

Proposed EU TP Directive and the *Amazon* Case – A New Lens on State Aid Investigations

This article delves into the Court of Justice of the European Union's decision in the *Amazon* State aid case in December 2023 and its implications. It examines how the Proposed EU Transfer Pricing Directive might impact future State aid investigations led by the European Commission. Using the *Amazon* case as a practical example, the authors compare known facts and legal arguments with possible changes on the horizon. They offer considerations for any future harmonization of transfer pricing rules at the EU level.

1. Introduction

The first wave of State aid investigations of the European Commission (hereinafter the Commission) that involve transfer pricing continues to break on the shore of the Court of Justice of the European Union (ECJ) without success.¹ High-profile cases like *Amazon* (C-457/21 P),² which is the focus of this article, no longer attract major attention because the ECJ is consistently finding errors in the Commission's approach. As a result, the verdict in favour of taxpayers might have been expected.

While State aid investigations may have exceeded their period of peak interest, they have laid the foundation for a new hot topic in EU law. On 12 September 2023, the Commission proposed a directive on transfer pricing (Proposed EU TP Directive) to harmonize key TP principles across the European Union.³ The Proposed EU TP

Directive is part of the "Business in Europe: Framework for Income Taxation" (BEFIT), an initiative intended to reduce tax compliance costs for large, cross-border MNEs in the European Union.⁴

In this article, the authors examine the potential impact of the Proposed EU TP Directive on future State aid investigations. As this topic is broad and coupled with many uncertainties, the scope of the article is limited to the *Amazon* case and how a similar fact pattern might be assessed under the Proposed EU TP Directive.⁵ To achieve this, section 2. introduces the *Amazon* case from the initial facts to the ECJ decision. As this case is one of the most complex State aid TP cases,⁶ the analysis is limited to selected key points relevant to this article's theme. Section 3. looks ahead to the Proposed EU TP Directive and discusses how the current proposal could impact the outlook of the *Amazon* case and TP State aid allegations in general. Section 4. provides closing thoughts on the interplay between the Proposed EU TP Directive and State aid case law.

2. Navigating the *Amazon* Case – An Overview

2.1. *Amazon* case in a nutshell

Amazon conducted its European operations through two entities based in Luxembourg: Amazon Europe Holding Technologies SCS (LuxSCS) and Amazon EU SARL (LuxOpCo). The US headquarters, Amazon Inc, was wholly owned and controlled LuxSCS. Acting as a holding company, LuxSCS wholly owned its main subsidiary LuxOpCo and through it the remainder of Amazon's European distribution entities.⁷

In 2003, Amazon applied for and received a tax ruling in Luxembourg that – among other items it covered, which are not reflected herein – confirmed its tax position based on two key legal points:

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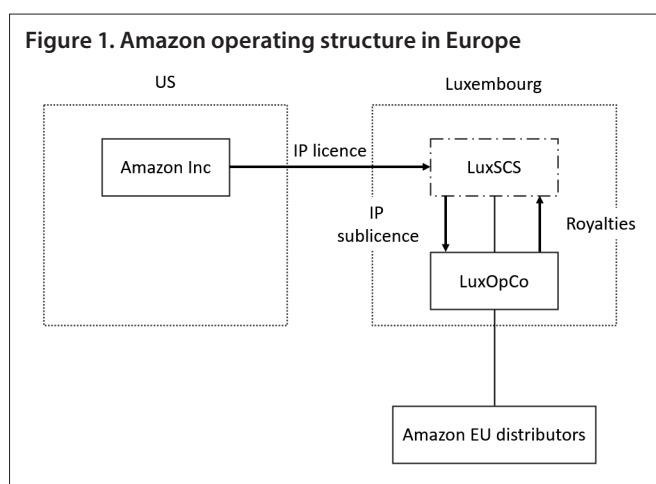
1. This is with the exception of the *Belgian Excess Profit Scheme*, in respect of which illegal State aid was ultimately confirmed. However, in the case against Belgium, an "aid scheme" was targeted, while in the other cases, such as *Amazon*, it was "individual aid". See B. Michel, *ECJ Determines "Only in Belgium" Excess Profit Ruling Practice Constitutes Aid Scheme, but Did It Provide Illegal Aid?*, 62 Eur. Tax'n. 2/3 (2022), Journal Articles & Opinion Pieces IBFD.
2. LU: ECJ, 14 Dec. 2023, Case C-457/21 P, *Commission v. Amazon.com and Others*, available at <https://curia.europa.eu/juris/document/document.jsf?text=&docid=280624&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=2112434> (accessed 5 Jan. 2024).
3. European Commission, Proposal for a Council Directive on Transfer Pricing, COM(2023) 529 (12 Sept. 2023), available at https://taxation-customs.ec.europa.eu/system/files/2023-09/COM_2023_529_1_EN_ACT_part1_v7.pdf (accessed 31 Jan. 2024) [hereinafter Proposed EU TP Directive].

4. European Commission, Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT), SWD(2023) 308 final-SWD(2023) 309 final (29 Sept. 2023), available at https://eur-lex.europa.eu/resource.html?uri=cellar:35311f2e-5210-11ee-9220-01aa75ed71a1.0001.02/DOC_1&format=PDF (accessed 6 Feb. 2024).
5. Although there are many important aspects of the Proposed EU TP Directive and State aid investigations that are considered important by the authors and have been extensively dealt with in the literature, such as the EU fundamental rights and freedoms perspective, these fall outside the scope of the article.
6. 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.
7. Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C ex 2014/NN) implemented by Luxembourg to Amazon, paras. 90-115, OJ L153 (2018) [hereinafter Amazon Commission Decision].

