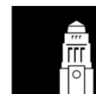

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AMAZON AND THE STATE AID TAX SAGA

LEOPOLDO PARADA*

Abstract

This contribution summarises the main aspects of the EU General Court's decision and explores some of its lessons for the future of state aid regulation in the European tax law context. Most notably, it critically evaluates the reasoning of the EU General Court to uphold the use of the OECD Transfer Pricing Guidelines as a baseline to determine the correct application of a domestic arm's length standard as well as the limitations stated for its potential retroactive use. It also explores the unpalatable strategy of the Commission to test and check for the best transfer pricing method and the partial support granted by the court in this regard. Finally, it elaborates on issues referred to the burden of proof, the role of hybrid entity structures and stateless income for state aid purposes. All matters firmly addressed by the court.

I. Introduction

On 12 May 2021, the EU General Court (hereinafter also "the Court") confirmed the unsuccessful attempt of the European Commission to prove the existence of an illegal state aid granted by the Grand Duchy of Luxembourg to Amazon via a specific tax ruling.[1] The decision is not novel, and, in fairness, it does not contribute anything truly new in comparison to previous decisions of the Court during the

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[1] EU General Court, 12 May 2021, Cases T-816/17 and T-318/18, *Grand Duchy of Luxembourg, Amazon EU Sàrl and Amazon.com, Inc. v European Commission,* ECLI:EU:T:2021:252 (hereinafter, "GC Decision in Amazon").

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whole state aid tax saga.[2] However, it is worth revisiting it, especially if one wishes to understand the future developments of EU state aid regulations in the European tax law context.

This contribution summarises the main aspects of the Court's decision and explores some of its lessons for the future. Most notably, it evaluates the reasoning of the Court to uphold the use of the OECD Transfer Pricing Guidelines (hereinafter, "OECD TP Guidelines") as a baseline to determine the correct application of a domestic arm's length standard as well as the limitations stated for a potential retroactive application. It also explores the unpalatable strategy of the Commission to test and check for the best transfer pricing method and the partial support granted by the court in this regard. Finally, it elaborates on issues referred to the burden of proof, the role of hybrid entity structures and stateless income for state aid purposes. All matters firmly addressed by the Court.

The contribution is divided in four sections. Section 2 summarises the most relevant aspects associated to the court's decision, especially to understand the context and background of the current judgement. Section 3 explores four important lessons from the Court's decision, including the use of the OECD TP Guidelines as a baseline to determine the correct application of the arm's length standard; the look for a best transfer pricing method; the burden of proof, and the role of hybrid entity structures and stateless income for state aid purposes. Section 4 provides some final remarks.

[2] Other similar cases of the state aid tax saga include, for example, EU General Court, 15 July 2020, *Ireland v Commission* and *Apple v Commissio*n, Cases T-778/16 and T-892/16, ECLI:EU:T:2020:338 (hereinafter, "GC Decision in Apple"), and EU General Court, 24 September 2019, *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission,* ECLI:EU:T:2019:670 (hereinafter, "GC Decision in Fiat").

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II. Background and context

Following the Commission's description in the case under analysis, the business structure of Amazon can be presented as follows:[3]

