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The OECD Base Erosion and Profit Shifting Action Plan and European Union Law

[contents on back cover]

SWEET & MAXWELL

tax benefits vis-à-vis the applicable national law and not vis-à-vis a system of law that either the Commission, the OECD or some leading EU Member States consider to be the most desirable. This is where fiscal sovereignty draws the line.

So, from this author's perspective, State aid rules cannot be used to impose the OECD transfer pricing guidelines on Member States without prior consent, nor force the latter to read and apply them in one particular way. Neither can these rules require that transfer pricing adjustments must per se be restricted to anti-abuse situations or to restrictions where other States make corresponding adjustments. All of this will depend on how the national tax system normally operates. State aid should only come into play once we divert from the national legal system to the benefit of a particular tax payer, sector of industry or group of companies.

Even if the content of rulings is to be actively exchanged between tax authorities within the EU, something this author wholeheartedly supports as a first start, we should not assume that double non-taxation will be something of the past. Differences between national tax systems still exist and tax authorities of another Member State may not even be in a position to act on what they see and close any holes without a proper domestic legal basis.

To conclude, Member States should not back away from becoming actively involved in the ongoing State aid disputes, even if it would mean that their intervention would save another State's ruling regime from scrutiny. The tone that is now set by the European Commission may create precedents that will have a long-term effect and that may restrict EU Member States in their fiscal sovereignty beyond the current scope of State aid rules. Obviously, it is hard for politicians to be seen as going against Commission actions to ensure that multinationals pay a "fair share" of tax, as they enjoy broad public support and media attention, but in the long run the Commission's vigour may turn out not to be in the EU's best interests if the anti-BEPS project does not lead to the result intended.

Base erosion and profit shifting; EU law; Member States; OECD; State aid; Tax policy; Transfer pricing

Tax Rulings and State Aid Law

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Abstract

Recently the compatibility of tax rulings with EU State aid law was intensively discussed due to the European Commission's investigation of such rulings under Article 107 of the Treaty on the Functioning of the European Union (TFEU). Several tax jurisdictions provide for the possibility of obtaining advance assessments from tax authorities before a certain taxable activity. On the one hand, rulings can serve as a proper tool to create legal certainty for both taxpayers and tax authorities. On the other hand, rulings have been criticised as a mechanism which is used to confer a tax advantage upon certain taxpayers. Such a beneficial treatment could lead potentially to prohibited State aid. Therefore, this article aims to examine the circumstances under which tax rulings could violate EU State aid law.

The importance of rulings in tax law systems

Several legal systems provide for the possibility of obtaining a legal assessment from the tax authority during or even before a potentially taxable activity. This is often referred to as "advance ruling" or "ruling".[1] Such instruments vary significantly depending on the legal system. The binding nature of such rulings often varies to the same extent as the group of beneficiaries.[2] Similarly, there are various reasons why legislators decide to create such instruments. Rulings often support the assessment being carried out by the taxpayer themselves, during the course of which the taxpayer will have no possibility of knowing what the legal opinion of the authority will be should controversial legal issues arise. Sometimes rulings are created to encourage a co-operative relationship between the authority and the taxpayer. In some cases, the authority may, as a result of a ruling practice, obtain advance information concerning a taxpayer's planned structures which it would otherwise only have received at a later date during a tax audit. In such a situation the tax authority can propose that the legislator closes any loopholes which may have been inadvertently created in the law before the taxpayer is able to take advantage of them. Finally, binding advance information often serves to harmonise administrative practices on specific legal issues before legal disputes end up before a court. As a rule, rulings contribute to legal certainty, which is not only in the interests of taxpayers and the administration, but is also conducive to a positive tax climate.[3]

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[1] I. Kerschner and M. Stiastny, "The Experience with Advance Pricing Agreements" (2013) 41(11) *Intertax* 588.
[2] M.J. Ellis, General Report, in Cahier de Droit Fiscal International, *Advance Rulings* (Rotterdam: Kluwer, 1999), 41 and following.
[3] Compare: Ellis, above fn.2, 24.