- Hybrid entity status: LuxSCS was structured as a limited partnership in Luxembourg and thus transparent for tax purposes. LuxSCS, however, was considered tax opaque in the United States. It elected to be taxed as a corporation (through the check-the-box system), which led to deferred taxation. As a result of the interplay of Luxembourg and US rules, LuxSCS did not pay any corporate tax in either of the countries by virtue of this hybrid mismatch.
- Application of the profit split method to price royalties: LuxSCS concluded contracts with Amazon US entities, being the IP owners, which granted LuxSCS the right to exploit and sublicense the valuable IP. Subsequently, LuxSCS sublicensed the IP to the European operating company, LuxOpCo. The royalties paid by LuxOpCo for the use of the IP were priced using the residual profit split method. Consequently, the majority of the IP-related returns were attributed to LuxSCS, recognized as the value creator of the group in the European Union. This meant that the royalties were effectively not taxed due to the hybrid entity status of LuxSCS.⁸
- Role of LuxSCS: LuxSCS was a passive owner of the IP and thus should not have been awarded the majority of the IP-related residual profit.¹³
- TP method: Considering the recharacterization of the entities, the transactional net margin method (TNMM) is the most appropriate method to be applied. The profit split method was not preferred, as it is used in situations in which both parties make unique and valuable contributions to the transaction. The tested party for the TNMM should be LuxSCS, the least complex entity.¹⁴

The Commission considered that the Luxembourg tax administration approved a tax ruling based on a TP analysis that was not in line with the arm's length principle and the OECD Guidelines. Consequently, Amazon's holding company derived a favourable treatment in comparison to similar domestic entities. These aspects will further be dissected in sections 2.3. and 2.4. The decision ordered the clawback of the illegal State aid that was provided through this TP error, which amounted to approximately EUR 250 million.¹⁵

Figure 1. presents the key facts in a straightforward visual.



2.2. Commission's view

The Commission started its investigation targeting Amazon in 2014⁹ and delivered the decision alleging illegal State aid in 2017.¹⁰ In the Commission's view, the accurate delineation of the intra-group licensing transaction should have resulted in the following:

- Role of LuxOpCo: LuxOpCo was the entity performing valuable functions in relation to the IP.¹¹ This conclusion especially holds true in light of the development, enhancement, maintenance, protection and

2.3. General Court

Following the Commission's decision, Luxembourg and Amazon EU Sàrl and Amazon.com (together "Amazon") appealed to the General Court of the European Union (hereinafter General Court). Ireland intervened on the side of Luxembourg, acting in line with its position in the *Apple* case, in many points similar to the *Amazon* case.¹⁶ The applicants raised several pleas, the most important ones being: (i) the existence of a tax advantage provided to Amazon, (ii) its selectivity, (iii) the TP analysis and (iv) the use of later versions of the OECD Guidelines.¹⁷

On 12 May 2021, the General Court delivered its decision in *Luxembourg v. Commission and Amazon EU and Amazon.com v. Commission* (Joined Cases T-816/17 and T-318/18). The General Court concluded that the Commission's decision should be annulled because the Commission failed to establish the existence of illegal State aid.¹⁸

8. Id., at paras. 121-159.

9. European Commission, *State aid: Commission investigates transfer pricing arrangements on corporate taxation of Amazon in Luxembourg*, Press Release IP/14/1105 (7 Oct. 2014), available at http://europa.eu/rapid/press-release_IP-14-1105_en.htm (accessed 6 Feb. 2024).

10. See Amazon Commission Decision, *supra* n. 7.

11. Id., at para. 415.

12. OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017), Primary Sources IBFD.

13. Amazon Commission Decision, *supra* n. 7, at paras. 548-549.

14. Id., *supra* n. 7, at para. 542.

15. European Commission, *State aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million*, Press Release IP/17/3701 (4 Oct. 2017), available at http://europa.eu/rapid/press-release_IP-17-3701_en.htm (accessed 6 Feb. 2024).

16. G. Bellenghi, *The General Court in Amazon and Engie: A New Effect-based Approach Aimed at the Endorsement of the 'Vestager Doctrine'?*, 6 European Papers 2 (2021), available at https://www.europeanpapers.eu/en/europeanforum/general-court-in-amazon-and-engie-endorsement-of-vestager-doctrine#_ftn21 (accessed 5 Jan. 2024).

17. LU: GC, 12 May 2021, Joined Cases T-816/17 and T-318/18, *Grand Duchy of Luxembourg and Amazon v. Commission*, ECLI: EU:T:2021:252, paras. 102-110 (accessed 21 Feb. 2024).

18. *Amazon* (T-816/17 and T-318/18), para. 590.

