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Alexandra Miladinovic

# Selectivity and the Arm's Length Principle in EU State Aid Law

23

European and International  
Tax Law and Policy Series



# Selectivity and the Arm's Length Principle in EU State Aid Law

## Why this book?

During the past few years, the European Commission has increasingly focused on identifying fiscal State aid falling under the State aid prohibition enshrined in article 107(1) of the Treaty on the Functioning of the European Union (TFEU). The LuxLeaks affairs, in particular, drew the attention of the European Commission to the transfer pricing ruling practices of the Member States, which resulted in several negative decisions and extremely high recoveries. In the State aid assessment of transfer pricing rulings, the European Commission assigned a very special status to the arm's length principle – a leading principle in international tax treaty law. For this reason, the European Commission's decisions raised several questions concerning the complex area of fiscal State aid and, particularly, the application, interpretation and content of the selectivity criterion. The existence of an independent EU arm's length principle that forms part of the selectivity analysis has been a focal point of scholarly discussions.

This book examines the selectivity criterion, which is the most crucial condition of the State aid prohibition laid down in article 107(1) of the TFEU. More precisely, it investigates the relevance of the arm's length principle in and for the selectivity assessment. The author specifically examines any potential special impact that the arm's length concept may have on the selectivity analysis regarding Member States' measures related to the corporate tax base determination for the purpose of article 107(1) of the TFEU. This is aimed at substantiating the potential existence of an EU arm's length principle, either stemming from the selectivity criterion as such or its application to specific Member States' tax measures.

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## Abstract

The significance of the arm's length concept in terms of the State aid prohibition of article 107(1) of the Treaty on the Functioning of the European Union has not been examined thoroughly in academic literature. Therefore, this book analyses the possible implications of the arm's length concept for the selectivity analysis, which constitutes the crucial criterion in the State aid assessment. The analysis is pursued from two different angles. First, it examines whether the arm's length concept may be seen as an inherent part of the selectivity analysis. To that end, the author performs an in-depth examination of the selectivity criterion. The study of the jurisprudence of the EU courts shows that the selectivity analysis resembles a discrimination assessment, which is not possible without any further scrutiny of the national legislation. Hence, the book concludes that the arm's length condition does not constitute an inherent part of the selectivity assessment. Second, to substantiate the relevance of the arm's length condition in the selectivity analysis, various national measures related to the corporate tax base determination are scrutinized, thereby focusing mostly on legal provisions and administrative acts that include or apply the arm's length condition. Since the national measures comprising of the arm's length condition need to observe the same standards as any other national measures to comply with article 107(1), the results of the analysis show that the arm's length concept does not have a special status in the selectivity assessment.

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# Chapter 1

## Introduction

### 1.1. Background: The Commission’s view on the arm’s length “principle” under article 107(1) of the Treaty on the Functioning of the European Union

For decades, the European Commission has been applying the State aid prohibition of article 107(1) of the Treaty on the Functioning of the European Union (TFEU)<sup>1</sup> in the field of direct tax law, in respect of which the EU Member States have retained their competences.<sup>2</sup> The competition policy of the European Union was developed to ensure the proper functioning of and fair competition within the internal market.<sup>3</sup> Laid down in article 107(1) of the TFEU, the State aid prohibition is part of the competition rules in EU primary law and provides the following: “Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.” In short, it prohibits the provision of advantages, in any form, by national public authorities to undertakings

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1. *Treaty on the Functioning of the European Union* (13 Dec. 2007), Treaties & Models IBFD [hereinafter TFEU].

2. Based on the principle of conferral laid down in the *Treaty on European Union* art. 5(2) (7 Feb. 1992), Treaties & Models IBFD, “the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States”. Direct taxation is not listed in arts. 3-6 of the TFEU and, therefore, remain part of the shared competences of the Member States. See P. Pistone & R. Szudoczky, *Coordination of Tax Laws and Tax Policies in the EU*, in *Introduction to European Tax Law on Direct Taxation* p. 10 (M. Lang et al. eds., Linde 2020); and Commission Notice on the notion of State aid as referred to in Article 107 (1) of the Treaty on the Functioning of the European Union, C/2016/2946, OJ C 262/34, para. 156 (19 July 2016), available at [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016XC0719\(05\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016XC0719(05)&from=EN) (accessed 27 Oct. 2021).

3. See H. Hofmann, R. Chari & C. Micheau, *Rationales for State Aid Rules*, in *State Aid Law of the European Union* p. 1 et seq. (H. Hofmann & C. Micheau eds., Oxford University Press 2016); and H. Hofmann, *State Aid Review in a Multi-Level System*, in *State Aid Law of the European Union* p. 9 (H. Hofmann & C. Micheau eds., Oxford University Press 2016).

on a selective basis.<sup>4</sup> Hence, prohibited State aid exists if four cumulative conditions are fulfilled.<sup>5</sup> First, the measure must confer an advantage on its recipients that relieves them from charges that are normally borne by undertakings. Second, the advantage must be granted by the state or through state resources. Third, the advantage conferred must be selective in that it favours “certain undertakings or the production of certain goods”. Fourth, the measure must affect competition and trade between Member States. In the State aid assessment, the most crucial factor is selectivity.<sup>6</sup> The challenges in applying the State aid rules to fiscal measures are reflected in the constant evolution of the method through which selectivity is to be established according to the Commission’s practice and the case law of the EU courts.<sup>7</sup>

Particularly in the past couple of years, the Commission has been increasingly focused on identifying fiscal State aid and challenging the Member States’ tax measures.<sup>8</sup> Predominantly, the LuxLeaks scandal<sup>9</sup> and public hearings on aggressive tax avoidance behaviour by large multinational en-

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4. See A. Miladinovic, *The State Aid Provisions of the TFEU in Tax Matters*, in *Introduction to European Tax Law on Direct Taxation* p. 106 (M. Lang et al. eds., Linde 2020); and E. Fort, *EU State Aid and Tax: An Evolutionary Approach*, 57 *Eur. Taxn.* 9, p. 374 et seq. (2017), *Journal Articles & Opinion Pieces IBFD*.

