FACULTAD DE DERECHO

THE IMPORTANCE OF THE CCCTB FRAMEWORK

Consequences and Opportunities in Light of the Apple Tax Case Ruling (July 15th 2020)

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Abstract

Over the last two decades, harmful tax competition practices by Member States and tax avoidance schemes by Multinational Enterprises have rested at the core of the European Commission's quest for the harmonization of corporate taxation. Brussels' strategy against these unfair practices has been designed around two very different pillars: (i) first, a legislative proposal named "the Common Corporate Consolidated Tax Base", which has failed due to the absence of political unanimity (which is needed to pass any EU-wide tax legislation); (ii) and second, a contested State aid law approach, which has suffered several judicial setbacks due to the legal difficulties that arise regarding its implementation.

Therefore, the study of this dissertation focuses on the definition of harmful tax competition and aggressive tax planning, in order to provide a critical analysis of the suitability and the prospects of previous strategies adopted by the Commission in this field. For such purpose, the intricate interaction between tax rulings (as long-established national fiscal practices) and Article 107 TFEU is approached through a detailed case-law review. As a conclusion, a novel legal alternative which allows for fairer cross-border corporate taxation in the European Union is proposed: the application of Article 116 TFEU in order to implement the CCCTB framework through a qualified majority vote.

Keywords

European Union, corporate tax harmonization, tax avoidance, tax rulings, CCCTB, State aid, Article 116 TFEU.

Resumen

Durante las dos últimas décadas, las prácticas perjudiciales de competencia fiscal por parte de los Estados miembros y los esquemas de evasión fiscal de las empresas multinacionales han constituido el núcleo de la lucha de la Comisión por la armonización del impuesto de sociedades. La estrategia de Bruselas contra estas prácticas desleales se ha diseñado en torno a dos pilares muy diferentes: (i) en primer lugar, una propuesta legislativa denominada "Base Imponible Común Consolidada del Impuesto de Sociedades (BICCIS)", que ha fracasado debido a la ausencia de unanimidad política (necesaria para aprobar cualquier legislación fiscal a escala de la UE); (ii) y, en segundo

lugar, un controvertido planteamiento de ayudas de estado, que ha sufrido varios reveses judiciales debido a las dificultades jurídicas que plantea su aplicación.

Por lo tanto, el estudio de este trabajo se centra en la definición de la competencia fiscal perjudicial y la planificación fiscal agresiva, con el fin de proporcionar un análisis crítico de la idoneidad y las perspectivas de futuro de las estrategias adoptadas hasta ahora por la Comisión en este ámbito. Para ello, se aborda la compleja interacción entre los acuerdos previos de valoración (como prácticas tributarias nacionales bien consolidadas) y el artículo 107 del TFUE, a través de una detallada revisión de la jurisprudencia. Como conclusión, se propone una novedosa alternativa jurídica que permitiría una fiscalidad empresarial transfronteriza más justa en la Unión Europea: la aplicación del artículo 116 del TFUE para implementar el marco BICCIS mediante un voto por mayoría cualificada.

<u>Palabras clave</u>

Unión Europea, armonización fiscal empresarial, elusión fiscal, acuerdos previos de valoración, BICCIS, ayudas de estado, Artículo 116 TFUE.

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LIST OF ABBREVIATIONS

AOE – APPLE OPERATIONS EUROPE

AOI – APPLE OPERATIONS INTERNATIONAL

APAs – ADVANCED PRICING AGREEMENTS

ASI – APPLE SALES INTERNATIONAL

BEPS – BASE EROSION AND PROFIT SHIFTING INITIATIVE

CFC – CONTROLLED FOREIGN CORPORATION

CUP – COMPARABLE UNCONTROLLED PRICE

EC – EUROPEAN COMISSION

EU – EUROPEAN UNION

FCFE – FIAT CHRYSLER FINANCE EUROPE

MNEs – MULTINATIONAL ENTERPRISES

CCCTB – COMMON CORPORATE CONSOLIDATED TAX BASE

ECJ – EUROPEAN COURT OF JUSTICE

EGC – EUROPEAN GENERAL COURT

FDI – FOREIGN DIRECT INVESTMENT

IMF – INTERNATIONAL MONETARY FUND

IP – INTELLECTUAL PROPERTY

IRS – INTERNAL REVENUE SERVICE

LuxOpCo – AMAZON EU SÀRL

LuxSCS – AMAZON EUROPE TECHNOLOGIES HOLDING SCS

OECD – ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT

SMBV – STARBUCKS MANUFACTURING EMEA BV

TFEU – TREATY ON THE FUNCTIONING OF THE EUROPEAN UNION

TNMM – TRANSACTIONAL NET MARGIN METHOD

US – UNITED STATES

CHAPTER 1: INTRODUCTION

1. BACKGROUND

Ever since the Treaty of Rome was signed in 1957, the project of European integration has focused on the creation of a single market that allows for the free movement of capital, goods, services and labor. To safeguard these four freedoms, European institutions were vested with great powers in order to ensure economic convergence among Member States, through the supervision and intervention of national policies in the fields of competition, financial markets regulation and trade (both external and within the single market). When the Euro was introduced as the common currency in 1999, monetary policy joined the abovementioned economic practices and also fell under the scope of the newly born European Union (hereinafter, EU).

During the past decades, economic and monetary convergence has served as the driving force of the single market. However, fiscal policies on the other hand have been largely retained by national authorities, albeit under certain institutional agreements regarding sound budgetary policy and subject to an *ex-ante* control by the Commission (Laruffa, 2014). In its early stages, European institutions considered that direct taxation remained a sovereign area under the discretion of national governments (Nikolic, 2012). Under this institutional framework in which taxation remained one of the few instruments at the hands of national capitals, multiple Member States promoted advantageous corporate taxation regimes in order to attract Foreign Direct Investment (hereinafter, FDI). This practice became more frequent at the end of the twentieth century, thus leading to an environment of harmful tax competition within the EU (Hrushko, 2017). As a result, multiple initiatives were brought forward in order to attain a certain level of fiscal harmonization at the European level, mostly regarding indirect taxation. However, harmonization of direct taxes (and namely, corporate taxes) has always turned out to be much more problematic, due to political unwillingness to give up sovereignty in this matter. Some symbolic measures were taken, such as the Code of Conduct for Business Taxation adopted by the Council of Economics and Finance on December 1st, 1997, which constituted a political compromise by Member States to refrain from adopting fiscal policies that could stimulate harmful tax competition but lacked any binding force (Hrushko, 2017).

The Commission was well aware of this absence of political consensus, which impeded the unanimity of all Member States required to pass any EU-wide direct tax legislation. While at the same time, Brussels was becoming increasingly concerned about Multinational Enterprises (hereinafter, MNEs) profiting from the scenario of tax competition between Member States by implementing their own aggressive tax planning schemes. In spite of being acknowledged as the ideal long-term solution, a legislative process that established a single set of European corporate taxation rules seemed to be too idealistic and somehow implausible. For this reason, the European Commission took a different approach: as long as legislative harmonization remained unreachable, State aid law could be used to hinder tax competition among Member States and the subsequent aggressive tax planning by MNEs. This approach, also known as "harmonization through the back door", gained track at the beginning of the twenty-first century when the Commission started to scrutinize national business taxation practices, and more specifically, tax rulings (Hrushko, 2017).

After years of investigations, in February 2014 six Member States were inquired regarding certain tax ruling practices that allegedly violated European State aid law. The Commission was convinced that these states had adopted tax rulings allowing companies to abuse transfer pricing rules in order to allocate profits to untaxed subsidiaries (Hrushko, 2017). Among these six cases, the Commission Decision of 30.08.2016 on State Aid SA.38373 (2014/C) (hereinafter, the Apple Decision) was significantly notorious, due to the unprecedented amount of retroactive taxes that the Commission ordered Apple Inc. (hereinafter, Apple) to pay back. Brussels concluded that the Cupertino-based tech giant had obtained an estimated of €13 billion in the form of tax breaks from the Irish government, which constituted illegal State aid.

For some time it seemed that European institutions had emerged victorious in their crusade against aggressive fiscal practices (by both MNEs and Member States), but in July 2020 the Commission suffered a major defeat at the hands of the European General Court (hereinafter, EGC): just like in two other previous cases involving Starbucks and Fiat, the Court found that the Commission's Apple Decision did not meet the burden of proof needed to determine the existence of illegal State aid, and for this reason the Decision was annulled. Although this ruling has been appealed by Brussels before the European Court of Justice (hereinafter, ECJ), it surely sheds light on the poor prospects

for "harmonization through the back door" and the flawed suitability of State aid law for combatting abusive tax planification.

2. AIMS AND OBJECTIVES

The recent judgement by the EGC in the Apple case has sparked a heated debate over the Commission's role in fighting aggressive fiscal planning within the EU. As the following Chapter will explain, Brussels' battle against harmful tax competition between Member States is certainly legitimate. However, the means for pursuing this battle have been heavily criticized by many tax scholars, and the scrupulous treatment received by the Commission's decisions at EU courts questions the suitability of the discrete application of State aid rules as a fitting instrument for harmonizing the European corporate tax base. Thus, this dissertation will address such judicial scrutiny and the prospects of Brussels's appeal before the ECJ in the Apple case, in order to determine whether the Commission should leave "harmonization through the back door" behind. More importantly, this dissertation aims to go one step further and analyze alternative courses of action for implementing a reasonable level of fiscal integration among Member States.

For this purpose, the following structure will be followed: **first**, the origins and consequences of fiscal competition practices between Member States will be analyzed, in order to understand how MNEs benefit by implementing their own aggressive tax schemes. For illustration purposes, the Apple case will be used as reference for understanding such fiscal engineering strategies. **Second**, this dissertation will review previous initiatives by the Commission to battle fiscal competition and tax avoidance, and more specifically, its 2016 proposal for a Common Corporate Consolidate Tax Base (hereinafter, CCCTB) and its State aid law approach. This section will focus on the causes behind the poor results of these past harmonization attempts, as well as the judicial treatment received by the latter through a case law review. And **lastly**, this dissertation will scrutinize the forecasts of harmonized European corporate taxation upon the theoretical study of the expected outcome of the Commission's appeal in the Apple case. This final chapter will be supported by the prior case law review on the complex intersection between EU State aid law and national tax rulings. It will include an analysis of existing legal alternatives to "harmonization through the back door" as well as to the unanimity of Member States. And namely, Article 116 of the Treaty on the Functioning

of the European Union (hereinafter, TFEU) will be addressed as a potentially powerful mechanism for corporate tax harmonization.

3. RELEVANCE OF RESEARCH

Amidst the unprecedented economic and social crisis caused by the Covid-19 pandemic, the EU has pledged to avoid a massive destruction of companies and jobs through once-in-a-generation stimulus packages, thus assuming the cost of high indebtedness. And in the face of growing financing needs, most Member States want to tackle the tax loophole that large multinationals, especially big tech companies, are allegedly leaving in their treasuries. The task is extremely ambitious, as it counts with internal EU dissent as well the strong opposition of powerful and traditional allies such as the United States (hereinafter, US), which is home to the companies that would be most affected by the proposed novel corporate taxation rules (i.e., Amazon, Alphabet, Apple and Facebook).

However, the Commission seems to maintain its strong will: when asked about the implementation of a Digital Services Tax in an interview with CNBC[1], Paolo Gentiloni declared that big tech giants were the "real winners" of the coronavirus crisis and should consequently pay a "fair amount" of taxes in Europe. The Italian Commissioner has also addressed the press regarding the judicial setback suffered in the Apple Decision, stating that[2] "A single ruling is not discouraging our commitment. I would say the contrary."

In this post-pandemic recovery context in which Brussels is actively pushing for a fairer and more effective corporate tax regulation, a profound analysis of previous harmonization initiatives in this field seems to be exceptionally relevant. Without looking into past failures, European institutions will hardly promote the adequate fiscal mechanisms that fulfill the financing needs of Member States in a context of massive public spending. However, the feasibility of such mechanisms currently lies at the **intricate crossroads between antitrust law and well-established fiscal practices** (i.e., tax rulings). For this reason, a further analysis of both potential repercussions emerging

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[1] The whole interview can be accessed through the following link: https://www.cnbc.com/2020/09/05/big-tech-needs-to-pay-more-tax-eus-gentiloni-says.html

[2] The Commissioner's remarks have been published by several news outlets, including the Financial Times: https://www.ft.com/content/6cc18c26-04e0-410d-9c0a-3f1baf1a1685

from the expected ECJ's ruling and alternative legal strategies is indeed indispensable, as it clarifies the prospects for harmonization of corporate taxation at the EU level.

4. METHODOLOGY

For such purposes of clarification, this dissertation will resort to a **mixed-approach analysis** of the current state of aggressive tax planning and harmful tax competition in the EU, as well as previous legislative initiatives and court rulings in the field of fiscal integration and State aid law. On the one hand, the **quantitative component** of this mixed-approach will allow for a precise measurement of the economic impact that abusive fiscal practices leave on Member States' public finances. It will be carried out through the review of the data provided by national tax authorities as well as the reports published by the Organization for Economic Cooperation and Development (hereinafter, OECD) and the Commission. While on the other hand, the **qualitative component** of this dissertation will allow to contextualize such economic impact and the measures taken to mitigate it, thus providing an in-depth understanding of the lights and shadows of European tax harmonization. This second pillar of the mixed-approach will rely on academic publications by tax scholars as well as a case-law study of EGC judgements that deal with national tax rulings.

CHAPTER 2: HARMFUL TAX COMPETITION AND AGGRESSIVE TAX PLANNING WITHIN THE EU. THE CASE OF APPLE IN IRELAND AND THE LOSS OF STATE SOVERIGNITY

This chapter aims to provide a detailed contextualization of the issue at stake in this dissertation: the prospects for harmonization of the corporate tax base at the EU level. For this purpose, harmful tax competition by Member States and its flipside phenomenon, aggressive tax planning by MNEs, will be studied. This study will focus on how these realities have emerged, providing an analysis of their scope and their impact on the traditional cross-border taxation system (both globally and within Europe). And as a conclusion, the case of Apple's tax strategy in Ireland will serve to illustrate the complexity and the damaging consequences of such impact.