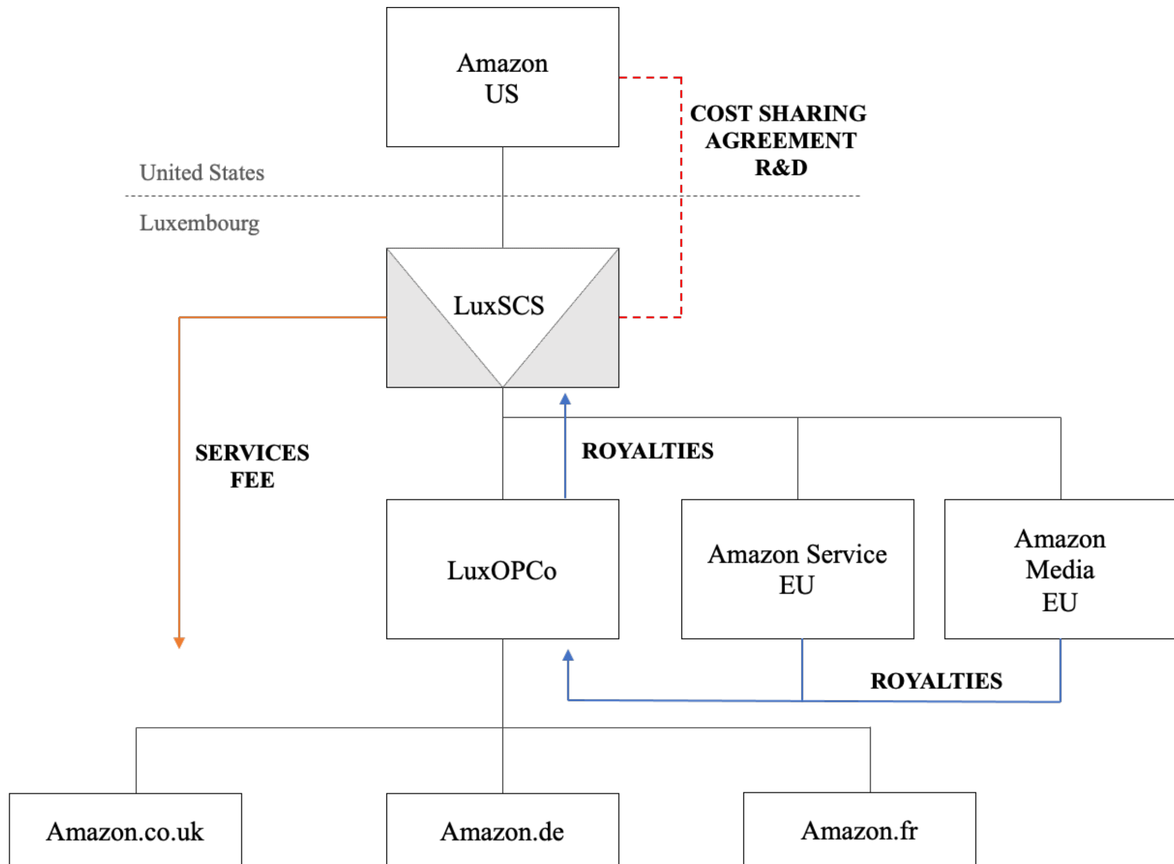

Figure 1: Amazon business structure

As noted above, whilst the headquarters of the group were still located in the United States (hereinafter, "Amazon US"), the business in Europe was basically structured around two companies established in Luxembourg: Amazon Europe Holding Technologies SCS (hereinafter, "LuxSCS"), and its wholly owned subsidiary, Amazon EU Sàrl (hereinafter, "LuxOpCo"). LuxSCS concluded different agreements with the US companies of the group, most notably a license and assignment agreement for pre-existing intellectual property, and a cost-sharing

[3] GC Decision in Amazon, supra n. 1, paras 20-21.

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agreement (CSA) by which LuxSCS obtained the right to exploit certain intellectual property rights. Similarly, LuxSCS entered into a license agreement with LuxOpCo for the use of the intangibles assigned to LuxSCS, and by which this latter received an annual payment of royalties from LuxOpCo.[4]

In 2003, and before a business restructuring of the group was completed in 2006, Amazon obtained a tax ruling from the *Administration des Contributions directes* (Luxembourg's direct tax authorities) confirming two important matters.[5] First, it confirmed the method for calculating the rate of royalties that LuxOpCo was supposed to pay to LuxSCS for the use of intangibles under the license agreement already mentioned.[6] Second, it confirmed that LuxSCS did not have a separate tax personality from that of its partners under Luxembourgish law, and therefore, it was not subject to corporate income tax or net wealth tax in Luxembourg,[7] regardless of its opaque tax treatment under US law.[8] The tax ruling at issue applied during the relevant period of 2006-2014.[9]

In 2014, the Commission requested the Grand Duchy of Luxembourg to provide information regarding the tax ruling at issue and decided to initiate a state aid investigation, which concluded in 2017.[10] By then, the Commission achieved the conclusion that the tax ruling created an economic advantage in favour of LuxOpCo since the transfer pricing arrangement endorsed in it departed from a reliable approximation of a market-based outcome, resulting therefore in a general reduction of LuxOpCo's taxable basis for corporate income tax purposes in

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[4] GC Decision in Amazon, supra n. 1, paras 1-7 and 22-36.
[5] GC Decision in Amazon, supra n. 1, para 8 and 11.
[6] GC Decision in Amazon, supra n. 1, para 9.
[7] LuxSCS is a *Société en Commandite Simple* under Luxembourg law. GC Decision in Amazon, supra n. 1, para 10.
[8] Technically speaking, LuxSCS became a 'reverse hybrid entity', that is, an entity considered as tax transparent in its country of establishment whilst regarded as tax opaque in the country of its investors. See L. PARADA, *Double Non-Taxation and the Use of Hybrid Entities: An Alternative Approach in the New Era of BEPS*, Alphen aan den Rijn, Kluwer Law International, 2018, pp. 116-118.
[9] GC Decision in Amazon, supra n. 1, para 12.
[10] GC Decision in Amazon, supra n. 1, para 13. See also, European Commission, 4 October 2017, (EU) 2018/859 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon, OJ 2018 L 153.

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Luxembourg.[11] Subsequently, both the Grand Duchy of Luxembourg and Amazon brought independent actions against the Commission's decision which the EU General Court decided ultimately to annul.[12]

Although the EU General Court's decision is a solid victory for Amazon and the Grand Duchy of Luxembourg, the reasoning of the Court leaves important lessons for future state aid issues concerning tax rulings, especially to understand the future of EU state aid regulation in the European tax law context. This is precisely what the rest of this contribution will be focused on.[13]

III. A few lessons from *Amazon* in the state aid tax saga

This Section now explores four important lessons from the Court's decision, especially to understand the future of EU state aid regulation in the European tax law context. This includes: i) the use of the OECD TP Guidelines as a baseline to determine the correct application of the arm's length standard; ii) the look for a best transfer pricing method; iii) the burden of proof, and iv) the role of hybrid entity structure and stateless income for state aid purposes.

