EU State Aid and Tax: An Evolutionary Approach

In this article, the author traces the historical development of the State aid doctrine in the direct taxation area, providing an analysis of the difference between State aid and taxation, an overview of the evolution of EU State aid policy, as well as an in-depth study into each requirement to be met in order for a measure to qualify as unlawful State aid.

1. Introduction

The European Union, for over 60 years, has been built on core principles, values and fundamental freedoms, such as free competition and trade between its economies. Amongst the obstacles to these freedoms, State aid, in its many forms, has been identified as a distortive instrument. To preserve competition and the development of the EU Single Market, a State aid legal framework was implemented under article 87(1) of the EC Treaty (1957), currently articles 107 to 109 of the Treaty on the Functioning of the European Union (TFEU) (2007). This regime aims to control aid granted by sovereign states to companies, but also to safeguard the proper functioning of the internal market, as well as to avoid any discrimination or protectionism that would affect competition.

The underlying principle of the State aid rules is the prohibition of any State aid that would threaten or distort competition within the European Union by favouring certain companies or the production of certain goods if such aid affects trade between Member States. Various exemptions exist, however, that preserve the primary obligations of a welfare state and the macroeconomic development of the European Union. Member States do not lack ingenuity when it comes to attracting investment and helping a business or an economically disadvantaged region. Through subsidies or tax breaks, these measures are likely to be classified as State aid. Tension has thus grown between the application of European and national rules on direct taxation. As reported by the Court of Justice of the European (ECJ), although the implementation of a tax measure is the responsibility of national authorities, it remains true that the exercise of such a power may, where appropriate, be incompatible with article 107 of the TFEU.

In order to avoid implementation by Member States of State aid that could distort competition, the EU Commission was granted the power to control and verify the compatibility of state measures to ensure the functioning of the internal market. As a result, the EU Commission has strong investigative and decision-making powers in a wide range of fields, including taxation. Nonetheless, tax measures have not always been subject to the strict scrutiny that began in the late 1980s. Since 2013, however, investigations have been undertaken by the EU Commission into national measures to determine the existence of unlawful State aid. This new approach is in line with the modernization of State aid regulation, which was launched in 2012 to contribute to sustainable growth, as well as budgetary consolidation. These developments followed, at an EU level, the action plans on corporate taxation designed to make taxation fairer and more efficient (for example, the Common Consolidated Corporate Tax Base (CCCTB) initiative and the Anti-Tax Avoidance Directive (2016/1164), and, at an international level, the fight against tax evasion and tax avoidance (for example, the OECD’s Base Erosion and Profit Shifting (BEPS) Project).

To fully understand the European Union’s State aid policy with respect to taxation, the author first analyses the difference between State aid and taxation in order to clarify the European Union’s competition policy objectives, taking into account the autonomy of Member States in the field of direct taxation (section 2.). The author then provides an overview of the evolution of EU State aid policy (section 3.) before performing an in-depth study of each requirement to be met in order for a measure to qualify as unlawful State aid (section 4.).

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1. Treaty Establishing the European Community, 23 Mar. 1957, EU Law IBFD.
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2. State and Taxation: Two Separate Aspects

2.1. Origin of fiscal State aid

Governments grant large subsidies to their domestic industries in several ways (for example, direct or indirect subsidies in the form of tax breaks). Public subsidies of this nature are an important instrument for achieving financial stability, economic growth, competitiveness and/or environmental protection. There is no doubt that public subsidies can be a powerful tool not only to achieve social objectives or address market failures, but also to stimulate local and national economies.

State aid is an advantage in the form of assistance provided by a public entity, or a publicly-funded entity, to selected undertakings (any corporate entity selling goods or services in a market) with the potential to distort competition and affect trade between Member States.

According to the founding treaties of the European Union, one objective was to control State aid by ensuring that government interventions do not distort competition and EU trade. Amongst the most significant impediments to free competition and free trade, State aid is a distorting tool that can be rapidly applied. Due to the ingenuity of actors in the EU markets, State aid appears in many forms and disguises. As a result, and in order to prevent any distortion of the internal market, the definition of State aid was originally set out in article 4 of the European Coal and Steel Community Treaty (1951)9 and later in article 87(1) of the EC Treaty, as a “prohibited principle”, subject to certain exceptions justified by common interest objectives.