2.3.1. Selectivity

The main reason for the General Court not upholding the Commission's decision was the inability of the Commission to prove that the advantage provided by Luxembourg was selective. According to article 107 of the Treaty on the Functioning of the European Union (2007) (TFEU),¹⁹ a national tax measure (e.g. a tax ruling) is classified as State aid if it:

- is granted by a Member State or through State resources;
- is liable to affect trade between the Member States;
- confers a selective advantage on the beneficiary; and
- distorts or threatens to distort competition.²⁰

The selective advantage in terms of the beneficiary criterion (selectivity) was crucial to the assessment by the General Court in its State aid examinations. To establish selectivity, an analysis of whether a measure favours certain undertakings over others in a comparable situation is required. This analysis consists of three steps:

- step 1: Identify the reference tax system, that is the “normal” tax system applicable in the Member State concerned;
- step 2: Demonstrate that the tax measure at issue is a derogation from that reference tax system. This means that it needs to be proven that the tax measure differentiates between operators who are in a comparable factual and legal situation; and
- step 3: If such differentiation exists, it must be established whether it is justified by the nature or general structure of the system.²¹

The Commission was required to prove the first two steps while the Member State in question must present the justification (step 3).²²

The General Court found that the Commission had failed in step two. Specifically, none of the arguments the Commission put forward were enough to substantiate the claim of a different treatment providing an advantage in the system of “normal” taxation in Luxembourg. Even though there may be a “methodological error” in the application of the arm's length principle, this cannot lead to the assumption of a selective advantage. The Commission needs to demonstrate that this error led to a reduction of the tax burden compared to what the taxpayer would have borne without benefiting from the tax ruling.²³

The General Court rejected the Commission's attempts to prove that the advantage existed, on the following grounds:

- the Commission underestimated the role of LuxSCS, which performed functions and assumed risks that are not typically seen in a passive owner of intangibles. Consequently, the Commission failed to demonstrate that LuxSCS would have been a more appropriate tested party due to it being “less complex” and therefore making the search for reliable comparables easier;
- even if LuxSCS was accepted as the more appropriate tested party, the TNMM application and the remuneration calculated by the Commission were incorrect due to “numerous errors”;²⁴ and
- none of the alternative lines of reasoning (“subsidiary findings of an advantage”) – such as the proposed use of the profit split method instead of the TNMM, the choice of operating expenses as the profit level indicator nor the inclusion of a cap-and-floor mechanism – were accepted as methodologically sound and sufficient to fulfil the selectivity criterion.²⁵

The Commission appealed the decision of the General Court, providing the opportunity for the ECJ to give the final verdict on this issue.

2.4. ECJ

On 14 December 2023, the ECJ delivered its decision in *Commission v. Amazon.com and Others* (Case C-457/21 P),²⁶ confirming that Amazon had not received illegal State aid. The ECJ ruled that the Commission committed errors of law that led to the cancellation of its decision.

While the ECJ reached the same outcome as the General Court, it disagreed with the General Court's reasoning on two important points: (i) the existence of an “EU arm's length principle” and (ii) the use of the OECD Guidelines. This was expected, since the same argumentation had already been put forward in the *Fiat* (Joined Cases C-885/19 P and C-898/19 P) decision delivered in November 2022.²⁷ Considering the line of reasoning followed by the ECJ in the *Fiat* and *Amazon* cases, it seems justified to assume that the ECJ will follow the same line of reasoning in *Apple* (Case C-465/20)²⁸ and rule that Apple did not receive State aid due to the Commission's errors of law.

In section 2.4.1., the authors will elaborate on the implications of not having an EU arm's length principle. Then, in section 2.4.2., the interpretation of the role and significance of the OECD Guidelines will be discussed.

19. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), Primary Sources IBFD.

20. Commission Notice of 19 July 2016 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 (2016).

21. *Amazon* (T-816/17 and T-318/18), paras. 114-115.

22. As established in PT: ECJ, 6 Sept. 2006, Case C-88/03, *Portugal v. Commission*, para. 81; IT: ECJ, 8 Sept. 2011, Joined Cases C-78/08 to C-80/08, *Paint Graphos*, paras. 69-70; AT: Opinion of Advocate General Kokott, 16 Apr. 2015, Case C-66/14, *Finanzamt Linz*, ECLI:EU:C:2015:242, paras. 81-83; and LU: Opinion of Advocate General Pikamäe, 16 Dec. 2021, Joined Cases C-885/19 P and C-898/19 P, *Fiat Chrysler Finance Europe*, ECLI:EU:C:2021:1028, para. 68, Case Law IBFD.

23. *Amazon* (T-816/17 and T-318/18), para. 123.

24. *Amazon* (T-816/17 and T-318/18), para. 296. For more details on the errors in the functional analysis, see for example T. Lyons, *Luxembourg v European Commission; Amazon EU Sarl and Amazon.com Inc vs European Commission: the issue of competence again*, British Tax Rev. 4 (2021).

25. Bellenghi, *supra* n. 16.

26. *Amazon.com and Others* (C-457/21 P).

27. LU: ECJ, 8 Nov. 2022, Joined Cases C-885/19 P and C-898/19 P, *Fiat Chrysler Finance Europe v. European Commission*, Case Law IBFD.

28. On 25 Sept. 2020, the Commission appealed the General Court's decision in the *Apple* case before the ECJ (Case C-465/20 P).

Section 2.4.3. will provide final considerations on the outcome of the *Amazon* case and what it could mean for future State aid cases.

2.4.1. Non-existence of an EU arm's length principle

Coming back to the three-step test to determine selectivity described in section 2.3.1., the ECJ identified a flaw in the first step – identification of the reference system. The Commission made a crucial error by wrongfully asserting an “EU arm's length principle”.

