Tax Rulings and State Aid: A Treacherous Mix
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Introduction
Last November a group of reporters affiliated with the International Consortium of Investigative Journalists revealed a trove of a few thousands documents concerning the tax treatment reserved by Luxembourg’s tax authorities to multinational corporations based in the Grand Duchy. More specifically, the published documents covered more than 500 arrangements between Luxembourg’s government and some 340 companies in the period 2002-2010. As a matter of fact, a significant part of these revelations had already emerged about two years earlier, albeit without making the same sensation, when the first complaint relative to the theft of documents was made.

However, much can change in two years’ time. The focus of the international community on the taxation of businesses operating in several national markets reached a climax, thus catalyzing the efforts of the G-20, the United Nations, the OECD, the European Commission and of a number of national governments, not least—although not exclusively—by virtue of the progressive “dematerialization” and “delocalization” of services and manufacturing engendered by technological innovation.1 Furthermore, the European Commission has recently set in motion a few investigations with the aim of ascertaining whether the arrangements between a number of national tax authorities and companies—such as Apple (in Ireland), Starbucks (in the Netherlands) and Amazon and FIAT Finance (in Luxembourg)—amounted to an unduly favourable treatment under the provisions of the regulations on state aid. Moreover, in an unfortunate coincidence, in the very days when the media was loudly raising the issue of the so-called “Luxleaks,” Jean-Claude Juncker was taking office as President of the European Commission. In his tenure as Luxembourg’s Prime Minister and Fi-

1 For an overview of these efforts, see Massimiliano Trovato, “La tassazione dell’economia digitale. Una soluzione in cerca di un problema?” [The Taxation of the Digital Economy: A Solution in Search of a Problem?], Istituto Bruno Leoni Special Report, 18 ottobre 2014, pp. 2-5, http://brunoleonimedia.it/public/Papers/IBL_SR-Tassazione_Digitale.pdf (forthcoming in English). Most recently, the United Kingdom has introduced a 25% tax on the profits allegedly generated in Britain by businesses lacking a “permanent establishment.”
nance Minister, in the mid-90s Juncker had been instrumental in making a country of some half a million people one of the nerve centers of the Continent’s economy.

It is thus understandable that the combined impact of these developments enormously increased the prominence of the leaked documents and indirectly buttressed its underlying narrative, namely that of a conspiracy by Luxembourg’s government with several multi-national corporations, guaranteeing to those willing to establish their headquarters in the Grand Duchy a significant reduction of their tax burden, thus harming the other European states, cheated out of tax revenues for dozens of billions of euros. As the currently-fashionable economist Thomas Piketty put it: “They were looking for a new business model, so they stole the tax base of their neighbours.”

The immediate impact of the Luxleaks revelations was to drive Luxembourg to reform the rules governing these arrangements, with the enactment on January 1st, 2014 of a decree that also covered still pending requests. This measure introduced new rules to increase the transparency of the process and, most importantly, charged a specially-appointed committee with the task of determining a straightforward definition for future rulings. In spite of Luxembourg’s actions, some parties would enlarge on this issue to take a closer look at the state of the international tax regime. This would appear to be the gist of the efforts of European Commissioner to Competition Margrethe Vestager, who broadened the scope of the investigation, requiring all 28 EU member States to document their tax rulings between 2010 and 2013.

As remarked above, the effects of the more lenient tax jurisdictions and the principle of tax competition are the subject matter of a broad and spirited discussion in other venues, so that invoking the issue of state aid might appear to be unwarranted. From this brief introduction, however, a principle can be inferred that seems to be entirely overlooked by the many parties that are riding the wave of the current investigations and of the widespread outrage on this issue with the aim of buttressing the case for a stronger harmonization of tax regimes: the rationales of enhancing competition and increasing tax revenues do not necessarily imply the same conclusions and they would rather seem to involve a fundamental inconsistency.