1. HARMFUL TAX COMPETITION

The current economic context is undoubtedly defined by a high level of competition that arises in all relevant areas, including national taxation policies (Tofan, 2019). However, tax competition does not strictly fall under the traditional definition of economic competition: competition *per se* refers to a free market scenario in which participants' behavior is solely determined by the law of supply and demand; while tax competition involves national (or even regional) governments driven by political and economic interests, rather than a supply and demand logic (Tofan, 2019). In this sense, tax scholars have defined tax competition as a **"strategic fiscal context, within the wider framework of non-cooperation among tax jurisdictions** (countries, states, or regions of a federation), **where each establishes some tax-related parameters according to taxes practiced by the others"** (Keen, 2008). This chapter will only approach tax competition between countries ("horizontal tax competition"), and more specifically, between EU Member States.

In light of the abovementioned definition, one key question arises: is tax competition inherently negative? Traditionally, the academic literature had been strongly divided in this matter: on the one hand, there were those who claimed that tax competition inevitably leads to a "race-to-the-bottom" scenario in which tax bases are eroded thus leading to the under-provision of public services; while on the other hand, some scholars resorted to

Tiebout's "taming Leviathan" arguments to sustain the idea that tax competition serves as a guarantor for the efficient supply of public services by containing government expenditure (Wishdale, 2012). However, this debate has been outdated, since a consensus has been built on the inapplicability of Tiebout's arguments to our current global economic context (Tofan, 2019). A more up-to-date approach considers the effects of tax competition from a **performance perspective**: they can be either fair or harmful, depending on whether competition is used for **attracting real investment** or for the **artificial shift of corporate profits** (de Wilde, 2018). In this regard, from a tax law outlook, it is considered that beneficial outcomes arise when countries engage in competition through the adjustment of their respective corporate tax rates with the purpose of promoting real economic activity within their territories. These potential benefits of "fair tax competition" were already acknowledged by the European Commission in the Explanatory Memorandum of its 2011 proposal for a CCCTB[3].

On the contrary, harmful tax competition occurs when countries promote taxation regimes with the intention of unduly affecting MNEs' choices of fiscal residence (de Wilde, 2018). As it has already been explained, tax rate differentials among Member States do not necessarily pose harmful effects. In fact, the profound difference between the EU's lowest corporate tax rate (Bulgaria's 10%) and the highest (Malta's 35%) has never been a concern for the Commission's harmonization proposals (Hentze, 2019). In contrast, the true core of harmful tax competition between Member States lies on **preferential tax regimes and tax rulings**[4] (although these two are usually accompanied by excessively low tax rates).

Through these regimes and rulings, MNEs are able to artificially shift profits from the country where real investment is taking place towards the "tax shelter" jurisdiction (de Wilde, 2018). And once they have been shifted, modest statutory rates alongside minimal effective rates ensure that their **profits remain virtually untaxed**. This cross-border shift is carried out through **intra-group distributions of financial resources and intellectual**

[3] For further information, refer to Point 1 of the 2011 Proposal's Explanatory Memorandum, accessible through the following link: https://ec.europa.eu/taxation_customs/sites/default/files/resources/documents/taxation/company_tax/common_tax_base/com_2011_121_en.pdf

[4] Tax rulings are controversial individual agreements between tax authorities and taxpayers (in this case, MNEs), which will be further defined in Chapter 3.

property (hereinafter, IP), which are only possible thanks to the establishment of controlled legal entities in the involved jurisdictions (as it will be further explained in the following sections of this Chapter). From an economic perspective, such artificial shift of profits is feasible due to the **absence of third-party market factors** in the intra-group environment in which these distributions take place (de Wilde, 2018). And from a legal standpoint, no significant obstacles arise either, due to the intangible nature of financial resources and IP as opposed to physical assets such as capital or labor (de Wilde, 2018). For these reasons, it its multinational technological companies with subsidiaries in different Member States and whose main source of revenue arises from intangible assets that have been at the epicenter of the controversy regarding harmful tax competition.

The overall result of this harmful tax competition scenario is that MNEs (and especially, those of the technological sector) end up paying **minimum or zero taxes for a large portion of their European income**, at the expense of the corporate tax base and the fiscal revenue of the origin Member State in which real investment occurs (de Wilde, 2018). But it is not only European countries that are harmed by this situation: **local and medium-sized companies are excluded from advantageous tax regimes and rulings**, and thus they end up assuming a disproportionately high portion of their country's corporate fiscal burden in comparison to MNEs. However, far from receding, all these damaging impacts of harmful tax competition between Member States have only intensified in recent years, due to the increased mobility of intangible assets and the expansion of tech giants throughout the continent, which are mostly groups headquartered in the US. As a result, and as tax scholars have already demonstrated, **levels of harmful tax competition and the subsequent decline of tax collection are significantly higher within the EU than in other world regions** (Celebi, 2013).

This high-degree of harmful tax competition has a negative impact on the welfare systems of the Union (Eggert & Haufler, 2006), especially in the case of high-tax countries that experience a loss of fiscal revenue due to the shift of corporate profits towards tax shelter jurisdictions. This is the case of larger Member States like Germany and France, while it is smaller countries that constitute the so-called **tax shelters**, and namely: **Ireland, the Netherlands, Luxembourg and Malta**. The case of Ireland is especially notorious, since it is estimated that **Irish tax laws help to shift around €78 billion in corporate profits annually** (Barrera & Bustamante, 2018). It is thus easy to notice the diverging interests

among European states regarding corporate taxation. As an illustration of this divergence, Figures 1 and 2 in Appendix I reflect the differences in the evolution of corporate tax collection between larger high-tax Member States and smaller “tax shelters”. In Figure 1, Ireland’s 2019 percentage of corporate tax collection more than doubled that of Germany’s. And in Figure 2, a similar pattern is distinguished between French and Dutch percentages. The reality that lies behind these figures is that during the two past decades, certain Member States (including Ireland and the Netherlands) have promoted the so called **“carrot regimes”** (de Wilde, 2018) within their jurisdictions. The term is quite self-explanatory: MNEs are tempted by certain small Member States to artificially shift their European (and even global) profits towards their jurisdictions, where they will remain largely untaxed. Through these regimes, the involved Member States are able to attract enormous amounts of FDI. However, as a recent study by the International Monetary Fund (hereinafter, IMF) has proven, such investment is not genuine: 40% of current global FDI flows are not based on real business activity and are indeed financial engineering instruments used to minimize companies’ tax liabilities (Damgaard, Elkjaer, & Johannesen, 2019). According to this study, Ireland, the Netherlands, Luxembourg and Malta collectively amount for more than **half of the world’s total phantom inward FDI flows** (Damgaard, Elkjaer, & Johannesen, 2019).

As a form of phantom investment, FDI flows seized by these four Member States do not seek to stimulate growth and job creation through the transfer of capital, skills and technologies. On the contrary, their sole purpose is to transfer profits to the group’s-controlled entity in that tax jurisdiction, known as **“corporate tax shell”**, which has no business activity. But even if these void corporate tax shells have few or no employees and pay minimal taxes, they still somehow contribute to the tax shelter’s economy by purchasing tax advisory, accounting, and other financial services, as well as by paying registration and incorporation fees (Damgaard, Elkjaer, & Johannesen, 2019). It is for this reason that Ireland, the Netherlands, Luxembourg and Malta have **opposed any modification of current cross-border taxation rules**, including the Commission’s harmonization proposals, as they would suffer the loss of income derived from phantom FDI.

Their resistance to such measures is based on the argument of **tax sovereignty**, and it has been one of the determining factors behind the failure of the Commission’s CCCTB

proposal (in both its 2011 and 2016 versions) as well as a source of litigation before European courts against Brussels' State aid law approach. However, as the following section will explain, **harmful tax competition does not create sovereign winners and losers**, as all countries (including tax shelters) lose in terms of sovereignty to one increasingly powerful actor: MNEs. The remaining sections of this chapter will present the damaging effects of the harmful tax competition environment created by Ireland, the Netherlands, Luxembourg and Malta, in which their overly favorable regimes have led other countries to fear that their choice of tax policies will be undermined (Barrera & Bustamante, 2018). As a final remark, Figure 3 in Appendix I reflects the "race-to-the-bottom" of Member States' statutory corporate tax rates in the past two decades[5], which has been fueled by harmful tax practices (Nikolic, 2012).

2. AGGRESSIVE TAX PLANNING

The previous section has provided a detailed analysis of harmful tax competition practices between Member States, which allows us to now approach their flipside phenomenon: aggressive tax planning schemes by MNEs. However, while such prior analysis was restricted to the EU dimension, the current section must broaden its scope to a multinational level. This is due to the very own nature of technological MNEs (which, as it was already explained, are the main target of the Commission's crusade against tax avoidance): these firms operate globally, through multiple subsidiaries across the world and typically headquartered on US soil. And for this reason, the study of their tax planning strategies must be carried out from an international perspective, rather than a solely European one. As a first step, a precise definition of the notion of tax planning is required: in an economic context of ever-increasing globalization, an emerging global marketplace and the high mobility of assets, MNEs have focused on the maximization of their profits through a series of **tax-motivated responses to investment location decisions** (de Wilde, 2018). Since taxes are regarded as corporate costs, MNEs proceed to allocate their resources to those jurisdictions with relatively lower average effective tax rates[6] (hereinafter, AETRs) on investment returns (to which in the previous section we have

[5] The same phenomenon has been experienced worldwide: according to estimates by tax experts, the **global average corporate tax rate dropped from 49% in 1985 to 24% in 2018** (Tucker, Stiglitz, & Zucman, 2020).

[6] Increasingly lower AETRs are themselves the result of harmful tax competition practices, as it has already been explained in the previous section.

referred to as "tax shelter jurisdictions"). It is precisely this **strategic geographical allocation of resources** that constitutes the notion of tax planning (de Wilde, 2018).

In light of this definition, when should tax planning be considered "aggressive"? In a similar sense to what happened with fiscal competition, it is the purposes for which tax planning is implemented that could potentially make it aggressive. In this regard, MNEs can resort to tax shelters to **allocate either real or paper resources**[7]. In the first case, groups relocate physical assets such as capital and labor, which implies a shifting of real and taxable profits; while the allocation of **paper investments** consists in **arbitrarily shifting intangible resources available within the MNE** (namely, IP and financial resources) towards the tax shelter, mainly **through intra-group financing and licensing agreements** (de Wilde, 2018). From an economic perspective, both forms of tax planning could be considered detrimental. But it is only the latter that it is deemed as problematic from a tax law standpoint: when MNEs engage in the artificial geographical shifting of profits through intra-group designs, which lack any economic substance, their tax planning becomes aggressive (de Wilde, 2018).

As contradictory as it might sound, such aggressive practices are only possible because of the stance that the existing international taxation system takes on MNEs. For the general public, these firms are presented as unified organizations under a single directing will. But in reality, they **divide into multiple subsidiaries, affiliates and separate corporations across various tax jurisdictions** (Morgan, 2017). The well-established international consensus is that these entities which compose the firm shall be **treated as separate legal persons**. And as such, they are allowed to own the equity, assets and debt of other of the firm's entities (for instance, one of the subsidiaries could own the IP that sustains the business activity of another entity integrated in the same firm). In this context in which all corporations of a MNE are treated as fully operational legal subjects and are thus allowed to do business between themselves, **intra-firm transactions** (which are mostly based on the transfer of intangible resources) **have become of enormous economic significance**: it is estimated that this kind of operations now amount to somewhere between 60% and 70% of total international trade (Morgan, 2017). While

[7] However, tax scholars have been able to prove that MNEs' degree of tax responsiveness is much higher for the allocation of paper investments (IP and financial resources) than for the allocation of real investments (capital and labor), which is less apparent (de Wilde, 2018).

simultaneously, these transactions have served to articulate MNEs' abuse of the international taxation system.

Indeed, by allowing the establishment of subsidiaries and affiliates across several jurisdictions and treating those corporations as separate legal entities within the firm, the international corporate taxation system gives MNEs the opportunity to exploit tax rate differentials, different tax regimes, weaknesses and loopholes in tax treaties and differences in the way in which jurisdictions are willing to treat multinational companies (Morgan, 2017). This situation is intensified by two factors: (i) belligerent incentives from small states eager to attract multinationals (Kinder & Agyemang, 2020), as we saw in the previous section for the case of Ireland, the Netherlands, Luxembourg and Malta; and (ii) the system's application of **increasingly anachronistic notions**, such as that of "permanent establishment" (a condition granted for tax purposes to those entities with a physical presence of at least six months within a specific jurisdiction) which ignores the growing capacity of MNEs to fully operate without a continuous physical base.

Overall, and for the abovementioned reasons, the current system allows MNEs to engage in arbitrage activities, resulting in **enormous levels of tax avoidance** (Morgan, 2017). This practice refers to the adverse use of the fiscal regimes for reducing tax burdens, as opposed to tax evasion, which is the direct illegal non-payment of owed taxes (Quentin, 2017). And at the core of tax avoidance lies the practice of setting up entities in tax shelter jurisdictions and then resorting to intricate strategies for concentrating profits in those locations, thus leading to a **notable difference between where actual business activity takes place and where income is ultimately reported** (Kleinbard, 2011). As a result, it is estimated that just within the EU, €1 trillion of corporate taxes are avoided every year by MNEs (European Commission, 2012). But how has this situation originated? Has the international corporate taxation system become overly permissive regarding tax avoidance practices?

As many tax scholars have already pointed out, the current capacity for arbitrage and tax avoidance by MNEs is a **systemic issue** that has been evolving since the past century: it was in the early 20th century during the previous era of globalization that the basic constituents of international taxation emerged, in a context in which the flow of physical goods dominated global trade and MNEs reproduced their systems of production and

administration in strategic jurisdictions (Morgan, 2017). In this context, the founding principles of our current international taxation system were laid down by the League of Nations in 1924, which gave national administrations the right to tax a company's profits based on whether it was physically present in their territories (Kinder & Agyemang, 2020). At the time, the main concern was to avoid double taxation by both the firm's country of origin and the multiple foreign jurisdictions in which it operated. For this purpose, international tax treaties were promoted, under the auspice of the newly born OECD and its successive model tax conventions (the first version being enacted in 1963).