A. The use of the OECD Transfer Pricing Guidelines

One of the characteristics in the *Amazon* state aid case relates to the fact that the Commission used a series of OECD TP Guidelines, in different chronological versions, to demonstrate the existence of a tax advantage in favour of LuxOpCo.[14] This action raises two important legal questions. The first one refers to the legal value of the guidelines, more specifically to which extend the OECD TP Guidelines can be used as a sort of *allocation benchmark* to check Member States' profit allocations. The second one refers to the temporal dimension that the use of the guidelines entails. That is, it attends to the question on what guidelines are to be

[11] GC Decision in Amazon, supra n. 1, paras 16-18.
[12] GC Decision in Amazon, supra n. 1.
[13] It is important to mention that the EU General Court's decision in Amazon can still be appealed before the Court of Justice of the European Union (CJEU).
[14] GC Decision in Amazon, supra n. 1, para 146 et seq.

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used once accepting that the OECD TP Guidelines can be used as an allocation benchmark. Let me refer to these two issues separately.

1. The OECD TP Guidelines as an allocation benchmark

As for the role of the OECD TP Guidelines as an allocation benchmark, the Court seems to sympathise with it. Indeed, and although the Court recognises that the guidelines are merely a non-binding legal tool, it ruled in the case under analysis that "the Commission was entitled to base its findings concerning the existence of an advantage on the guidelines".[15]

This is not the first time that the EU General Court confirms what seems to be a new prerogative of the Commission to use arm's length as a sort of free-standing obligation to check Member States' correct profit allocations. Indeed, in *Apple,* for example, the Court already supported this approach and found, as well as in *Amazon*, grounds in the Court of Justice of the European Union (CJEU)'s decision of *Forum 187*.[16] In that case, the Court ratified that the arm's length standard could be used as an *allocation benchmark* "to ensure that transactions between integrated group companies are treated for tax purposes by reference to the amount of profit that would have arisen if the same transactions had been carried out by non-integrated stand-alone companies".[17] In *Amazon*, the Court simply ratified what seems to be this new prerogative when concluding that if "national tax law does not make a distinction between integrated undertakings and stand-alone undertakings for the purposes of their liability to corporate income tax, that law is intended to tax

[15] GC Decision in Amazon, supra n. 1, para 154.
[16] GC Decision in Apple, supra n. 2, paras 34-35 and 192 et seq. See also, CJEU, 22 June 2006, *Belgium and Forum 187 v Commission*, Cases C-182/03 and C-217/03, EU:C:2006:416, para 97 (confirming that member states should apply the arm's length standard as embedded in their domestic laws to resemble prices that would have been charged in conditions of free competition). See also, European Commission, Decision of 17 February 2003 on the aid scheme implemented by Belgium for coordination centres established in Belgium (Text with EEA relevance) (notified under document number C (2003) 564, para 95).
[17] GC Decision in Apple, supra n. 2, para 194.

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the profit arising from the economic activity of such an integrated undertaking as though it had arisen from transactions carried out at market prices".[18]

Although the scenarios are different in both cases —unlike *Amazon*, in *Apple* there was no arm's length standard recognised in the national legal system of Ireland— the Court's confirmation of the Commission's line of reasoning is not exempt of a similar criticism.[19]

First, and foremost, this line of reasoning appears to violate the well-settled understanding that Member States are sovereign to decide in direct tax matters which events should be taxed, and how that taxation shall occur within the limits of their territory. Therefore, following the Commission's approach, the Court just confirms that the alleged sovereignty of Member States in direct tax matters is not such and that an arm's length control by the Commission —as regards the proper allocation of profits or the application of the arm's length standard— is now possible.[20] However, there is one caveat, which is that if the OECD TP Guidelines have been formally incorporated or acknowledged within domestic law, there would be no reason to disregard their use as part of a reference system, at least in theory.[21]

Second, the approach adopted by the Court puts at risk the advanced legal certainty offered by the whole system of tax rulings in Luxembourg. Indeed, and despite the criticism (sometimes valid) that one can pose on the tax ruling system in

[18] GC Decision in Amazon, supra n. 1, para 118.
[19] Some of this criticism can also be found in: R. MASON, « State Aid Special Report — Part 6: Arm's Length on Appeal » *Tax Notes*, Feb. 5, 2018, p. 771. See also, P. BAKER, «A Week of State Aid, Transfer Pricing and Tax Rulings », 49 *Intertax* 8/9, 2021; L. PARADA, « Between Apples and Oranges: The EU General Court Decision in the 'Apple Case' », *EC Tax Rev.* 2, 2021.
[20] PARADA, supra n. 19, p. 57 (raising a similar criticism regarding the GC decision in Apple).
[21] In this opinion, see W. HASLEHNER, « Double Taxation Relief, Transfer Pricing Adjustments and State Aid Law », in I. Richelle, W. Schön and E. Traversa (eds), *State Aid Law and Business Taxation*, Heidelberg, Springer, 2016, pp. 148-149 (although recognising that, in practice, only a few Member States have explicitly adopted the OECD TP Guidelines).