**State aid and tax measures**

Article 107 of the Treaty on the Functioning of the European Union (TFEU) declares “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring

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3 On this issue, see again “La tassazione dell’economia digitale. Una soluzione in cerca di un problema?,” particularly pp. 15-19.
certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, to be incompatible with the internal market." In the light of the clause "in any form whatsoever," it is clear that tax measures can amount to prohibited state aid, as confirmed by the consistent case law by the European Court of Justice, and as clarified by the Commission’s Notice 98/C 384/03, that to this day is the reference regulation on this issue.4

To this purpose, of course, it is necessary that all the requirements in the above-mentioned definition do apply: "favouring certain undertakings," either by decreasing the taxable base or the amount of the tax, or by deferring or even cancelling its tax liabilities; "aid granted by a Member State or through State resources," that can be understood to include the forfeiture of tax revenues; any aid that "distorts or threatens to distort competition," that translates into the relative enhancement of the competitiveness of the favoured undertaking in the face of its competitors; and the selectivity of any such measure, as evinced by either its written provisions or by its actual implementation.

It is the case to stress that state aid law does not challenge "the power of Member States to decide on the economic policy which they consider most appropriate and, in particular, to spread the tax burden as they see fit across the different factors of production,"5 as explicitly recognized by former Commissioner Almunia in his remarks on the investigation on the tax ruling granted by Luxembourg to Amazon. The point is instead to draw a line between the issue of tax competition and that of market competition.

In other terms, the benchmark for assessing the legitimacy of any tax measure is the overall tax regime of the country in question, while the tax regimes of other Member States appear to be irrelevant in this context. A more favourable tax regulation than those in force in a different country—as, for instance, a lower tax rate—may well entail a benefit for the interested businesses and shall have, as a rule, an impact on their position vis-à-vis their competitors, but this should be immaterial to the purpose of the regulation of state aid, so long as it affects all the economic actors and all the manufactures present in the relevant country and therefore it does not raise issues of selectivity.

**Advance Tax Agreements: a) Theory**

Advance Tax Agreements (ATAs), or "tax rulings," are well-known instruments in most European and OECD countries and aim to guarantee a reliable and stable relationship between companies and tax authorities. Their rationale is akin, under several respects, to those of instruments with a much wider scope, such as Italy's "interpello," Spain's "consulta", France's "rescrit," or the United States'  

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5 Ibid, p. 5.
“private letter ruling.” Tax rulings, however, differ for the bilateral nature of the procedure. Advance Tax Agreements are specifically aimed to the international operations of businesses, and in particular to the discipline of transfer pricing (in this case they are called Advance Pricing Agreements, APAs), namely the money value assigned to goods or services exchanged between related parties, typically represented by business arms of the same multi-national group. APAs, in particular, are the object of recommendations by OCSE and the European Commission.7

In no respect advance tax agreements can thus be considered irregular elements of the international taxation regime, nor does it seem legitimate to presume they do somehow contravene European rules on state aid, barring further qualifications. This is evidenced, for instance, by the provisions of the Draft Commission Notice on the notion of State aid,8 which underwent public consultation in early 2014, whereby the major elements of selectivity are identified that may be deemed to be unlawful (discretionary administrative practices by the tax authorities, preferential tax treatment with respect to other businesses that are in a comparable legal and factual situation, any settlement that is contrary to the applicable tax provisions and results in a lower amount of tax9).

If tax rulings are to be deemed broadly legitimate in the framework outlined by the Draft Commission Notice, this must even clearer within the scope of the 1998 Communication, that does not even mention this issue.

**Advance Tax Agreements: b) Practice**

It is however the case to delve on the nature of these agreements, particularly as to the way the issue of discretional treatment can be actually articulated within this framework. As we have recalled above, tax rulings meet the need for certainty of the law, a need that is particularly heightened by the complexity of tax regulations everywhere. The recourse to such instruments is thus evidence of the underlying ambiguity in the very fabric of these regulations or, at least, that the interpretation of the rules is a challenging endeavour. To do away with ambiguities and uncertainties is extremely advantageous for businesses to provide a stable frame of reference for their organizational decisions and to limit as much as possible the likelihood of controversies arising, a disagreeable pros-

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7 See Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU (COM/2007/71).