5. See Commission Notice on the notion of State aid as referred to in Article 107 (1) of the Treaty on the Functioning of the European Union, C/2016/2946, OJ C 262/1, para. 5 (19 July 2016), available at [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016XC0719\(05\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016XC0719(05)&from=EN) (accessed 27 Oct. 2021) [hereinafter Commission Notice on the notion of State aid (2016)].

6. See, e.g. PT: ECJ, 6 Sept. 2006, Case C-88/03, *Portuguese Republic v. Commission of the European Communities*, para. 54, *Case Law IBFD*; and M. Lang, *State Aid and Taxation: Selectivity and Comparability Analysis*, in *State Aid Law and Business Taxation* p. 29 (I. Richelle, W. Schön & E. Traversa eds., Springer 2016).

7. See C. Micheau, *Evolution of State Aid Rules: Conceptions, Challenges and Outcomes*, in *State Aid Law of the European Union* p. 18 et seq. (H. Hofmann & C. Micheau eds., Oxford University Press 2016); and R. Szudoczky, *The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation: Primary Law, Secondary Law, Fundamental Freedoms and State Aid Rules* p. 483 (IBFD 2014), *Books IBFD*.

8. See, e.g. Commission Notice on the notion of State aid (2016), *supra* n. 5, at para. 119. See also, e.g. Miladinovic, *supra* n. 4, at p. 109; and W. Schön, *Tax Legislation and the Notion of Fiscal State Aid: A Review of 5 Years of European Jurisprudence*, in *State Aid Law and Business Taxation* p. 4 (I. Richelle, W. Schön & E. Traversa eds., Springer 2016).

9. In 2014, a journalistic investigation leaked hundreds of tax rulings that were confidentially issued by several EU Member States. The documents were published on the Luxembourg Leaks Database of the International Consortium of Investigative Journalists; see <https://www.icij.org/investigations/luxembourg-leaks/explore-documents-luxembourg-leaks-database/> (accessed 30 Mar. 2021).

terprises<sup>10</sup> have drawn the attention of the Commission to the transfer pricing ruling practices of the Member States.<sup>11</sup>

Transfer pricing rulings are instruments issued by tax authorities to provide legal certainty to taxpayers before a taxable event materializes and are tax rulings that are specifically dedicated to solving issues related to the application of national transfer pricing legislation.<sup>12</sup> By issuing transfer pricing rulings, tax authorities typically endorse transfer pricing arrangements that are proposed by the taxpayer to determine prices for intra-group transactions between related group entities and, thereby, establish the taxable basis.<sup>13</sup>

In 2014, the Commission opened formal State aid investigations concerning the selectivity of transfer pricing rulings granted by the national tax authorities to Apple in Ireland, Fiat in Luxembourg and Starbucks in the Netherlands.<sup>14</sup> Soon after, the first negative decisions by the Commission confirming the existence of illegal State aid were published and resulted in extremely high recoveries from the aid recipients by the Member States.<sup>15</sup> At this point, the Commission has taken several negative final decisions, such as in the cases concerning transfer pricing rulings that were issued by national tax administrations on the basis of the Belgian excess profit

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10. For example, in the United Kingdom, the House of Commons Committee of Public Accounts inquired about the tax structures of multinational enterprises and held public hearings on the matter. See, e.g. UK: House of Commons Committee of Public Accounts, *HM Revenue & Customs: Annual Report and Accounts 2011-12, Nineteenth Report of Session 2012-13* (2012), available at <https://publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/716/716.pdf> (accessed 10 Apr. 2021).

11. See, e.g. European Commission, Press Release IP/14/309, *State Aid: Commission Orders Luxembourg to Deliver Information on Tax Practices* (24 Mar. 2014); European Commission, Press Release IP/14/2742, *State Aid: Commission Extends Information Enquiry on Tax Rulings Practice to All Member States* (17 Dec. 2014); and A. Miladinovic & R. Szudoczky, *Transfer Pricing and EU State Aid*, in *Fundamentals of Transfer Pricing* p. 522 (M. Lang et al. eds., Wolters Kluwer 2019).

12. See Commission Notice on the notion of State aid (2016), *supra* n. 5, at para. 169; M. Lang & A. Zeiler, *Discretionary Power of Tax Authorities as a State Aid Problem*, in *EU Tax Law and Policy in the 21st Century* p. 104 (W. Haslehner, G. Kofler & A. Rust eds., Wolters Kluwer 2017); and M. Lang, *Tax Rulings and State Aid Law*, *British Tax Review* 3, p. 391 (2015).