Instead of identifying the arm's length principle and its application under national legislation, the Commission declared the arm's length principle to be an indispensable part of its State aid assessments pursuant to article 107(1) of the TFEU. This has set the foundation for a sui generis “EU arm's length principle”, available as a “tool” for establishing the reference system, regardless of whether a Member State has incorporated it into its national legal system.²⁹ The legal basis for this interpretation was found in the ECJ decision in *Belgium and Forum 187* (Joined Cases C-182/03 and C-217/03).³⁰ Although criticized in the doctrine due to negative effects on legal certainty and tax sovereignty, the General Court approved the usage of the arm's length standard in this manner in several decisions,³¹ including in the *Amazon* case.³²

The ECJ found that, to establish a potential discrimination case, only the national law of that state (except for a situation in which EU tax law has been harmonized with the national law) may be used as a reference to compare undertakings in similar circumstances.³³ Further, the ECJ explicitly states:³⁴

that the arm's length principle can only be applied if it is recognised by the national law concerned and in accordance with the detailed rules defined by it. In other words, as EU law currently stands, there is no autonomous arm's length principle that applies independently of the incorporation of that principle into national law for the purposes of examining tax measures in the context of the application of Article 107(1) TFEU (see, to that effect, judgment of 8 November 2022, *Fiat Chrysler Finance Europe v Commission*, C-885/19 P and C-898/19 P, EU:C:2022:859, paragraph 104).

This position, first declared in the *Fiat* case and now confirmed in the *Amazon* case, represents the end of an EU arm's length principle created through the far-fetched interpretation of the Commission.

Interestingly, Luxembourg's national tax law did entail an arm's length principle that could have served as a basis

for identifying the reference system.³⁵ However, it seems that the Commission was trying to establish an autonomous EU arm's length principle in the *Amazon* and *Fiat* cases in preparation for the *Apple* case. In the *Apple* case, Ireland argued that the arm's length standard (for attributing profit to branches of non-resident companies) set out in its national law could not be used, as the dispute involved a branch.³⁶ As the State aid investigations are getting their closure at the ECJ level, it can be concluded that the Commission's strategy backfired. Nevertheless, precisely this setback may have inspired the proposal for an EU TP Directive, as will be discussed in section 3.1.

2.4.2. Interpretation of the role and significance of OECD Guidelines

In section 2.4.1., the Commission's choice of trying to enforce a sui generis arm's length principle was discussed. Another point raised in several decisions prior to the *Amazon* case by the General Court and the Commission (e.g. *Fiat* (T-755/15)³⁷ and *Starbucks* (T-760/15 and T-636/15))³⁸ refers to the content of the arm's length principle. In the *Fiat* case, the General Court seemed vague in defining what is understood by the arm's length principle.³⁹

Specifically, the Decision of the General Court states:⁴⁰

the Commission failed to define the content of the arm's length principle as described in the contested decision, suffice it to note that it is apparent from the contested decision that that principle is a tool for checking that intra-group transactions are remunerated as though they had been negotiated between independent undertakings.

This is an example that shows that there may be a variety of views on what is embedded in the expression “arm's length principle”.

This difference in meaning stems from the increasing number of transfer pricing disputes, as well as from the differences in concepts between the OECD Guidelines and the domestic legislation.⁴¹ This may create confusion on whether to use the definition in the domestic legislation or the OECD Guidelines.

As an example, in the *Amazon* case, although the OECD Guidelines are not legally binding under EU law or in many of the Member States, the Commission, supported

29. 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.
30. BE: ECJ, 22 June 2006, Joined Cases C-182/03 and C-217/03, *Kingdom of Belgium & Forum 187 ASBL v. Commission*, [2006] ECR I-05479.
31. A. Miladinovic, *Selectivity and the Arm's Length Principle in EU State Aid Law* (M. Lang et al. eds., IBFD 2022), Books IBFD.
32. *Amazon* (T-816/17 and T-318/18), para. 154.
33. *Amazon.com and Others* (C-457/21 P), paras. 39-40.
34. Id., para. 42, also referring to *Fiat Chrysler Finance Europe v. European Commission* (C-885/19 P and C-898/19 P), para. 104.

35. LU: *Loi du 4 Décembre 1967 concernant l'impôt sur le revenu* [Luxembourg Income Tax Law], as amended, available at <https://impotsdirects.public.lu/fr/legislation/LIR.html> (accessed 20 Feb. 2024).
36. R. Mason, *Ding-Dong! The EU Arm's-Length Standard Is Dead*, 108 Tax Notes Int'l (5 Dec. 2022), available at <https://ssrn.com/abstract=4301471> (accessed 5 Jan. 2024).
37. *Fiat* (T-755/15).
38. *Starbucks* (T-760/15 and T-636/15).
39. J. Monsenego, *Some observations on Starbucks, Fiat, and their potential impact on future amendments to the arm's length principle* (Kluwer International Tax Blog, 28 Sept. 2019), available at <https://kluwertaxblog.com/2019/09/28/some-observations-on-starbucks-fiat-and-their-potential-impact-on-future-amendments-to-the-arms-length-principle> (accessed 8 Jan. 2024).
40. *Fiat* (T-755/15), para. 155, at sec. D, point 2, a).
41. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2022), Primary Sources IBFD. The most recent OECD Guidelines were released in Jan. 2022. The previous editions include OECD Guidelines 1995, 2010 and 2017.

by the General Court, opted for yet another far-fetched interpretation. The Commission claimed that the OECD Guidelines “reflect the international consensus” on transfer pricing and thus are practically needed for interpretation of TP issues.⁴² Using this vague justification, the Commission based its TP analysis on the OECD Guidelines, although they were not formally incorporated into Luxembourgish tax legislation at the time when the APA was concluded.⁴³

The ECJ found that this interpretation of the role and significance of OECD Guidelines was incorrect, as the Commission took into consideration an instrument outside of the national tax system.⁴⁴ The OECD Guidelines could have been invoked only if they had been incorporated into the domestic legislation (and only in the way that they had been transposed by the particular Member State).