9 As an aside, this would raise the question of what might be the suitable remedy in case the agreement entails an increased amount of tax. This is, however, outside the scope of state aid.
pect both for taxpayers and tax authorities.

It would thus appear that requiring any such agreement to be reduced to the mere restatement of applicable regulations is an unrealistic prospect, for two basic reasons. First, identifying such regulations can be problematic; moreover, any opening with respect to their interpretation can be compensated by the removal of the threat of future legal-administrative actions. After all, the demand for such a rigorous standard to advance tax agreements seems to be incongruous as the system does allow—subject to specific conditions—the recourse to tax amnesties and settlements, that is, instruments that imply by definition some degree of forfeiture and concession by tax authorities.

Even more so, the opening to a limited degree of discretion should be allowed within the sphere of transfer pricing, that involves a hard-to-define assessment of the value of the goods or services traded between related entities. This may be the case either because these goods and services lack a reference market of sufficient liquidity—as in the use of trademarks of large international groups—or because they are involved in highly-integrated production processes, which hinder the task of disentangling the contribution of each separate participant to assess their respective values. In such cases, a degree of arbitrariness is unavoidable, which, moreover, does pertain not only to the final determination of transfer prices, but also to the most appropriate method to reach it.

OECD’s directions in this area provide that the assessment of transfer prices can be arrived to by different, enumerated approaches—so long as the principle of free competition is safeguarded (the so-called “arm’s length principle”), which prescribes that all transactions between related entities within a same international group must be concluded under the same terms and conditions that would apply to unrelated undertakings in the same circumstances. Besides, these guidelines do expressly allow the recourse to different approaches than those described in the OECD document, as conditions dictate. We can thus conclude that, in most cases, it is impossible to arrive at a strictly univocal transfer price. By contrast, the likely, real-world outcome is a range of different prices, all perfectly legitimate and compliant with applicable regulations.

Under this respect, the European Commission’s role should consist less in prescribing a preferred approach than in making sure that individual tax rulings are in compliance with the relevant OECD guidelines, as well as that the approach used to establish transfer prices (as endorsed by the local tax authorities) is among the approved ones or that the decision of using it be properly explained.

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10 See the Draft Commission Notice, § 165-69 and 172-73.
12 Ibid., p. 63.
In other terms, we must reiterate that the benchmark for assessing the degree of selectivity of any agreement is the general regulations as applicable in each Member State. In the case of transfer pricing, that is the core issue of the investigations we are looking into, the general applicable regulations are informed by the arm’s length principle, as articulated in the OECD guidelines and adopted by the several national legal systems. It is, however, a somewhat “flexible” benchmark: the Commission is charged with making sure that it is enforced in a consistent manner, but it should not dictate its own uniform understanding of the principle itself.

Another relevant aspect—that places in sharp relief the tension between tax rules and competition rules—is the possibility of concluding advance agreements by companies that feature comparable factual and legal circumstances. The Luxleaks revelations have shown that some 340 companies have benefited from the recourse to tax rulings. If this is evidence—as many critics would contend—of a veritable emergency from a fiscal standpoint, that resulted in some harm for the other European countries, for our purposes the widespread recourse to this practice would seem to exclude—or at the least play down—any charge of discriminatory application. Of course, as a rule “everybody does it” does not excuses an inherently harmful behaviour, but when the hazard lies precisely in a selective treatment being awarded to some parties only, the pervasiveness of a particular conduct should exclude its unlawfulness.

Of course—in the light of its possible impact—the assessment of tax measures should be informed by the utmost caution, as the consequences are not limited to the potential future inapplicability of purportedly unlawful regulations, but they can entail the recovery of tax money left unpaid—by virtue of the agreed qualifications—for up to ten years.