In some countries, however, ruling practice also has a reputation as a framework for arrangements between the tax authorities and the taxpayer which are not consistent with the law. Binding advance rulings often remain unpublished, and are only known to the two parties to the proceedings. Therefore, rulings are often accused of securing benefits for the taxpayer to which the taxpayer is not entitled, under the protection of tax secrecy. For that reason, the European Commission has published a proposal to include an automatic exchange of tax rulings and advance pricing agreements in the Council Directive on administrative cooperation in the field of taxation (Directive on Administrative Cooperation).[4] In addition, the Commission has deliberated over whether and under which circumstances such advance rulings can be problematic under State aid law.[5] This should prompt us to examine rulings more closely in the light of EU State aid law.

The criteria of State aid law

The prohibition of State aid under EU Law results from paragraph 1 of Article 107 TFEU:

> "Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

According to the case law of the CJEU a measure is qualified as State aid if each of the four cumulative criteria, on which this provision is based, is met. These criteria refer to the financing of the measure by the State or through State resources (first criterion), its conferring of an advantage on an undertaking (second criterion), the selectivity of that measure (third criterion), and the effect of the measure on trade between Member States and the distortion of competition resulting from that measure (fourth criterion).[6] It has long been considered that not only subsidies but also tax reductions and tax exemptions may qualify as State aid.[7] It should not make a difference if a Member State subjects an undertaking to the usual taxation and then grants aid to that undertaking, or whether it imposes lower taxes on it beforehand.[8] Nor should it make a difference whether a tax exemption is granted or the fiscal criterion is so narrowly defined that

[4] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC. See G. Gottholmseder, *Automatischer Austausch von Tax rulings—EU-kommission veröffentlicht Entwurf zur Ergänzung der Amtshilferichtlinie, SWI* 2015, 151 and following.
[5] Commission Decision SA.38373, 11 June 2014, *Apple*; Commission Decision SA.38375, 11 June 2014, FFT; Commission Decision SA.38374, 11 June 2014, *Starbucks*; Commission Decision SA. 38944, 7 June 2014, *Amazon*.
[6] *Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v Paint Graphos Soc. coop. arl, Adige Carni Soc. coop. arl, in liquidation v Agenzia delle Entrate and Ministero dell'Economia e delle Finanze and Ministero delle Finanze v Michele Franchetto* (*Paint Graphos*) (Joined Cases C-78/08 to C-80/08) [2011] ECR I-07611 at [43].
[7] *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community* (C-30/59).
[8] F.P. Sutter, *EG-Beihilfenverbot und sein Durchführungsverbot in Steuersachen* (Vienna: Linde, 2005), 72 and following.

an exemption is not necessary at all.[9] This is merely a question of drafting technique. As a result, the legal description of the taxable event can already trigger State aid.[10]

When examining tax provisions as to their State aid character, selectivity is usually of central importance. The older case law of the CJEU placed the primary focus on the search for "normal taxation."[11] A measure was considered a State aid if it constituted an exemption to the general system of taxation. In its more recent case law, however, the CJEU recognised that this approach does not yield satisfactory results.[12] In reality, anyone who distinguishes "normal taxation" from the exception by allowing other tax provisions to apply, is making a distinction between at least two provisions that have a different scope and which provide for different legal consequences.[13] What criteria are relevant in determining which of those provisions is the rule and which the exception? Whether the legislator expressly designates one of the two provisions as the rule and the other as an exception cannot be of any relevance, since this depends either upon coincidences in drafting techniques, or upon the discretion of the legislator in deciding whether or not there is a "suspicion of State aid" based merely on which formulation the legislator may choose—and without changing the scope and the legal consequences of the two provisions.[14] Moreover, examining the intention of the legislator would not yield any more results.[15] The terminology used by the authors of the laws or the materials does not change the fact that their ultimate aim is to have one or the other legal consequence apply under certain circumstances. Finally, those who ask which provisions have a large scope and which have a smaller scope, so as to distinguish the rule from the justifiable exception on the basis of this assessment, are equally doomed to fail.[16] Legal provisions offer only an abstract definition of what constitutes the group of taxpayers to be governed by them. The number of taxpayers actually affected is not foreseeable. Records on how many taxpayers were affected by which rule in the past do not provide any clues for the future. The approach recently taken by the CJEU in its judgment in *Hervis Sport- és Divatkereskedelmi Kft. v Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Foigazgatósága* (*Hervis*), that is, to establish a discrimination for the purposes of the fundamental freedoms when a provision applies to non-residents "in the majority of cases"[17] has not played any role in State aid law to this date, and is dogmatically anything but convincing in the field of fundamental freedoms. Even assuming that there are corresponding predictions as to the possible number of cases that will be affected by one or another provision in the future, there is no reason to apply the selectivity criterion only under the condition that the minority will be privileged

