of proof, it seems reasonable to consider that only the version that was known at the moment the domestic measure was adopted should be taken into account in assessing a ruling on the basis of article 107(1) of the TFEU.

3.3.4. *Content of the EU arm's length "benchmark"*

Another question regards the exact content of that "benchmark". The starting point is the recognition: (i) that EU law (either primary or secondary law) does not provide any indication about its content; (ii) domestic transfer pricing rules are not decisive in establishing meaning; (iii) the OECD Guidelines are not, in themselves, binding. In terms of logical reasoning, full consideration of these premises creates issues in terms of legal certainty, as one needs to extract very specific authorizations and prohibitions (for example, adjustments) from a very general principle.

Adding to the complexity, the Commission has introduced another variable that was accepted by the Court: namely the functional or teleological control of the validity of the (OECD or domestic) transfer pricing rules, which are only considered valid if they lead to a "reliable approximation of a market-based outcome".

This complexity is exacerbated by the fact that the GC has avoided defining or providing criteria on what is a "reliable approximation of a market-based outcome". This leaves the interpreter with a new (validity) test for which no criteria are provided.

Against this background, and adding to the existing uncertainty in the TP area, a new issue emerges: what are the domestic or OECD rules that lead to a "reliable approximation of a market-based outcome"? Which paragraphs/articles can be relied upon and which paragraphs/articles should be dismissed? Taking into account the primacy and direct effect of EU law, shall undertakings and tax authorities start to ignore provisions of their domestic TP rules based on the consideration that they do not lead to a reliable approximation of a market-based outcome? And what evidence would they have to gather to substantiate their position? Are there market-based methods and non-market based methods?

This raises even more fundamental questions. As we know, transfer pricing works by approximation, and the use of the OECD methodologies typically leads to a range of results that are evident in transactions between independent enterprises (the arm's length range). Taking into account the GC decisions, can undertakings even rely on the domestic rules or transfer pricing Guidelines, knowing that if they are strictly followed, the outcome will always be a "reliable approximation of a market-based outcome"? Or should they always introduce a final rationality test, assessing if the arm's length range (or parts of it) leads to a market-based outcome (introducing a new layer into the transfer pricing analysis within the European Union)? In other words, does it suffice to comply with domestic rules and the OECD Guidelines or, in addition, should undertakings introduce a final "approximation of a market-based" test? And, in the latter scenario, what do they need to test? Should the Commission start a programme identifying which rules lead to a reliable approximation of a market-based outcome or which results are a sufficient approximation of market-based outcomes?

3.4. Admissibility of TNMM

In both cases, the GC accepted the TNMM for the determination of the tax base. This is one of the methods suggested by the OECD Guidelines and a method that is frequently used in the practice of transfer pricing throughout Europe.

The TNMM departs from a comparison between the net profit margin of an undertaking obtained from a non-arm's length transaction and the net profit margin of undertakings operating at arm's length in respect of similar transactions. It then determines the net profit margin by reference to a profit level indicator, such as costs, sales or assets. In order words, it takes into account the relationship between the net profit of standalone companies and a profit indicator and extrapolates the profit method that members of integrated companies would have. The determination of the profit indicator and of the margin depends on the facts and circumstances of the case.

The TNMM is, in most jurisdictions, a subsidiary method. Whenever the information available allows for the application of more direct methods (such as CUP, cost-plus or resale-minus), the said methods should be applied.

involvement in various aspects of the work of the OECD through a representative that does not have the right to vote and does not officially take part in the adoption of legal acts submitted to the OECD Council.

73. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 256.

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The underlying assumption is that the results obtained through the use of those methods would be more accurate.

The GC did not attribute too much relevance to the method chosen or even to its subsidiarity. In its view, "choosing the transfer pricing method is not an end in itself, but is done with a view to the intra-group transaction for which the arm's length method level must be determined, and not the other way around".[74]

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

3.5. Evidence/burden of proof

In both decisions, the GC made an effort to clarify the burden of each of the parties. According to the GC: (i) the Commission has to provide evidence of the existence of aid, and; (ii) the Member State has to provide evidence of justifications for the different treatment between undertakings.[75] The GC merely reiterated its long-standing position on this issue, which is based on general principles for the distribution of the burden of proof.

The GC clarified that evidence is only allowed insofar as it pre-dates the action that led to the aid.[76] One has to "place oneself in the context of the period during which the measures at issue were taken in order to assess the economic rationality of the conduct of the Member State".[77]

In transfer pricing cases, the GC recognizes that Member States benefit from a certain "margin of appreciation in the approval of transfer pricing"[78] which, however, does not prevent the Commission from verifying "whether the transfer pricing accepted by a Member State corresponds to a reliable approximation of a market-based outcome and whether any variation that may be identified in the course of that examination does not go beyond the inaccuracies inherent in the methodology used to obtain that approximation".[79] This substantially increases the burden to be met by the Commission, which not only has to provide evidence of aid (in this instance, a deviation from the reference framework) but also that this deviation goes "beyond the inaccuracies inherent in the methodology". In future cases, the GC will likely be asked to clarify whether the "inherent inaccuracies" refer to (i) the precise pricing within the quartiles; (ii) tolerable differences in the selection of the elements on which each method relies (comparables, profit indicator); (iii) the fact that no transfer pricing methodology will ever lead to a precise market-based outcome since any method takes into account the relationship between the parties and the fact that there are no criteria on what is considered a reliable approximation of that market-based outcome. At this point, the GC's decision leads to uncertainty and may give rise to unnecessary litigation.