Lastly, a brief consideration on one of the mentioned requirements, namely the recourse to State resources. Although in general the forfeiture of an amount of tax revenues can be properly equated with state aid, it is still doubtful whether this is true when we consider that, in some cases, an undertaking may require the granting of a favourable tax ruling as a precondition for establishing itself in a particular jurisdiction. In such cases, the alternative is not between the expected “full” revenues and lower revenues, but rather between lower revenues and no revenues at all (and, importantly, no contribution to the national economy). Again, the rationale of such remark seems to be in tune with that of the generally acknowledged lawfulness of tax amnesties and settlements, when these further the fulfillment (however partial) of the tax liabilities of an economic actor.

Conclusion
For all these reasons, the Commission’s activism on the issue of tax agreements is a worrying development. To begin with, it threatens to undermine the very need of legal and regulatory certainty that is the rationale of this instrument: it is
hard to see why any business should undertake negotiations with the tax authorities of a given country in the face of the concrete risk that the deal arrived to be subsequently overturned by the EU (with the severe consequences, moreover, that this would entail in terms of financial penalties). The European Commission’s efforts should be more fruitfully spent in improving the clearness and the uniformity of the regulatory framework, for instance by completing the review of the guidelines for the enforcement of the regulations on state aid, as restated in the Draft Commission Notice mentioned above.

It is hard not to feel that behind the professed aim of safeguarding competition lie other, more prosaic interests of a fiscal nature. The issue is the pretended sovereignty on the tax base of businesses, as colourfully stated by Thomas Piketty in the quote at the beginning of this essay: government budgets are under pressure and multi-national corporations—if possible American and preferably operating in the digital realm—represent an ideal target for raising new revenues. Under closer scrutiny, however, this appears to be quite a short-sighted scheme, for two reasons: first, the new sources of revenue might well dry out; and second, because the factor that can help the European economies to start growing again is less the tax revenue accruing to the host State than the investments made by multi-national undertakings.

In the EU scheme, it would appear that countries such as Luxembourg and their favourable tax regimes are chiefly seen as a hurdle, and a not particularly challenging one, to overcome. This is not the place to present an overview of the benefits of tax competition, that in actual fact also serves high-tax countries, therefore we shall limit ourselves to an incidental observation.

In an instructive interview with the Luxembourgish daily d’Lëtzebuergere Land—later commented upon with polemical intents by the British Guardian—Amazon’s former Chief Tax Officer Robert Comfort stated that the advantageous terms of the Luxembourgish tax regime, despite their undoubted importance, were not the only determinant of Amazon’s decision to locate in the Grand Duchy its European headquarters: “The Luxembourg government presents itself as business partner, and I think it’s an accurate description: it helps to solve problems.” It is not too much of a leap to surmise that this proactive approach has something to do with the greater capability of attracting capitals that characterized Luxembourg, as opposed to countries where businesses find that the only relationship with the local authorities is that with the tax collector.

Leaving aside the issue of tax competition, we ought to look into the relationship—if any exists—between sanctioning any supposed state aid granted through tax agreements and the contrast to tax avoidance (or, as it is referred to these days, “profit shifting and base erosion”). More to the point, it is unclear whether the European Commission is indirectly pursuing the second goal under the cloak of the provisions of the first, thus exceeding its legal authority in direct

taxation matters. The request for the documentation of the agreements concluded in all the Member States, regardless of any evidence of wrongdoing, might well be evidence that prosecuting cases of state aid is not the primary goal of the Commission.

Of course, the right and the duty of the Commission to thoroughly and fairly investigate possible cases of state aid is not in doubt, but this requires the existence of solid evidence. To face a presumed tax emergency with tools devised to safeguard competition is not only an intellectually dubious endeavour, but it also seems to be a blatant breach of the boundaries set by European law, with the consequence of invalidating both goals. Trawling for revenues is not necessarily a rewarding approach: it may yield the occasional big catch, but it is more likely to cripple the trawler.