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

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5 December 2023, the Court of Justice of the European Union (“CJEU”) delivered its judgment in a decision which annulled the EU Commission’s decision to grant illegal state aid to Engie (formerly known as GDF Suez) for tax rulings granted by a Member State or through State representations. The CJEU annulled the EU Commission’s State Aid Decision in the Engie case because it failed to determine whether the Engie financing structures resulted in the tax treatment of the Engie group as in breach of EU law.

According to the CJEU’s decision, tax rulings obtained by the group in 2008 and 2010 did not entail any particular tax benefit because they confirmed the general tax law application under Luxembourg tax law which would have applied to all companies in the same situation in a very similar manner.

The Engie case at a glance

In 2008 and 2010, Engie implemented two financing platforms involving several Luxembourg companies. Authorisation of tax rulings granted by Engie Groupe Système (which buys, sells and trades liquefied natural gas and related activities) 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 subsidiary 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 realised an arm’s length financing margin that reassuringly corresponded to the company for its functions performed, risks assumed and assets used in regard to its financing activities. Likewise, Engie LNG Supply recognised 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 realised by Engie LNG Supply and the 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 recognised 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 realised in the parent’s accounts are not taxed in the subsidiary’s accounts in accordance with the Luxembourg tax law.

Overall, the Engie financing structures resulted in the realisation and taxation of an arm’s length remuneration for the entities that are financed by the convertible loans which performed, risks assumed and 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 representation is considered as a state aid 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 common market, in that it affects trade between Member States.

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.

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 national law or the law of a Member State);

(ii) Assessment as to whether the measure derogates from that competent legal regime in such a manner that it is not comparable with that of other undertakings that are factually and legally in a similar situation; and

(iii) According to the jurisprudence of the CJEU, a measure must be found to be selective on the basis of the “comparability test” (a similar principle is applied to that of the normal tax system).

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 in 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 taxable entity is yielding 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 that capital gains realised in relation to the convertible loan is taxable under the scope of the State aid rules if it is justified by the nature or the general scheme of the tax system (“justification test”).

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 an investigation into the tax ruling practices of Luxembourg’s 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 justified to give legal certainty in bad faith 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 last case SimCorp Nominees (Luxembourg) S.A. and Apple cases, the German 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 use it as a basis for other pending State aid cases before the CJEU and the ongoing state aid investigations.

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