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Luxembourg, it is undeniable that it also accomplishes an important role to provide legal certainty to taxpayers seeking for that.[22] As such, it appears at least questionable that an *ex-post* evaluation of the allocation of profits may change the outcome originally agreed, demanding integrated undertakings profit levels very close to those profits reported by stand-alone companies.[23] Moreover, the Court did not answer the question on whether this evaluation is still possible when a Member State did indeed draw the distinction between integrated and stand-alone companies.[24]

2. Temporal dimension in the use of the OECD TP Guidelines

As for the temporal dimension in the use of the OECD TP Guidelines, that is, what guidelines exactly are to be used as a benchmark to check Member States' correct profit allocations, the parties disagreed. Whilst the Commission argued that the 2010 and 2017 versions of the OECD TP Guidelines—which included the method of Development, Enhancement, Maintenance, Protection and Exploitation functions (DEMPE method) used by the Commission to assess the allocation of profits to LuxOpCo — could also be used, Amazon and the Grand Duchy of Luxembourg argued against it, considering that such retroactive application to a 2003 tax ruling would be just extemporaneous.[25]

As noted already, even when the Court agreed with the use of the OECD TP Guidelines as an allocation benchmark, it also confirmed that a retroactive application of them is simply not possible. In the words of the Court: "Leaving aside

[22] For a criticism of the tax ruling system, using as example the Grand Duchy of Luxembourg, see, for example, O. MARIAM, « The State Administration of International Tax Avoidance », 1 *Harvard Business Law* Review 7, 2017 (using Luxembourg as an example of how a national tax administration consciously and systematically assists taxpayers to avoid taxes in other jurisdictions). More recently, see L. LEDERMAN, « Best Practices in Tax Rulings », 22 November 2021, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3969099 (focusing on the 2014 Lux Leak scandal and arguing for public disclosure of anonymised tax rulings).
[23] PARADA, supra n. 19, p. 57 (raising a similar criticism regarding the GC decision in Apple).
[24] R. MASON, « State Aid Enforcement after Amazon », *Tax Notes Federal* 171, 2021, p. 1396.
[25] GC Decision in Amazon, supra n. 1, paras 147-152.

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the fact that, at the time of the adoption of the tax ruling at issue, in 2003, as at the time of its last extension in 2010, the OECD Guidelines constituted merely indicative, non-binding guidance for the Luxembourg authorities, the only OECD guidelines available at the time of the adoption of the tax ruling were the 1995 OECD Guidelines".[26] The Court also added that "in the contested decision, the Commission referred, however, to the 2010 and 2017 versions of the OECD Guidelines, which amounts to an inappropriate application *ratione temporis* of the reference framework, which should be determined on the basis of the facts and the pricing methods which existed at the time of the adoption of the measures at issue".[27]

In spite of the above, the Court left the door open to a retroactive application in the case when the new versions of the guidelines are used only to clarify older versions but without amending them.[28] Although this approach served precisely to reject the use of the DEMPE method introduced in the 2017 version of the OECD TP Guidelines, it is undeniable that it will create interpretation issues, and most certainly, it will affect legal certainty in the future.[29] Indeed, drawing the line between a mere clarification and a new element (or a new method) in the guidelines can be more blurry than it was in the case under analysis where an entirely new transfer pricing method was introduced. However, could the Court have achieved the same conclusion if some elements of this new method (or any other method introduced in future guidelines) were already present in old TP guidelines? Would that be enough to affirm that a new method introduced in future guidelines is not an amendment but rather a clarification of the old ones? Probably the answer would become harder and possibilities for interpretative mistakes (or conscious ones) will increase, too.

[26] GC Decision in Amazon, supra n. 1, para 147.
[27] Ibid.
[28] GC Decision in Amazon, supra n. 1, para 151.
[29] GC Decision in Amazon, supra n. 1, para 152.

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B. Checking and testing for the "best" transfer pricing method

Another interesting aspect, which indeed took most part of the technical analysis in the Court's decision, refers to the correct application of the transfer pricing method agreed in the tax ruling at issue: the transactional net margin method or TNMM, as well as the Commission's attempt to suggest a better method to be applied, that is, the profit-split method.

1. The correct application of the TNMM

Beyond all the transfer pricing technicalities involved in this case, what the Commission claimed was basically that the TNMM was not applied correctly, ultimately deriving in LuxOpCo paying too little taxes in Luxembourg, which in turn grants this undertaking an advantage from a state aid law perspective. Indeed, and according to the Commission, choosing LuxOpCo and not LuxSCS as the tested party for purposes of applying the TNMM, ensured that most of the residual profits of the two companies were allocated to LuxSCS, which was indeed a tax transparent entity in Luxembourg, that is, it was not subject to corporate income tax. This outcome, ensured by the ruling, would have had departed from a reliable approximation of a market-based outcome.[30]

The Court ultimately (and rightfully) rejected the Commission's claim.[31] However, what is still worrisome is the Commission's repetitive attempt to determine not only what is the most suitable allocation method but also to apply it in a certain manner,

[30] GC Decision in Amazon, supra n. 1, para 47. The Commission also raised other technical arguments, including the fact that if LuxSCS would have been the tested party, the remuneration paid should have been based upon a markup on costs. This would have left LuxOpCo with most of the residual profits of the two companies. The Commission also relied on a 5% markup based on the 2010 OECD TP Guidelines. See also, MASON, supra n. 24, p. 1397.
[31] GC Decision in Amazon, supra n. 1, para 252.

