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# EU Competence: How the European Commission is trespassing Member States' exclusive competence to harmonise corporate taxation

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## The 2014 investigations into tax rulings





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## The 2014 investigations started in the US

- Apple State aid investigation initiated in the US in 2013.
- In June 2013 information requests send to tax authorities in selected Member States on their respective tax rulings.
- The Secretary of US Treasury formally expressed concerns that the Commission “appears to be adopting an entirely new legal theory and applying it retroactively in a broad and sweeping manner.”
- Moreover, “enforcement actions... are inconsistent with, and likely to contrary to, the BEPS project” and “appears to be targeting U.S. companies disproportionately.

## Introduction

- The Commission ordered Ireland to recover €13bn (plus interest!) from Apple, covering the period from 2003 to 2014.



- Prior to the *Apple* case, the Commission ordered Luxembourg and Netherlands to recover illegal aid in the *Starbucks* and *Fiat* cases.



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## Problem

- The Commission does not respect the line between taxation policy and State aid control.
- The Commission must not overstretch the interpretation of the State aid prohibition to fill-in for the lack of homogeneous EU tax legislation.
- The Commission is using State aid to achieve tax harmonization through the back door.
- Positive versus negative integration.



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## Competence

- Only certain forms of taxation are harmonized at the EU level.
- Direct taxation falls within the competence of the Member States.

### HOWEVER

- Taxation is subject to the Commission's State aid control.
- The Court of Justice of the European Union recognized fiscal aid in its early jurisprudence (e.g. *Case 173/73 Italy v Commission*).



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## National tax rulings and State aid

- Tax rulings are not problematic *per se*.
- Specific tax ruling might constitute a selective economic advantage to an undertaking within the meaning of Article 107(1) TFEU.
- The Commission's approach in these cases is problematic.
- Novel interpretation of EU State aid law.



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## Novel interpretation

- First novelty: the Commission is conflating the criteria of 'advantage' and 'selectivity'.
- Second novelty: the Commission is rendering the arm's length principle part of its assessment under Art. 107(1) by equating the breach of the arm's length principle with selective aid.





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## First novelty

- The Commission only focuses on ‘advantage’ and ignores ‘selectivity’.
- While a detection of an economic advantage could create a rebuttable presumption (in some cases) that it is selective, it does not alter the fact that economic advantage and selectivity are two separate conditions, which requires a separate analysis.
- The Court of Justice has said in C-15/14 *Commission v MOL*:

“the requirement as to selectivity under Article 107(1) TFEU must be clearly distinguished from the concomitant detection of an economic advantage” (para 59).



## First novelty

- This is all the more important in cases concerning tax.
- AG Kokott highlighted in her Opinion in C-66/14 *Finanzamt Linz* that:

“In matters of tax law in particular, however, the decisive criterion is whether a provision is selective, because the other conditions laid down in Article 107(1) TFEU are almost always satisfied. [...] The criterion relating to the selectivity of a national provision therefore requires careful handling. If the provision concerns neither one or more individually identifiable sectors capable of being defined by reference to their economic activity, nor individually identifiable undertakings, as the wording of Article 107(1) TFEU requires, then the provision in question cannot in principle be assumed to be selective.” (paras 114-115)



## Second novelty

- The Commission is rendering the arm's length principle (ALP) part of its assessment under Art. 107(1) by equating the breach of the arm's length principle with selective aid.
- This is a dangerous development in State aid law, as ALP is not a method for the assessment of the selectivity of a measure.
- Transfer pricing tax rules are not harmonised at the EU level.
- The Commission applies the ALP as derives from the OECD Model Tax Convention.
- However, under which legal formula do the OECD rules become a part of the Commission's assessment under Article 107(1) TFEU?



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## Second novelty

- A particular Member State might not have transposed the ALP principle into its legal system.
- Moreover, there might be differences in the way the APL has been adopted and applied in different Member States.
- Therefore, there can be no legal explanation as to why the OECD's notion of the ALP should be part of the EU State aid apparatus.
- Consequently, the assessment regarding the existence of an advantage should be based on national rules.
- This interpretation is consistent with the EU's system of competences and safeguards the prerogative of Member States in tax matters.



