

Op-Ed



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“The Arm’s Length Principle, the Principle of Non-Discrimination and the Definition of the Reference Framework Constituting ‘Normal’ Taxation”

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Juan Jorge Piernas López

On 16 December 2021, Advocate General (AG) Pikamäe issued his Opinions in cases *Fiat Chrysler Finance Europe v Commission* ([C-885/19 P](#)) and *Ireland v Commission and others* ([C-898/19 P](#)), which raise very relevant questions related the control of State aid by the European Commission, particularly in relation to the application of the arm’s length principle for the examination of the economic advantage criterion under Article 107(1) TFEU in cases of alleged aid granted through tax rulings.

The Opinions concern two appeals brought by Fiat Chrysler Finance Europe (‘FIAT’) and Ireland, respectively, against the [judgment of the General Court](#) of 24 September 2019 confirming the validity of a 2015 [Commission decision](#), which found that a 2012 tax ruling issued by the Luxembourg authorities in favour of FIAT constituted unlawful and incompatible State aid under Articles 107 and 108 TFEU. This Op-Ed will mainly focus on some relevant aspects of the Opinion issued in the *Ireland v Commission* case (C-898/19 P), which led AG Pikamäe to propose

the Court of Justice to set aside the judgment of the General Court and to annul the contested Commission’s decision, and briefly comment on the Opinion issued in the *Fiat v Commission* (C-885/19 P) case, before drawing some conclusions.

The arm’s length principle, Article 107(1) TFEU and the principle of non-discrimination

In support of its appeal, Ireland, joined by the Grand Duchy of Luxembourg and FIAT, raised five grounds of appeal. The first ground of appeal, which the AG considered well-founded, alleged that the General Court had erred in law in its application of Article 107 TFEU by endorsing the arm’s length principle for the analysis of the existence of an economic advantage as it had been applied in the contested decision. In this regard, the AG noted, in line with the General Court, that ‘the arm’s length principle, as referred to in the decision at issue, derives from national law, and not from Article 107(1) TFEU itself’ (Opinion, at

point 94 *in fine*). In particular, the AG underlined that the application of the arm's length principle derived, according to the General Court's judgment, from the fact that national law was intended to accord the same treatment to integrated companies and stand-alone companies for the purposes of corporate taxation.

In this context, AG Pikamäe added that if the Court of Justice considered that the reasoning for the contested decision should be understood as meaning that the arm's length principle derived from Article 107(1) TFEU, it would remain to be ascertained whether a principle of equal treatment of taxpayers (mentioned in paragraph 228 of the contested decision) could be derived from that provision. To this extent, the AG concluded that 'Article 107(1) TFEU, which lays down a general prohibition on the granting of State aid, in no way establishes a general principle requiring equal treatment of taxpayers.' The AG found support for this conclusion in the case-law of the Court according to which the Treaty contains no general principle of non-discrimination beyond the grounds which are expressly stated (Opinion, at point 97).

In this regard, in recent judgments the General Court found (in cases [T-238/20](#) and [T-259/20](#)) that differences in treatment on grounds of nationality included in two State aid measures were permitted under Articles 107(2)(b) TFEU and Article 107(3)(b) TFEU as those articles could be regarded as [special provisions](#) contained in the Treaties under Article 18(1) TFEU (see for example [T-238/20](#) at paragraph 31). It would therefore appear that the General Court found that the principle of non-discrimination was also implemented in the Treaty State aid provisions.

This interpretation would be coherent with the decision of the General Court in the *Thermenhotel Stoiser Franz* judgment ([T-158/99](#)), where it held that the first paragraph of Article 18 TFEU was not apt to be applied independently in the context of a State aid case 'by reason of the existence of the competition rules of the Treaty' (paragraph 147). The General Court added that the competition rules 'cover discrimination, not in relation to the nationality of the undertakings allegedly affected, but by reference to the geography and sector of the market considered.' (Ibid).

In this context, the notion of State aid, and particularly the criterion of selectivity, entails a certain degree of different treatment or discrimination. As the Court of Justice has held 'The concept of selectivity [is] linked to that of discrimination' (*Commission v Hansestadt Lübeck*, [C-524/14 P](#)) and selective measures favour some undertakings over others 'who accordingly suffer different treatment that can, in essence, be classified as discriminatory' (*Commission v World Duty Free Group, Banco Santander and Santusa*, [C-20/15 P](#) and [C-21/15 P](#)). In light of these precedents, it could be argued that, while Article 107(1) TFEU does not explicitly refer to equal treatment, the granting of State aid in contravention of that provision entails a certain discrimination which could be justified under Articles 107(2) TFEU and 107(3) TFEU. Furthermore, it also appears from the Court's case-law that certain differences in treatment are not acceptable under Article 107 TFEU. Indeed, the Court of Justice held in *Nuova Agricast* ([C-390/06](#)) that 'State aid, certain of the conditions of which contravene the general principles of Community law, such as the

principle of equal treatment, cannot be declared by the Commission to be compatible with the common market'(paragraph 51). Hopefully the Court of Justice will provide guidance on the relationship between the principle of equal treatment and Article 107 TFEU in the judgment on the cases under review and in the appeals to the abovementioned decisions of the General Court ([C-209/21 P](#) and [C-210/21 P](#)).