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reducing transfer pricing to a sort of exact science, which is far from reality.[32] Indeed, if we just remember the situation in *Apple,* the Commission also claimed that the allocation method applied to the two Irish subsidiaries of this group resembled the TNMM. Therefore, it decided to use it for purposes of determining whether the Irish subsidiaries received an advantage or not.[33] Curiously, however, the Commission challenged the application of the TNMM method to Starbucks's coffee roasting facility, considering it inappropriate, which simply demonstrates that transfer pricing is far from providing a unique standard solution.[34]

The Commission's attitude as well as the Court's lenient and inconsistent position on this matter are equally criticisable. First, there is no reason to prescribe a priority of transfer pricing methods when neither domestic law nor the OECD TP Guidelines establish one. Indeed, an incorrect application of an allocation method in transfer pricing should not amount to anything else than a mistake, whose correction should not become a new prerogative of the Commission either.[35] Therefore, it is at least arguable that the Commission attempts now to exercise a sort of "best-method control" as if the sovereignty of Member States in direct tax matters was not relevant anymore. Second, supporting the Commission's approach may create in the long-term a sensation of uncertainty for taxpayers who must now turn not only to national tax authorities in the seek for legal certainty —through tax rulings— but also to the Commission which must now confirm both the allocation method and its proper application following unrealistic standard of sophistication as regards profits' attribution.[36]

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[32] P. WATTEL, « The Cats and the Pigeons: Some General Comments on (TP) Tax Rulings and State Aid After the Starbucks and Fiat Decisions' », in I. Richelle, W. Schön and E. Traversa (eds), *State Aid Law and Business Taxation,* Heidelberg, Springer, 2016, p. 186. See also, GC Decision in Apple, supra n. 2, para. 455 (confirming that in transfer pricing not only one outcome is possible).

[33] GC Decision in Apple, para 316.

[34] PARADA, supra n. 19, p. 60.

[35] Ibid. (providing a similar argument in the context of the Apple case).

[36] See also in this opinion, for example, W. HASLEHNER and A. ANCORA, « The Apple State Aid Case », in M. Lang et al (eds), *CJEU - Recent Developments in Direct Taxation 2019,* Vienna, Linde, 2020, p. 235.

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2. The Profit-Split as "best method"

The Commission did not stop here, though. It also claimed, as a subsidiary argument, that as both LuxSCS and LuxOpCo performed important functions. Therefore, the correct transfer pricing method should have been the profit-split method and not the TNMM.[37] Unlike what one could have expected, though, the Commission did not make any attempt to calculate the contributions of each undertaking to establish the profit-split. In contrast, it limited itself to state that the application of such method would have ensured higher profits attributable to LuxOpCo.[38]

Surprisingly, the Court considered and reviewed the argument, which appears to have failed only on the fact that the Commission did not prove that applying the profit-split method would have ultimately resulted in more income for LuxOpCo and less for LuxSCS.[39] Indeed, as stated by the Court: "To prove the existence of an advantage, the Commission had to show that LuxOpCo would have received greater remuneration had the profit split method been applied as compared with what it actually received pursuant to the tax ruling at issue".[40] Although the Court correctly asserts that it is the Commission's task to show that a higher remuneration could have been attributed to LuxOpCo, the Court demonstrates again a very lenient approach in what seems to be the newly created prerogative for the Commission in state aid cases related to tax rulings: to find out the best transfer pricing method available. If this is the case, taxpayers may expect very little from advance rulings aimed to ensure legal certainty in the future.

C. Burden of proof

Another important confirmation that came across during the Court's decision under analysis refers to the burden of proof. Indeed, the Court confirmed in *Amazon* that

[37] GC Decision in Amazon, supra n. 1, paras 34 and 300-301 and 317.
[38] Ibid.
[39] GC Decision in Amazon, supra n. 1, paras 508 et seq.
[40] GC Decision in Amazon, supra n. 1, para 512.

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it is not enough for the Commission to prove that a methodological error was made when applying a particular transfer pricing method, it is still the Commission's task to demonstrate the existence of an advantage. In other words, the Court simply clarified, as it equally did in *Apple*,[41] that the incorrect application of the arm's length standard is not equivalent or does not automatically mean that the existence of a tax advantage has been proved.

The question of burden of proof has more important implications than one may expect at first sight. Indeed, if the Commission proves that the decision adopted by the Grand Duchy of Luxembourg was entirely discretionary, there would be some grounds to shift the burden of proof onto the Grand Duchy of Luxembourg.[42] This is supported in previous CJEU case law where the CJEU has stated that "if the competent authorities have a broad discretion to determine the beneficiaries or the conditions under which a financial assistance is provided…", such discretion can be considered selective. [43] However, such a discretion should not be general in nature.[44] That is, a degree of discretion is still acceptable to the extent that it is exercised within the objective limits of the tax system.[45]

Therefore, the Court's confirmation regarding the burden of proof is very welcome because as other commentators have stated already "the commission must do its legwork— it cannot simply assume the conclusion of various alternative transfer pricing methods that it claims the member state should have used".[46] This has total logic since transfer pricing is not —as recognised in *Apple*, too— an exact science, that is, transfer pricing can suppose varied possible results.[47] Therefore, it is the Commission's task not only to demonstrate that an improper allocation has been carried out, but that the improper profit allocation results in a specific advantageous

[41] GC Decision in Apple, supra n. 2, para 333 and paras 216 and 319.
[42] HASLEHNER and ANCORA, supra n. 36, p. 238.
[43] CJEU, 18 July 2013, *P Oy*, Case C-6/12, ECLI:EU:C:2013:325, para 27.
[44] CJEU, 29 June 1999, *DM Transport*, Case C-256/97, ECLI:EU:C:1999:332, para 27.
[45] CJEU, 18 July 2013, *P Oy*, Case C-6/12, ECLI:EU:C:2013:325, paras 25 and 26.
[46] MASON, supra n. 24, pp. 1399-1400
[47] GC Decision in Apple, supra n. 2, para. 333. See also this argument in: PARADA, supra n. 19, pp. 61-62.

