State aid and tax rulings

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What's the latest?

The European Commission has recently published letters dated 11 June 2014, which were sent to Ireland and Luxembourg regarding the treatment of Apple and Fiat respectively (as was reported in last week's *Tax Journal*). The letters outline why, in the Commission's preliminary view, certain advance pricing arrangements constitute state aid.

The investigation into the Netherlands' treatment of Starbucks is ongoing. A letter of 9 July 2014 has been sent to the Netherlands regarding corporate tax exemptions for public undertakings. On 1 October 2014, the Commission announced that it was extending its investigations covering Gibraltar to include tax rulings. The latest news concerns Amazon in Luxembourg (see page 3).

What do the letters to Ireland and Luxembourg say?

After setting out some history, they discuss the topic of advance pricing rulings generally, outline the structure of the Apple Group and Fiat Finance and Trade Ltd ('Fiat') respectively, and consider the contested measures. The third section is taken up with an assessment of whether or not aid exists, setting out the basic rules governing the existence of state aid. These are discussed by my colleague Kelly Stricklin-Coutinho in the article at page 8.

The shorter final section states the Commission's 'preliminary view' that aid has been given. It requests all information which could help the Commission to make an assessment of the existence of aid and highlights a number of specific matters on which information is needed.

Some of the information sought is fundamental. In the case of Luxembourg, the Commission is even seeking confirmation that the company in question is Fiat. In the case of Apple, it requests matters such as company accounts and cost sharing agreements between companies. The letter to Ireland, in particular, contains selective quotations from documents in the Commission's possession and necessarily omits significant material subject to 'professional secrecy'.

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It is not surprising that the Commission's letters have been reported in the national press as setting out a serious case. Quotations devoid of context can make any case look impregnable. Fundamental propositions of law may appear beyond dispute, although supported on examination by a footnote referring to a single sentence in one judgment.

Although the initial statement of any case may be its high point, it would be unwise to deny that the Commission's case is serious. But these letters are the beginning and not the end of a procedure under article 108.2 of the Treaty on the Functioning of the European Union. The procedure may not end in tears, but it does seem likely to end in litigation.

What is the alleged aid?

In both cases, it is alleged that a selective advantage has been given to the enterprises. Their tax liabilities are said to have been reduced by non-compliance with the arm's length principle. So far as Ireland is concerned, it is the allocation of an allegedly low profit to the Irish branches of two companies which is at issue. So far as Luxembourg is concerned, the remuneration received by Fiat is said to be too low. Its level of taxable funds, as well as its level of earnings from them, is challenged.

The *OECD Transfer Pricing Guidelines 2010* are heavily relied on. The precise relationship between the arm's length principle and the existence of an advantage and of a selective advantage for state aid purposes is not necessarily as straightforward as the Commission suggests. It contends that the existence of an advantage and selectivity are satisfied if non-compliance with the arm's length principle is established.

Leaving that aside, so far as Ireland is concerned, the first justification advanced by the Commission is that the taxable base in question was established not by the use of a particular methodology but by negotiation. This 'reinforces the idea that the outcome ... is not arm's length' (para 58). The OECD's guidelines themselves say: 'transfer pricing is not an exact science but does require the exercise of judgment on the part of the tax administration and taxpayer' (para 1.13). Is each to exercise judgement independently of the other? Unattractive as many may find it, there is not always a single 'right amount' of tax to pay. Often, there will be a range of 'relatively equally reliable' figures in an 'arm's length range' (para 3.55). This may become more significant as these cases develop.

Of course, there are other justifications for the Commission's position. For example, looking at Ireland again, a 1991 ruling is criticised for being open-ended, rather than being effective for a set period of time. The letter sets out the duration of agreements in other EU member states. It appears not to refer, though, to the circumstances under which an open-ended agreement may be reviewed by Revenue commissioners. These may be significant.

What's the next step?

The letters of 11 June 2014 required information to be sent to the Commission within one month of receipt. The Commission's final decision is to be taken, so far as possible, within 18 months of the procedure opening. It seems that Ireland and Luxembourg have a far from easy task in front of them.

Who will be next?

Other EU tax administrations ought to be reviewing their general rulings' procedure, as well as individual rulings. Both administrations and companies will want to ensure they have documentation and arguments to support past and future agreements. No doubt, some will also be taking advice on the possibility of aid being recovered. The sums at stake are likely to be very large.