[9] M. Lang, *Die Auswirkungen des gemeinschaftsrechtlichen Beihilferechts auf das Steuerrecht 17. ÖJT Band IV/1* (Vienna: Manz, 2009), 25.
[10] *British Aggregates Association v Commission of the European Communities and United Kingdom* (*British Aggregates v Commission*) (C-487/06 P) [2008] ECR I-10515 at [89].
[11] See C. Micheau, "Tax selectivity in State aid review: a debatable case practice" (2008) 17(6) ECTR 276, 277 and following.
[12] *European Commission and Kingdom of Spain v Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland* (Joined Cases C-106/09P and C-107/09P) [2011] ECR I-11113.
[13] M. Lang, "State Aid and Taxation: Recent Trends in the Case Law of the ECJ" (2012) 11(1) EStAL 411, 419.
[14] *British Aggregates v Commission* (C-487/06 P), above fn.10, [2008] ECR I-10515 at [89].
[15] Lang, above fn.9, 25.
[16] M. Lang, "Seminar J: Steuerrecht, Grundfreiheiten und Beihilfeverbot" (2010) 19(15) IStR 570, 576.
[17] *Hervis Sport- és Divatkereskedelmi Kft. v Nemzeti Adó- és Vámhivatal Közép-dunántúli Regionális Adó Foigazgatósága* (C-385/12) [2014] 3 CMLR 2 (ECJ) at [39].

over the majority. Therefore, it was for good reason that the CJEU did not rely exclusively in the past on the rule-exception approach, and does so even less today. In his opinion in the case *British Aggregates v Commission*, Advocate General Mengozzi correctly summarised the previous case law as follows[18]:

> "With particular reference to State measures of a fiscal nature, the case-law shows [...] that even measures which are selective, in that they differentiate between undertakings, may escape being classified as aid, if that differentiation is justified by the nature or structure of the tax regime of which they form part [...]. It follows, according to the Court, that, in order to determine whether or not a measure is selective [...] 'it is appropriate to examine whether, within the context of a particular legal system, that measure constitutes an advantage for certain undertakings by comparison with others which are in a comparable legal and factual situation'."

Not only can general rules have a State aid character, but also those cases in which the authority of a State does not abide by its own legal regulations and unlawfully favours an undertaking can equally constitute State aid.[19] According to earlier case law, this can be considered an unjustified exemption from normal taxation. The State aid character of such unlawful benefits also becomes evident against the background of more recent case law: undertakings subjected by law to a tax obligation find themselves in a similar situation. When individual undertakings are favoured through the non-application of tax laws, the result is an unjustifiable, unequal treatment of what in essence are similar situations.

Rulings as State aid?

The considerations presented so far already demonstrate that the question is not whether rulings violate State aid law in general. This question must be addressed separately against the background of each legal system. A ruling can only be considered a selective measure if it results in unequal treatment where certain undertakings or the production of certain goods are favoured over others.