Although this position of the ECJ ultimately invalidated the whole TP analysis of the Commission and General Court, it is interesting to note the approach of the General Court on static versus dynamic interpretation of the OECD Guidelines.

In its decision, the Commission used the 1995, 2010 and 2017 versions of the OECD Guidelines. However, since the tax ruling was scrutinized before 2010, the General Court found that:

- the 1995 version was the appropriate one to use;
- the 2010 version was deemed not relevant, unless it offered a useful clarification, without further elaboration, of the guidelines already set out in 1995; and
- the 2017 version was deemed irrelevant because the OECD Guidelines were published after the relevant period.⁴⁵

Finally, the ECJ did not delve further into scrutinizing the TP analysis itself and stopped at the inadequately identified reference system (both the arm’s length principle and the use of OECD Guidelines).

2.4.3. Considerations for future State aid cases

For future State aid cases that are similar to the Amazon case, where the reference system does contain the arm’s length standard and the guidance (OECD or other) on its application, the Opinion of Advocate General Kokott may be relevant. Advocate General Kokott stated that even if the ECJ were to consider itself bound by the choice of the incorrect reference system, the Commission decision should still fail to satisfy the second step of proving that a selective advantage exists. For the Commission to succeed in proving illegal State aid through transfer pricing (which is not an exact science), the findings must be manifestly erroneous.⁴⁶

42. *Amazon* (T-816/17 and T-318/18), para. 155.

43. Amazon Commission Decision, *supra* n. 7, para. 241.

44. *Amazon.com and Others* (C-457/21 P), para. 56, also referring to *Fiat Chrysler Finance Europe v. European Commission* (C-885/19 P and C-898/19 P), para. 96.

45. *Amazon* (T-816/17 and T-318/18), para. 154.

46. LU: Opinion of Advocate General Kokott, 8 June 2023, Case C-457/21 P, *Commission v. Amazon.com and Others*, ECLI:EU:C:2023:466, paras. 114 and 120.

Advocate General Kokott’s stance on manifest errors raises the bar for the Commission in future TP cases. However, it is noteworthy that the Advocate General’s Opinions are not binding and the ECJ may reason differently regarding selectivity. Regardless, the Commission must first address the issues of the arm’s length principle and its EU-level application before proceeding to scrutinize the TP analysis itself. Only then can the dispute proceed to the next stage in which the TP analysis itself is scrutinized.

3. Future Outlook

3.1. Introductory remarks

This section aims to analyse how an ECJ decision on State aid might evolve in the future should the Proposed EU TP Directive be approved. As mentioned in section 1.2.1., it looks like the Proposed EU TP Directive is an attempt to provide a legal base to counteract the gap identified by the General Court and ECJ decisions in cases such as *Amazon* or *Apple*. In the following subsections, the authors briefly introduce (i) the main definitions of the Proposed EU TP Directive, (ii) their interaction with the OECD Guidelines, and (iii) the implications it would have had for the *Amazon* case had the Proposed EU TP Directive been applicable at the time.

3.2. Proposed EU TP Directive

The Proposed EU TP Directive’s stated goal is to enhance tax certainty, reduce compliance costs and mitigate the risk of double taxation and litigation in cross-border intra-group transactions within the European Union. If adopted unanimously by the EU Council, Member States would be required to apply the Proposed EU TP Directive starting from 1 January 2026⁴⁷ or even as early as 2025.⁴⁸

Taking into consideration the *Amazon* case, the article now turns to some definitions and their application included in the Proposed EU TP Directive. These are, among others:

- OECD Guidelines: The Proposed EU TP Directive includes a definition of the OECD Guidelines in article 3(18). It defines the OECD Guidelines by reference to the 2022 version, together with any amendments that the European Union approves in the context of the OECD Committee on Fiscal Affairs;
- associated enterprise: According to article 5 of the Proposed EU TP Directive, “associated enterprise”

47. European Commission, *Questions and Answers on BEFIT and transfer pricing*, available at https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_4407 (accessed 31 Jan. 2024). The authors note that the European Parliament has an advisory role, meaning that the Council must consult the European Parliament prior to adoption of the Proposed EU TP Directive.