13. See Miladinovic & Szudoczky, *supra* n. 11, at p. 523; and R. Lyal, *Transfer Pricing Rules and State Aid*, 38 *Fordham International Law Journal* 1, p. 1020 (2015).

14. See European Commission, Press Release IP/14/663, *State Aid: Commission Investigates Transfer Pricing Arrangements on Corporate Taxation of Apple (Ireland) Starbucks (Netherlands) and Fiat Finance and Trade (Luxembourg)* (11 June 2014).

15. See, e.g. European Commission, Press Release IP/16/2923, *State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to EUR 13 Billion* (30 Aug. 2016).

scheme,<sup>16</sup> as well as the tax rulings obtained by Starbucks,<sup>17</sup> Fiat<sup>18</sup> and Amazon.<sup>19</sup> According to the Commission, these cases all “concerned national schemes that accept multinational corporations pricing their intra-group transactions in a manner that does not reflect the conditions that apply between independent companies at arm’s length”.<sup>20</sup> The *Apple* case,<sup>21</sup> which was also closed with a negative decision in the wake of the Commission’s tax ruling scrutiny, is not a classic transfer pricing case, since the tax ruling, which was found selective by the Commission, concerned profit attribution to a resident permanent establishment. However, the legal reasoning for the finding of selectivity was still very similar to that of the other mentioned cases.<sup>22</sup>

While the Commission based its selectivity assessment on different and alternative lines of reasoning in the transfer pricing ruling cases,<sup>23</sup> one specific aspect of its decisions was very peculiar from a State aid perspective: in the Commission’s view, a tax ruling that endorses outcomes not reflecting what would result from the ordinary application of the national law may confer a selective advantage if it lowers the taxpayer’s tax liability as compared to companies in a similar factual and legal situation.<sup>24</sup> Therefore,

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16. Commission Decision (EU) 2016/1699 of 11 January 2016 on the excess profit exemption State aid scheme SA.37667 (2015/C) (ex 2015/NN) Implemented by Belgium, C(2015) 9837, OJ L 260/61 (2016), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D1699&from=EN> (accessed 27 Oct. 2021).

17. Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks, OJ L 83/38 (2015), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017D0502&from=GA> (accessed 27 Oct. 2021).

18. Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) which Luxembourg Granted to Fiat, OJ L 351/1 (2015), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016D2326&from=EN> (accessed 27 Oct. 2021).

19. Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon, C/2017/6740, OJ L 153/1 (2017), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018D0859&from=EN> (accessed 27 Oct. 2021).

20. European Commission, *DG Competition Working Paper on State Aid and Tax Rulings* para. 3 (2016), available at [https://ec.europa.eu/competition/state\\_aid/legislation/working\\_paper\\_tax\\_rulings.pdf](https://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf) (accessed 10 Apr. 2021) [hereinafter *Working Paper on State Aid and Tax Rulings* (2016)].

21. Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple, OJ L 187/1 (2016), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017D1283&from=EN> (accessed 27 Oct. 2021).

22. See Miladinovic, *supra* n. 4, at p. 110.

23. See, e.g. Commission Decision (EU) 2018/859, *supra* n. 19, at paras 583 and 585.

24. See Commission Notice on the notion of State aid (2016), *supra* n. 5, at para. 170; and Miladinovic & Szudoczky, *supra* n. 11, at p. 524.

in terms of transfer pricing rulings, the Commission argues that a ruling endorsing transfer pricing for intra-group transactions not corresponding to the arm's length principle confers a selective advantage upon its recipient.<sup>25</sup> For the purposes of taxation and the calculation of taxable profits, this means that prices charged for transactions between related entities should be in accordance with comparable transactions between standalone entities in comparable circumstances to comply with article 107(1) of the TFEU.<sup>26</sup> The reason for the Commission's conclusion is the following: most national corporate income tax systems are fundamentally based on the idea of taxing the profits of each corporate entity separately, irrespective of whether they are standalone entities or part of a corporate group.<sup>27</sup>

While standalone entities operate in the market and typically price their transactions based on market conditions, entities forming part of a corporate group are not subject to market forces when contracting with each other.<sup>28</sup> As the prices of their intra-group transactions are not dictated by the market, the arm's length principle serves the purpose of approximating market prices that would have been charged between independent enterprises.<sup>29</sup> Since the "arm's length principle" aims to ensure that all economic operators are treated in the same manner when determining their taxable base for corporate income tax purposes, regardless of whether they form part of an integrated corporate group or operate as standalone companies on the market,<sup>30</sup> the arm's length principle, according to the Commission, "is therefore an application of Article 107 (1) of the Treaty which prohibits unequal treatment in taxation of undertakings in a similar factual and legal situation".<sup>31</sup> Based on this premise, the Commission concludes that the arm's length principle "is inherent in Art. 107 (1) TFEU".<sup>32</sup> In some decisions, the Commission has even explained that the arm's length principle that it applies "is a general principle of equal treatment in taxation falling within the application of Article 107 (1) of the TFEU, which binds the Member States and from whose scope the national tax rules are

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25. See *id.*, at para. 171.

26. See W.C. Haslechner, *Transfer Pricing Rules and State Aid Law*, in *Research Handbook on European Union Taxation Law* p. 435 et seq. (C. Panayi, W.C. Haslechner & E. Traversa eds., Edward Elgar Publishing 2020); and Miladinovic & Szudoczky, *supra* n. 11, at p. 524.

