

## Commission decision on Fiat ruling confirmed



In a judgment of 24 September 2019, the General Court of the European Union (“Court”) dismissed actions brought by Luxembourg and Fiat Finance and Trade (“FFT”) against a European Commission decision of 21 October 2015 (“decision”) according to which a tax ruling issued by the Luxembourg tax authorities in favour of FFT constituted illegal state aid.

FFT, based in Luxembourg, provides treasury and financial services to other group companies established in Europe. In 2012, the Luxembourg tax authorities granted a tax ruling on transfer pricing (“Advance Pricing Agreement”) to FFT confirming the arm’s length character of the remuneration of FFT as determined by a transfer pricing study.

Without going into the details of the transfer pricing methodology, FFT considered it appropriate to segregate its capital by reference to its different activities for the application of the transactional net margin method (TNMM) and to apply different rates. In particular, the capital used to finance the shareholdings was excluded from the calculation of FFT’s remuneration on the grounds that they had no part in the exercise of the treasury and financial activities.

In the decision, the Commission found that the Advance Pricing Agreement endorsed an artificial and complex methodology for the calculation of FFT’s taxable profits, which “did not reflect the economic reality”. It concluded that Luxembourg had granted a selective advantage to FFT resulting in an undue reduction of its tax burden since the estimated remuneration due to FFT, in consideration for the financial services provided, did not reflect an appropriate arm’s length remuneration.

According to the Court, the Commission did not err in finding illegal state aid. Regarding state aid law guiding principles, the Court rejected claims that the Commission had engaged in tax harmonisation in disguise and considered that, when applying Article 107(1) TFUE, it can use the arm’s length principle, consisting in verifying whether intra-group transactions are remunerated as if negotiated under market conditions to determine whether a selective advantage has been granted. As to the factual assessment, it considered that the Commission correctly found that the methodology endorsed by the Advance Pricing Agreement was incorrect and, specifically, that the whole capital of FFT should have been taken into account and a single rate applied.

Although it may be appealed, the judgment is important for its support of the Commission’s approach in fiscal state aid investigations, in particular in relation to the use of the arm’s length principle as a “tool” or “benchmark” to assess whether a tax ruling confers a selective advantage under the state aid rules. This confirmation also results from the judgment of the same day

relating to alleged state aid granted by the Dutch authorities to Starbucks although it was held in that case that the Commission did not respect the requested standard of proof to establish an advantage.

It should be noted that since 2012 Luxembourg has reshaped its transfer pricing framework and formally adopted the key principles of the OECD Transfer Pricing Guidelines, as revised by the BEPS Report on Actions 8.10. In particular, in 2016, the Luxembourg tax authorities issued a new circular, replacing the 2011 circular relied upon in the context of the Advance Pricing Agreement, which provides guidance on the practical application of these principles to intra-group financing activities carried out by Luxembourg companies.