

Brief Overview of the ECJ Advocate General's Opinion in the UK CFC Group Financing Exemption and a Trip Down Memory Lane, Revisiting Analogous State Aid Cases

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According to the [opinion](#) of Advocate General (AG) Medina of the Court of Justice of the European Union (ECJ) (delivered on 12 April 2024), the European Commission and the General Court (GC) of the European Union erred in law when using the UK controlled foreign company (CFC) rules as reference framework for determining whether a selective advantage had been granted in the UK CFC Group Financing Exemption case – SA.44896 (summary [here](#)). According to the AG, the correct reference system should be the general UK corporation tax system as a whole, given that the CFC rules form part of the general system and cannot be severed from it. The AG pointed out that, when determining the reference framework, the Commission is, in principle, required to accept the interpretation of national law given by the Member State concerned. The Commission's interpretation will prevail only if the Member State interpretation is manifestly incompatible with the wording and objectives of the national provisions at issue.

The AG opinion in this case is in line with ECJ judgements in well-known cases departing from investigations launched by the Commission with respect to the compatibility of Member States' tax ruling practices with EU State aid law. Developments in these cases have recently unfolded at the two courts of the Court of Justice of the European Union, changing the manner in which future investigations might be tackled. The key concerns in the debate at the ECJ level focused on:

- > the reference system used for investigations;
- > the role of the Commission and the autonomy of Member States in areas that are not harmonized at EU level; and
- > the potential creation of autonomous legal principles.

The present note further revisits three of these cases, looking specifically into the debate on the reference system used in the selectivity analysis.

Fiat

In Fiat – SA. 38375 (summary [here](#)), the Commission considered that the tax ruling granted by Luxembourg to Fiat, which endorsed a transfer pricing methodology for the determination of the company's taxable profit in Luxembourg, constituted illegal State aid. The methodology was deemed inappropriate, as it did not reflect a reliable approximation of a market-based outcome.

On 24 September 2019, the GC dismissed the actions seeking annulment of the Commission decision (details [here](#)). On 16 December 2021, AG Pikamäe considered two appeals brought separately by Ireland and Fiat Chrysler Finance Europe against the judgment of the GC and arrived at different conclusions (summary [here](#)).

On 8 November 2023, the ECJ overturned the GC's judgment and annulled the Commission's decision by ruling that, in a State aid analysis, the selective advantage of a tax ruling based on the arm's length principle stipulated in the legislation of a Member State must be determined in accordance with the normal tax system of that Member State, and not with parameters and rules that do not form part of it (summary [here](#)). According to the ECJ, the national rules on the application of the arm's length principle must be considered in determining the reference system for evaluating a selective advantage. The ECJ therefore found that the GC committed an error of law by accepting the reference system chosen by the Commission and failing to consider how the arm's length principle was incorporated into Luxembourg law. The ECJ also noted that the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) can only be used in a selectivity analysis if they are specifically referenced in national provisions.

Engie

In Engie – SA. 44888 (summary [here](#)), the Commission considered that the tax rulings confirming the deductibility in Luxembourg of accrued, but unpaid, charges connected with a convertible loan with no corresponding taxable income at the level of the holder of the convertible loan constituted illegal State aid. The Commission considered that a deduction-without-inclusion outcome is not in line with Luxembourg tax rules, even though such principle was not stipulated in the law at the moment of the ruling. In addition, the Commission held that Luxembourg should have applied an anti-abuse rule.

On 12 May 2021, the GC concluded that the Commission was right to determine that a selective advantage was conferred as a result of the non-application of national provisions relating to abuse of law (summary [here](#)).

On 4 May 2023, AG Kokott led the debate towards the reference system used in the selectivity analysis and opined that the judgment of the GC and the Commission decision should be annulled, as national law alone constitutes the reference framework. The AG considered that the Commission and GC founded their decisions on an incorrect reference framework – they assumed that Luxembourg tax law contained a principle of correspondence according to which a tax deduction presumes taxation of underlying profits (summary [here](#)).

In line with the AG opinion, the ECJ ruled on 5 December 2023 that the selective advantage of a tax ruling granting an exemption for income that was not taxed at the level of the payer must be determined in accordance with the normal tax system of a Member State, including its administrative practice and case law, and not based on parameters and rules that do not form part of the tax system of that Member State (summary [here](#)).

Amazon

In Amazon – SA. 38944 (summary [here](#)) the Commission found that the tax ruling granted by Luxembourg to Amazon constituted incompatible State aid, as the royalty that one subsidiary had paid to another artificially diminished the tax base of the first subsidiary and, ultimately, that of the Amazon group. The methodology used was deemed inappropriate by the Commission, as it did not reflect a reliable approximation of a market-based outcome in line with the arm's length principle, nor was it reflective of the functional profiles of the relevant entities.

On 12 May 2021, the GC ruled that there was no selective advantage granted in favour of the Luxembourg subsidiary of the Amazon group and annulled the Commission's decision (details [here](#)).

On 8 June 2023, AG Kokott noted that the existence of a selective advantage in this case is inextricably linked with the question of whether the reference system was determined correctly and held that the GC correctly annulled the Commission decision, due to the absence of a demonstrated selective advantage (details [here](#)).

On 14 December 2023, the ECJ upheld the GC judgment based on a different ground. It noted that defining the correct reference system is a key point when assessing selectivity in State aid cases. The ECJ pointed out that, since there is no autonomous EU arm's length principle, the Commission may rely on it only if it is incorporated into the national law concerned. Likewise, the OECD Guidelines can be of practical importance only if Luxembourg tax law makes explicit reference to them. The ECJ concluded, therefore, that the Commission had wrongly determined the reference system, which should be the normal tax system applicable in the Member State (summary [here](#)).

Short conclusion

The ECJ judgements discussed dramatically affected the application of State aid rules in tax ruling cases. The outcome makes it difficult for the Commission to identify State aid by using a narrower/incorrect reference system deriving from principles that are not incorporated into national law. The fiscal competence and autonomy of Member States in areas that have not been harmonized at the EU level would be disregarded if the Commission could easily define a reference framework based on an ideal/fair tax outcome.

Moving fast forward, a decade after the Commission's decisions, the European Union nowadays uses/has proposed other measures to deal with tax avoidance and ensure fair competition. More about these in a forthcoming note.

IBFD references

- For links to IBFD summaries of the final Commission decisions, IBFD summaries of ECJ judgments and the latest news reports, IBFD articles and papers on cases investigating the compatibility of Member States' tax ruling practices with EU State aid law, see the [State Aid and Tax Rulings Tax Dossier](#)
- EU tax law developments are reported in the daily IBFD [Tax News Service](#)
- For more details on harmful tax competition and forbidden State aid, see [T. Morales Gil & S. Kale, Direct Taxation, Global Topics IBFD](#)
- [A. Xygka, 2023: The Year of State Aid Developments](#), 64 Eur. Taxn. 5 (2024), Journal Articles & Opinion Pieces IBFD
- [M. Shi, Fiat Emerges Victorious in State Aid Battle with European Union: What's Next?](#), 63 Eur. Taxn. 2/3 (2023), Journal Articles & Opinion Pieces IBFD