27. See, e.g. Commission Decision (EU) 2018/859, *supra* n. 19, at p. 588 et seq.

28. See *id.*, at para. 245.

29. See *Working Paper on State Aid and Tax Rulings* (2016), *supra* n. 20, at para. 3 et seq.

30. *Id.*, at para. 3.

31. Commission Notice on the notion of State aid (2016), *supra* n. 5, at para. 172.

32. *Id.*, at para. 173.

not excluded”.<sup>33</sup> As a consequence, the arm’s length principle “necessarily forms part of the Commission’s assessment under Article 107 (1) TFEU . . . , independently of whether a Member State has incorporated this principle into its national legal system”.<sup>34</sup>

In support of its view, the Commission constantly refers back to the case law in the *Belgium and Forum 187* case.<sup>35</sup> Although the Commission has taken negative decisions on national schemes that applied the arm’s length principle in its State aid practice in the past, these are the only cases that have reached the Court of Justice of the European Union (ECJ) so far and can provide guidance on the application of the State aid rules to transfer pricing.<sup>36</sup> In this decision, the ECJ was concerned with a special Belgian tax regime for coordination centres that provided for a different determination of taxable income than the general domestic corporate income tax system.<sup>37</sup> Since the regime allowed for the exclusion of certain costs in calculating the transfer prices of the coordination centres, the ECJ decided that “the transfer prices do not resemble those which would be charged in conditions of free competition” and found the rule selective.<sup>38</sup> In a working paper, the Commission explained that, by means of this decision, “the European Court of Justice endorsed the arm’s length principle for determining whether a fiscal measure prescribing a method for an integrated group company to determine its taxable profit gives rise to a selective advantage for the purposes of Article 107 (1) TFEU”.<sup>39</sup> Hence, the Commission interpreted this decision as a precedent for contending that the arm’s length principle represents the yardstick against which a ruling has to be measured in the selectivity assessment.<sup>40</sup>

Consequently, at least in the view of the Commission, the arm’s length principle necessarily forms part of a State aid-proof corporate income tax system, regardless of whether an explicit rule prescribing its application exists in national law.<sup>41</sup> In this context, the Commission points out that the arm’s length principle under art 107(1) of the TFEU is not the one de-

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33. Commission Decision (EU) 2016/2326, *supra* n. 18, at para. 228.

34. Commission Notice on the notion of State aid (2016), *supra* n. 5, at para. 172.

35. BE: ECJ, 22 June 2006, Joined Cases C-182/03 and C-217/03, *Kingdom of Belgium & Forum 187 ASBL v. Commission*. See also, e.g. *id.*, at para. 171.

36. See also *Miladinovic & Szudoczky*, *supra* n. 11, at p. 520 et seq.

37. See *Belgium & Forum 187 ASBL* (Joined Cases C-182/03 and C-217/03), para. 5 et seq.

38. *Id.*, at para. 96.

39. *Working Paper on State Aid and Tax Rulings* (2016), *supra* n. 20, at para. 4.

40. See *Miladinovic & Szudoczky*, *supra* n. 11, at p. 521.

41. Critically, see, e.g. *Haslehner*, *supra* n. 26, at p. 433 et seq.



rived from international tax treaty law, thereby referring, in particular, to the one enshrined in article 9 of the OECD Model Tax Convention on Income and on Capital (OECD Model).<sup>42</sup> Moreover, it does not overlap with the interpretation provided for in the OECD Transfer Pricing Guidelines (OECD Guidelines).<sup>43</sup> Nevertheless, the Commission exclusively relies on the OECD Guidelines to prove that arrangements in various cases are not in line with the arm's length principle.<sup>44</sup> In this respect, the Commission argues that the OECD Guidelines are used as a reference and appropriate guidance for proper transfer pricing because they represent an international consensus concerning the interpretation of the arm's length principle and common ground on how to approximate the most reliable market outcomes.<sup>45</sup> However, accepting their soft law, and, therefore, non-binding character,<sup>46</sup> the Commission does not find itself bound by the OECD Guidelines that it uses as a tool for interpreting the arm's length principle that is applied on the basis of article 107(1) of the TFEU.<sup>47</sup> Yet, the Commission maintains that "if a transfer pricing arrangement complies with the guidance provided by the OECD Transfer Pricing Guidelines, ... a tax ruling endorsing that arrangement is unlikely to give rise to State aid".<sup>48</sup> Notably, the OECD Guidelines seem to have a special role in the Commission's selectivity assessment with regard to transfer pricing rulings.<sup>49</sup>

## 1.2. Research question and its relevance

In general, the selectivity analysis is considered the most complex part of the State aid assessment, and for this reason, the selectivity criterion of article 107(1) of the TFEU has been one of the focal points in scholarly discussions in the past decade.<sup>50</sup> One main element that creates confusion

42. See, e.g. Commission Decision (EU) 2016/2326, *supra* n. 18, at para. 228.

43. See, e.g. Commission Decision (EU) 2017/1283, *supra* n. 21, at para. 255.

44. See, e.g. *Working Paper on State Aid and Tax Rulings* (2016), *supra* n. 20, at para. 17 et seq.; and Haslehner, *supra* n. 26, at p. 444.