Today, the international corporate taxation system is built upon the combination of these bilateral treaties based on the OECD model treaties and institutional arrangements by both regional blocs and individual states (Morgan, 2017). The basis of these treaties and arrangements lies on the **existence of separate legal entities within MNEs**, and their main focus is **transfer pricing**: the system for valuation of intra-firm transactions, which has governed the taxation of goods and services sold between individual entities of MNEs since the 1920s (Tucker, Stiglitz, & Zucman, 2020). In this sense, the traditional **arm's length principle** currently recognized by Article 9 of the OECD model convention rules that transactions between entities of a firm must be **assessed to whether they take place at a recognizable market price**, since such pricing supposedly prevents the advantageous shifting of corporate profits (Morgan, 2017). This concept of transfer pricing and its subsequent arm's length principle were certainly suitable for the early 20th century international economic context, in which most trade occurred between separate firms and consisted in manufactured goods (Tucker, Stiglitz, & Zucman, 2020). However, economic conditions have drastically changed: services now comprise a large portion of international trade, which is itself mostly based on intra-firm transactions; a great deal of activity takes place on digital platforms without the need for physical presence; and branding, IP and administration are continuously detached from production (Morgan, 2017).

In this new scenario, **the long-standing notion of transfer pricing and its arm's length principle have become inconsistent**: the existence of an MNE implies cost savings due to reduced transaction costs between its corporations, but the arm's length principle presumes that a representative price is extracted from a market interaction among separate entities, and thus these different logics mean that prices should be different (Morgan,

2017). However, it is extremely difficult to establish a market reference price for most transactions, since the majority of international trade is already happening at the intra-firm level. Furthermore, the arm's length test for where profits should be allocated (in other words, who would get those profits if all of the MNE's entities operated in free competition against each other) fails when it comes to economic rent[8], **since such rent would not even exist in the ideal competitive benchmark** (Sandbu, 2020).

As an overall result, MNEs are now able to structure their transactions so that little or no tax is paid in any jurisdiction: the main international tax concern is no longer double taxation, but potential **double non-taxation** (Morgan, 2017). In fact, opaque tax structures are now the norm for MNEs and paying as little tax as possible is seen by many as "good business" (Kinder & Agyemang, 2020). Specialized financial, tax and consultancy services (such as those of the "Big 4") have played a key role in facilitating this surge of tax avoidance (Morgan, 2017), which becomes even more striking in the technological sector: tech giants whose business is primarily based on IP and intangible assets pay hardly any taxes, not just within the EU, but in any jurisdiction at all (Tucker, Stiglitz, & Zucman, 2020). It is thus easy to see why an increasing number of experts are calling for a drastic dismantling of the current system: **it may formally oppose tax avoidance, but its outdated features and principles make it uncapable of effectively preventing it** (Morgan, 2017).

3. THE CASE OF APPLE'S TAX STRATEGY IN IRELAND

By discussing Apple's tax planning strategy on Irish soil, this section will be able to complement the previous theoretical analyses with a **practical illustration** of both harmful tax competition practices promoted by Member States (i.e., Ireland), and aggressive tax planning schemes implemented by technological MNEs (i.e., Apple). This case-study will also serve to provide a factual background for the Commission's 2016 Apple Decision that will be studied in the next Chapter. For these purposes, this section will rely on official investigations by US Congressional committees, which will be accompanied by academic publications.

[8] As it has already been explained, economic rent is one of the intangible assets (alongside IP) that is typically transferred between corporations of an MNE.

It must be noted that Apple's Irish tax planning strategy dates back to the 1980's, when it set up its first controlled foreign corporation (hereinafter, CFC) in Ireland: Apple Operations International (hereinafter, AOI). During the following decades, in which the company developed a series of new product lines that achieved record-breaking sales (Macintosh, iPod and iPhone), Apple focused on **manipulating the nature of the income obtained through its subsidiary AOI**, which is a purely Irish corporation (Yang, Meziani, & Shen, 2016). However, it was not until 2013 that these practices came under public scrutiny in the frame of the **US Levin Congressional Committee** (Morgan, 2017). This Committee was held in a context in which Washington authorities were becoming deeply concerned about the drastic downturn in tax revenues, derived from an increasing practice by North American global companies in which they transferred significant amounts of their earnings to CFCs in tax shelters (Barrera & Bustamante, 2018).

And after the publication of the Committee's conclusions, the EC launched its own investigation onto Irish tax rulings in 2014. The inquiries by both US and European institutions revealed an **overly favorable tax regime agreed between Dublin and Apple**, by which the Cupertino based MNE has been able to avoid an enormous amount of corporate taxes through an aggressive strategy built on three pillars (Yang, Meziani, & Shen, 2016). First, regarding the status of its foreign-sourced income in Ireland, Apple successfully argued in 1991 that its computer technology was developed on the other side the Atlantic, and for this reason Irish tax authorities should from then on **treat AOI's income as foreign-sourced rather than domestic** (European Commission, 2016). Consequently, all profits shifted from other European subsidiaries towards AOI would remain completely untaxed under Irish laws.

Secondly, and upon this departure point of its tax strategy, **Apple addressed the profit allocation ratios amongst its CFCs**. In this sense, the tech giant wanted to maximize the fiscal benefits of its untaxed subsidiary, and for this purpose AOI established several other controlled corporations: Apple Sales International (hereinafter, ASI) and Apple Operations Europe (hereinafter, AOE) in Ireland; and Apple Singapore and Apple Asia (which fall out of our study). Since its creation, ASI has operated a chain of eight retail stores across Europe (Yang, Meziani, & Shen, 2016) and it has also been responsible for sales in Asia and Africa. In other words, ASI is the sole seller of Apple products on European soil, and as such, it is entitled to all profits derived from the continent's retail

stores (thus minimizing tax liabilities in the jurisdictions where these stores are located). But at the same time, all those profits had to be allocated to ASI's parent company, AOI (which as it has already been explained, was tax-free by agreement with Dublin's authorities). The **ratios applied for this allocation were structured at such high levels that almost all profits were deemed tax-free**, and the remaining portion of profits left within ASI was so small that its Irish tax liability was minimal (Yang, Meziani, & Shen, 2016). These ratios were indeed agreed between Dublin and Apple in **two separate tax rulings from 1991 and 2007** respectively, that will be addressed in Section 2 of Chapter 3. And a result of these schemes, the **Irish AETR applied to ASI fell from the statutory rate of 12.5% in 2003 to an insignificant 0.005% in 2014** (Barrera & Bustamante, 2018). Figure 4 in Appendix I depicts the abovementioned corporate structure adopted by Apple.

And lastly, the third pillar of Apple's aggressive tax strategy has focused on the treatment of its CFCs' profits by US tax authorities. First of all, it must be noted that thanks to differences between US and Irish regulations, **Apple's CFCs in Ireland have been effectively considered "stateless" for fiscal purposes**: in spite of owning and operating the IP rights of their Californian parent company, ASI, AOI and AOE are all incorporated in Ireland, and therefore they cannot be considered tax residents under US tax laws; nonetheless, they are not Irish tax residents either, since Ireland requires the managing and control of the corporations to be located in its territory. Through this abusive technique, known as **"double Irish"**, Apple has effectively escaped the tax residency of its CFCs from any world jurisdiction (Barrera & Bustamante, 2018).

Upon this basis, we can now understand how Apple shielded its CFC's profits from the US Internal Revenue Service (hereinafter, IRS): under the country's Tax Code's worldwide income policy, MNEs like Apple are taxed on their global income, although the payment of these taxes is not due until cash dividends from CFCs are received by the US parent company (this regime is known as the **"deferral clause"**). Moreover, the domestic parent corporation is allowed to claim a credit for the foreign income taxes it pays, which is known as a **foreign tax credit** (Bodle, 2017). And in order to avoid the abuse of this deferral and foreign tax credit regimes, Subchapter F of the Code requires parent companies to pay taxes on passive foreign income such as interest payments,

dividends, royalties and sales revenue transferred between their CFCs (Barrera & Bustamante, 2018).

However, **Apple managed to avoid Subchapter F through a series of legal loopholes and weaknesses, particularly the "check-the-box" and "look-through" rules** (US Senate Permanent Subcommittee on Investigations, 2013), which fall out of the scope of this dissertation. As a result, and since AOI never paid any cash dividends to its parent company, **between 2009 and 2012 Apple effectively underreported otherwise taxable profits of $44 billion, thus leading to a $10 billion loss in tax revenue to the IRS** (US Senate Permanent Subcommittee on Investigations, 2013). Overall, the reality depicted in the conclusions of US Congress inquiry (and which is built upon the three pillars previously explained) sheds light on the enormous damage caused by Ireland's fiscal policies, which have served to actively promote an extremely aggressive tax planning scheme by Apple (US Senate Permanent Subcommittee on Investigations, 2013):

- Out of the $145 billion that Apple holds in cash, cash equivalents and marketable securities, **$102 billion are located in "offshore" entities** (i.e., CFCs) with the intention of diminishing tax liabilities both foreign and domestic.

- Apple's primary CFC, AOI, has been effectively recognized as a "stateless" entity for tax residency purposes. And in spite of receiving $30 billion of income between 2009 and 2012, **it has paid no corporate income tax to any national government** in that same period.

- Apple's profit-allocation ratios between its subsidiaries have served to **shift billions of dollars of income** towards tax shelters jurisdictions (and namely, to Ireland).

As a final remark, it must be noted that in spite of its unprecedented proportions, Apple's tax avoidance strategy in the EU is **certainly not unique**. Later on, in Section 2 of Chapter 3, this thesis will approach the aggressive fiscal schemes of three other U.S. companies operating on European soil: **Fiat-Chrysler, Starbucks** and **Amazon**. All of these are MNEs which have abused the preferential regimes of different tax shelter jurisdictions (**Luxembourg** and **the Netherlands**), and therefore have been inquired by

the Commission regarding alleged State aid law violations. Just like in the case of Apple in Ireland, such abusive regimes were promoted through various tax rulings concerning the European subsidiaries of the three MNEs, and the artificial shit of corporate profits was safeguarded as part of intra-group transactions. Further detail will be provided for each of these cases through a detailed case-law review.

In conclusion, the detailed analysis of the three Sections of this Chapter leads to an unequivocal conclusion: it is time for an **integral reform of the international corporate taxation system** that guarantees a fair share of public contribution by technological MNEs. In this sense, Brussels' concern over harmful tax competition and tax evasion seems to be absolutely justifiable. As French finance minister Bruno Le Maire declared to the Financial Times[9], the eradication of legal loopholes that allow companies to escape taxes is **purely a matter of fairness**, since it guarantees a more reasonable corporate contribution to the public effort. However, the end does not always justify the means, and the Commission has repeatedly failed to deliver a proper fiscal harmonization strategy. These previous and failed attempts will comprise the following Chapter.

[9] Le Maire's remarks can be accessed through the following link: https://www.ft.com/content/40cffe27-4126-43f7-9c0e-a7a24b44b9bc

CHAPTER 3: BRUSSELS' QUEST AGAINST HARMFUL TAX COMPETITION AND AGGRESSIVE TAX PLANNING. AN ANALYSIS OF PREVIOUS INITIATIVES

At the beginning of the century, Brussels launched a series of initiatives with the intention of hindering tax avoidance. However, their success has been rather modest and avoidance of corporate taxes has experienced a stable growth in the past two decades, as previously explained. For this reason, this Chapter will present these failed strategies in detail with the intention of understanding the causes behind their poor performance. Namely, **the 2016 CCCTB Proposal and the Commission's State aid law approach** will be studied, allowing for a further discussion of legal alternatives in Chapter 4.

1. THE TALE OF A FAILED TAX REVOLUTION: THE 2016 CCCTB PROPOSAL

The proposal for an EU CCCTB dates back to 2001, when the Commission released a Communication containing a project for the elimination of the obstacles suffered by EU companies operating at the cross-border level. However, a strong lack of support from both Member States and European companies condemned the initiative to immediate failure (Göndör, 2017). In the following years, the EC focused on the creation of working groups in order to produce a more technically sound version of the original proposal, and a final draft of an EU directive was launched in 2011. This updated motion for a CCCTB achieved the provisional endorsement of the European Parliament and was able to gain strong support from the business sector (Göndör, 2017). However, the fierce opposition by a group of Member States (led by Ireland, the Netherlands, Luxembourg and Malta) impeded its approval. In order to surpass this political disagreement, **the Commission relaunched the proposal in 2016 by dividing it into two separate phases**. First, rules for a common tax base should be established, entering into force by January 2019. And in a second phase programmed for 2021, the most controversial element of the proposal would be implemented: the **consolidation of European profits and losses of MNEs and their subsequent formulary allocation to the firm's individual corporations** (van de Streek, 2018).

After five years, it is obvious that this 2016 relaunching of the CCCTB has been **once again unsuccessful**, in spite of its promising and novel "phased approach". The absence of a political compromise by all Member States remains undefeated, and the Commission

has not been able to overcome the unanimity required by Article 115 of the TFEU (which shields the fiscal sovereignty of Member States). However, this failure is **not due to legal shortages or economic deficiencies** in tackling tax avoidance. On the contrary, the CCCTB framework takes a revolutionary and effective approach by which **the arm's length principle is abolished and a system of unitary taxation is implemented** (Hentze, 2019). This section will thus address the aspects of the 2016 proposal that aim to revert the systemic flaws of traditional cross-border corporate taxation (which were previously studied in Chapter 2). Upon this basis, we will be able to understand the causes behind the opposition of EU tax shelter jurisdictions.