In fact, State aid regimes concern taxation because, while direct funding of private enterprises is an efficient but rather crude and obvious device of public aid, tax incentives are more elegant and discrete.9 Through the establishment of the common market, the EU Commission and the ECJ have always been alert to any measure that could distort competition. In 1961, State aid was defined in the decision in Gezamenlijke Steenkolenmijnen (Case C-30/59) as follows:10

The concept of aid is nevertheless wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, therefore, without being subsidies in the strict meaning of the word, are similar in character and have the same effect.

2.2. A competitive environment within a globalized world

EU State aid policy cannot be fully understood without appreciating the broader objectives of EU competition policy. After all, the rules on State aid form part of the overall competition objectives of the European Union, as evidenced by the TFEU, which assigns exclusive competence regarding the establishment of competition rules necessary for the functioning of the internal market to the European Union.11

Competition policy is an instrument used to achieve the European Union’s objectives, including a high level of economic growth, prosperity, competitiveness and cohesion between Member States through the establishment of a common market.

This policy constitutes the cornerstone upon which the European Union is built. Indeed, EU authorities have been given “broad powers in the competition field in order to ensure the achievement of a market economy with free competition”12, i.e. where private enterprises act primarily on the basis of economic rationality in a market free from public interference.13

Competition is a form of rivalry amongst companies in their efforts to increase profits, market share and sales volume by varying the elements of marketing, such as prices, product distribution and promotion. Consumers steer the market and, in a sense, eliminate from the market companies that are not able to compete and prosper. Accordingly, when subsidies are allocated to some companies and not others, competition is distorted, which could lead to inefficiencies regardless of the objectives pursued by the Member State that granted the subsidies.

To achieve free competition in an open European market, joint action by both supranational entities and national authorities has been undertaken. Both the EU Commission and the Council, by virtue of articles 101 to 109 of the TFEU, have been granted the powers to achieve a market with free competition. In addition, Member States were required to dismantle any barriers, either administrative or legal, but without ceding their sovereignty.

2.3. Fiscal sovereignty in the European Union

Throughout the construction of the European Union and its common market, the powers of the European authorities constantly expanded, except in the field of taxation. This concentration of powers was a prerequisite to achieving a single market without borders and building a common area of freedom, security and justice.14 In order to achieve such homogeneity between all Member States, however, national legal systems were put under the purview of EU law, resulting in a conflict between the conditions and restrictions of the “law of integration” and the territoriality principle.15

Despite an exception to this principle in respect of indirect taxation, taxation has largely remained in the hands

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11. Art. 3 TFEU.
of each Member State due to a general desire not to forfeit the fiscal power associated with allowing national lawmakers to control their budgets. In fact, tax sovereignty implies that there is an inseparable relationship between a sovereign state and its inherent prerogative to levy taxes within its territorial jurisdiction. Such a national prerogative has been preserved, which is evident in the absence of common legislation on direct taxation. From an EU law perspective, there are few references to taxation other than in articles 110 to 113 of the TFEU. These legal provisions deal with taxation in the context of harmonization, and prohibit any legislative action by the EU authorities in tax matters unless unanimity is reached amongst the Member States. The main examples of fiscal integration are the VAT Directive (2006/112), the Capital Duty Directive (2008/7) and certain excise duties. Except for these indirect taxes, Member States remain free to decide whether to introduce or abolish tax burdens, i.e. increase or reduce their taxes within their jurisdiction.

Apart from the prerogatives granted to the Council and the EU Commission, the ECJ also plays an important role in the evolution of tax action within the European Union. Indeed, the ECJ has, in many decisions, considered that “the sovereignty of the Member States in tax matters does not justify national tax rules which result in the discrimination or unjustified restriction of cross-border activities covered by the fundamental freedoms of the EC Treaty”.

As a result, even though Member States benefit from fiscal autonomy in respect of direct taxation, their national tax measures have to comply with fundamental principles, i.e. the freedom of establishment and the free movement of services, capital and goods, including EU State aid rules, which enjoy primacy over domestic legislation.