45. See, e.g. Commission Decision (EU) 2018/859, *supra* n. 19, at para. 244.

46. See, e.g. Commission Decision (EU) 2016/2326, *supra* n. 18, at para. 87.

47. See, e.g. Commission Notice on the notion of State aid (2016), *supra* n. 5, at para. 173; and Miladinovic & Szudoczky, *supra* n. 11, at p. 528.

48. Commission Notice on the notion of State aid (2016), *id.*, at para. 173.

49. Critically, see, e.g. E. Traversa & P.M. Sabbadini, *State-Aid Policy and the Fight Against Harmful Tax Competition in the Internal Market: Tax Policy in Disguise?*, in *EU Tax Law and Policy in the 21st Century* p. 129 (W. Haslehner, G. Kofler & A. Rust eds., Wolters Kluwer 2017).

50. See, e.g. M. Tenore, *APAs and State Aid: A New Era of European Tax Law?*, in *EU Law and the Building of Global Supranational Tax Law: EU BEPS and State Aid* p. 222 et seq. (D. Weber ed., IBFD 2017), Books IBFD.

and leaves many open questions with regard to the assessment might be the inconsistency of the jurisprudence of the ECJ with respect of the application of the selectivity test to fiscal measures.<sup>51</sup> Although many scholars and Advocate Generals have tried to shed some more light on the assessment of selectivity and have aimed to contribute to a better understanding, the application of the selectivity criterion is far from clarified.<sup>52</sup> As put succinctly by Advocate General Bobek, “[t]he discussion on the precise contours of the second condition – selectivity of the aid – has given rise to a rich debate ... . It is, however, fair to admit that in spite of these efforts, the assessment of selectivity continues to be ‘a difficult exercise with an uncertain outcome’ in practice”.<sup>53</sup> Thus, the criterion of selectivity of the State aid prohibition of article 107(1) of the TFEU is not yet perfectly understood and requires further clarification.<sup>54</sup>

Specifically, the Commission’s approach in the transfer pricing ruling cases has provided even more fuel for extensive discussions with regard to the selectivity criterion and created the necessity for further research on the peculiar requirement of the State aid prohibition of article 107(1) of the TFEU.<sup>55</sup> In particular, through the application of the arm’s length principle in the assessment, the Commission added another component to the selectivity analysis

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51. See, e.g. P. Nicolaidis, *Excessive Widening of the Concept of Selectivity*, 16 EStAL 1, p. 62 et seq. (2017); M. Aalbers, *Gibraltar: A Rock Solid Interpretation of the Selectivity Criterion*, 16 EStAL 3, p. 495 et seq. (2017); P. Nicolaidis & I.E. Rusu, *The Concept of Selectivity: An Ever Wider Scope*, 11 EStAL 4, p. 791 (2012); J. Temple Lang, *The Gibraltar State Aid and Taxation Judgment – A “Methodological Revolution”?*, 11 EStAL 4, p. 805 (2012); and P. Rossi-Maccanico, *Gibraltar: Beyond the Pillars of Hercules of Selectivity*, 11 EStAL 2, p. 445 (2012).

52. See, e.g. P-J. Loewenthal, *Fiscal Selectivity: A Notion in Need of Clarity*, in *New Perspectives on Fiscal State Aid: Legitimacy and Effectiveness of Fiscal State Aid Control* p. 53 (C.D. Pietro ed., Wolters Kluwer 2019); L. Panci, *Latest Developments on the Interpretation of the Concept of Selectivity in the Field of Corporate Taxation*, 17 EStAL 3, p. 353 et seq. (2018); J.J. Piernas López, *Revisiting Some Fundamentals of Fiscal Selectivity: The ANGED Case*, 17 EStAL 2, p. 274 et seq. (2018); J.L. Buendía Sierra, *Finding Selectivity or the Art of Comparison*, 17 EStAL 1, p. 85 et seq. (2018); C. Micheau, *Tax Selectivity in European Law of State Aid: Legal Assessment and Alternative Approaches*, 40 European Tax Law Review 3, p. 325 et seq. (2015); A. Bartosch, *Is There a Need for a Rule of Reason in European State Aid Law? Or How to Arrive at a Coherent Concept of Material Selectivity?*, 47 Common Market Law Review 3, p. 731 et seq. (2010); and DE: Opinion of Advocate General Wahl, 20 Dec. 2017, Case C-203/16, *Dirk Andres v Commission*, para. 90, Case Law IBFD.

53. BE: Opinion of Advocate General Bobek, 21 Apr. 2016, Case C-270/15, *Kingdom of Belgium v. Commission*, para. 19.

54. See also Loewenthal, *supra* n. 52, at p. 53; and B. Pérez-Bernabeu, *Refining the Derogation Test on Material Tax Selectivity: The Equality Test*, 16 EStAL 4, p. 582 et seq. (2017).

55. See, e.g. Haslehner, *supra* n. 26, at p. 449.

that may not necessarily be considered less complex or less debated.<sup>56</sup> The arm's length concept is recognized as being a globally accepted standard, particularly in the field of international tax treaty law.<sup>57</sup> Some would even go so far as to say that it could have the status of customary international law.<sup>58</sup> Applied in tax law, it aims to put related entities on equal footing with standalone entities in order to treat them in an equivalent manner for the purposes of corporate income taxation.<sup>59</sup> In terms of this rationale, it appears, at first sight, that there are some similarities between the arm's length concept and the selectivity criterion, given that the main idea of non-discrimination is inherent in the selectivity analysis, as it prohibits the unequal treatment of undertakings that are in objectively comparable situations.<sup>60</sup> Perhaps due to these similarities does the Commission consider the arm's length principle to have a very special status in the State aid assessment.