48. On 22 Feb. 2024, members of the Committee on Economic and Fiscal Affairs of the European Parliament adopted an opinion that calls for the effective date of the Proposed EU TP Directive to be shortened to 1 Jan. 2025. The European Parliament is yet to confirm this opinion, after which it will pass to the Council for consideration when the Member States adopt the definitive act. For more details, see <https://www.europarl.europa.eu/news/en/press-room/20240219IPR17822/transfer-pricing-meps-want-quicker-application-of-new-rules> (accessed 26 Feb. 2024).

means: “a person who is related to another person in any of the following ways: (a) a person participates in the management of another person by being in a position to exercise a significant influence over the [sic] other person; (b) a person participates in the control of another person through a holding that exceeds 25% of the voting rights; (c) a person participates in the capital of another person through a right of ownership that, directly or indirectly, exceeds 25% of the capital; (d) a person is entitled to 25% or more of the profits of another person”;

- arm’s length principle: article 3(1) of the Proposed EU TP Directive provides the following definition of the arm’s length principle: “the international standard that prescribes that associated enterprises must transact with each other as if they were independent third parties. In other words, the transactions between two associated enterprises should reflect the outcome that would have been achieved if the parties were not related i.e. if the parties were independent of each other and the outcome (price or margins) was determined by (open) market forces”; and
- selection of the TP method: article 9(1) of the Proposed EU TP Directive prescribes the use of one of following five TP methods: (i) the comparable uncontrolled price method; (ii) the resale price method; (iii) the cost-plus method; (iv) the transactional net margin method; and (v) the profit split method in determining the arm’s length price. According to article 9(2) of the Proposed EU TP Directive, other valuation methods or techniques may be used only when none of the aforementioned five TP methods can be reasonably applied, and only to the extent taxpayers demonstrate that results are consistent with the arm length’s principle.

Before diving into the question of how the Proposed EU TP Directive deviates from the OECD Guidelines, the authors note that article 14(2) of the Proposed EU TP Directive states that EU Council may introduce further rules on how the arm’s length principle and the other provisions laid down in Chapter II of the Proposed EU TP Directive are to be applied in specific transactions or dealings concerning the following: (i) the transfer of intangibles asset or rights in intangible assets between associated enterprises, including hard-to-value intangibles; (ii) the provision of services between associated enterprises, including the provision of marketing and distribution services; (iii) cost contribution arrangements between associated enterprises; (iv) transactions between associated enterprises in the context of business restructurings; (v) financial transactions; and (vi) dealings between the head office and its permanent establishments. Further, quite some feedback has been provided by the business community, scholars and other stakeholders on the Proposed EU TP Directive. In short, the feedback concerns, among other things, definitions of the arm’s length principle, associated enterprise,

use and application of the TP methods and the identification of commercial and financial relations.⁴⁹

3.3. Differences between Proposed EU TP Directive and OECD Guidelines

One of the differences between the Proposed EU TP Directive and the OECD Guidelines pertains to the definition of the arm’s length principle. The OECD Guidelines define the arm’s length principle as:⁵⁰

Where conditions are made or imposed between the two (associated) enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprise, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

49. See Q. Mulder et al., *A Closer Look at the European Commission Proposal for Harmonized Rules for Transfer Pricing*, 31 Intl. Transfer Pricing J. 1 (2023), Journal Articles & Opinion Pieces IBFD; O.R.A. Hoer, *Critical Analysis of the European Commission’s Directive Proposal on Transfer Pricing*, 113 Tax Notes Intl. 1, pp. 29-39 (2024). Feedback from Member States: Finland, available at <https://vm.fi/paatos?decisionId=0900908f808569bf>; Germany, available at [https://www.europarl.europa.eu/RegData/docs_autres_institutions/parlements_nationaux/com/2023/0529/DE_BUNDESRAT_CONT1-COM\(2023\)0529_DE.pdf](https://www.europarl.europa.eu/RegData/docs_autres_institutions/parlements_nationaux/com/2023/0529/DE_BUNDESRAT_CONT1-COM(2023)0529_DE.pdf); and Sweden, available at <https://www.regeringen.se/contentassets/sets/e7970777eebc44e8a3c8420da088484c/direktiv-om-internprissattning-202324fpm9.pdf> (all accessed 14 May 2024). Feedback from businesses and organizations: American Chamber of Commerce to the European Union (AmCham EU), available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3450259_en; Business Europe, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3450182_en; Deloitte, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3450291_en; European Tax Advisors Federation (ETAf), available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3448236_en; International Chamber of Commerce (ICC), available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3450236_en; Invest Europe, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3448236_en; KPMG, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3449836_en; Maisto e Associati, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3450222_en; PwC, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3450261_en; Union of Luxembourg Enterprises (UEL), available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/F3450198_en; and others available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Transfer-Pricing-Directive-Head-Office-Tax-system-for-SMEs-Business-in-Europe-Framework-for-Income-Taxation/feedback_en?p_id=32319337 (all accessed 20 Feb. 2024).

50. *Supra* n. 41 at Ch. I, sec. B (Statement of the arm’s length principle), sec. B.1 (Article 9 of the OECD Model Tax Convention).

Scholars and the business community⁵¹ are of the opinion that the current definition included in the Proposed EU TP Directive of the arm's length principle uses broad terms that may have an impact on the interpretation of the standard and its interaction with the domestic legislation. For instance, the term "transact" used in the Proposed EU TP Directive may lead to a different understanding than the expression "commercial or financial relations" in the OECD Guidelines. Further, the Proposed EU TP Directive uses the expression "(open) market forces", which does not appear in article 9 of the OECD Model (2017).⁵² These inconsistencies may lead to additional uncertainty and difficulties in applying a harmonized EU arm's length principle.⁵³

Another notable difference between the Proposed EU TP Directive and OECD Guidelines relates to the selection of the TP methods. Articles 9 and 10 of the Proposed EU TP Directive seem to suggest a stricter hierarchy when applying the TP methods compared to the OECD Guidelines. The conditions under which methods other than those mentioned in article 9(1) of the Proposed EU TP Directive can be used are listed in article 9(2) of the Proposed EU TP Directive. Reference can be made to section 3.3.