### 3. State Aid and Business Taxation: A New Policy

#### 3.1. Introductory remarks

Despite reports scrutinizing all Member States’ practices of tax aid in light of article 107 of the TFEU, it has only been in the past 20 years that European authorities have adopted a new approach to fiscal State aid.

From the outset, the prohibition against State aid has been understood as a very broad ban on any form of subsidy, including tax benefits. Taxation cases were, however, rare until the late 1980s. This reluctance to remedy or reduce the application of State aid to tax matters changed with a new political approach by European authorities. This new approach sought to harmonize the Member States’ tax rules, fight unfair methods of tax competition amongst Member States and remove tax obstacles to the functioning of the internal market. In the meantime, the OECD published a report in 1998 entitled Harmful Tax Competition – An Emerging Global Issue, which reaffirmed the importance of fighting harmful tax competition due to the interaction between the states’ tax regimes.

These developments resulted in the adoption of several European resolutions, as well as case law supporting competition in the internal market. The intention of European authorities was to interfere with national tax measures by applying the fundamental freedoms. These efforts, together with State aid proceedings that helped to dismantle harmful domestic tax measures in a short period of time, assisted in preventing discrimination and restrictions on cross-border activities and in achieving fiscal neutrality.

#### 3.2. Code of conduct, communications and reports

In 1992, the Conclusions and Recommendations of the Committee of independent experts on company taxation analysed the fiscal situation within the European Union, pointing out major differences in the corporate tax systems operated by each Member State, as well as considerable variations in their corporate tax rates and tax bases. The bottom line was that, due to political pressure from certain Member States, it was determined that fiscal distortions within the European Union that result in excessive loss of tax revenue with regard to business taxation, the taxation of savings income and the existence of withholding taxes on cross-border interest, as well as royalty payments between companies, should be abrogated.

In December 1997, the Ecofin Council adopted the Code of Conduct on Business Taxation (the Code), which encouraged the EU Commission to issue guidelines on State aid rules on business taxation and commit to the strict application of the aid rules. Moreover, the Code provided for coordinated action by all Member States to remove harmful tax competition within the European Union so as to improve tax transparency through a system of information exchange between Member States and assessments of any tax measures covered by the Code.

Although the Code was a non-binding agreement, it clearly had political force. In adopting such a gentleman’s agreement, Member States undertook to roll back existing tax measures that constituted harmful tax competition and refrain from introducing any future measures.

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18. IT: ECJ, 27 May 1981, Joined Cases C-142/80 and C-143/80, the Queen v. Inland Revenue Commissioners, ex parte Commerzbank AG. ECJ Case Law IBFD; and GR: ECJ, 29 Apr. 1999, Case C-311/97, Royal Bank of Scotland plc v. Elliniko Dimosio, ECJ Case Law IBFD.


that could distort the Single Market. Moreover, according to paragraph J of the Code, the EU Commission made a commitment to issue guidelines on State aid rules. As such, this:

The fight against harmful tax or unfair tax was aimed not only at a more effective use of State aid law but also at general tax measures which lure foreign capital and other investment away from their source country, by offering tax rates or tax bases or an administrative practice which did not reflect the true balance of taxes and public services of the poaching Member State.

Although monitoring State aid and tackling harmful tax competition both have the same goal, i.e. reducing distortions of competition within the internal market, the procedure for examining tax schemes, from the viewpoint of State aid, is distinct from work in connection with the Code. In fact, the qualification of a tax measure as harmful will not necessarily affect its possible qualification as State aid.

3.3. European Commission’s 1998 Notice

Further to the Code and a communication in October 1997, “the Commission undertook to draw up guidelines on the application of Articles 87 and 88 of the EC Treaty to measures relating to direct business taxation, and committed itself to the strict application of the aid rules concerned”.

This is considered the starting point of a new EU State aid policy on business taxation, which clarified and reinforced its application. In addition, it provided an opportunity for EU authorities to interfere in a field in which the EU framework was not, at that time, strong.

In order to clarify the question of whether a tax measure could qualify as aid under article 107 of the TFEU (formerly article 87 of the EC Treaty), the 1998 Commission Notice on the application of the State aid rules to measures relating to direct business taxation proposed clarifications and a road map to determining whether or not past and future national measures could comply with State aid procedural requirements.