In its decisions concerning transfer pricing rulings, the Commission has contended that the principle of equal treatment in taxation is part of the assessment under article 107(1) of the TFEU and prohibits, for the purpose of the corporate income tax base determination, the unequal treatment of entities forming part of a corporate group and standalone entities not participating in a group through the acceptance of deviations from the arm's length principle.<sup>61</sup> Further, the Commission has emphasized that the application of the arm's length principle, for the purposes of corporate income taxation, was relevant to the State aid analysis, independent of its application in national law.<sup>62</sup>

Although the Commission, in its later decisions and publications, refrained from repeating the latter statement and put it more into perspective,<sup>63</sup> it still

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56. See A. Navarro, *Transfer Pricing*, in *Research Handbook on International Taxation* p. 102 et seq. (Y. Brauner ed., Edward Elgar Publishing 2020); and Miladinovic & Szudoczky, *supra* n. 11, at p. 525 et seq.

57. See *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* para. 1.1. (10 July 2017), Primary Sources IBFD [hereinafter *OECD Guidelines* (2017)].

58. See G. Kofler, *The BEPS Action Plan and Transfer Pricing: The Arm's Length Standard Under Pressure?*, *British Tax Review* 5, p. 647 (2013); and J. Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* p. 288 et seq (Kluwer 2010).

59. See *OECD Guidelines* (2017), *supra* n. 57, at para. 1.8.

60. Similarly, see, e.g. Miladinovic & Szudoczky, *supra* n. 11, at p. 524; and P.J. Wattel, *Stateless Income, State Aid and the (Which?) Arm's Length Principle*, 44 *Intertax* 11, p. 792 (2016).

61. See, e.g. Commission Decision (EU) 2017/502, *supra* n. 17, at pp. 262, 264.

62. See, e.g. Commission Decision (EU) 2016/2326, *supra* n. 18, at para. 228.

63. See, e.g. Commission Decision (EU) 2018/859, *supra* n. 19, at para. 589.

deserves some closer scrutiny. Given the great media coverage, the Commission's approach has often been discussed from a political perspective.<sup>64</sup> However, the Commission has been heavily criticized for the stance taken in the transfer pricing ruling decisions and from a legal perspective, since it created uncertainty with regard to the application of article 107(1) of the TFEU.<sup>65</sup> In scholarly literature, in particular, the existence of an independent "EU arm's length principle" that should form part of the selectivity assessment has been much debated.<sup>66</sup> Thus, the Commission's approach and its reasoning touches upon various issues in the complex area of fiscal State aid, mainly concerning the application, interpretation and content of the selectivity criterion, which are not completely clear and deserve further scrutiny.

Inspired by the Commission's decision-making practice in transfer pricing ruling cases, some scholars have conducted research on related matters in academic literature.<sup>67</sup> Among others, extensive academic research has focused on the technical, transfer pricing-related aspects of the Commission's decisions, the existence of an "EU arm's length principle" and their reconciliation with State aid law.<sup>68</sup> Other studies, also against the backdrop of the respective Commission decisions, have concentrated on the selectivity considerations with regard to different methods for the allocation of the corporate tax base.<sup>69</sup> Since those previous studies were also motivated by the Commission's approach, parts of those studies already touched upon

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64. See, e.g. F. Vanistendael, *Are the EU and U.S. Headed for a Tax War?*, 83 Tax Notes International, p. 1057 (2016).

65. See, e.g. Miladinovic & Szudoczky, *supra* n. 11, at p. 539 et seq; R. Luja, *Do State Aid Rules Still Allow European Union Member States to Claim Fiscal Sovereignty?*, EC Tax Review 5/6, p. 318 (2016); S. Moreno González, *State Aid and Tax Competition: Comments on the European Commission's Decisions on Transfer Pricing Rulings*, 15 EStAL 4, p. 556 et seq. (2016); and US: Department of the Treasury, *The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings* (24 Aug. 2016), available at <https://www.treasury.gov/resource-center/tax-policy/treaties/documents/white-paper-state-aid.pdf> (accessed 10 Apr. 2021).

66. See, e.g. R. Bonnici, *The European Commission's Arm's Length Standard: Relationship and Compatibility with the Arm's Length Principle under Transfer Pricing*, 26 Intl. Transfer Pricing J. 1 (2019), Journal Articles & Opinion Pieces IBFD; and W. De Cock & T. Joris, *Is Belgium and Forum 187 v. Commission a Suitable Legal Source for an EU 'At Arm's Length Principle'?*, 16 EStAL 4, p. 553 et seq. (2017).

67. See, e.g. Haslehner, *supra* n. 26, at p. 432 et seq.

68. See P. Szotek-Verwerken, *Multinational Enterprises, European State Aid and Transfer Pricing* (SDU 2020); and A. Miladinovic & R. Petrucci, *The Recent Decisions of the European Commission on Fiscal State Aid: An Analysis from a Transfer Pricing Perspective*, 26 Intl. Transfer Pricing J. 4 (2019), Journal Articles & Opinion Pieces IBFD.