Lastly, the Proposed EU TP Directive is silent when it comes to defining the DEMPE functions of intangibles. The implications of this lack of explicit guidance are also discussed in section 3.3.

3.4. Potential outcome and considerations in the *Amazon* case

In sections 3.1. and 3.2., the authors discussed some similarities and differences between the Proposed EU TP Directive and the OECD Guidelines. Now, let us explore how the various arguments brought forward in the *Amazon* case by different parties would be analysed if the Proposed EU TP Directive were to apply.

3.4.1. Existence of EU arm's length principle

One of the main arguments questioned in the *Amazon* case was the Commission's use of a sui generis "EU arm's length principle". This argument was dismissed by the ECJ, as the Commission cannot apply a principle that is not included in national legislation.⁵⁴ What is interesting to note is that, in Luxembourg, there is a definition of the arm's length principle in the national legislation that could have been invoked. The arm's length principle is reflected in various articles of the Luxembourg Income Tax Law. The main provisions with respect to transfer pricing are articles 56 and 56bis of the Luxembourg Income Tax Law.⁵⁵

Article 56 of the Luxembourg Income Tax Law has been aligned with article 9 of the OECD Model (2017) with respect to the arm's length principle, as follows:⁵⁶

- When an enterprise participates, directly or indirectly, in the management, control or capital of another enterprise, or
- where the same individuals participate, directly or indirectly, in the management, control or capital of two enterprises and
- where, in either instance, the two enterprises are, within their commercial or financial relations subject to conditions made or imposed which differ from those which would be made between independent enterprises,
- the profits of these enterprises are to be determined under conditions prevailing between independent enterprises and taxed in consequence.

The first question that arises is why the Commission did not rely on the above definition of the arm's length principle in the national legislation. It would seem that the Commission was more interested in having a general arm's length principle based on the OECD Guidelines valid at the EU level. This general arm's length principle is now laid down in article 3(1) of the Proposed EU TP Directive, which differs slightly from the definition provided in article 56 of the Luxembourg Income Tax Law. If the Proposed EU TP Directive were to be adopted, the definition in the national legislation may need to be adjusted.

The second question that arises is how the language included in article 3(1) of the Proposed EU TP Directive would impact the sui generis "EU arm's length principle" used by the Commission in the *Amazon* case.

The definition of the arm's length principle found in article 3(1) of the Proposed EU TP Directive seems ambiguous and may lead to further interpretations. In the definition set out in article 3(1), the term "market forces" is used. "Market forces" in this context encompasses supply, demand, competition and prevailing economic conditions. Article 56 of the Luxembourg Income Tax Law refers only to "conditions prevailing between independent enterprises". As an example, it may happen that enterprises, as part of a general group policy, may consider a lower price to penetrate a market and their behaviour may be, under article 3(1), at arm's length while, under article 56, such pricing may be considered not at arm's length, as two independent parties would not agree to it, preferring a different strategy to enter the market. This makes the definition of the arm's length principle in the Proposed EU TP Directive wider in scope than article 56 of the Luxembourg Income Tax Law and opens the door to new questions and different interpretations.

3.4.2. Determination of the role and significance of OECD Guidelines

Another point made in the *Amazon* case relates to the fact that the EU Commission used various versions of the OECD Guidelines in its decision (the 1995, 2010 and the 2017 versions). However, since the tax ruling being

51. See *supra* n. 49.

52. OECD Model Tax Convention on Income and on Capital (21 Nov. 2017), Treaties & Models IBFD.

53. See R. Petrucci & A. Myzithra, *The EC's Proposal for a Directive on Transfer Pricing: Paving the Road for a Common Application of the Arm's Length Principle*, 31 Intl. Transfer Pricing J. 1 (2024), Journal Articles & Opinion Pieces IBFD.

54. *Amazon.com and Others* (C-457/21 P), paras. 39-40.

55. Art. 56 Luxembourg Income Tax Law, *supra* n. 35.

56. Unofficial translation, as available at LU: Income Tax Law, 1967, arts. 56 and 56bis (last amended 2018), Primary Sources IBFD.

scrutinized dates from before 2010, the General Court found that the 1995 version of the OECD Guidelines was the appropriate version to apply in this instance, as the later versions could not be applied retroactively.⁵⁷

Article 3(18) of the Proposed EU TP Directive includes a definition of the OECD Guidelines as being the 2022 version and any further amendments as approved by the European Union. This would allow the Commission to rely on the most recent version of the OECD Guidelines available assuming the Proposed EU TP Directive was in place at the moment of the Luxembourg tax ruling.

However, since the Proposed EU TP Directive refers specifically to the 2022 OECD Guidelines, the same retroactivity argument brought forward in the *Amazon* case could still be raised, namely that the later version of the OECD Guidelines may not be used retroactively when scrutinizing a ruling that dates from before 2010.⁵⁸ This matters because the 2022 (and 2017) OECD Guidelines, as opposed to the earlier versions, include recommendations concerning the DEMPE functions when analysing intangibles. If the Commission could have performed a DEMPE analysis, it could have determined the roles played by LuxSCS and LuxOpCo from this perspective and properly assessed their arm's length remuneration.