The EU Commission issued a detailed set of directions as to the types of tax provisions and practices that could be identified as State aid. With reference to article 107 of the TFEU, being the core of the EU State aid regime, there is a high-level description of each criterion to be fulfilled in order to have a tax measure considered as prohibited. Moreover, the EU Commission reiterated the principle of non-discrimination and the distinction between general measures and State aid. A general tax measure will, in principle, if it is not discriminatory, be offered to all taxpayers on an equal basis. State aid, however, is a selective tax measure or incentive applicable only to certain undertakings or goods and not to the whole economy.

Following its commitment, on 11 July 2001, the EU Commission decided to initiate 15 State aid procedures regarding special corporate tax regimes in 12 Member States (including France, Germany and the United Kingdom). The measures that were under investigation mainly related to special tax regimes granted to multinational groups or in respect of insurance and financial activities. In November 2003, out of the 15 procedures were terminated and, in 2004, the EU Commission issued its report on actions taken in the field of fiscal aid.

3.4. The European Commission’s 2004 report

The 2004 report provided an initial review of the actions that have been undertaken by the EU Commission since 2001 rather than outlining an exhaustive list of all tax State aid cases handled since the 1998 Notice. From the report, it is evident that the EU Commission’s investigations were not based on new guidelines, but rather on custom practices applicable in other areas. Therefore, in assessing the compatibility of tax measures with the State aid regime, the EU Commission based its rationale on ECJ case law, which provided it with an opportunity to clarify the application of State aid rules to tax measures.

3.5. The European Commission’s 2016 Notice

On 19 May 2016, the EU Commission published its final notice on the notion of State aid (2016 Notice) with the objective of providing clarification to public authorities and companies and to facilitate public investment by identifying measures that do not need prior approval.

In addition, the 2016 Notice also contains guidance on the definition of State aid itself by analysing each criterion that must be met in order for a measure to be identified as incompatible with the internal market.

The 2016 Notice updated the 1998 Notice and set out the EU Commission’s current understanding of article 107(1) of the TFEU based, in particular, on its recent State aid decisions, but also as interpreted by the ECJ and the General Court. This corresponds to the EU Commission’s


28. Id.
efforts with regard to the State aid modernization programme launched in 2012. The 2016 Notice identifies specific issues concerning tax measures that have been subject to recent investigations by the EU Commission. Amongst the tax measures identified, the 2016 Notice focused on cooperative societies, undertakings for collective investment, tax amnesties, tax rulings and settlements, depreciation/amortization rules, fixed basis tax regimes for specific activities, anti-abuse rules and excise duties.

3.6. ECJ case law

Apart from the resolutions and guidelines that have been adopted by the EU Commission and other EU bodies since the 1990s, the ECJ also played an important role in the prohibition of State aid by laying down principles and confirming that the “concept of aid includes not only positive benefits such as subsidies, but also interventions in various forms which ‘mitigate the charges which are normally included in the budget of an undertaking’ (Steenkolenmijnen Case 30/59)”.

Relevant landmark ECJ cases regarding fiscal State aid include Gezamenlijke Steenkolenmijnen, Italian Textile (Case C-173/73), Banco Exterior de España (Case C-387/92), British Aggregates (Case C-487/06) and Italian Cooperatives (Joined Cases C-78/08 to C-80/08).

4. Legal Framework

4.1. Definition

4.1.1. Principle

State aid can be defined as an economic or financial advantage, conferred directly or indirectly on a selective basis to companies by national public authorities. A company that receives support, either through subsidies or tax incentives (i.e. public resources) obtains an advantage over its national and European competitors that it would not have had under normal circumstances. The beneficiary company is thus relieved of a burden to which its finances would otherwise normally be subject.

Article 107(1) of the TFEU sets out the general rule that any aid granted by a Member State, by favouring certain undertakings or the production of certain goods, is incompatible with the internal market. Accordingly, the article provides that:

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.

This provision prohibits Member States from allocating advantages to certain enterprises and thus interfering with the Single Market. Such a prohibition will not impact each Member State’s legislation in the same manner, as “free competition is not guaranteed by public non-interference, but on the contrary by a wide-reaching collection of taxes from everyone whose economic situation is comparable to that of other taxpayers”.