One argument against rulings which is often put forward from a tax policy perspective is the lack of transparency of such rulings[20]: tax authorities assess the taxable activity envisaged by the taxpayer beforehand and, apart from the authority and the affected taxpayer, no one else knows the settlement which has been reached. This fact alone need definitely not be of concern from the point of view of State aid law if the results of regular tax proceedings or a later tax audit never become publicly known either. The ruling only anticipates the decision that the relevant authority or another authority would reach anyway at a later stage. Therefore, if the tax settlements are generally subject to tax secrecy, the fact that the anticipated settlement also remains secret cannot be regarded as a problematic, unequal treatment under State aid law.

[18] *British Aggregates v Commission* (C-487/06 P), above fn.10, [2008] ECR I-10515, Opinion of Advocate General Mengozzi, July 17, 2008 at [83].
[19] See, for instance Commission Decision 1999/509/EC of 14 October 1998, concerning aid granted by Spain to companies in the Magefesa group and their successors (notified under document number C(1998) 3211) (Magefesa) [1999] OJ L198/15, July 30, 1999.
[20] See Commission notice on the application of the State aid rules to measures relating to direct business taxation [1998] C 384/3 December 10, 1998, para.22.

This does not mean, however, that the lack of transparency is completely unobjectionable under State aid law, since tax secrecy creates an environment which favours or at least facilitates individual arrangements between the authorities and the taxpayers, which are not covered by the law. Other taxpayers have virtually no opportunity to see the tax files of others. This is one of the reasons why authors on this topic consider admitting a competition complaint on State aid law issues, so as to at least offer competitors who may suspect an unlawful preferential treatment of another undertaking the possibility of forcing the review of the administrative settlements of the other taxpayer.[21] The legal protection thus granted, however, has its limits: competitors who are completely unaware that a taxpayer competing with them was granted an inadmissible advantage, will not even come up with the idea of resorting to legal remedies.[22] This problem, however, does not arise because of rulings, but is primarily due to the tax assessment carried out under the protection of tax secrecy in several countries.

Hence those rulings which unlawfully favour taxpayers are definitely problematic under State aid law. But even in those cases, the problem is not the ruling but the arrangement behind the official decision which is made between the tax authority and the taxpayer to assess the taxable activity which is in breach of the law. Such "deals" between the authorities and taxpayers may also be entered into in completely different circumstances: the tax assessment, which is subject to tax secrecy in many countries, also runs the risk of degenerating into a vehicle for unlawful deals between tax authorities and taxpayers. The same applies to arrangements made in the course of later tax audits which exceed the room for manoeuvre granted by the law.

On the other hand, however, it could give rise to concerns under State aid law if the possibility of seeking a ruling were not available to all taxpayers but only to certain undertakings or the production of certain goods. After all, obtaining a legally binding assessment of a taxable activity by the authority beforehand—that is, before the tax assessment proceedings—may represent a financially significant advantage. Taxpayers who do not have to wait for the tax assessment or for an even later tax audit, but who have already received binding assessments on controversial legal issues in advance, could occasionally benefit in the case of a sale of their undertaking or parts thereof. The binding ruling on otherwise controversial legal issues can alone enable the selling taxpayer to obtain a higher purchase price. The seller could bring into account the fact that the buyer of the undertaking is immune from lengthy disputes with the tax administration and does not have to live with the uncertainty of tax litigation risks, which may lead to a higher tax burden. Therefore, when the group of those taxpayers who can use a ruling is limited according to criteria which allow only certain undertakings to obtain a ruling, although others who are not entitled to get a ruling are in a similar situation, this can be regarded as an inadmissible State aid.

[21] See M. Lang, "Rechtschutzfragen abgabenrechtlicher Beihilfengewährung" in Studiengesellschaft für Wirtschaft und Recht (ed.), *Beihilfenrecht* (Vienna: Linde, 2004), 85; A. Mamut, *Konkurrentenschutz im Abgabenrecht* (Vienna: Lexis Nexis, 2010), 143.
[22] See Lang, above fn.9, 95 and following.

Equal treatment; EU law; State aid; Tax administration; Tax authorities; Transparency