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treatment. In other words, proving the causation link between the error and the reduction in the chargeable profits becomes indeed crucial.[48]

D. Hybrid entities and non-taxation for state aid purposes

Another interesting, although questionable, argument raised by the Commission in the case under analysis, was that LuxSCS would have been created only for purposes of tax optimisation.[49] This issue would derive from the alleged advantage created by the despair tax characterisation that this entity received both in Luxembourg and in the United States, ultimately ensuring the "non-taxation of profits".[50] In fact, as noted already in this work, LuxSCS was indeed considered a tax transparent entity under Luxembourg law, that is, it was not subject to tax at the level of the entity in this country (i.e., income flew through its owners under Luxembourg law's perspective), whilst in the United States the same entity was still considered as tax opaque, that is, taxation should occur, for US tax purposes, only at the entity level.[51] Therefore, it was the mismatch in the characterisation of this entity (LuxSCS) as well as its outcome (non-taxation of profits) the two factors under which the Commission based this whole argument.

Fortunately, the Court was categorically discarding the Commission's argument. Indeed, in words of the Court: "The relevant question in the context of the present action is…not whether LuxSCS was created purely for tax purposes, nor whether the income which it generated was actually taxed in the United States in the hands of its partners, but rather whether LuxOpCo paid a royalty which was overpriced and whether, as a result, LuxOpCo's remuneration and, therefore, its taxable base were artificially reduced".[52] This proves to be true "even if it were established, that

[48] PARADA, supra n. 19, p. 62 (in reference to the Apple case).
[49] GC Decision in Amazon, supra n. 1, para 278.
[50] GC Decision in Amazon, supra n. 1, para 281.
[51] The entity was technically a "reverse hybrid entity". See PARADA, supra n. 8 (explaining the concept).
[52] GC Decision in Amazon, supra n. 1, para 281.

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LuxSCS was a 'fictitious' company".[53] These two assertions of the Court have important implications that go certainly beyond the case under analysis.

First, it confirms that state aid rules respond (and have always responded) to the rationale of preventing illegal subsidies that may affect competition within the internal market. Therefore, state aid law should not be the result of the frustration to tackle tax avoidance in the form of under-taxation or non-taxation derived from disparities among countries.[54] This is simply because state aid law was never designed for this purpose.[55] The foregoing does not mean that the Commission must simply forget about state aid investigations related to the improper application of tax rules,[56] but that these investigations should respond exclusively to the fact of determining whether the actions under scrutiny have granted a selective advantage to a specific undertaking (or sector) or not, ultimately affecting the general functioning of the internal market.[57] This is precisely where the importance of what the Court said relies upon. Indeed, and in my view, when the Court states that the crucial issue in the case under analysis is not whether LuxSCS was created for tax

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[53] GC Decision in Amazon, supra n. 1, para 282.

[54] Commentators have argued in the past that state aid rules might play a role on this. See, for example, P. ROSSI-MACCANICO, « Fiscal Aid, tax competition, and BEPS », *Tax Notes Int'l* 857, 2014 (justifying the use of state aid law to combat base erosion and profit shifting as well as harmful tax competition). However, one must say that this argument presumes a sort of general principle under European law to combat abusive practices, which is an issue that has been openly rejected by the CJEU in the past. See, for example, CJEU, 29 March 2012, *3M Italia*, Case C-417/10, ECLI:EU:C:2012:184, para. 32, which states: "…it is clear that no general principle exists in European Union law which might entail an obligation of the Member States to combat abusive practices in the field of direct taxation…". However, I do recognise that this could change after the so-called « Danish cases » where the CJEU ruled that "the principle that abusive practices are prohibited nonetheless constitutes a general principle of EU law which applies irrespective of whether the rights and advantages that are abused have their basis in the Treaties, in a regulation or in a directive". CJEU, 26 February 2019, *N Luxembourg 1 and Others v Skatteministeriet*, Joint Cases C-115/16, C-118/16, C-119/16 and C-299/16, ECLI:EU:C:2019:134, para 101. See also on this matter, for example, R. DANON, D. GUTMANN, M. LUKKIEN, G. MAISTO, A. MARTIN JIMENEZ and B. MALEK, « The Prohibition of Abuse of Rights After the ECJ Danish Cases » 49 *Intertax* 6/7 (2021). Unfortunately, a further analysis of these issues certainly exceeds the very unambitious and limited scope of this article.

[55] In this opinion, see also R. LUJA, « State Aid Rules and Their Limits », *Tax Notes Int'l* 353, 2014.

[56] R. MASON and S. DALY, « State Aid: The General Court Decision in Apple », 99 *Tax Notes Int'l* 1317, 2020, p. 1319.

[57] LUJA, supra note 55.

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purposes only, or whether the income flowing through this entity will be ultimately taxed in the United States, but rather whether LuxOpCo's payment of royalties was overpriced reducing artificially the its taxable base, the Court acknowledges and reinforces the essence of state aid law which is to ensure free and fair competition within the EU internal market and not to prevent or combat profit shifting, base erosion or legislative mismatches.[58] As such, this is a very much welcome confirmation.