The arm's length principle and the definition of the reference framework constituting 'normal' taxation

The AG then moved to analyse the fifth complaint raised by Ireland, in essence, that the General Court had erred when it endorsed the Commission's use of the arm's length principle on the basis of the (presumed) objective of Luxembourgish tax law – namely that of taxing integrated and stand-alone undertakings in the same way – and not (or not only) on the basis of the arm's length principle as it was established under Luxembourgish law in Article 164(3) of the Income Tax Code (and Circular No 164/2).

The AG considered this claim well-founded and underlined that 'the legal reasoning followed by the Commission, principally, and endorsed by the General Court in the judgment under appeal defines the reference framework constituting "normal" taxation by relying on a version of the arm's length principle based on an uncodified element such as the (purported) objective of Luxembourg tax law'. He added that such approach constituted 'an undue interference in the Member States' tax autonomy' (Opinion, at point 111).

While the AG's position is appealing, there are also arguments in favour of the approach followed by the General Court which are, in my view, more in line with the settled case-law of the Court of Justice. In this regard, the Court has consistently held that Article 107(1) TFEU does not distinguish between measures of State intervention by reference to their causes or their aims but defines them in relation to their effects, and thus independently of the techniques used. To this extent, in the *Gibraltar* judgment ([C-106/09 P](#) and [C-107/09 P](#)) the Court criticized that the regulatory technique endorsed by the General Court in that case excluded the possibility of finding selective advantages (paragraph 88). The Court also added that the consequence of such an approach 'would be that national tax rules fall from the outset outside the scope of control of State aid merely because they were adopted under a different regulatory technique although they produce the same effects in law and/or in fact' (paragraph 92).

In the case at hand there is no doubt as to the applicability of the State aid rules. However, the approach suggested in the Opinion would limit the Commission's ability to apply the arm's length principle as a tool to determine the existence of an economic advantage under Article 107(1) TFEU even in cases, like the present, where such principle is formally adopted under national law. Indeed, as the AG noted, 'if the arm's length principle were incorporated into the national legal order, the number of national tax authorities whose tax rulings might be subject to Commission scrutiny from a State aid perspective would be reduced and the OECD guidelines would become de facto binding by restricting the

Commission's discretion in examining those rulings' (Opinion, at point 110).

In addition, it also appears that the conclusion reached by the General Court, allowing the Commission to use the arm's length principle as a 'tool' to verify whether a particular tax measure related to the pricing for intra-group transactions confers an economic advantage could be consistent with the settled case-law of the EU Courts under which Member States must refrain, in the exercise of their competences in the field of direct taxation, from adopting measures which may constitute incompatible State aid under Article 107 TFEU.

Furthermore, the General Court's judgment seems also balanced as it added that when the Commission uses the arm's length principle as a 'tool' '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, the Commission can identify an advantage within the meaning of Article 107(1) TFEU only if the variation between the two comparables goes beyond the inaccuracies inherent in the methodology used to obtain that approximation' (paragraph 144). To this extent, the Court of Justice has also seemingly supported the Commission's approach in the recent *Magnetrol* judgment ([C-337/19 P](#)) by rejecting the argument made by Belgium in the sense that 'the Commission's position of regarding tax rulings on excess profit as State aid when those rulings are not in line with what the Commission considers to be a correct application of the arm's length principle is tantamount to forced harmonisation of the rules on the

calculation of taxable income, which does not fall within the jurisdiction of the European Union' (paragraphs 159 *et seq.*).

The Opinion on the appeal brought by *FIAT* (C-885/19 P)

Regarding the appeal brought by *FIAT* (C-885/19 P), the applicant advanced three grounds of appeal. While the AG proposed the Court to reject them all, it is noteworthy that *FIAT* defended that the Commission was required to take account of the intra-group and cross-border dimension of the effects of the tax ruling at issue when determining whether that ruling conferred an advantage as the alleged benefit was reduced or neutralised at group level. The General Court had rejected this interpretation, recalling that the analysis of the advantage criterion had to be carried out by reference to the situation of the beneficiary in comparison with other undertakings of the same Member State. The AG supported this finding and interestingly added in this regard, with reference to distinguished State aid experts, that 'The rationale of [the prohibition included in Article 107(1) TFEU] has to be equated with that of the EU rules on free movement [...] More specifically, the objective of the State aid rules is, as is well known, to avoid a subsidies war between the Member States of the European Union, which would lead to the creation of obstacles to the free movement of companies and of goods, services, workers and capital' (Opinion, at points 154 and 155).

Conclusions

The Opinions of Advocate General Pikamäe in the reviewed cases address key issues concerning the control by the European Commission of State aid allegedly granted through tax rulings. In particular, the conclusion on the interpretation of the arm's length principle could, if followed by the Court, significantly limit the Commission's ability to employ this principle in future cases. Having said that, it is not clear whether the Court of Justice will follow the AG's opinion in light of the effects-based definition of State aid and the non-formalistic approach adopted by the Court of Justice in relation to taxation and State aid.

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