Such a concept is objective and leaves no margin for discretion by any European authorities, especially the EU Commission. As a general concept, principles have been set out in order to deal with diversified measures, to guarantee transparency and to avoid discrimination between Member States.

4.1.2. Exception

As an exception to the incompatibility principle, certain categories of aid are deemed compatible with the internal market. These include:

(1) categories of automatically compatible aid: aid with a social character, aid to remedy natural disasters or exceptional occurrences – article 107(2) of the TFEU;

(2) categories of aid that is compatible upon a discretionary decision of the EU Commission: aid to promote the economic development of areas with an abnormally low standard of living, aid to promote culture and heritage conservation and aid to facilitate the development of certain economic activities – article 107(3) of the TFEU.

4.2. The four cumulative elements

A tax measure granted to a company does not qualify as State aid per se; it needs to meet certain key elements determined through a rather complex analysis. In fact, according to Advocate General Ruiz-Jarabo Colomer, “the dividing line between measures which may constitute public subsidies, on the one hand, and measures forming part of a State’s general system of taxation, on the other, may sometimes be difficult to draw”.

In order to determine whether a tax measure falls under the general tax policy without being identified as State aid, the ECJ laid out in Altmark (Case C-280/00) a clear methodology that has since been followed not only in case law, but also by the EU Commission, as reflected in its notices.
In particular, article 107(1) of the TFEU provides that a measure is incompatible with the internal market of the European Union where it:

1. is granted on a Member State or financed through state resources. The tax measure must be granted by the state or through state resources in any form whatsoever;
2. confers an economic advantage on the recipient (which needs to be an undertaking): The beneficiary undertaking must receive an advantage that is likely to reduce the costs normally borne by its budget and that are not linked to consideration allocated in exchange;
3. is granted on a selective basis: The tax measure must be "selective or specific", i.e. favour only certain undertakings or the production of certain goods; and
4. has an effect on competition and trade: The tax measure must affect trade between Member States and distort or threaten to distort competition; this is the raison d’être of State aid control.

If each of these four requirements is met, the relevant measure will constitute impermissible State aid (unless approved by a decision of the EU Commission).

4.2.1. Element (1): The measure must be granted by a Member State or financed through state resources

To constitute State aid, the measure must be sourced from the state, i.e. through its own intervention and financed through the state’s resources. As confirmed in Preussen Elektra (Case C-379/98) and as further elaborated on in the 2016 Notice, “the granting of an advantage directly or indirectly through State resources, and the imputability of such a measure to the State, are two separate and cumulative conditions for State aid to exist”.

There are numerous cases where the ECJ illustrates the complexity involved in applying this element to a state tax measure. In addition to the fact that a measure could result in a cost upon the State, i.e. a loss of tax resources, it would also have to be assessed with reference to the beneficiary.

As tax measures are usually issued by the tax authorities of a relevant state, determining whether or not the measure stems from state intervention should be straightforward. With regard to a transfer of state resources, a decision to grant a certain tax advantage will always result in a loss of tax revenue for the state. Such a shortfall in tax will ipso facto be considered a transfer of state resources pursuant to article 107 of the TFEU, being equivalent to the consumption of state resources in the form of a fiscal expenditure.

In addition, the possibility that a tax aid could have a positive overall effect on the state’s budget would not prevent its qualification as State aid, as a transfer of state resources must not be assessed at the level of the state itself, but at the level of individual recipients (i.e. taxpayers). This was confirmed in the EU Commission’s decision regarding Belgium’s attempt to justify its coordination centres regime by arguing that the “transfer of state resources” requirement was not met, as the tax measure attracted foreign companies with the effect of generating additional resources for the state’s budget.

4.2.2. Element (2): Conferring an advantage

The notion of an advantage for State aid purposes encompasses not only positive benefits, but also measures that, in various forms, mitigate those charges normally included in the budget of an undertaking. As confirmed by the case law, the notion of an advantage must be understood as wider than the term subsidy, being, “normally defined as a payment in cash or in kind made in support of an undertaking other than the payment by the purchaser or consumer for the goods or services which it produces”.