The GC does not go so far as to require the Commission to provide evidence of the right pricing or of the methodology that would lead to a reliable approximation of a market-based outcome. This is made particularly clear in the *Fiat* decision. After accepting the Commission's claim that the tax ruling "endorsed a methodology for determining FFT's remuneration that did not enable an arm's length outcome to be achieved and that resulted in a reduction of FFT's tax burden",[80] the GC considered that it was up to the appellants to "show that the Commission had wrongly concluded that the amount of tax payable by FFT was lower than that which it would pay under normal market conditions".[81]

The GC took the opportunity to clarify its own role in these cases. As a rule, in an action to annul a Commission decision on State aid, the Court should "carry out a comprehensive review as to whether a measure falls within the scope of Art. 107(1) TFEU".[82] However, and as transfer pricing has an "approximate nature", the court's review is limited to verifying "whether the errors identified in the contested decision, and on the basis of which the Commission found there to be an advantage, go beyond the inaccuracies inherent in the application of a method designed to obtain a reliable approximation of a market-based outcome".[83] Thus, the judicial review is restricted to testing: (i) the logical coherence of the reasoning proposed by the Commission (and whether there are no errors); (ii) if this reasoning leads to the conclusion that the pricing does not allow for an approximation of a market-based outcome, beyond the "inherent inaccuracies". Mere identification of errors in the application of pricing methodologies does not suffice for these purposes.[84]

A careful reading of both decisions shows that the outcome is sensitive to the way the parties formulate their arguments and to the level of evidence produced. In *Starbucks NL*, the GC easily dismissed the Commission's claims that the royalties paid to Alki should have been zero,[85] noting that there was economic value in the transacted IP. However, the dismissal would not have been that easy (or would ultimately not have occurred) had the Commission instead argued and provided evidence that the amount of royalties intolerably deviated from any reliable approximation of a market-based outcome since stand-alone companies would never define royalties by refer-

74. Id., para. 209.
75. Id., paras. 194 and 195 and *Luxembourg v. Commission* (T-755/15 and T-759/15), paras. 202 and 203.
76. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 243.
77. Id., para. 244.
78. Id., para. 196.
79. Id., para. 196 and *Luxembourg v. Commission* (T-755/15 and T-759/15), para. 207.
80. *Luxembourg v. Commission* (T-755/15 and T-759/15), para. 286.
81. Id., para. 340.
82. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 198 and *Luxembourg v. Commission*, para. 206.
83. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 199.
84. Id., paras. 201 and 211 and *Luxembourg v. Commission*, para. 207.
85. *The Netherlands v. Commission* (T-760/15 and T-636/16), para. 360 et seq.

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ence to the difference between, roughly, a company's revenues and its costs (regardless of the amount of revenue and of the costs).

4. Open Issues

The GC did not object to the Commission's view that article 107(1) of the TFEU, combined with a consideration of the purpose of the CIT tax system "allows the Commission to check whether t[he] pricing corresponds to pricing under market conditions"[86] and that the arm's length benchmark for that assessment is not derived from domestic law or the OECD Guidelines.

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

From now on, taxpayers can no longer rely entirely on a transfer pricing ruling, as such a ruling can always be challenged by the Commission in the event that it considers that the ruling leads to a benefit that is not at arm's length.

Now, the ultimate word on what concerns transfer pricing is, from an administrative perspective, given to the Commission and, from a judicial perspective, to the CJEU.

Full reliance on domestic statutes of limitation is no longer possible since what is considered aid can be recovered in respect of the previous ten years. From a very practical perspective, this means that all documentation and dossiers have to be kept for much longer than the period established under company or tax law.

Member States now have to be much more careful in adopting rulings and APAs and are being pushed to strengthen their domestic transfer pricing rules by reviewing them carefully in order to remove any features that may lead to results that are not "market-based".

5. The Statement

The CFE acknowledges the clarifications brought by the GC's decision in respect of the admissibility of the Commission's action in verifying the compatibility of a Member State's transfer pricing rulings with the TFEU's prohibition against State aid, in particular as concerns the burden of proof.

The CFE hopes that the CJEU will bring further clarity to the technical specifics of the arm's length principle, such as the admissibility of one-sided methods (such as the TNMM) and the permissible leeway allowed in assessing Member State measures in light of article 107(1) of the TFEU, as that "tool" of assessment is based only on the broad principle of the Member States' corporate income tax systems.

The CFE notes that the new concepts and criteria are not sufficiently clear and leave ample room for divergent interpretations. The CFE is concerned that this situation will have an impact on legal certainty for businesses across Europe, particularly taking into account that the recovery of aid may be requested for a period of up to the ten previous years.

86. *Luxembourg v. Commission* (T-755/15 and T-759/15), para. 143.

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