CJEU annuls the EU Commission's State Aid Decision in the Engie Case

*By Oliver R. HOOR, ATOZ Tax Advisers **

On 5 December 2023, the Court of Justice of the European Union ("CJEU") delivered its judgment in the Engie state aid case, concluding that the EU Commission's review of the tax rulings granted by Luxembourg to the Engie group was in breach of EU law. This article provides a clear and concise overview of (i) the fact pattern of the Engie case, (ii) how the concept of state aid applies in the field of taxation and (iii) the decision of the CJEU.

According to the decision of the EU Commission of 20 June 2018, Luxembourg granted illegal state aid to Engie (formerly known as GDF Suez) and should collect circa EUR 120m of taxes from Engie, a partly state-owned, French multinational which operates in the fields of electricity generation and distribution, natural gas, nuclear and renewable energy. In the Engie case, the EU Commission challenged the tax treatment confirmed in two tax rulings obtained by the group in 2008 and 2010. However, the tax treatment described in these tax rulings did not entail any particular tax benefit but merely confirmed the general tax treatment under Luxembourg tax law which would have applied to other companies in the same situation in a very similar manner.

Following the decision of the EU Commission, the Engie group and Luxembourg brought actions before the General Court of the European Union, which dismissed their actions (see judgement of 12 May 2021, Luxembourg and Others vs. Commission, T-516/18 and T-525/18). Engie and Luxembourg then brought an appeal before the CJEU.

The Engie case at a glance

In 2008 and 2010, Engie implemented two financing platforms involving several Luxembourg companies. Among these entities are Engie LNG Supply (which buys, sells and trades liquefied natural gas and related products in Luxembourg) and Engie Treasury Management (which manages internal financing within the Engie Group) which have both been financed by a convertible loan granted by a Luxembourg sister company.

The convertible loans have been classified as a debt instrument and the provisions recorded in relation to these loans have been deductible for Luxembourg tax purposes. With regard to the financing activities performed by Engie Treasury Management, the latter realized an arm's length financing margin that remunerated the company for its functions performed, risks assumed and assets used in regard to its financing activities. Likewise, Engie LNG Supply realized an arm's length remuneration for its trading activities (after the deduction of provisions recorded in relation to the convertible loans).

Notably, the decision of the EU Commission did not challenge the arm's length nature of the remuneration realized by the two Luxembourg companies that are financed by the convertible loans. The decision of the EU Commission was merely based on the application of Luxembourg tax law, challenging the overall tax liability arising in Luxembourg at the level of the entities involved in the financing transactions.

The respective sister companies (granting the convertible loans to Engie LNG Supply and Engie Treasury Management, respectively) transferred their right to receive the shares under the convertible loans via a forward sale agreement to the common parent company.

In this regard, the parent companies recognized a participation in the subsidiaries that were financed with convertible loans. This tax treatment is based on the economic approach which is a variation of the substance over form concept. The future capital gains realized by the parent company in regard to its subsidiary are tax exempt in accordance with the Luxembourg participation exemption regime.

Overall, the Engie financing structures resulted in the realization and taxation of an arm's length remuneration for the entities that are financed by the convertible loans, giving regard to the functions performed, the risks assumed and the assets used. As such, the tax treatment was consistent with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

How to determine the existence of state aid in the field of taxation?

1. The concept of State Aid

According to Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU"), any aid granted by a Member State or through State resources in any form whatsoever, including tax measures, which distorts or threatens to distort competition by favouring certain undertakings or the provision of certain goods shall be incompatible with the internal market, in so far as it affects trade between Member States.

According to the settled case-law of the CJEU, for a measure to be categorized as aid within the meaning of Article 107(1) TFEU, all conditions set out in that provision must be fulfilled. Hence, for a measure to be categorized as State aid, the following cumulative conditions have to be met:
(i) The measure has to be granted by State resources;
(ii) It has to confer an advantage to undertakings;
(iii) The advantage has to be selective; and
(iv) The measure has to affect trade between Member States and to distort or threaten to distort competition.[1]

State aid cases in tax matters usually fail because it cannot be evidenced that an advantage granted to an undertaking is of a selective nature.

2. Focusing on selectivity

According to CJEU case law, Article 107(1) TFEU requires a determination whether, within the context of a particular legal system, a measure constitutes an advantage for certain undertakings in comparison with others in a comparable legal and factual situation.[2]

For that purpose, the CJEU developed the following three-step analysis to determine whether a particular tax measure is selective:
(i) Identification of the reference legal system (e.g. the Luxembourg corporate tax system);
(ii) Assessment as to whether the measure derogates from that common regime in as much as it differentiates between economic operators who, in the light of the objective assigned to the tax system, are in a comparable factual and legal situation ("comparability test"). In other words, it has to be analysed whether the tax treatment of a taxpayer is more beneficial than that of other undertakings that are factually and legally in a similar situation; and
(iii) According to the jurisprudence of the CJEU, a measure found to be selective on the basis of the "comparability test" can still be found to fall outside the scope of the State aid rules if it is justified by the nature or the general scheme of the tax system ("justification test").

3. Considerations regarding the Engie case

The tax treatment of the two financing structures follows the treatment of the underlying transactions for accounting purposes. This is a general principle under Luxembourg tax law. The tax treatment follows the accounting treatment unless a specific tax provision or concept provides otherwise.