In this regard, after the implementation of its first phase through the harmonization of national accounting and depreciation rules and the enacting of a single European tax code, in the 2016 CCCTB proposal **the traditional separate accounting method was replaced by a formulary apportionment mechanism** (Göndör, 2017). In other words, intra-group transactions would no longer be priced at the going market price for a comparable transaction, as if it had taken place among unrelated parties (European Commission, 2016). On the contrary, the arm's length principle would be dismantled and the profits and losses of the corporations on the group level would be allocated to each member of the group according to a specific apportionment formula (Ortmann & Pummerer, 2015). More specifically, the allocation key of **this proposed "profit split" would be built on three equally-weighted factors: (i) sales volume; (ii) number of employees[10]; and (iii) the capital invested**. The formula, as established In Article 86 of the 2011 Proposal, is the following (European Commission, 2011):

$$Share\ A = \left(\frac{1}{3}\frac{Sales^{A}}{Sales^{Group}} + \frac{1}{3}\left(\frac{1}{2}\frac{Payroll^{A}}{Payroll^{Group}} + \frac{1}{2}\frac{No\ of\ employees^{A}}{No\ of\ employees^{Group}}\right) + \frac{1}{3}\frac{Assets^{\ A}}{Assets^{Group}}\right)$$

In this formula, "A" refers to the specific Member State while "Group" relates to the total of the MNE operating in the EU. Consequently, "Share A" refers to the **share of the common tax base that is eligible for taxation** in "A". According to the Commission,

[10] At the same time, this **employment factor was divided into two sub-categories**: (i) the total number of employees; and (ii) the value of the payroll where employees work (Morgan, 2017).

this method guarantees that **profits are allocated to those jurisdictions where real economic activity is taking place** (rather than mere paper investments, as seen in Chapter 2) **and value is being created** (Hentze, 2019). This approach is certainly revolutionary, since unitary taxation by formula apportionment implies the consolidation of accounts, thus **treating the MNE as a whole rather than multiple independent legal entities** (Morgan, 2017). This poses several practical advantages: for instance, jurisdictions lose the incentive to offer tax discounts through patent or license boxes, which serve to attract IP and phantom FDI inward flows (Hentze, 2019).

And since taxable income or profits are allocated on the basis of real economic presence, MNEs no longer see advantages in engaging in profit shifting within the EU. In short, **"carrot regimes" are no longer viable and tax avoidance is hindered**. Such a drastic change would certainly have enormous consequences on corporate tax collection by Member States. However, this **potential impact is completely asymmetrical**: while large countries with higher levels of consumption and wider workforces (e.g., France, Italy, Spain or Germany) are benefited, small tax shelter jurisdictions experience a drastic loss in taxable corporate profits. For illustration purposes, Figures 5-6 in Appendix I depict the diverging percentages of taxable profits (according to each taxation method, arm's length vs. formulary apportionment) for a fictional MNE which is headquartered in Ireland and operates a subsidiary in France, generating sales from an innovative software product which amount to €900 million in France and €100 million in Ireland. These Figures show how, thanks to unitary taxation, **corporate profits would be reported and taxed in the jurisdiction where real economic investment is taking place** (i.e., France).

But at the same, it also demonstrates why tax shelter jurisdictions like that of Ireland have strongly opposed the implementation of the CCCTB. The **amount of taxable corporate profits that they would lose is vast** (Hentze, 2019): 50% in the case of the Netherlands; 86% in the case of Ireland; 90% in the case of Malta; and 97% in the case of Luxembourg. On the contrary, French, Italian and Spanish exchequers[11] would respectively see a rise of 62%, 44% and 34% in the amount of taxable business profits (Hentze, 2019). These

[11] **Germany's case** is peculiar: in spite of its comparatively large population, a wide workforce and intense capital investment, it would experience a modest **8% rise in taxable profits** through the implementation of unitary taxation. Tax scholars argue that this is due to the country's great export share (Hentze, 2019).

percentages reveal which Member States currently benefit the most from the abuse of transfer pricing methods and thus contribute in a higher proportion to tax avoidance in the EU.

As a final remark on the nature of the CCCTB proposal, it is essential to keep in mind that **neither the 2011 nor the 2016 version contemplated the unification of national corporate tax rates**, for the reasons that were already explained in Section 1 of Chapter 2. So, in conclusion, in spite of having failed due to the political unwillingness of tax shelter jurisdictions, **the unitary taxation by formulary apportionment method proposed by the CCCTB framework constitutes an effective and rational solution to the systemic deficiencies explained in the previous Chapter**. This beneficial impact would be even more significant in the case of tech giants, which would no longer be able to manipulate the allocation of their EU and global profits through intra-group distributions of IP and financial resources. For this reason, later on this dissertation will approach the implementation by the EC of such novel unitary corporate taxation methods through alternative legal mechanisms, thus escaping the special legislative procedure and the unanimity laid down in Article 115 TFEU.

2. ATTEMPTING HARMONIZATION OF CORPORATE TAXATION "THROUGH THE BACK DOOR": THE COMISSION'S STATE AID LAW APPROACH

Simultaneously to the failed legislative initiatives exposed in the previous Section, the Commission acknowledged the urgency of the fight against harmful tax competition and aggressive tax planning. And for this reason, Brussels introduced **an alternative and controversial approach**: the use of **State aid law to retroactively hinder tax avoidance** within the EU. Since 2012, this approach has focused on the scrutiny of **national tax rulings on the premise that a reduction in tax liabilities could imply an illegal benefit granted by the Member State to a company operating within its jurisdiction** (Hrushko, 2017). And overall, it has led to **eight formal decisions** by which the Commission has declared the granting of illegal State aid through tax rulings adopted by Luxembourg, the United Kingdom, Ireland, Belgium and the Netherlands, while four other investigations remain open (Canalejo, López, Navarro, & Vidal, 2020). Consequently, this Section will approach the legal framework behind this State aid law

approach, focusing on its treatment of tax rulings involving MNEs and the judicial setbacks it has yet suffered.

In this sense, it is important to remember that Stade aid is a legal concept unique to EU law (Hrushko, 2017), which prohibits the use of state resources to provide assistance to specific undertakings thus giving them an unfair advantage over other market players and damaging fair competition (UK Department for Business Innovation & Skills, 2015). It is Article 107 TFEU that regulates the terms of the illegality of State aid. And in following articles, the Treaty allows governmental intervention in certain cases in which the State aid that is given serves to support "general economic development".

Regarding its competences, Article 93 TFEU exclusively entrusts State aid control to the Commission and vests it with enormous powers for the purposes of investigation and recovery of illegal aid (Hrushko, 2017). In this sense, **four cumulative conditions** need to be met so that the EC can rule the illegality of a national measure under Article 107 TFEU (Gunn & Luts, 2015): (i) the measure must confer **an advantage** on an undertaking; (ii) this measure must be **selective**; (iii) it must be granted by the State and **through State resources**; and (iv) it must (threaten to) **distort competition** and affect internal EU trade. Once the EC has determined that the State measure meets these criteria and does not fall under the economic development exemption, it issues a final decision to the Member State and orders it to recover the illegal aid (Hrushko, 2017). This Decision can be appealed to the EGC by both the Member State and the involved undertaking, and the judgements of the EGC can then be appealed to the ECJ exclusively for the review of legal matters (DeNovio, Righini, & Gibbs, 2016). In respect to its content, the notion of State aid has evolved over time and expanded from its original focus on subsidies (Hrushko, 2017). Indeed, it now covers a wide array of public incentives and it is settled case law that the prohibition of **Article 107 TFEU also applies to Member States' tax measures** (Gunn & Luts, 2015), and more specifically, to their tax rulings. These controversial agreements between taxpayers and tax administrations determine, prior to the tax liquidation, how the transactions between entities within the same firm will be valued during a specific period of time[12] (Canalejo, López, Navarro, & Vidal, 2020). In

[12] Under Spanish law, tax rulings (or APAs) could be considered the equivalent to "*acuerdos previos de valoración"*, foreseen in "*Ley 27/2014, de 27 de noviembre, de Impuesto sobre Sociedades"* (Canalejo, López, Navarro, & Vidal, 2020) .

other words, they deal with the issue of transfer pricing, and for this reason they are also known as **“advanced pricing agreements” (hereinafter, APAs)**. Advocates of these rulings claim that they serve to provide certainty with regards to the fiscal implications of investments and transactions in advance of MNEs proceeding with them (Berger, Levine, Liebman, & Wiacek, 2015).

However, within its active battle against harmful tax competition practices (in which tax rulings play a leading role, as seen in Chapter 2), the Commission has consolidated the position that **any ruling that goes beyond the mere interpretation of the general tax system can potentially qualify as illegal State aid** (Bär-Bouyssière, 2015). Brussels' conviction lies on its fear of Member States actively collaborating to the allocation of profits to untaxed subsidiaries, and was enhanced by the repeated failures of legislative harmonization attempts described in the previous Section. In this context, the practical evaluation of the State aid law approach seems to be extremely relevant. And for this purpose, **four decisions in this field will be analyzed**: (i) Fiat-Luxembourg; (ii) Starbucks-Netherlands; (iii) Apple-Ireland; and (iv) Amazon-Luxembourg. Such analysis will focus on their factual background, the legal arguments upheld by Brussels and the **judicial treatment received from European courts on appeal**, when applicable. The overall goal is to lay the ground for the study of both the prospects of the Commission's appeal in the Apple case and the need to find legal alternatives for EU corporate tax harmonization.

2.1. Fiat – Luxembourg Case

2.1.1. Commission's Decision 2016/2326, of 21 October 2015, on State aid SA.38375

The Fiat case concerns an APA issued in 2012 by Luxembourg's tax authorities in favor of Fiat Chrysler Finance Europe (hereinafter, FCFE), a subsidiary of the Fiat conglomerate based in the Grand Duchy that provides treasury and financing services to the group. In the aforementioned APA, Luxembourg approved the method used by Fiat to value the remuneration received by its subsidiary for the financing services it provided (Lyal, 2015). According to Brussels' inquiries, the APA in question conferred a selective advantage to the subsidiary by reducing FCFE's tax burden compared to that which would

have been borne by an independent company not integrated in the Italo-American group. In order to determine that such a difference existed, the EC examined whether the 2012 APA foresaw the calculation of transfer prices that effectively reduced the taxable base of FCFE without being consistent with those that would have been paid by an independent company for the same services. As a result of this examination, the Commission determined that the method used by the group's subsidiary was not correct and indeed resulted in **a reduction of the taxable profits amounting to €20 - €30 million**. Consequently, Brussels declared that the tax ruling constituted illegal State aid, incompatible with the internal market, which had to be recovered by national authorities.

2.1.2. Judgment of the General Court, of 24 September 2019, in Case T-755/1: Grand Duchy of Luxembourg v Commission

Both Luxembourg and Fiat appealed the Decision before the EGC (with the support of Ireland, which decided to intervene in the case for the promotion of its own fiscal interests) and requested its annulment for the following reasons: (i) the Commission had applied an analysis leading to disguised tax harmonization ("harmonization through the back door"); (ii) the APA in question did not confer an advantage; and (iii) it did not match the selectivity requirement laid down in Article 107 TFEU. First, with regard to the plea concerning disguised tax harmonization, the EGC rejected that, in examining whether the tax ruling at issue complied with the rules on State aid, the EC carried out a form of tax harmonization that could infringe the exclusive powers of the Member States in the field of taxation. On the contrary, **the judgment stated that Brussels merely exercised its legitimate powers** to verify whether Luxembourg's tax ruling had conferred on the beneficiary an advantage over standard taxation methods, as defined by national tax law, thus breaching of Article 107 TFEU.

Secondly, with regard to the existence of an advantage for Fiat, the judgment examined whether the EC was entitled to analyze the contested tax ruling in light of the "arm's length" principle, which has already been explained in detail in the previous Chapter. The Court rejected the appellants' objection and stated that **the Commission could legitimately make use of this transfer pricing principle as a tool to verify whether a tax measure is selective for the purposes of Article 107 TFEU**. In particular, the judgment pointed out that, in the case of tax measures in general and APAs in particular,

the very existence of an advantage can only be established by comparison with standard taxation practices. Thus, in order to determine the existence of a tax advantage, the position of the specific undertaking (i.e., Fiat) must be compared with its hypothetical position in the absence of the APA and under general tax rules (European General Court, 2019). In this sense, in order to determine whether the prices foreseen in the tax ruling are indeed market prices, **the arm's length principle rightfully comes into force as a tool for the application of Article 107 TFEU**. The judgment also examined whether the Commission had correctly established that the methodology for calculating the remuneration of FCFE, as approved by the 2012 APA, resulted in a reduction of Fiat's taxable profit in breach of the arm's length principle. In this regard, the Court concluded that **Luxembourg significantly underestimated the capital necessary to carry out FCFE's activities and bear the associated risks**. Therefore, FCFE's remuneration, calculated as a return on equity, was not a reliable approximation based on market conditions and thus resulted in a reduction of its tax burden and an advantage within the meaning of Article 107 TFEU.

Third, regarding the alleged selectivity of the advantage granted to Fiat, the Court concluded that the Commission did not err in finding that the advantage conferred on Fiat by the tax ruling in question was selective, being an individual measure. The Court adds that, in any event, the Decision resorted to the **essential three-step selectivity analysis** in tax matters. This analysis consists of considering whether, in light of a defined standard taxation frame of reference (first step), the APA measure departs from that framework (second step) in a way that is inconsistent with the overall scheme and objectives of the tax system (third step). Lastly, it should be noted that among the four that fall under the study of this Section, **this case involving Fiat and Luxembourg stands out as the only one in which the EGC upheld the Commission's Decision**. However, the judgment is not final as the undertaking has appealed against it before the ECJ[13].

2.2. Starbucks – Netherlands Case

2.2.1. Decision 2017/502, of 21 October 2015, on State aid SA.38374

[13] Fiat's appeal can be consulted through the following link: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62019CN0885&qid=1619022308975&from=ES

In 2008, Dutch tax authorities entered into an APA with a Dutch subsidiary of the Starbucks group (Starbucks Manufacturing EMEA BV; hereinafter, SMBV) dedicated to the roasting of coffee beans. The intention of this agreement was to determine, for the purposes of calculating corporate income tax on SMBV, the subsidiary's remuneration for its production and distribution activities within the MNE. The tax ruling also confirmed the amount of the royalty that SMBV had to pay to another corporation of the same group (Alki, registered in the United Kingdom) for the licensing of IP rights and know-how associated with Starbucks roasted coffee products. In this sense, **the APA validated the transactional net margin method** (here in after, TNMM) used by the North American MNE for the calculation of such royalty. This TNMM is one of the five methods recognized by the OECD for determining whether the valuation of intra-firm transactions is consistent with the arm's length principle, and it is based on a comparison of two net profit margins: on the one hand, the net profit margin of a certain taxpayer which arises from a non-arm's length transaction; and on the other hand, the net profit margins attained by arm's length undertakings in similar transactions (OECD, 2017).