Second, the Court also draws an important distinction to understand the role of hybrid entities in future tax state aid cases. Indeed, if we recall, the Commission appears to be convinced that the sole fact that two countries disagree in the characterisation of an entity for tax purposes is enough to consider a particular structure as potentially advantageous under Article 107(1) TFEU. This conclusion is certainly disproportionate and, if followed, would imply that any transaction that involves a hybrid or reverse hybrid entity —or any other qualification mismatch— would be susceptible to be automatically regarded as a tax advantage for state aid purposes. Such a result would contradict the proper understanding of hybrid entities, which are the result of disparities among countries in a world that is far from being harmonised, and which is also applicable in a pure European law context.[59]

Third, and finally, the Court also admonished the idea of paying any attention to the outcome derived from the mismatch in the characterisation of entities, that is, stateless income. Indeed, if we recall, the Commission emphasised that the mismatch created in the case under analysis resulted in the non-taxation of profits neither in Luxembourg nor in the United States, that is, income remained stateless or not taxed. However, the court —rightfully, in my view— rejects the argument, an issue that was not even necessary in the *Apple* case where neither the

[58] See more on this matter at supra n. 54.
[59] On the matters of hybrid entities within and outside the EU context, see, for example, PARADA, supra n. 8. See also, C. MARCHGRABER, *Double Non-Taxation and EU Law*, Alphen aan den Rijn, Kluwer Law International, Eucotax Series, 2017; G. FIBBE, *EC Law Aspects of Hybrid Entities*, Amsterdam, Doctoral Series IBFD, Vol. 15, 2009.

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Commission nor the court considered the stateliness of income a relevant issue for purpose of the state aid analysis.

Some commentators have been critical in the past regarding the lack of attention paid by the court to stateless income. Most notably, Stephen Daly and Ruth Mason, in reference to the *Apple* case, considered such lack of attention as 'mild'. According to these authors, the Commission should have paid more attention to the fact that the Irish rules of corporate residence (the origin of the mismatch in the *Apple* case) could have been devised in such a way to achieve stateless outcome.[60] These authors support the judges' view in *Gibraltar* where the CJEU found plausible that an apparently neutral tax system could be devised to give advantage to a specific group of undertakings, amounting therefore to a *de facto* state aid.[61] As I have argued in the past, too, the argument of these authors is attractive but it should be taken cautiously because it misleads the discussion out of the scope of state aid law.[62] Allow me to offer some of these observations again here.

Firstly, the facts in *Gibraltar* are rather different to those in *Amazon* or *Apple*. Indeed, in *Gibraltar*, the whole corporate tax system was replaced (devised) to avoid state aid law. This is the reason why the CJEU found that illegal state aid existed 'as applied' or *de facto*. In *Amazon*, the Luxembourg rules to characterise entities for tax purposes are just a matter of sovereignty that Luxembourg enjoys in direct tax matters. Any other alleged intent as to benefit specific companies that decide for a tax transparent treatment is a matter of proof. The *Apple* case is not different either. It is true that a modification to the Irish rules was made in 1999 introducing the place of incorporation as a factor to determine the tax residence of entities, also allowing the use of the place of management and control under certain circumstances. However, whether that modification attends to the specific intention of allowing Irish companies controlled by US entities to be stateless is again a

[60] MASON and DALY, supra n. 56, p. 1328.
[61] CJEU, 15 November 2011, *Commission v. Gibraltar and United Kingdom*, Joined Cases C-106/09 P and C-107/09 P, ECLI:EU:C:2011:732.
[62] PARADA, supra n. 19, p. 62.

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matter of proof.[63] In other words, one should avoid the temptation to consider that the simple disagreement of laws among countries would necessarily amount to a legislative intent to prompt an advantage to certain undertakings.

Secondly, one should not forget that it is the Commission itself who confirmed in 2009 that advantages from tax disparities between jurisdictions are not within the scope of state aid law to the extent that the national tax systems are themselves coherent.[64] Therefore, the fact that Luxembourg uses a set of domestic rules to characterise entities for tax purposes and not others is just a prerogative of the Grand Duchy of Luxembourg to the extent that the system in itself is coherent, regardless of its interaction with other jurisdictions. In fact, if such an interaction creates a mismatch, and stateless income, too, is a matter out of the scope of state aid legislation, and which should be addressed —if considered undesirable— through other legal tools, including, e.g., anti-avoidance provisions. Following this approach simply reinforces the legal nature of state aid law which focuses on the tax system of a singular member state in isolation.[65]

Thirdly, and even if the argument of *de facto* selectivity that Daly and Mason propose might hypothetically succeed, one should not forget that stateless income or the non-taxation of economic behaviours is not, and has never been, an issue under EU law, at least not from a state aid law perspective.[66] In other words, the whole state aid matter has always been limited to the determination of whether domestic tax rules may generate a selective advantage to some undertakings, constituting a derogation from the normal system of taxation. It is true that some

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[63] MASON and DALY, supra n. 56, p. 1328 (where the authors elaborate on the argument that the United States was one of the seven tax treaty partners of Ireland applying the place of incorporation by then, which would have purposedly allowed the mismatch between US and Irish laws). In contrast, see PARADA, supra n. 19, p. 62.