69. See J. Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (Wolters Kluwer 2018).

the application of the arm's length principle in the State aid assessment. However, no research thus far has concentrated extensively on the dimensions of the non-discrimination rule of article 107(1) of the TFEU with the aim to substantiate whether the selectivity analysis includes, either as part of the State aid assessment itself or through the application of the selectivity analysis to national legislation or administrative acts, a special non-discrimination prerequisite for standalone and related entities in matters related to the corporate income tax determination that may specifically be satisfied through the arm's length concept. Therefore, this book aims to examine the status of the arm's length condition in the selectivity assessment under article 107(1) of the TFEU and the potential existence of an "EU arm's length principle" and investigates to what extent the application (or non-application) of the arm's length concept in terms of the tax base determination for corporate income taxation purposes impacts the finding of selectivity. Hence, rather than an assessment of the transfer pricing methods that were scrutinized by the Commission in its decisions in the transfer pricing ruling cases or the examination of the compatibility of particular methods to allocate the corporate tax base with the State aid prohibition, the focus of this research lies in the in-depth examination of the condition of selectivity and the analysis of any possible implications of the arm's length concept within the selectivity assessment.

Essentially, the legal research conducted within this book aims to contribute to more clarification with regard to the condition of selectivity under the State aid prohibition of article 107(1) of the TFEU and, specifically, its interrelationship with the arm's length condition. Through the assessment from different angles and at different levels, this book aims to analyse the extent to which the arm's length condition may impact the selectivity assessment, which is a question that has not yet been extensively examined and answered through academic research. This book conducts legal research that contributes to academic debates and resolves some of the remaining ambiguities surrounding the State aid prohibition. At an abstract level, this book examines the implications of the selectivity analysis for the national rules and administrative acts regarding the corporate tax base determination. To provide a generalized solution, this research is not limited to applying the selectivity analysis with respect to the legislation of a particular jurisdiction, but addresses this topic more abstractly. Thus, it makes presumptions and analyses different, alternative scenarios to reach a comprehensive outcome. The results reached in this book should bring more clarity to the application of the State aid prohibition in tax matters in general and could also be helpful with regard to topics that do not necessarily concern the corporate tax base determination. Since the decisions of

the General Court regarding the actions for annulment related to the Commission's negative decisions were appealed,<sup>70</sup> the ECJ will, sooner or later, decide on the matters that are examined in this book. However, this does not mean that the research is redundant: even after the judgments of the EU courts, open questions will possibly remain. A comprehensive, critical legal analysis may contribute to better understanding and more clarification, which could be helpful in finding both theoretical and practical solutions for other future fiscal State aid-related topics.

### 1.3. Outline

This book will approach the relevance of the arm's length concept in the selectivity assessment under article 107(1) of the TFEU from two different angles, which is why it is divided into two main parts. Part 1 examines the relationship between the arm's length concept and the condition and assessment of selectivity more generally, and Part 2 applies the selectivity test to various national measures related to the corporate tax base determination, thereby focusing mostly on legal provisions and administrative acts that include or apply the arm's length condition. By using the two-pronged approach, this book aims to scrutinize whether it is possible to identify any special impact of the arm's length concept on the outcome of the State aid analysis – that is, the existence of an “EU arm's length principle”, either deriving from the selectivity condition per se or from its application to specific national measures.

Part 1 is dedicated to the examination of possible implications of the arm's length concept for the assessment of selectivity under article 107(1) of the TFEU in general. Part 2 is comprised of three chapters (chapters 2, 3 and 4). To start, chapter 2 elaborates further on the meaning of the arm's length concept. Specifically, it discusses its rationale and main function and explains the use and application of the arm's length concept in respect of national tax legislations, as well as its understanding in international tax treaty law. Largely, in the field of international tax treaty law, the arm's length concept seems to have gained a very special nature, which is com-

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70. See, e.g., LU: General Court, 24 Sept. 2019, Case T-755/15, *Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v. Commission*; NL: General Court, 24 Sept. 2019, Case T-760/15, T-636/16, *Kingdom of the Netherlands and Others v. Commission (Starbucks)*; IE: General Court, 15 July 2020, Case T-778/16, T-892/16, *Ireland and Others v. Commission (Apple)*; and BE: EGC, 14 Feb. 2019, Case T-131/16, *Kingdom of Belgium and Magnetrol International v. Commission*.

monly referred to as the “arm’s length principle”.<sup>71</sup> Among others, chapter 2 aims to explore whether the arm’s length principle of international tax treaty law, as the term may suggest, can be seen as a legal principle that has a universal meaning that may be relevant in national legislations or EU law.<sup>72</sup>

Subsequently, chapter 3 scrutinizes whether the selectivity criterion under the State aid rules, which is applied by the EU courts as a non-discrimination rule,<sup>73</sup> incorporates any extraordinary non-discrimination prerequisites that apply specifically with regard to the corporate tax base determination of standalone and related entities. In other words, it aims to explore whether the arm’s length concept can be considered a special expression of the selectivity condition under article 107(1) of the TFEU that is applicable in matters of corporate income taxation, irrespective of what is regulated in the national corporate income tax systems or national rules on the tax base determination. Thus, it analyses whether the selectivity condition comprises a component that mandates equal treatment in taxation through the application of the arm’s length concept, which ought to be observed in order to comply with article 107(1) of the TFEU. To that end, chapter 3 examines the content and form of assessment of the selectivity criterion of article 107(1) of the TFEU by taking into consideration the jurisprudence of the EU courts. In this respect, it specifically analyses the decision of the ECJ in the *Belgium and Forum 187* case,<sup>74</sup> which has been the only case concerning transfer pricing in relation to State aid that has reached the ECJ thus far. Through a thorough analysis, chapter 3 aims to draw conclusions on whether the arm’s length concept is an integral part of the assessment of the State aid prohibition.