However, the Commission considered that this royalty paid by SMBV to Alki could not be justified as it did not adequately reflect market value: only the Dutch subsidiary was required to pay for the use of know-how, and no other Starbucks subsidiaries in the same situation nor independent roasters to which roasting was outsourced were required to pay for IP licensing and the use of the group's know-how (European Commission, 2015). In fact, according to the Commission, **these exceptional payments within the MNE served to unduly shift SMBV's profits to Alki**, which then remained untaxed on British soil. In conclusion, and in a similar way to the case of Fiat, Brussels ruled that the methodology applied by the APA subscribed between Dutch authorities and SMBV did not comply with the criteria derived from the arm's length principle regarding transfer pricing, which is indeed recognized under Dutch law (Lyal, 2015). Therefore, a selective advantage was conferred on this subsidiary by reducing its tax burden and Dutch authorities were ordered to **recover €20 - €30 million in untaxed profits**.

2.2.2. Judgment of the General Court, of 24 September 2019, in Cases T-760/15 and T-636/16: Kingdom of the Netherlands v Commission

The Netherlands and Starbucks brought an action before the EGC for the annulment of the 2015 Decision on the following grounds (Lapresta & Beltrán de Lubiano, 2019): (i) error in the use of the arm's length principle to determine the existence of an advantage in breach of Member States' fiscal sovereignty; (ii) error in considering that the choice of a particular accounting method to determine SMBV's remuneration constituted an advantage; and (iii) error in considering that the application of the tax ruling and the validation of the TNMM method had conferred an advantage on Starbucks' subsidiary company. In relation to the use of the arm's length principle, the EGC reproduced the same considerations of the Fiat case and **confirmed the use of this principle as a tool for determining the selectivity of intra-group pricing schemes under Article 107 TFEU** (Lapresta & Beltrán de Lubiano, 2019).

The judgment then analyzed in detail the reasoning of the Decision in relation to the alleged errors committed by the APA in the application of the transfer pricing methodology for the case of the SMBV. In this sense, the Decision's reasoning on the existence of unlawful State aid was mainly based on the fact that the 2008 tax ruling had selected a certain transfer pricing method (TNMM) to the detriment of another method (the comparable uncontrolled price method; hereinafter, CUP), when indeed both of them are included in the OECD Guidelines for the determination of transfer prices in intra-group transactions[14].

However, the Court's ruling stated that **the mere non-compliance with certain methodological requirements does not necessarily lead to a reduction in the undertaking's tax burden**. Therefore, the Commission had the burden of going beyond and proving that the alleged methodological errors identified in the tax ruling: (i) did not allow for a reliable approximation of the subsidiary's economic results under arm's length conditions; and (ii) that they led to an effective reduction of the tax burden. The judgment concluded that the Commission's analysis did not meet this burden, as it did not prove that the alleged error identified in relation to the choice of the TNMM method instead of CUP method had indeed led to a tax burden that was "too low". Consequently, the

[14] The CUP method is contained in Part II of the OECD's 2017 Transfer Pricing Guidelines, and compares the price charged for property or services transferred within an intra-firm transaction to the price charged for property or services transferred in a comparable extra-firm transaction in similar conditions(OECD, 2010).

judgment stated that **the Decision erred in considering that the mere choice of the TNMM method**, in the present case, **conferred an advantage** on the Starbucks group subsidiary.

Regarding the royalty paid to SMBV's sister corporation (Alki), the Decision had considered (upon the application of the arm's length principle) that it would have been non-existent if it had been negotiated between independent companies (Lyal, 2015). The judgment, after analyzing the functions of the subsidiary in question and the comparable contracts considered by the Decision, concluded that **the Commission had not sufficiently proven that the amount of the royalty should have been zero**, since the IP that was transferred had an economic value as it was necessary for SMBV's activity. Furthermore, the EGC found that **the Decision failed to determine that the amount fixed in the APA could give rise to an advantage** (European General Court, 2019).

Lastly, in respect to the Decision's claim that the prices paid by the Dutch subsidiary were too low in light of the CUP method, the judgment ruled that in order to demonstrate such excessively low prices the Commission should have compared them with those paid by independent companies. However, due to the **absence of such a comparison**, it was not possible to presume the existence of an economic advantage. In sum, the EGC stated that one of the criteria for determining the existence of State aid was not met (the existence of an economic advantage for the benefit of the undertaking) and, therefore, **the Decision was annulled**. This annulment is final, since the Commission has not appealed (Lapresta & Beltrán de Lubiano, 2019).

2.3. Apple – Ireland Case

2.3.1. Decision 2017/1283, of 30 August 2016, on State aid SA.38373

This Decision concerns **two tax rulings from 1991 and 2007** which were previously addressed in Section 3 of Chapter 2. For this reason, discussion will be restricted to how these APAs were treated by the Commission, without once again delving into Apple's intricate corporate structure and its tax strategy Ireland. In this sense, Brussels considered that the market valuation standards and the criteria for the attribution of activities, risks and benefits to both ASI and AOE had not been adequately applied (Canalejo, López,

Navarro, & Vidal, 2020). **Therefore the methodology used in both tax rulings did not comply with OECD Guidelines on transfer pricing**. As in the two previous cases, the Commission considered that although at the time Irish national legislation did not formally incorporate neither the arm's length principle nor the OECD Guidelines, these tools were indeed adequate for the application of Article 107 TFEU. In the Commission's view, if these principles had been correctly applied, Irish tax authorities would have determined the allocation of all profits from sales activities (other than interest income earned by Apple's Irish subsidiaries in normal market circumstances) to AOI and ASI and therefore they would have been taxed at the applicable Irish corporate tax rate (as previously seen, 12.5%). In sum, the Commission found **that Ireland had granted State aid to the two Apple subsidiaries by selectively reducing their tax burden**[15] and ordered the country to recover the amounts due (approximately, €13 billion).

2.3.2. Judgement of the General Court, of 15 July 2020, in Cases T-778/16 and T-892/16: Ireland v. Commission

Because the unprecedented amount of uncollected taxes to be retroactively recovered, the 2016 Apple Decision soon became the **landmark case of the State aid law approach**. The Commission seemed to have secured its position as a watchful referee on the implementation of national fiscal rules, and the example of Apple could serve as a warning notice to MNEs to put their tax affairs in order, at least in Europe (Houlder, Barker, & Beesley, 2016). And for these same reasons, **the EGC's annulment of the Decision in July 2020 constituted the main setback (yet) suffered by Brussels** in the quest against tax avoidance by MNEs. Therefore, a more detailed analysis of the Court's ruling will be provided for this case than for the three other decisions included in this Section. Such exhaustive study is indeed necessary, so that the **prospects for the Commission's appeal** before the ECJ can be properly addressed.

In this sense, the appeal by Ireland and Apple of the 2016 Decision relied on both general legal pleas and pleas alleging the misapplication of the settled case-law criteria. In its judgement, the EGC first rejected (as it had already done in the previous Fiat and Starbucks cases) the general allegation that the Commission was encroaching on the exclusive tax powers of the Member States. Thus, **it recognized beyond doubt that the**

[15] For further detail, refer to pages 20-23 in Chapter 2.

Commission is entitled to assess tax measures in the light of State aid rules, including tax rulings (Canalejo, López, Navarro, & Vidal, 2020). Secondly, the Court also accepted that the general regime for the taxation of corporate profits (i.e., Irish corporation tax and not the specific provisions applicable to non-residents) constituted the correct frame of reference for assessing whether the contested measure was an unjustified exception constituting State aid. This is relevant, since the **existence of a selective advantage has to be assessed against that reference framework**.

Thirdly, the Court saw no objection to the Commission's joint analysis of the existence of an advantage of the measure and its selectivity. In particular, the EGC recalled that **in tax cases, the two steps often overlap**: the exemption from a general rule of taxation may be selective (it is an exception to the general regime applicable in comparable factual and legal situations not justified by the nature of the system) and at the same time generate an advantage to the group (or an individual company, as the case may be) benefiting from that exemption (Canalejo, López, Navarro, & Vidal, 2020). Finally, and in accordance with its Fiat and Starbucks judgements, the Court also accepted that both the arm's length principle and the OECD transfer pricing Guidelines, even if they are not part of the national tax rules, are appropriate tools to employ in the application of Article 107 TFEU to national tax rulings. This **does not mean**, however, **that the Commission can determine what constitutes "normal" taxation regardless of national law**, and then impute any deviation from this "normal" taxation to an infringement of the State aid rules (Canalejo, López, Navarro, & Vidal, 2020).

In spite of these initial findings by the EGC confirming Brussels' theoretical framework of analysis, **the Court reminds the Commission that it carries the burden of proof for all the four constituent elements of State aid** (as seen before, existence of an advantage, selectivity, state origin of the resources and distortion of market competition). In particular (and this is essential, as we will see later on) the Court finds that it is **not sufficient for the Commission to demonstrate the existence of a methodological error in the tax ruling** (e.g., that the tax ruling in question does not properly apply national law, the arm's length principle or the OECD Guidelines). As previously stated in the Starbucks case, **it is also necessary to demonstrate that this error confers a selective advantage to the company to which the tax ruling is addressed** (in the present case, ASI and AOE). In other words, it must show that, in the absence of the error, the company

would have been taxed at a higher rate than that actually borne, which is something that the Decision fails to prove in the present case.

In fact, the 2016 Decision was based on three subsidiary lines of reasoning on the existence of a selective advantage, which were individually rejected by the EGC (Canalejo, López, Navarro, & Vidal, 2020). First, the Court rejected the Commission's leading argument, according to which there was a selective advantage since all the profits should have been attributed to the subsidiaries in Ireland (AOE and ASI). In this regard, the Judgment accuses the Decision of applying State aid rules in a way that disregarded the case law of Irish courts on the treatment of subsidiaries of non-resident groups operating in Ireland, **which leads the Commission to fail in its analysis of the relevant requirements under national law**. Under these requirements, in order to conclude that ASI and AOE should have been taxed in Ireland on all their profits generated on a universal basis, the Commission should have demonstrated that the income allocated to these two subsidiaries corresponded to their activities and functions under **a comparability analysis (functional and factual)**, and not to their Cupertino head offices (which is what the two contested tax rulings established, as explained in Section 3 of Chapter 2). In other words, the Commission had assumed the imputation of all income to the two Irish subsidiaries and excluded any role of the US head office, but had failed to prove that the income corresponded to the activities of the subsidiaries and thus **it did not accredit the existence of a selective advantage for ASI and AOE** (Canalejo, López, Navarro, & Vidal, 2020).

Secondly, the Court rejected that there was a selective advantage insofar as the tax rulings applied an erroneous choice of methods for the attribution of income to subsidiaries (i.e., the use of the TNMM, under transfer pricing rules, calculated on the operating cost). According to the Judgment, the Commission failed to demonstrate that (under the application of TNMM) the choice of the Irish branches as tested parties, the use of operating costs as profit indicators and the choice of the profitability levels accepted in the tax rulings, would have led to a reduction in the tax burden borne by the two Apple subsidiaries. It is true that **the EGC found objections to the Irish administrative process that led to the APAs and that it disagreed in their assessment** by national tax authorities. However, insofar as the Commission did not prove that these errors resulted in lower effective taxation, **the mere methodological error is not sufficient to**

demonstrate the existence of a selective advantage (the same conclusion was reached in the Starbucks case).

Thirdly, the Court rejected the Commission's final line of argument, according to which there was a selective advantage since the tax rulings had been granted on a discretionary basis. In this regard, the Judgment considered that **the mere existence of discretion would not be enough to demonstrate a selective advantage on its own**: it needs to be accompanied by evidence that such discretion has resulted in lower taxation (European General Court, 2020). Ultimately, the Court concluded that the Commission had not demonstrated the existence of a selective advantage conferred by the tax rulings and annulled the 2016 Decision.

2.3.3. Case C-465/20 P: Apple's appeal before the ECJ

On September 25th 2020, the abovementioned annulment was appealed by the Commission before the ECJ[16]. Due to the enormous significance of this case, the upcoming resolution by the EU's highest court will be of extreme relevance. If confirmed, the annulment of the 2016 Apple Decision will be extremely discouraging for the prospects of corporate tax harmonization through the implementation of State aid law approach. While if such annulment was reverted, the Commission would add a gigantic (and rare) victory to its fight against harmful tax competition and aggressive tax strategies. For this reason, an analysis of the prospects of the appeal in question is necessary. However, it should be noted that this analysis is **purely hypothetical**, and that it is built upon the theoretical and case law scrutiny of this dissertation.

First of all, and as previously explained, the scope of the ECJ's review is restricted to legal issues. In this sense, State aid law experts have pointed out that **the EGC's judgment is carefully crafted on its points of law and follows the settled case law** (Espinoza, Fleming, Khan, & Brundsen, 2020). The analysis in this Section has shown that such case law places an **increasing emphasis on the Commission's burden of proof**, especially when it comes to selectivity of the measure in question. For this reason,

[16] The full appeal can be consulted through the following link: https://curia.europa.eu/juris/document/document.jsf?text=&docid=237178&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=10268552

as reputed State aid lawyer Alfonso Lamadrid has expressed[17], **Brussels' appeal before the ECJ seems to be "an uphill battle"**. Indeed, the annulment of the Apple and Starbucks decisions have proved that the Commission faces extreme difficulties when providing sufficient investigative evidence. In the present case, this insufficient investigation was notorious in the Commission's allegations of the selectivity of the APAs' measures granted to ASI and AOE. More specifically, Brussels did not give enough attention to Irish case law and omitted the factual and functional comparative analysis. And for this reason, **it failed to comply with two stages of the required three-step selectivity test** (previously explained in the study of the Fiat-Luxembourg Case): (i) the proper definition of the framework of reference; and (ii) the departure from such framework. This premature and obvious theoretical failure in its analysis makes the prospects of the Commission's appeal very poor, and allows this dissertation to predict **an unequivocal defeat of the State aid law approach at the hands of the ECJ**: the annulment of the Apple Decision by the ECG is most likely to be confirmed.