The Proposed EU TP Directive is silent about the DEMPE functionality despite the fact that it allows for application of the 2022 OECD Guidelines. On the one hand, it can be argued that, as the Proposed EU TP Directive does not explicitly include the DEMPE analysis, it may not be used under the Proposed EU TP Directive. On the other hand, as the Proposed EU TP Directive is incorporating the 2022 OECD Guidelines version, the DEMPE analysis is indirectly included and thus applicable. The lack of explicit guidance may impede the Commission from using the DEMPE analysis confidently in determining the functionality of entities in intangibles-related transactions. This uncertainty may be resolved, however, in the future, as the EU Council has reserved the right to lay down further rules relating to specific intra-group transactions, including intangibles, in article 14(2)(a) of the Proposed EU TP Directive.

3.4.3. Proving the unlawful State aid advantage

According to the Advocate General's Opinion, for the Commission to succeed in proving that illegal State aid was granted through transfer pricing, the findings must be manifestly erroneous.⁵⁹ Further, the General Court confirmed that it is not enough for the Commission to prove that a methodological error took place when applying a particular TP method: it is still the Commission's task to prove the existence of an advantage.⁶⁰ 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 prevents the Commission from shifting the burden of proof to the Member State by arguing that its decision was entirely discretionary. Hence, the Commission needs to prove, based on facts established in the functional analysis, how the scrutinized company received a benefit that was not granted to other companies in the Member State in question.

In the *Amazon* case, the application of the TNMM was also discussed. In its decision, the General Court rejected the Commission's argument that the TNMM was not applied correctly and that the profit split method was a more appropriate TP method.⁶¹ However, this does not prevent the Commission from future attempts to determine both the most suitable allocation method and its proper application. The General Court simply acknowledged that the Commission failed to prove that the incorrect application of the TNMM, and the application of the profit split method as a better method, would necessarily ensure a tax advantage to LuxOpCo. Therefore, in a way, the General Court approved the right of the Commission to test and check for the best TP method and its correct application in State aid investigations. The Proposed EU TP Directive could serve as a better tool for this purpose than the OECD Guidelines, as it would be applicable in all Member States and more legitimate than a soft law instrument.

However, the Commission's analysis might be more complex due to the Proposed EU TP Directive's stricter application of TP methods, requiring a meticulous progression through various methods before considering the profit split method. Specifically, the analysis should be much more robust, showing why all the traditional methods cannot be used. Once this is fully established, only then could the application of the profit split method be considered.

4. Conclusion

In this article, the authors have flagged some of the possible effects that the Proposed EU TP Directive may have on future State aid investigation cases⁶² should it be adopted by Member States. For this purpose, the *Amazon* case served as a real-life example. In the *Amazon* case, the ECJ confirmed that Amazon had not received illegal State aid. The ECJ ruled that the Commission committed errors of law that led to the cancellation of its decision. Through an analysis of the *Amazon* case and the Proposed EU TP Directive, the authors reflected on the impact of the Proposed EU TP Directive on TP and on future State aid practice should it be adopted.

57. *Amazon* (T-816/17 and T-318/18), para. 154.

58. It should be noted that, in the same art. 3(18), the Proposed EU TP Directive provides for a possibility for the application of further amendments to the OECD Guidelines, if approved by the European Union.

59. *Supra* n. 46, AG Opinion in *Commission v. Amazon.com and Others* (Case C-457/21 P).

60. *Amazon* (T-816/17 and T-318/18), para. 308.

61. *Id.*, paras. 494-508.

62. A new wave of State aid investigations is possible, as announced in Mar. 2023 by Executive Vice President Margrethe Vestager, even following the negative decision of the ECJ in the *Fiat* case, see F. Yun Chee, EU competition chief flags fresh probes into multinationals' tax deals, Reuters (20 Mar. 2023), available at <https://www.reuters.com/business/eu-competition-chief-flags-fresh-probes-into-multinationals-tax-deals-2023-03-20/> (accessed 8 Jan. 2024).

The Commission, with the Proposed EU TP Directive, aims to increase tax certainty, reduce compliance costs and mitigate the risk of double taxation and litigation for cross-border intra-group transactions within the European Union. It also aims to reduce the opportunities for companies to use transfer pricing for aggressive tax planning purposes. The intention behind the Proposed EU TP Directive is to address these issues through inclusion of the OECD arm's length principle and OECD Guidelines into EU law. Looking at the current version of the proposal, however, the Commission may still face insecurity and encounter difficulties in applying it in a satisfactory way in the *Amazon case* and other similar cases.

One possible way forward is for the Proposed EU TP Directive language to be further refined. Alternatively, one could opt to endorse the definitions provided by the OECD Guidelines to avoid discrepancies.⁶³ What will happen in practice to the BEFIT package (including the Proposed EU TP Directive), i.e. whether the initiatives will be adopted and in what form, remains to be seen.

63. Closer alignment ("as close as possible") of the Proposed EU TP Directive to the OECD Guidelines is advocated by the Committee on Economic and Fiscal Affairs of the European Parliament in its opinion; see *supra* n. 48.



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