Chapter 4 examines whether the arm’s length concept could have the status of a general principle of EU law. Basically, general principles of EU law are part of the sources of EU law that emerge through an evaluative approach in the case law of the ECJ.<sup>75</sup> In particular, the general principles of EU law have a relevant interpretational function for both primary and secondary EU law.<sup>76</sup> Since the Commission has regularly referred to the “general

71. See, e.g. *OECD Model Tax Convention on Income and on Capital and Commentary* art. 9(1) and (4) (2017), Treaties & Models IBFD.

72. Critically, see, e.g. Haslehner, *supra* n. 26, at p. 432.

73. See, e.g. ES: ECJ, 21 Dec. 2016, Joined Cases C-20/15 and C-21/15, *Commission v. World Duty Free Group SA and Others*, para. 54; and Lang, *supra* n. 6, at p. 36 et seq.

74. *Belgium & Forum 187 ASBL* (Joined Cases C-182/03 and C-217/03).

75. See T. Tridimas, *The General Principles of EU Law* p. 20 et seq (Oxford University Press 2007).

76. See Szudoczky, *supra* n. 7, at p. 100.

principle of equal treatment in taxation” when applying the arm’s length condition,<sup>77</sup> chapter 4 elaborates on whether the arm’s length concept could qualify as a general principle and, through this qualification, may have potential impact on the selectivity assessment. This examination presupposes the further scrutiny of that particular source of EU law, which is why the chapter focuses, in particular, on the emergence of general principles – that is, the different ways in which they may originate, their function and scope of application, as well as their possible influence on the selectivity assessment. Then, it examines whether the arm’s length condition fulfills the relevant attributes of general principles and explores the potential repercussions of that finding with regard to the State aid assessment.

Part 2 is comprised of four chapters (chapters 5, 6, 7 and 8). It aims to examine whether the arm’s length concept impacts any of the steps in the selectivity analysis of national measures. Hence, it pursues an extensive selectivity analysis with respect to the national legal rules and administrative acts concerning the tax base determination for the purpose of national corporate income taxation in order to find a solution to the question of whether and, if so, under what circumstances national measures that include or relate to the arm’s length condition comply with article 107(1) of the TFEU. Thus, Part 2 is based on the premise that the application of the selectivity criterion always depends on the national legislation and aims to challenge the assumption of a special relevance of the arm’s length condition in the selectivity assessment by showing that the national laws and administrative acts, through the use or application of the arm’s length condition, still have to meet certain requirements to be compatible with the State aid prohibition. Such an analysis entails a detailed comparability assessment and justification analysis of different rules and administrative measures that concern the determination of the corporate tax base.

For this reason, chapter 5 starts with a general overview of the material steps of the selectivity analysis. The comparability of two sets of undertakings is of pivotal importance for the finding of *prima facie* selectivity and the subsequent steps of the selectivity analysis, consisting of justification and proportionality.<sup>78</sup> In that chapter, the steps will be analysed and examined in detail.

Chapter 6 will perform a thorough comparability analysis of selected groups of undertakings, the comparability of which seems particularly rel-

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77. See, e.g. Commission Decision (EU) 2016/2326, *supra* n. 18, at para. 228.

78. See Lang, *supra* n. 6, at p. 36 et seq.



evant for the examination of the selectivity aspects related to the corporate tax base determination. Hence, it will mainly focus, on the one hand, on the comparability of standalone and related entities and, on the other hand, on the comparability of resident entities that are related to other resident entities and resident entities that are related to non-resident entities. In addition, it will examine possible justification grounds that may be accepted in the assessment of *prima facie* selective measures related to the determination of the corporate tax base.

Chapter 7 will then focus on the selectivity assessment in terms of discriminatory treatment through national legislation. It aims to examine the relevance of the arm's length condition included in national transfer pricing provisions for the purpose of State aid law and, therefore, examines the selectivity of various aspects with respect to rules that may be applied to determine corporate income. In this context, it scrutinizes the limits set by the State aid rules in the design of provisions on the tax base determination in order to conclude whether the national corporate income tax system is obliged to include transfer pricing provisions comprising an arm's length condition to meet the requirements of article 107(1) of the TFEU.

Since article 107(1) of the TFEU may not only be violated through the national law, but also through administrative acts,<sup>79</sup> chapter 8 examines whether and to what extent the EU Member States are required to observe the limits set by the State aid rules in respect of the determination of the corporate tax base, particularly via individual administrative acts. In particular, it will analyse the discrimination through tax rulings concerning the corporate tax base determination.

Finally, chapter 9 summarizes and concludes on the main findings of this book.

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79. See, e.g. FI: ECJ, 18 July 2013, Case C-6/12, *P Oy*, para. 27, Case Law IBFD; and Commission Notice on the notion of State aid (2016), *supra* n. 5, at para. 175 et seq.

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