2.4. Amazon – Luxembourg Case

2.4.1. Decision 2018/859, of 4 October 2017, on State aid SA.38944

In the latest of all four decisions subject to our study, the Commission addressed a tax ruling agreed between Luxembourg and Amazon in 2003 (and later extended in 2011) which focused on the treatment of Amazon EU Sàrl (hereinafter, LuxOpCo), a Luxembourgish subsidiary of the Seattle-based MNE. The group runs several subsidiaries in the Grand Duchy, most of which are part of a fiscal unit headed by LuxOpCo (Lyal, 2015). These CFCs are dedicated to the retail and other business activities of the group in Europe, mainly through retail websites. The inventory and the profits arising from these retail activities are owned by LuxOpCo, which is at the same time controlled by Amazon Europe Technologies Holding SCS (a limited partnership which also licenses IP to the Luxembourgish head subsidiary; hereinafter referred to as LuxSCS). In this regard, such limited partnership is transparent for tax purposes (Lyal, 2015): its income is only taxable in hands of the partners, which are three US incorporated companies non-resident in

[17] Lamadrid's cooments can be accessed through the following link: https://www.ft.com/content/6cc18c26-04e0-410d-9c0a-3f1baf1a1685

Luxembourg and without a permanent establishment there (and thus are not liable for taxation in the Grand Duchy).

The **controversy** around this corporate structure is **the fiscal treatment received by the head subsidiary**, which was originally determined in the 2003 APA and renewed in the 2011 version (Lyal, 2015): essentially, the return rate to LuxOpCo was fixed at the lesser of 4%–6% of its total operating expenses and the total EU operating profits of the group's websites, although subject to **a floor of 0.45% and a ceiling of 0.55% of Amazon's net EU sales revenue**. The exceeding amount was considered to be the royalty due to LuxSCS for the use of its IP (therefore constituting a deductible expense for the head subsidiary). It was the unusually long period of time for which this favorable fiscal treatment was in place that raised alarms in Brussels. In its 2017 Decision, the Commission argued that there were no indications of Amazon's request to tax authorities in 2003 being accompanied by a comparability report (which is typically requested to ratify the methods foreseen in tax rulings). Furthermore, the MNE's request was granted in just eleven working days, casting **doubts on the depth of the authorities' assessment** (Lyal, 2015).

Regarding the calculation applied in the APA, the Commission ruled that: (i) it did not appear to match any of the OECD methods; (ii) the royalty paid by the head subsidiary was not a function of output, sales or profits, instead it was calculated as the residual profit above a certain fixed level; and (iii) the profit margin of 4% - 6% seemed to low, a perception which was reinforced by the 0.55% of net turnover cap (Lyal, 2015). Overall, and according to the Decision, this calculation method allowed Amazon to reduce the operating company's (LuxOpCo) tax burden by 75%, since **almost three quarters of Amazon's profits in Europe were unduly shifted to the holding company** (LuxSCS) which acted as a corporate tax shell where the profits remained untaxed[18]. For this reason, the Commission declared Luxembourg's treatment of Amazon in the 2003 tax ruling to be illegal State aid, and ordered the State to recover an estimate of €250 million.

2.4.2. Cases T-816/17 and T-318/18: Luxembourg's and Amazon's appeals before the General Court

[18] For further explanation on the functioning of corporate tax shells, refer to page 14 in Chapter 2.

On December 14th 2017 and May 22nd 2018 respectively, Amazon and Luxembourg appealed the Commission's Decision before the EGC (which has joined the two separate actions into a single appealing). As opposed to the three previous cases, the Court has not yet released its judgement on the alleged State aid provided to Amazon by the Grand Duchy. However, the appellants' allegations have been released[19]. Thus, upon the basis of the previous case law review of the Fiat, Starbucks and Apple judgements, this dissertation will provide **a forecast of the expected EGC's response to each of the allegations** (once again purely hypothetical, as in the Apple case). Nonetheless, and for the purpose of conciseness, such forecast will be restricted to those allegations related to the controversial intersection between State aid law and tax rulings, which constitutes the core of this Section. In this respect:

i. First, the appellants claim that the Commission failed to demonstrate the existence of an advantage granted by the 2003 APA in favor of LuxOpCo. According to this argument, Brussels would have erred in finding that the royalty fee actually paid by LuxOpCo differs from the arm's-length price: the royalty fee that a third party would have paid for IP licensing would have indeed been greater than the fee paid by the head subsidiary to LuxSCS under the license agreement. Furthermore, Amazon and Fiat claim that the Commission has misapplied the TNMM method, and thus its transfer pricing calculations deviate from the arm's length principle.

   As seen in previous cases, **the existence of an advantage must be determined through a factual and functional comparability analysis**, which proves that in absence of the questioned calculation method, the undertaking would have been taxed at a higher rate. In the Apple case such analysis was clearly insufficient. However, in its 2017 Amazon Decision, **the Commission seems to have learned from past mistakes, and provides an extremely detailed comparability test running through paragraphs 401 to 579**. For this reason, **the appellants' claim in this sense does not have high chances of succeeding** in the EGC's expected resolution.

[19] For full consultation of the appeals, refer to the following links: https://eur-lex.europa.eu/legal-content/en/TXT/PDF/?uri=uriserv%3AOJ.C_.2018.072.01.0038.01.ENG (Luxembourg's appeal); and https://curia.europa.eu/juris/document/document.jsf?text=&docid=204705&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=4497850 (Amazon's Appeal).

ii. Second, both the undertaking and the Member State argue that the Commission wrongly assumed the selectivity of the 2003 APA. In this sense, Brussels would have concluded that there is an advantage in order to automatically assume that advantage's selectivity. When according to settled case law, it should have first defined the relevant frame of reference, for then identifying a derogation from that frame of reference (first and second steps of the selectivity analysis, as explained in page 35). Furthermore, according to the appellants, the Commission failed to prove the alleged selectivity: it had erred regarding the frames of reference and the existence of a derogation from them.

Again, the previous cases serve to illustrate the EGC's posture on selectivity: in paragraph 134 of its 2020 Apple Judgment, the Court reminded that, in order prove the selective nature of the advantage, the Commission is obliged to prove that the advantage in question is not enjoyed by other undertakings in a situation which is comparable (both legally and factually) to that of the recipient, within the context of the objectives pursued by the reference framework.

However, **Brussels' Amazon Decision seems to fail in this regard, as it resorts to an automatic presumption of selectivity reflected in paragraph 584**: "Given that the contested tax ruling is an individual measure, the Commission may presume that it is selective in nature, since it has demonstrated in Section 9.2 that it confers an advantage on LuxOpCo by endorsing a transfer pricing arrangement producing an outcome that departs from a reliable approximation of a market-based outcome which results in a lowering of LuxOpCo's taxable base and thus its corporate income tax liability in Luxembourg." Therefore, **the appellants' claim regarding insufficient proof for selectivity will be likely upheld by the EGC**.

iii. Lastly, the appellants claim that the Commission undertook covert fiscal harmonization through the exploitation of Article 107 TFEU and therefore infringed the exclusive competence of Member States in the area of direct taxation. Following the Court's settled case law, **this plea will most likely be rejected**. As stated in paragraph 105 of the EGC's Apple judgement: "According

to settled case-law, while direct taxation, as EU law currently stands, falls within the competence of the Member States, they must nonetheless exercise that competence consistently with EU law. Thus, instances of intervention by the Member States in the field of direct taxation, even if they concern issues that have not been harmonized in the European Union, are not excluded from the scope of the rules on State aid control" .

Overall, it seems obvious that in its judgement, **the EGC will maintain its well-established position and validate the Commission's theoretical framework when addressing national tax rulings through State aid law**. Furthermore, the existence of an advantage provided through state resources to Amazon's subsidiary seems to be proven thanks to a profound and comprehensive analysis by Brussels. However, **selectivity once again becomes the Achilles' heel of the State aid law approach**: in spite of being rightfully declared as advantageous, the 2003 APA adopted by Luxembourg is not sufficiently framed as selective. For this reason, **this dissertation expects the EGC to overturn the Commission's 2017 Amazon Decision**, thus striking one more blow to the practical implementation of Article 107 TFEU in Brussels' quest against tax avoidance by MNEs.

2.5. Conclusions on the judicial treatment of the State aid law approach

The in-depth case law review of this Section allows us to evaluate the results achieved by the State's aid law approach, which as it was explained, came into force partly because of the failure of legislative initiatives (and namely, the CCCTB). However, it must be taken into account that **the ECJ's position remains unknown**, as the second instance appeals in the cases of Fiat and Apple have not yet been resolved. With this cautionary remark in mind, the following conclusions could be extracted regarding the judicial treatment of the Commission's "harmonization through the back door" approach:

- The truth is that **judgments ratify the general conceptual framework used by the Commission** (Canalejo, López, Navarro, & Vidal, 2020), and therefore allow Brussels to continue investigating national tax rulings from the standpoint of the State aid rules. However, a highly meticulous EGC has also sent a very strong signal to the Commission about the **level of scrutiny to which it will subject its**

decisions. This means that the right to apply Article 107 TFEU to national APA is recognized, but the same time **the ECG strongly frames Brussels' powers to do so** (Lamadrid & Ibañez Colomo, 2019).

- Such **thorough scrutiny is especially relevant regarding selectivity**, which will only be accepted by the EGC when the Commission proves that the tax ruling effectively differentiates between market players who, in light of the purposes assigned to the national tax system in question, are in a comparable factual and legal situation (Cleary Gottlieb, 2016). **This point has proven to be extremely complicated in practice**, as Brussels needs to comply with the three step selectivity test. In this sense, **proving the deviation of an APA from standard tax treatment** (i.e., the treatment provided by OECD Guidelines) **is an enormous challenge**: transfer pricing is not an exact science and there might be a genuine difficulty in accurately defining a market price (OECD, 2010).

  For this reason, **all transfer pricing analyses are never straightforward** (Gunn & Luts, 2015): they raise legal issues of interpretation and require in-depth factual investigations (which are certainly overwhelming in the case of MNEs, as the Commission has to deal with intricate corporate structures and obscure sources of information). Overall, the previous case law review has proven that the process of determining the existence of a selective tax advantage (and even more importantly, its quantification for potential future recovery) **is not only filled with practical obstacles, but also with multiple legal challenges** regarding the issue of the margin of appreciation (Gunn & Luts, 2015). In fact, it has been this legitimate scope for errors recognized by the EGC to national APAs[20] that has undermined the Commission's decisions.

- Lastly, the annulment of both the Apple and Starbucks Decisions, alongside the poor prospects for the Amazon Decision, serves to reinforce the view of this dissertation that **State aid rules are not suitable for the harmonization of national corporate tax bases**.

[20] As tax scholars argue, in our modern-day tax system, the recognition of margins of appreciation is both necessary and unavoidable (Gunn & Luts, 2015).

CHAPTER 4: EUROPEAN CORPORATE TAX HARMONIZATION AT A CROSSROADS. THE NEED FOR A LEGAL ALTERNATIVE

The respective analyses of the previous chapters have provided a comprehensive portrayal of the current state of European corporate tax harmonization. While Chapter 2 served to present the urging need to reform cross-border corporate taxation in the EU, Chapter 3 has given a critical outlook on the Commission's previous attempts to tackle this need. In this sense, two very different paths in Brussels fight against tax avoidance have been addressed:

1. On the one hand, **an elegant and technically-sound initiative**: the CCCTB, which proposed a drastic reform of the outdated international taxation system. Its economic and legal features allowed it to effectively hinder harmful tax competition and aggressive tax schemes. However, EU tax shelter jurisdictions opposed its implementation (as it would put an end to their unfair and profitable tax regimes), and this political unwillingness condemned the CCCTB to failure due to the unanimity requirement that is settled in Article 115 TFEU.

2. And on the other hand, **a controversial covert approach**: the application of State aid law rules to national APAs in order to retroactively recover untaxed profits. In spite of counting with a solid theoretical ground (recognized by settled case law), the implementation of this approach has faced enormous practical difficulties, as previously explained in Chapter 3. Therefore, the Commission has suffered tremendous defeats through the repeated annulment of its decisions, thus reinforcing the position of both tax shelter jurisdictions and MNEs (e.g., Apple and Ireland or Starbucks and the Netherlands).

Upon this preceding descriptive basis, Chapter 4 will now tackle **future prospects** of EU fiscal harmonization by studying the legal mechanisms that the Commission should implement and the policy choices it should make in order to, once and for all, put an end to corporate tax avoidance in the EU (a task which becomes even more critical in the current context of Covid-19). More specifically, **arguments for the dismissal of the State aid law approach** will be presented, and the **implementation of the CCCTB through alternative legal means** will be upheld.

1. A LOST CAUSE: FURTHER SUBSTANTIAL REASONS TO LEAVE THE STATE AID LAW APPROACH BEHIND

The previous Chapter already presented the technical difficulties of this controversial approach, which are reflected in its judicial treatment. However, there are **further and larger reasons for which State aid rules should not be used to curb tax avoidance**, which will be addressed in this Section. First of all, the issue of corporate tax avoidance is *per se* a cross-border one, since MNEs benefit from the combination of multiple national tax regimes and measures, while Article 107 TFEU focuses on the measures of a specific State. For this reason, **State aid control is uncapable, by its own nature, of capturing the exploitation of mismatches between national regimes** (Lyal, 2015). In other words, the retroactive recovery of unpaid taxes through the application of State aid rules might act as patch to discourage aggressive fiscal planning, but it **does not tackle the structural causes behind corporate tax avoidance**. Furthermore, in this context it is extremely arduous to determine the renunciation of State resources that would normally be obtained through taxation: for instance, in the previously explained case of the "double-Irish" regime exploited by Apple, it is hard to see how Ireland has lost taxes that should have been paid in its jurisdiction, since the very intent of the tech giant was to avoid taxation not in Ireland, but in different jurisdictions[21] (Lyal, 2015).