## Consequences of novel approach

- The Commission's approach in relation to these cases, has blurred the boundaries between negative and positive integration.
- Under the current constitutional arrangement, direct taxation falls within the scope of national sovereignty, whereas the harmonisation aspects of direct taxation in the EU can only be achieved by means of a Council Directive, if Member States unanimously agree to that.
- AG Kokott highlighted in her Opinion in C-66/14 *Finanzamt Linz* that:  
  
“too broad an understanding of the selectivity of national provisions, however, harbours the risk of adversely affecting the division of competences between the Member States and the European Union” (para 113).



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## Consequences of novel approach

- Faced with the political difficulties in enacting new legislation in the field on direct taxation, the Commission has embarked on a journey to circumvent the political gridlock, by means of its wide powers under the EU's system of State aid control.
- The Commission is attempting to utilize Art. 107(1) to effectively harmonize the rules on transfer pricing across the EU.
- This exceeds the legitimate purpose of State aid law.



## Creeping Competence

- By bending the existing jurisprudence, the Commission encroaches upon the sovereignty of Member States in the field of direct taxation.
- The Commission is using State aid to gain competence in an area which is not shared competence.
- Blurred boundaries of positive (e.g. legislation) and negative integration (e.g. case law).
- Override the political obstacles in policy areas such as direct taxation, where the EU treaties require unanimity to decide on tax matters.

➡ Creeping expansion of the EU's competence in the area of direct taxation.



## Distribution of Competences in EU Law

- Exclusive competences of the EU (e.g. in the areas of customs union and common commercial policy).
  - Competences shared with Member States (e.g. in the areas of internal market, environment, and energy).
  - Competence to carry out actions to support, coordinate or supplement the actions of the Member States in certain policy areas (e.g. in the areas of human health, industry, and education).
- ➔ The exercise of EU competences is - in theory - controlled by the principles of subsidiarity and proportionality.





## The expansion of EU Competences

- The EU institutions are not all to blame as the Member States have allowed the creeping competence:
  - Through secondary legislation, and
  - By circumventing the prohibition of harmonisation inscribed in the treaties, in order to pursue common policies in an inter-governmental setting.
- Given the broad nature of EU competences and permissive approach of the CJEU → The EU continue to encroach on competences reserved to Member States.
- EU Commission is trying to achieve ‘integration through the back door’.



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## Member States' sovereignty in tax matters

- The application of State aid rules in the field of taxation is a politically sensitive topic.
- The EU has little legislative competence on the field of taxation and is mostly concerned with indirect taxes (such as VAT and excise duties).
- The Commission is particularly aware of the difficulties of achieving tax harmonization.
- The gap in EU Tax law arises from the apparent contradiction between the exclusive tax competence and the necessary harmonization to achieve the aims in regards to the single market.
- As early as 2001, the Commission has spoken about a move towards qualified majority voting in Articles 113 and 115 TFEU or resorting to 'other methods' for 'removing tax obstacles and distortions to the internal market.'



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## The creeping intrusion of the Commission into the territory of direct taxation

- Article 113 TFEU: **unanimity** + after consulting EU bodies+ indirect taxation.
- Article 115 TFEU: **unanimity** + after consulting EU bodies + functioning of the internal market.

➡ The requirement of unanimity evidences the importance of taxation for national sovereignty.

- A recent example on how **Article 115** is applied can be seen in the Common Consolidated Corporate Tax Base (CCCTB): it will allow corporations in the EU to be subject to a single set of rules for the determination of their tax base.

➡ Effective way to tackle obscure rulings (no need of Article 107 TFEU).

- The lack of a CCCTB in Europe today, encourages tax competition between the Member States.



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## Preamble of the CCCTB proposal

‘(1) ... Furthermore, tax planning structures have become ever-more sophisticated over time, as they develop across various jurisdictions and effectively take advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing the tax liability of companies.’

‘(2) To support the proper functioning of the internal market, the corporate tax environment in the Union should be shaped in accordance with the principle that companies pay their fair share of tax in the jurisdiction(s) where their profits are generated.’

‘(7) To mitigate tax avoidance risks, which distort the functioning of the internal market, a common corporate tax base should be designed broadly.’



