



Euro Tax Flash from KPMG's EU Tax Centre



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Advocate General proposes annulment of Commission decision on Luxembourg transfer pricing ruling

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On December 16, 2021 Advocate General (AG) Priit Pikamäe of the Court of Justice of the European (“CJEU” or “Court”) gave his opinion in the cases C-898/19 P (Ireland v Commission) and C-885/19 P. Both cases concern the validity of a 2015 decision issued by the European Commission (the “Decision”), which found a transfer pricing ruling granted by Luxembourg to be incompatible with EU State aid rules. In 2019 the General Court of the EU confirmed the validity of the Decision.

In the appeal before the CJEU brought forward by Ireland, the AG concludes that the previous ruling issued by the General Court infringes the provisions governing the division of competences between the EU and the Member States. As a result, the AG recommends that the CJEU sets aside the judgment of the General Court, allows Ireland’s appeal and annuls the Decision. On the other hand, the AG recommends that the appeal brought by the taxpayer in the case C-885/19 P should be dismissed.

Background

On October 21, 2015 the European Commission issued a [decision](#) according to which the transfer pricing ruling granted by Luxembourg to an Italian car manufacturing group constituted illegal State aid. In the Commission’s opinion, the alleged State aid arose from the methodology outlined in the tax ruling regarding the calculation of the taxable basis of a Luxembourg subsidiary performing intra-group financing and treasury activities. According to the

Commission, the ruling endorsed “artificial and complex methods” that do not “reflect economic reality” and thereby granted a selective and unfair competitive advantage to those companies.

Appeals were filed by the taxpayer concerned (T-759/15) and Luxembourg (T-755/15) with the General Court, which decided to join the cases and issued its decision on September 24, 2019. The General Court confirmed that the Commission was entitled to use the arm’s length principle to ascertain whether the ruling under review granted an advantage to its beneficiary. The General Court further analyzed the ruling and concluded that it provided a selective advantage to the group. In the General Court’s view, the fact that the corresponding advantage would be taxed in Italy at the level of another group entity was irrelevant. As a result, the General Court upheld the Commission’s findings that Luxembourg granted illegal State aid to the ruling’s beneficiary – see [Euro Tax Flash Issue 412](#).

Both the taxpayer involved in the proceedings and Ireland (supported by Luxembourg and the taxpayer) appealed the General Court’s judgment before the CJEU.

The AG opinion in case C-898/19 P (Ireland v Commission)

In his opinion, the AG recalled the three-step approach used to assess the existence of a selective advantage:

- (i) identify the reference system of ordinary or “normal” taxation;
- (ii) determine if the relevant measure entails a derogation from the reference system;
and
- (iii) assess if the derogation is justified by the nature or general scheme of the reference system.

In this respect, citing settled case-law, the AG considered that the reference system has to be determined based on the rules of national law, which includes EU and international law that is transposed in the domestic legislation. The AG also recalled that based on settled case-law, each Member State has exclusive competence to determine at their own discretion the characteristics of their domestic tax system in the areas of EU tax law that are not harmonized.

The AG continued by outlining the origin and the development of the arm’s length principle, as well as the evolving practice of the European Commission in applying the principle in State aid investigations. The AG noted that, in the disputed decision, the Commission defined the reference system based on the perceived intent of the Luxembourg legislation, and not based on the actual legal provisions. In the AG’s view, by upholding the Commission’s approach to apply a version of the arm’s length principle not codified in domestic law, the General Court disregarded the autonomy of Member States in matters of direct taxation and infringed the division of powers between the European Union and Member States.

The AG also took the view that, based on settled case-law, an error in the determination of the reference system vitiates the selectivity analysis.

In view of these considerations, the AG proposes that the CJEU sets aside the General Court’s decision, upholds the appeal brought by Ireland and annuls the Commission’s Decision.

The AG opinion in case C-885/19 P

The AG analyzed the objections brought forward by the taxpayer and concluded that the Commission was not required to consider the impact that the State aid measure granted to the taxpayer in Luxembourg had on the overall group. The AG also agreed that the fact that the ruling could lead to increased taxation in Italy does not alter the fact that the taxpayer received an advantage in Luxembourg.

Therefore, the AG concluded that, from this perspective, the analysis performed by the Commission was correct. Consequently, the AG proposed that the taxpayer's appeal should be dismissed.

EU Tax Centre Comment

The General Court's judgment had endorsed the application of a version of the arm's length principle, irrespective of whether the principle was actually implemented in domestic law or of how it was implemented. If followed by the CJEU, the AG opinion could represent a key turning point on how the Commission should approach the review of transfer pricing rulings.

As noted by the AG in his opinion, overturning the General Court's decision would clarify the role of the OECD's arm's length principle and guidelines in the context of State aid reviews, and would reduce the Commission's discretion in examining transfer pricing rulings.

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