Secondly, the Commission's investigations into national APAs have created an **environment of corporate uncertainty**. In this aspect, Brussels has ruled the recovery of retroactively assessed unpaid taxes as far as ten years into the past (Hrushko, 2017). By doing so, **the State aid law approach has violated the fundamental EU principle of legal certainty**, by which undertakings are able to identify their rights and obligations and thus act according to them. When applied to specific advantages granted to individuals, this principle means that such advantages should only be removed prospectively (Hrushko, 2017): this has not been the case of the Commissions' decisions studied in the previous Chapter, which withdrew advantages retroactively, even in those cases in which both the MNE and the Member State firmly believed in the legality of their APA.

[21] As explained in Chapter 2, the intention of MNEs is to escape higher AETRs in those jurisdictions where real economic activity takes place.

However, the impact of this uncertain tax context goes beyond the theoretical and leads to **specific and damaging consequences**. Indeed, the abovementioned decisions undermine G20's efforts to promote certainty in the international tax arena, and **threaten the good relations of the EU with some of its key global partners**. In particular, Brussels' State aid law approach has unsettled relations with Washington authorities, which regard the retroactive recovery of taxes as an attack to their own tax base (Gormsen, 2017). As a result, the EU's unilateral and covert harmonization approach has somehow **jeopardized cooperation in other international tax initiatives**, such as the OECD's Base Erosion and Profit Shifting initiative (hereinafter, BEPS). In this sense, some North-American authorities have been advocating against their country's involvement in BEPS, as a retaliation to what they perceive to constitute unfair taxation of U.S. MNEs (Gormsen, 2017).

On the corporate side, tax uncertainty in the EU **discourages MNEs' compliance with taxation rules**. As tax experts explain[22], companies have no incentive to follow tax regimes diligently if those regimes can be retroactively modified (Brunori, 2015). And more specifically, companies are **disincentivized to invest** in those unpredictable jurisdictions. In other words, the State aid law approach compromises the current flows of FDI enjoyed by EU countries. As seen in Chapter 2, in the case of tax shelter jurisdictions, such flows mostly refer to **phantom investments**, which do not necessarily correspond to real economic activity. However, they still represent a **great portion of the national economies of Ireland, Luxembourg and the Netherlands**, as they rely on advisory, accounting and other financial services, and require the payment of registration and incorporation fees[23]. For this reason, the disappearance of these FDI flows would lead to a ruinous loss of jobs and economic output, which, due to the economic interdependence of Member States, would reverberate across the whole of the EU (Hrushko, 2017).

All of the reasons presented in this Section lead this dissertation to consider that the focus of the Commission's tax harmonization strategy should be placed on **prospective and comprehensive legal reforms**, which are able to tackle the artificial shifting of profits

[22] Brunori's remarks can be accessed through the following link: https://www.forbes.com/sites/taxanalysts/2015/08/21/retroactive-tax-laws-are-just-wrong/ (Brunori, 2015)
[23] For further information, refer to page 15 of Chapter 2.

structurally, and namely, on the final relaunching of the CCCTB proposal. On the contrary, the **conceptual and material inconsistencies** that emanate from the application of Article 107 TFEU to retroactively hinder tax avoidance, alongside the practical impediments for the implementation of the State aid law approach (which have resulted in judicial setbacks, as explained in Chapter 3), lead this dissertation to conclude that the **EC should dismiss "harmonization through the back door"**. The State aid law approach **is not an effective nor a substantially appropriate mechanism for fighting tax avoidance**. Thus, a different policy choice must be implemented by Brussels' authorities, so that financing needs in the post-pandemic recovery context can be met.

2. SURPASSING UNANIMITY: ARTICLE 116 TFEU AS AN ALTERNATIVE MEAN FOR IMPLEMENTING THE CCCTB

Throughout previous sections, the State aid law approach has been discredited as a tool for tackling tax avoidance, while the **CCCTB's suitability** in this regard has been proven. Indeed, this legislative proposal **overcomes both the technical difficulties** detailed in Section 2 of Chapter **3 and the substantial deficiencies** explained in the previous Section (due to its comprehensive and prospective nature, which would put an end to the uncertainty caused by "harmonization through the back door"). For this reason, as a final argument, this Section will present **a legal mechanism to potentially overcome political unwillingness and implement the CCCTB framework**: **Article 116 TFEU**. The provisions of this Article would allow the Commission to implement unitary taxation by formulary apportionment without requiring the consent of Ireland, Luxembourg, Malta and the Netherlands (which seems to be an unrealistic option in the foreseeable future), since they refer to **qualified majority voting instead of unanimity**.

However, Article 116 remains **an unused precept**, which lacks any form of judicial interpretation. For this reason, it must be noted that this Section merely provides **a theoretical proposal** built upon the conclusions of previous Chapters and the few existing academic publications in this field. However, the **effective implementation of these provisions and their embracement by EU courts remain inevitably uncharted**. With this limitation in mind, we are able to proceed to the study of Article 116 as an alternative and potentially advantageous mean for the implementation of the CCCTB.

In this sense, this Treaty provision is considered by experts as a **"safety valve" to overcome veto deadlocks** in those cases in which market distortions require EU action (Nouwen, 2021). For this reason, it is deemed as a *lex specialis*[24] as opposed to the broad fiscal harmonization provisions of Articles 113, 114 and 115 TFEU (Nouwen, 2021). In other words, the special legislative procedure of Article 115 TFEU (and its subsequent unanimity requirement) is overridden. Indeed, such precept is regarded by many as the only existing Treaty provision that could allow the implementation of CCCTB's revolutionary approach (Englisch, 2020). This is because **its substantive scope is not restricted, and thus it could potentially comprise tax measures**.

However, there are **certain restrictions** to the application of Article 116 TFEU that need to be addressed. First, unlike previous Treaty provisions, this precept **cannot be used to battle distortions emerging from the parallel application of identical but uncoordinated national regimes**, it must instead tackle the pursuit of diverging regulatory approaches and taxation concepts by Member States (Englisch, 2020). However, the current harmful tax competition practices in the EU certainly overcome this essential requisite (as explained in Chapter 2): cross-border tax avoidance does not emanate from simply uncoordinated tax jurisdictions, on the contrary, its origin lies on the **substantially divergent treatment of intra firm transactions by Member States** (which is reflected in the APAs granted by shelter jurisdictions).

Second, the **diverging national measures and regimes must already be in force**, since the mere risk of a potential distortion is separately dealt with in Article 117 TFEU (Englisch, 2020). In short, Article 116 only allows for repressive EU legislation, rather than preventive. Once again, this requirement is by far covered, since **diverging and unfair tax regimes are already in place in many EU jurisdictions**. Third, and most importantly, the chances of success this unused precept for overcoming unanimity in tax matters depend on **how broadly the notion of "distortion of competition" is defined**. In practice, this definition remains unclear: TFEU provisions do not provide a clear interpretation of the concept of "distortion", as they indeed do with the notion of "disparity" (Nouwen, 2021). For this reason, there is a strong divide among legal experts in this matter. However, this dissertation agrees with the arguments held by Englisch,

[24] This limited nature is clearly expressed in the wording of the precept, which can be accessed through the following link: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A12016E116

who considers that **the wording of Article 116 seems to be sufficiently broad to include both general and specific distortions** (Englisch, 2020). This interpretation goes in line with the Commission's own policies, which in 1991 broadened their approach to market distortions (Nouwen, 2021): Brussels then concluded that distortions shall be determined by their effects on competitive conditions, rather than their nature. Furthermore, the **principle of "an ever closer Union"** settled in Article 1 TEU requires a broader interpretation of European institutions' powers under Article 116 than that initially foreseen by the original founding Member States: in the current context, in which diverging national regimes lead to the avoidance of billions of euros every year, **tax disparities can be seen as distorters of national economies**. For all of these reasons, it can be concluded that **substantial differences in national fiscal regimes are indeed covered by the provisions of Article 116 TFEU** (Englisch, 2020).

Lastly, before implementing the CCCTB framework through a directive adopted through the ordinary legislative procedure of Article 116, **the Commission would have to consult with tax shelter jurisdictions**. Only if such consultation fails to eliminate the distortion in question, the directive could be enacted. In this regard, it seems obvious (for the reasons explained in Chapters 2 and 3) that Luxembourg, Ireland, the Netherlands and Malta will oppose the reform of their tax shelter regimes upon consultation (in other words, the distortion will remain). For this reason, this final requisite of Article 116 TFEU seems to be overcome too. The **ultimate approval of the directive should pose no problems**: first, because it would count with an extensive previous technical work which is currently being undertaken by committees of both the Commission and the European Parliament (Nouwen, 2021); second, because it could rely on the previous 2016 proposal, which as explained in Chapter 3 was designed in a more suitable and technically sound format than its 2011 version; and third, because the qualified majority vote is likely assured, as the biggest and most influential Member States would benefit from the implementation of the CCCTB and have expressed their interest in drastically reshaping cross-border taxation rules.

In conclusion, this Chapter has been able to demonstrate that in the pressing scenario of Covid-19 and tax avoidance, the Commission should ultimately leave the fruitless State aid law approach behind and dedicate all its efforts to the **enforcement of Article 116 TFEU**, so that **unitary cross-border taxation by formulary apportionment** can be

established in the EU. This revolutionary method would **ensure higher and fairer public contribution of MNEs** in a context of massive government spending, and its implementation seems to be feasible from a legal standpoint (in spite of the lack of judicial precedents regarding the application of Article 116 TFEU). However, this Section has left **political implications aside**: fierce opposition to this “hard-law” harmonization should be expected from tax shelter jurisdictions, which might feel attacked by this “nuclear option” and thus jeopardize integration proposals in other fields (Wattel, 2013). These political barriers will have to be dealt with by Brussels **through intense negotiations and concessions**, which fall out the scope of this dissertation.

CONCLUSIONS

The three previous Chapters aimed to provide **an exhaustive analysis of a complex and pressing reality**: the avoidance of millions in corporate taxes every year by MNEs operating in the EU. Each of the Sections dealt with a specific issue, in order to settle the ground for a final study of viable alternatives to the Commission's failed harmonization attempts. For this reason, it now seems necessary to **recapitulate and put the conclusions of each of the Sections in connection with each other**:

i. Certain Member States have created a **climate of harmful tax competition within the EU**, through the promotion of "carrot regimes" which seek to attract enormous flows of phantom FDI. Namely, the "tax shelter" jurisdictions of Ireland, the Netherlands, Luxembourg and Malta have engaged in harmful practices through the endorsement of **tax rulings which enable the artificial shift of business profits**. As a result, European corporate tax rates have dropped steeply in the past decades, thus endangering the provision of public services.

ii. Upon this fiscal climate, **MNEs** have been able to implement their own **aggressive schemes**, by which they resort to intra-group distributions of IP and financial resources to **allocate paper investments to void subsidiaries** (known as "corporate tax shells") incorporated in the abovementioned jurisdictions. As a result, companies like Apple have effectively **underreported a large portion of their profits** in the jurisdictions where they carry out real economic activity.

iii. These realities have emerged as a consequence of the **dysfunctionality of the current cross-border taxation system**, which does not match today's modern digital economy. In this sense, transfer pricing, the arm's length principle, permanent establishment and the treatment of subsidiaries as separate legal entities stand out as **anachronistic notions** which are no longer suitable to ensure fair corporate taxation. On the contrary, they inevitably lead to **double non-taxation**, and experts have been long calling for the dismantling of the system.

iv. The **CCCTB** legislative proposal launched by the Commission in 2011 (and relaunched in 2016) emerged as a **comprehensive and structural reform** of this

flawed international tax system. Through the consolidation of Member States' fiscal rules, the CCCTB contemplated a scheme of **unitary taxation through formulary apportionment**. This revolutionary approach was built on the fiscal treatment of **MNEs as single entities**, instead of intricate conglomerates of separate subsidiaries and CFCs. In other words, the CCCTB framework replaced transfer pricing and its arm's length principle by an **apportionment formula** combining **three factors: labor, capital and sales**. Through this formula, MNEs would be **proportionately taxed** in each jurisdiction according to their share of real economic activity. In spite of its virtues, this legislative proposal **failed twice** because of the **opposition of EU tax shelter jurisdictions**, which would have to carry the economic burden of fairer cross-border corporate taxation.

v. Parallel to these legislative attempts, the Commission also launched a **"harmonization through the back door"** strategy, by which the State aid provisions of Article 107 TFEU were applied in order to rule the illegality of certain tax rulings and order the **retroactive recovery of taxes**. In particular, the Commission applied Article 107 to Apple, Amazon, Fiat and Starbucks, all of them being MNEs which have abused shelter jurisdictions with the purpose of avoiding millions of euros in taxes. However, the **judicial treatment** of the Commission's State aid decisions has proven that this is **not a suitable method for fiscal harmonization**: European Courts have subjected Brussels to very **strict standards of proof**, which are extremely hard to meet when it comes to the alleged **selectivity** of the contested tax rulings.

vi. Beyond its likely judicial annulment, the State aid law approach also suffers from other **substantial deficiencies**. In this sense, the retroactive recovery of taxes violates the **EU's fundamental principle of legal certainty**, and **hinders** both **international cooperation** in fiscal matters and current levels of **FDI** enjoyed by certain Member States. For this reason, this dissertation has thoroughly justified the dismissal of "harmonization through the back door", while advocating for the **implementation of the CCCTB framework through alternative legal mechanisms**. In this regard, **Article 116 TFEU** is indeed a **viable solution** to overcome the opposition of shelter jurisdictions and implement a system of unitary and equitable cross-border corporate taxation in the EU.