## Normative implications of the tax ruling saga

- The new-formulated principle spelled out by the Commission causes doctrinal uncertainty, without offering anything useful.
- The omission of a serious ‘selectivity’ analysis, removes a fundamental guarantee of Member States’ fiscal sovereignty, as it renders a finding of State aid quasi-automatic following a breach of the ALP.
- Article 4(2) TEU could act as an additional barricade vis-à-vis the Commission’s creeping competence in the field of direct taxation as it states that the EU shall respect Member States’ ‘national identities’ and ‘essential state functions’. Raising revenue and deciding how to spread the tax burden are ‘essential state functions’ par excellence.



## A tale of Negative and Positive integration?

- EU Competition Law has historically played a crucial role in supporting the teleological imperative of market integration.
- The Court has repeatedly stressed the role of antitrust rules in the imperative of economic integration: *Consten and Grundig*.
- The objectives of State aid law are less clear than traditional antitrust rules.
- The system of State aid control is intended to protect the internal market against segmentation through State aid.
- However, when the pursuit of EU integration leads to an activist interpretation of competition rules, thereby making inroads into the hard core of the Member States' competences, this raises serious normative concerns.



## A tale of Negative and Positive integration?

- State aid law would not normally raise normative concerns if it remained within the literal meaning and purpose of Article 107(1) TFEU.
- The interpretative scheme of negative and positive integration, can be a proxy to assess when the enforcement of State aid law, in policy areas falling within the competence of Member States, exceeds the legitimate purpose of State aid control, thereby raising normative red flags.
- ‘Negative integration’ refers to the removal of tariff and non-tariff barriers to trade as well as other obstacles to free and undistorted competition.
- ‘Positive integration’ refers to the reconstruction of a system of economic regulation at the EU-level (Articles 113-115 TFEU)

➔ Negative integration is about the interpretation of existing primary Union law, positive integration is about adopting new rules and standards.



## A tale of Negative and Positive integration?

- Using Article 107 TFEU in pursuit of positive integration exceeds the legitimate purpose of State aid law: the *ratio legis* of the EU system of division of competences, is exactly to preclude positive integration in policy fields reserved to the Member States.
  - In the specific case of taxation, a tax favouring ‘certain undertakings or the production of certain goods’ might confer an artificial competitive advantage to the beneficiary, therefore affecting trade within the common market.
  - The EU’s State aid regime is equipped to police those externalities, by removing distortions to trade.
  - HOWEVER, State aid law is not about prescribing policies, dictating positive rules or substituting the national legislative process.
- ➡ Qualitative difference between negative and positive integration in respect to policy fields falling within the Member States’ competence.





## A tale of Negative and Positive integration?

- The crux of matter in these cases was the efforts by the Commission to render ALP legally binding across the EU, through Article 107(1) TFEU.
- HOWEVER, as transfer pricing rules are not harmonised at the EU level, the Commission could assess the existence of an advantage only in reference to national rules.
- To accept the Commission's legal reasoning would entail the effective harmonisation of transfer pricing rules at the EU level:
  - Not a matter of a decision by DG COMP.
  - Circumventing the principles of subsidiarity.
- Commission takes a role of co-legislator in the tax sphere.



## A tale of Negative and Positive integration?

- The strategic utilisation of State aid provisions by the Commission, can have the same effect as positive integration; namely, the prescription of economic regulation at the EU-level.
- State aid law was originally meant as a negative integration tool, as it entails a prohibition, and by imposing the ALP onto the Member States the Commission alters the nature of the State aid mechanism.



## The Battle before the EU Courts

- The legality of the Commission's approach in the tax rulings saga has yet to be scrutinised by the EU Courts: annulment of the contested Commission's decisions (Starbucks, Fiat, and Apple).
- Competence argument: likely to play a little role in the Court's judgment.
- *PreussenElektra*: Advocate General Jacobs called the Court to reject the expansive interpretation of the notion of State aid, as advocated by the German Government and other interveners to the proceedings.



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## Conclusion

- The interpretation and enforcement of competition law by DG COMP can be an instrument to promote 'EU integration through the back door'.
- State aid: example of 'creeping competence'.
- Blurred boundaries between positive and negative integration.
- The Commission is circumventing the political gridlock in the field of direct taxation.
- There is no legal argument on why ALP should be part of EU Law, but can there be a practical explanation?



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