With regard to the tax treatment at the level of the parent company, the economic approach resulting in the recognition of a participation in the subsidiary owing the convertible loan is a special tax concept (i.e. the economic approach) that requires a different treatment for tax purposes. The application of the participation exemption regime to capital gains realized in relation to qualifying participations is a plain vanilla application of Luxembourg tax law.

Overall, the technical analysis of this financing structure is very robust, despite the EU Commission may not like the overall outcome in terms of tax liability at the level of the entities involved. In the absence of a selective advantage being granted to Engie, there should not be illegal State aid present in the Engie case.

Decision of the CJEU

The CJEU emphasized that the determination of the reference framework is of particular importance in the case of tax measures since the existence of an economic advantage for the purposes of Article 107 (1) of the TFEU may be established only when compared with the "normal" taxation. Here, the CJEU stresses that only the national law applicable in the Member State concerned must be considered to identify the reference system for direct taxation, that identification being itself an essential prerequisite for assessing not only the existence of an advantage, but also whether it is selective in nature.

The principle of legality of taxation (which forms part of the legal order of the EU as a general principle of law) requires that any obligation to pay a tax and all the essential elements defining the substantive features thereof must be provided by law, and the taxable person must be in a position to foresee and calculate the amount of tax due and determine the point at which it becomes payable.

It follows that the EU Commission is in principle required to accept the interpretation of the relevant provisions of national law given by the Member State concerned provided that the interpretation is compatible with the wording of those provisions. The EU Commission may depart from that interpretation only if it is able to establish (on the basis of reliable and consistent evidence) that another interpretation prevails in the case-law or administrative practice of that Member State. In the present case, the CJEU concludes that the EU Commission made errors in its various analysis of the reference framework defining the normal tax system.

The CJEU noted that the fiscal competence and autonomy of the EU Member States in areas that have not been harmonised at EU level would be disregarded if the EU Commission could define a reference framework exclusively based on the general objective pursued by national law of taxing all resident companies.

Another question was whether the non-application of the general anti-abuse rule ("GAAR") provided in Section 6 of the Tax Adaptation Law could establish the selective nature of the tax rulings. Here, the CJEU stated that a provision intended to prevent abuse in tax matters is inherently particularly general in nature and may be applied in a very wide range of contexts and situations. Furthermore, it falls within the Member States' own competence in the matter of direct taxation and, therefore, within their fiscal autonomy.

On this basis, the CJEU held that the EU Commission could not conclude that the non-application of the GAAR by the Luxembourg tax authorities to refuse the tax treatment sought by a taxpayer in a tax ruling request led to the grant of a selective advantage unless that non-application departs from the national case-law or administrative practice relating to that provision.

If that were not the case, the EU Commission would itself be able to define what does or does not constitute a correct application of such a provision, which would exceed the limits of the powers conferred on it by the Treaties in the field of State aid review and would be incompatible with the fiscal autonomy of the EU Member States.

All these errors led the CJEU to decide that the whole of the selectivity analysis and the EU Commission's decision is annulled.

Conclusion

In the Engie case, the CJEU decided in favour of the taxpayer and Luxembourg and annulled the State aid decision of the EU Commission. The EU Commission launched its investigation into the tax ruling practices of EU Member States back in June 2013, which has led to unprecedented legal uncertainty over the past decade. The question is whether, in hindsight, it was worth it, given that legal uncertainty is bad for business and investment.

The Engie State aid case is another example of the EU Commission's failure to respect EU law and the sovereignty of EU Member States in tax matters. The CJEU came to the same conclusion in the Fiat case. Similarly, in the Starbucks and Apple cases, the General Court did not find State aid.

Ultimately, the CJEU's decision is a positive sign for the rule of law and legal certainty. However, the EU Commission may see it as a bad omen for other pending State aid cases before the CJEU and the ongoing state aid investigations.

**** Oliver R. HOOR is a Tax Partner (Head of Transfer Pricing and the German Desk) with ATOZ Tax Advisers (Taxand Luxembourg).***

The author may be contacted at: oliver.hoor@atoz.lu

The author wishes to thank Marie Bentley (Chief Knowledge Officer) for her assistance.

atoz.lu

1) See Claire Micheau and Gauthier Charles de la Brousse "Case Studies of Tax Issues on Selectivity: Analysis of the Patent Box Scheme and the Reduced Taxation of Foreign-Source Interest Income" in "State Aid and Tax Law", Kluwer Law International, Netherlands 2013, p. 167.
2) See, for example, CJEU, *British Aggregates v. Commission of the European Communities*, Case No. C-387/06P (2008) ECR I-10515, para. 82; CJEU, *Kingdom of Spain v. Commission of the European Communities*, Case No. C-409/00 (2003) ECR I-1487, para. 47; CJEU, *Portuguese Republic v. Commission of the European Communities*, Case No. C-88/03 (2006) ECR I-7115, para 54; see Claire Micheau and Gauthier Charles de la Brousse "Case Studies of Tax Issues on Selectivity: Analysis of the Patent Box Scheme and the Reduced Taxation of Foreign-Source Interest Income" in "State Aid and Tax Law", Kluwer Law International, Netherlands 2013, p. 168.