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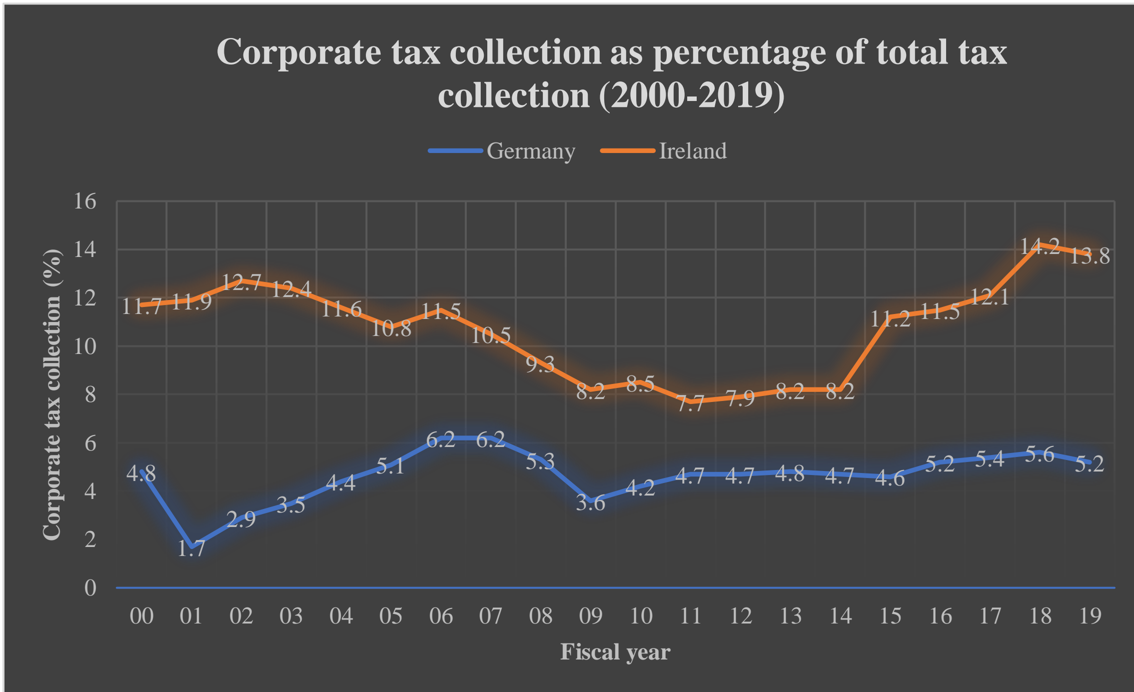
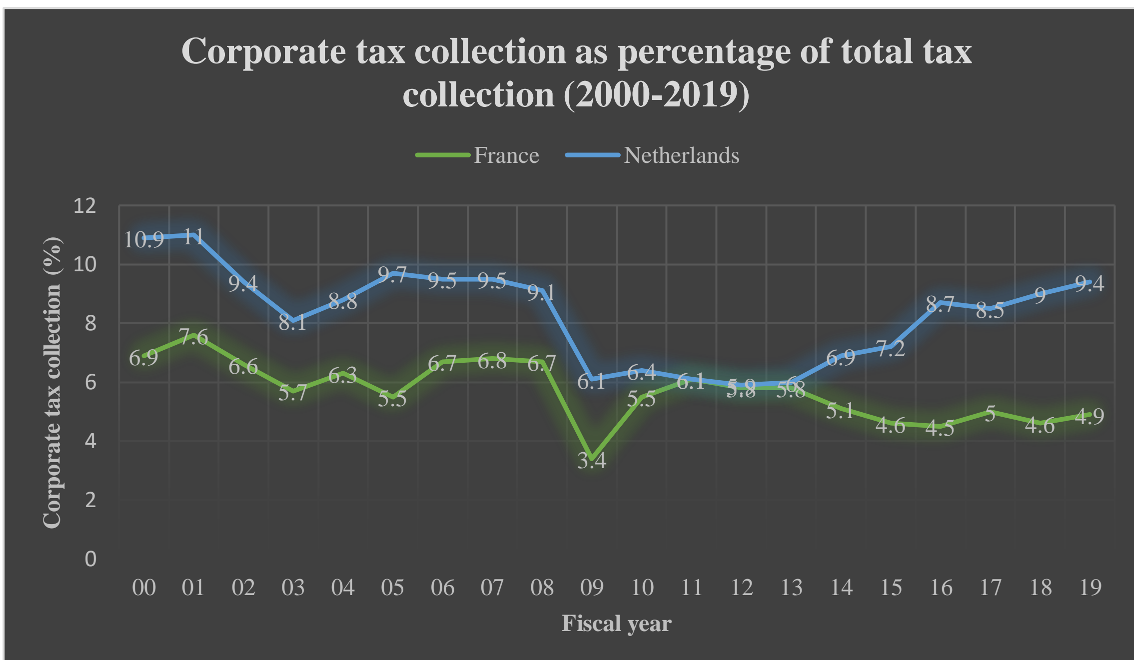
APPENDIX I

FIGURE 1



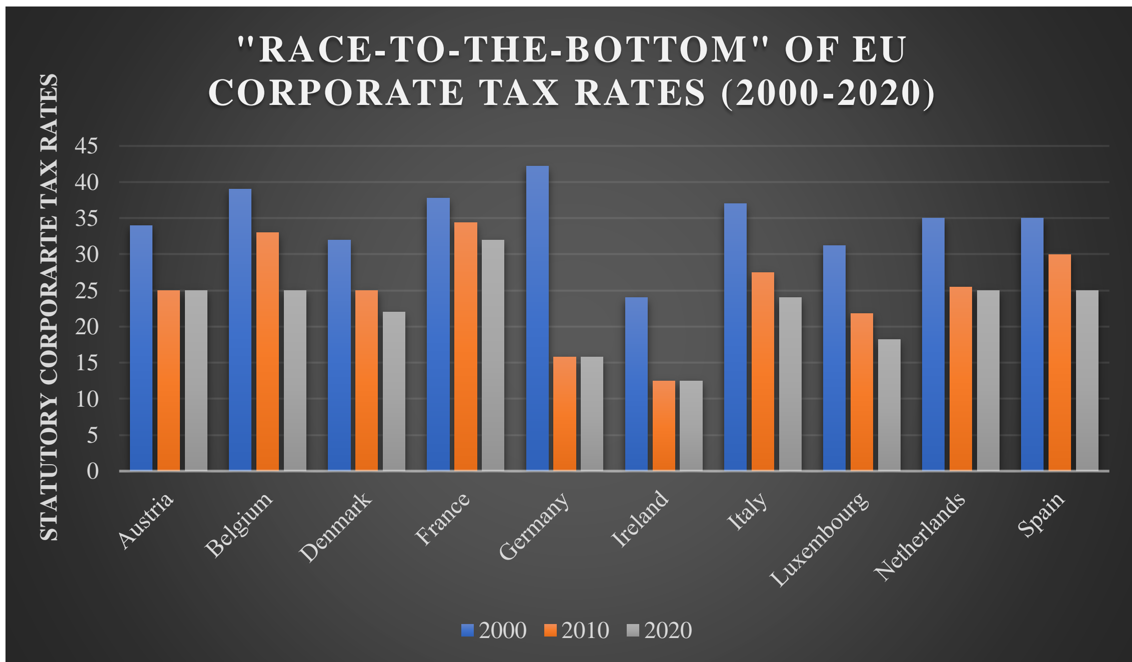
Source: OECD (2021). Tax on corporate profits (indicator). Doi: 10.1787/d30cc412-en

FIGURE 2



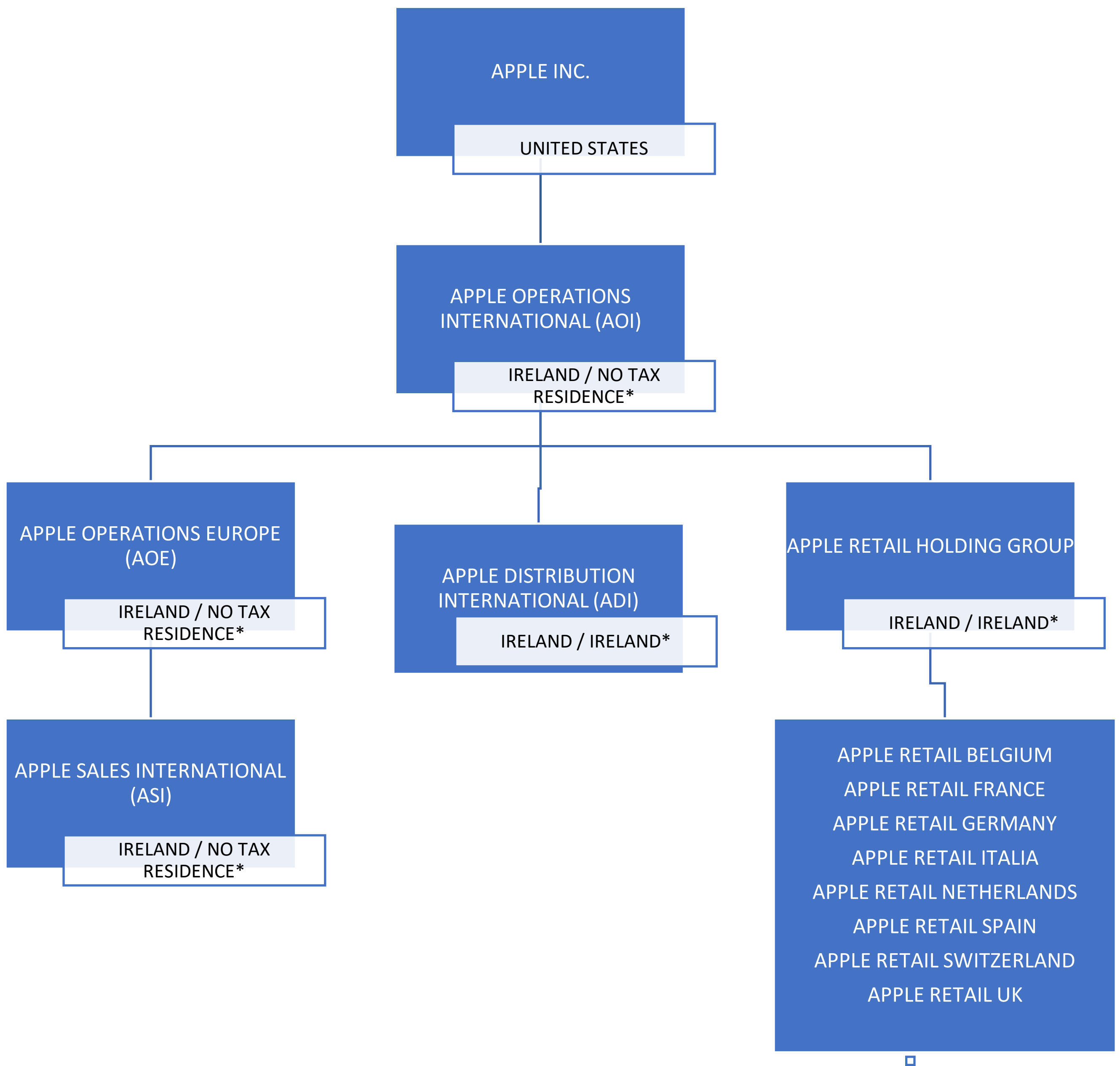
Source: OECD (2021). Tax on corporate profits (indicator). Doi: 10.1787/d30cc412-en

FIGURE 3



Source: OECD.Stat (2021), Statutory Corporate Income Tax Rates.

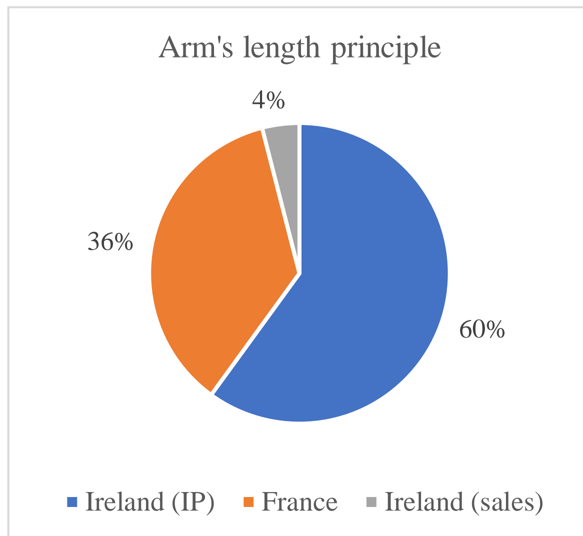
FIGURE 4

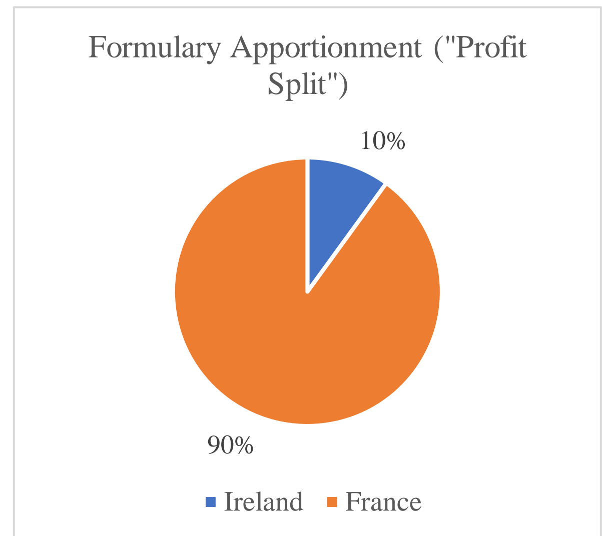


* Listed countries indicate incorporation and tax residence, respectively.

Source: US Senate Permanent Subcommittee on Investigations (2013).

FIGURES 5-6





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Judgement of General Court of 15 July 2020, *Ireland and Others v Commission*, T-778/16 and T-892/16. EU:T:2020:338. Accessible at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62016TJ0778&from=en

Appeal brought on 25 September 2020, by European Commission against the judgment of the General Court (Seventh Chamber, Extended Composition) delivered on 15 July 2020 in Joined Cases T-778/16 and T-892/16, *Ireland and Others v Commission*. Case C-465/20 P. Accessible at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62020CN0465&from=GA