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ATOZ ALERT

Fiat wins appeal against the EU Commission: A bombshell decision of the CJEU

11 November 2022

Background

On 8 November 2022, the Court of Justice of the European Union ("**CJEU**") rendered its judgment regarding the appeals filed by Fiat Chrysler Finance Europe (formerly Fiat Finance and Trade Ltd, FFT, C-885/19 P) and Ireland (C-898/19 P).

By their respective appeals, FFT and Ireland requested to have set aside the judgment of the General Court of the European Union of 24 September 2019 by which the latter dismissed their actions for annulment of the final State aid decision of the European Commission of 21 October 2015 on Fiat (SA.38375).

The State aid decision of the European Commission concerned a tax ruling issued by the Luxembourg tax authorities on 3 September 2012 which confirmed that the underlying transfer pricing analysis has been realized in accordance with the Circular 164/2 of 28 January 2011 and respects the arm's length principle. With its decision, the EU Commission requested Luxembourg to reclaim an amount of circa EUR 30m from the taxpayer.

The Fiat case at a glance

FFT is a Luxembourg subsidiary of Fiat S.p.A., the Italian parent company of the Fiat group which is one of Italy's largest industrial enterprises. FFT provided treasury services and financing to Fiat group companies based (mainly) in Europe (excluding Italy) and also managed several cash pool structures for Fiat group companies. FFT operated from Luxembourg where its head office is located and through two branches, one based in London (United Kingdom) and one in Madrid (Spain).

Fiat decided to centralise its financial and treasury functions, where all funding, corporate finance, bank relationship, foreign exchange and interest rate risk management, cash pooling, money market operations, cash balances management, collection and payment initiation were performed by FFT and the other treasury companies. FFT performed treasury functions for Fiat Group companies in Europe.

The transfer pricing analysis prepared for FFT was based on the guidelines and methodologies set out in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("**OECD Transfer Pricing Guidelines**") which reflect the international consensus towards the interpretation and application of the arm's length principle.

The transfer pricing analysis relied on the determination of the amount of capital at risk in line with the Basel II criteria. Moreover, FFT was meant to realize an arm's length risk remuneration in regard to its capital at risk (by using the Capital Asset Pricing Model, CAPM) and an arm's length remuneration for its functions performed. The transfer pricing method which was applied to determine an arm's length risk premium was the Transactional Net Margin Method ("**TNMM**").

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 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 categorised as State aid, the following cumulative conditions must be met:

(i) The measure has to be granted by State resources;
(ii) It has to confer an advantage to undertakings;
(iii) The advantage must be selective; and
(iv) The measure must affect trade between Member States and to distort or threaten to distort competition.

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.

The CJEU developed the following three-step analysis to determine whether a particular tax measure is selective:

(i) Identification of the reference legal system (in the present case, that is the Luxembourg corporate income 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**") (hence, it needs to be analysed whether the tax rulings granted by the Luxembourg tax authorities to FFT entails an advantage that is not consistent with Luxembourg corporate income tax law); and
(iii) Justification by the logic of the tax system ("**justification test**") (i.e. should there be a measure found to be selective on the basis of the "comparability test", it 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 system).

The State Aid Decision of the EU Commission

On 21 October 2015, the EU Commission adopted the decision that the tax ruling granted to FFT fulfilled all the conditions set out in Article 107 (1) TFEU for being classified as State aid within the meaning of that provision.

With regard to the condition relating to the existence of a selective advantage, the EU Commission considered the tax ruling to confer such an advantage on FFT, in so far as it had resulted in a lowering of FFT's tax liability in Luxembourg by deviating from the tax which FFT would have been liable to pay under the ordinary corporate income tax system.

More precisely, the EU Commission considered that it was required to verify whether the methodology accepted by the Luxembourg tax authorities in the tax ruling at issue departed from the methodology that leads to a reliable approximation of a market-based outcome, and thus the arm's length principle. Here, the EU Commission disregarded the guidance provided in Circular 164/2 and called for an autonomous interpretation of the arm's length principle.

In its decision, the EU Commission concluded that certain methodological choices approved by the Luxembourg tax authorities and underlying the transfer pricing analysis in the tax ruling at issue resulted in a lowering of FFT's tax liability compared to the amount which would have been payable by a standalone company.

Decision of the CJEU

The CJEU held that the decision of the EU Commission must be annulled in so far as the EU Commission erred in law in finding that there was a selective advantage in the light of a reference framework comprising an arm's length principle which does not derive from a full examination of the relevant national framework.

The CJEU further states that the error of the EU Commission in determining the rules applicable under the relevant national law (and, therefore, in identifying the "normal" taxation in the light of which the tax ruling at issue had to be assessed) necessarily invalidates the entirety of the reasoning relating to the existence of a selective advantage.

In other words, the EU Commission did not have the right to disregard Luxembourg transfer pricing rules and replace it with some kind of European interpretation of the arm's length principle.

Instead, the EU Commission must be able to establish that the parameters laid down by national law are manifestly inconsistent with the objective of non-discriminatory taxation of all resident companies (be they integrated or not) pursued by the national tax system, by systematically leading to an undervaluation of transfer prices applicable to integrated companies as compared to market prices for comparable transactions carried out by non-integrated companies.

However, according to the CJEU the EU Commission did not carry out such an examination in its decision, since its analytical framework did not include all the relevant norms implementing the arm's length principle under Luxembourg law. Therefore, the State aid decision of the EU Commission must be annulled.

Conclusion and outlook

The Decision of the CJEU in the Fiat case is a bombshell that gives an indication as to how the Court may decide in other State aid cases.

It is of particular importance that the CJEU clarified that only the national law applicable in the member state concerned must be taken into account in order to identify the reference system for direct taxation. This is relevant

for both the assessment of the existence of an advantage and the question as to whether an advantage is selective in nature.

Hence, the EU Commission cannot simply disregard (part of) the domestic tax law of a member state with a view to establish that a selective tax advantage has been granted to a taxpayer.

Ultimately, the decision of the CJEU contributes to legal certainty for taxpayers and may be seen as a bad omen for the EU Commission as other decisions in State aid investigations may share the same fate as the Fiat case.

Do you have further questions?

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