[64] The Commission already confirmed in 2009 that advantages from tax disparities between jurisdictions are not within the scope of state aid to the extent they the national tax systems are coherent. *See* Commission Decision C (2009) 4511 final (*Dutch group interest box*), OJ L 288/26 of 4 November 2009.

[65] LUJA, supra n. 55.

[66] W. SCHOEN, « Tax Legislation and the Notion of Fiscal Aid: A Review of 5 Years of European Jurisprudence », in I. Richelle, W. Schön and E. Traversa (eds), *State Aid Law and Business Taxation*, Heidelberg, Springer, 2016, p. 5.

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authors could argue that facilitating "tax arbitrage"[67] could indeed be considered as a derogation of the normal system of taxation, contrary to the principle of abuse of law.[68] However, such an assertion appears to be misleading, at least if one accepts that the prevention of abusive practices is neither a fundamental principle of EU law nor part of an international tax regime followed by all countries.[69]

All in all, therefore, both disparities in the characterisation of entities as well as stateless income are still far from state aid concerns.

IV. Concluding remarks

The EU General Court's decision in *Amazon* is certainly nothing new in comparison to previous decisions of the Court during the whole state aid tax saga. However, it still provides important lessons for the future of European state aid tax regulation and related case law.

First, it confirms what seems to be a new prerogative of the Commission to check Member States' correct profit allocations using for these purposes the OECD TP Guidelines. It also confirms that such prerogative is not absolute, at least from a temporal perspective, restricting the retroactive application of them to cases in

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[67] For a reference on the international tax literature on the concept "tax arbitrage", see, for example, H.D. ROSEMBLOOM, « Cross-Border Arbitrage: The Good, The Bad and the Ugly, Taxes », *The Tax Magazine,* Vol. 85, 2007; « M. KANE, « Strategy and Cooperation in International Responses to International Tax Arbitrage », 53 *Emory L.J.* 89, 2004; J. ROIN, « Taxation Without Coordination », 31 *The Journal of Legal Studies* 1, 2002; D. RING, « Policy Implications of Cross-border Tax Arbitrage », *Boston College Law Rev.* 44, 2002; T. GRESIK, « The Taxing Task of Taxing Transnationals », 39 *Journal of Economic Literature* 3, 2001; T. EDGAR, « Corporate Income Tax Coordination as a Response to International Tax Competition and International Tax Arbitrage », 51 *Canadian Tax Journal* 3, 2003; R. AVI-YONAH, « Competition, Tax Arbitrage and the International Tax Regime », 61 *Bull. Int'l Taxn.* 4, 2007. T. ROSENBUJ, « International Tax Arbitrage », 39 *Intertax* 4, 2011.

[68] P. ROSSI-MACCANICO, «Fiscal Aid, tax competition, and BEPS »*, Tax Notes Int'l* 857, 2014, p. 867.

[69] CJEU, 29 March 2012, *3M Italia*, C-417/10, ECLI:EU:C:2012:184. However, see CJEU, 26 February 2019, *N Luxembourg 1 and Others v Skatteministeriet*, Joint Cases C-115/16, C-118/16, C-119/16 and C-299/16, ECLI:EU:C:2019:134, para 101. See also, R. DANON, D. GUTMANN, M. LUKKIEN, G. MAISTO, A. MARTIN JIMENEZ and B. MALEK, supra n. 54.

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which the new guidelines serve a mere clarification of the old ones. As noted in this work, both conclusions are arguable. Indeed, granting the Commission an "arm's length control" poses questions both regarding the sovereignty of Member States in direct tax matter as well as regarding the advanced legal certainty that taxpayers look for in tax rulings. Similarly, allowing a retroactive application of the OECD TP Guidelines in the case when new versions are used only to clarify older versions but without amending them will unavoidably prompt new interpretative problems.

Second, and although the Court rejected both the Commission's argument that the TNMM was not applied correctly and that the profit-split was a better transfer pricing method, it does not truly prevent that the Commission attempts again to determine both the most suitable allocation method and its proper application. Indeed, recalling what was already stated in this work, the Court simply considered that in both cases the Commission failed to prove that the incorrect application of the TNMM or the application of the profit-split as a better method would necessarily ensure a tax advantage to LuxOpCo. However, it did not condemn the Commission's attempt to do so. In other words, the Court partially supported the unpalatable strategy of the Commission to test and check for the best transfer pricing method and its correct application.

Third, the Court confirmed that it is not enough for the Commission to prove that a methodological error has been taken when applying a particular transfer pricing method, it is still the Commission's task to prove the existence of an advantage. In other words, the incorrect application of the arm's length standard is not equivalent to a tax advantage for state aid purposes. This conclusion is relevant because it prevents the Commission switching the burden of proof towards the Member State in question arguing that its decision was entirely discretionary.

Fourth, and finally, it is tremendously important that the Court categorically rejected the argument of the Commission that LuxSCS was created only for tax optimisation purposes derived from the despair tax characterisation that this entity received both in Luxembourg and in the United States and resulting in the non-

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taxation of profits. Indeed, such rejection simply means that neither disparities in the characterisation of entities nor stateless income are state aid concerns. This reinforces the rationale of state aid law which is to prevent illegal subsidies that may affect competition within the internal market and not mismatches, non-taxation or abusive practices. For these cases, and once again, one can still use anti-avoidance provisions.

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