In fact, it includes any kind of advantage of a monetary nature, either granted by the state (for example, subsidies or loans) or owed to the state but not collected (for example, taxes and social security payments). The form of the advantage would not be relevant in determining whether or not it confers an economic advantage on the beneficiary undertaking. Only the effect of the measure granted by the state would be relevant, not the cause or objective of the state intervention.

The consequence of such a requirement is that the beneficiary undertaking must receive an advantage that it would normally not have obtained under normal market conditions, i.e. without the intervention of the state that granted the measure. As a result of the benefit of such an advantage, the position of the beneficiary undertaking in the market would be reinforced and would de facto be more competitive.

An advantage in the form of tax incentives is not excluded from the scope of article 107 of the TFEU. Although both tax legislation and the implementation of tax arrangements are matters for national authorities, the fact remains that the exercise of that competence might, in certain instances, prove incompatible with the TFEU.
As contemplated by both the EU Commission and the ECJ, the granting of a tax advantage reducing the overall tax liability of a company can be accomplished through:

- a reduction in the tax base by modifying the standard method of tax computation (for example, special deductions, special or accelerated depreciation arrangements and, notional methods of calculation of the tax base, such as the cost-plus method);\(^{54,55}\)

- a total or partial reduction in the amount of tax (for example, a tax exemption or credit) resulting in a lower effective tax burden of the taxpayer company;

- deferral of the collection of taxes due by the company, cancellation or even special rescheduling of tax debt further to negotiations with the tax authorities (for example, a lack of administrative measures to recover taxes, ineffective action by the tax authorities and the cancellation of taxes).

Consequently, a measure allowing certain undertakings a reduction in their tax payable, or a postponement of payment of taxes normally due could trigger a finding of State aid.\(^{57}\) A reduction in the administrative burden would be treated similarly in so far as it is intended to relieve economic operators of a financial burden that is inherent in the cost of their economic activities. In principle, such an advantage would relieve these operators of an expense, but this should not involve “aid” if there is no cost to state resources. Moreover, reimbursement by the state of taxes unduly levied would not qualify as an advantage because the assessment of those taxes was not legal.\(^{58}\)

To determine if a fiscal advantage exists, a comparison with the “normal” tax regime applicable to the undertakings will have to be made. To classify a tax measure as advantageous, however, such a comparison with an EU standard (i.e. elaborated on autonomously by EU authorities regardless of a Member State’s policies) would not be possible, as that would interfere with EU sovereignty. In addition, as Member States still have fiscal sovereignty in direct taxation matters, it would not be possible to “assess the existence of an advantage allegedly caused by a direct tax measure of one of the Member States with reference to the abstract notion of what a direct tax system ought to look like.”\(^{59}\) The comparison will thus be based on the tax system of the respective Member State in which the beneficiary of the advantage is established in light of the objectives pursued by that advantage.\(^{60}\) In this respect, the only benchmark available to the EU Commission and the ECJ to evaluate a tax measure as advantageous would be the general tax system in effect in a specific state. Such a position was also confirmed in the Advocate General’s Opinion in Gibraltar (Joined Cases C-106/09 P and C-107/09 P),\(^{61}\) recalling that there is no default tax system under EU law and that the reference framework must be the national framework, understood in light of the objectives pursued by the national legislator.

While this practice seemed to be well-established, as illustrated in previous case law, the EU Commission, in recent State aid investigations, in particular the Starbucks\(^{62}\) and Fiat\(^{63}\) decisions, appears to have departed from this practice, now considering that a tax measure would qualify as an advantage if it constitutes a derogation from the tax standard as determined by the EU Commission itself. Under this new approach, it appears that the EU Commission is now analysing the tax measure based on its own standards and not the general tax system applicable in the Member State under scrutiny. This new approach seems, in essence, to boil down to whether or not the EU Commission approves of a tax measure as applied to a specific structure, and whether it believes it to be in line with its own tax principles. This, consequently, raises the issue of whether the EU Commission, especially the Directorate General (DG) for competition, is implicitly expanding its role beyond its legal prerogatives by acting as a supra-national tax authority that reviews Member States’ tax measures.

4.2.3. Element (3): On a selectivity basis

A selective advantage is present if, under a particular statutory scheme, a measure favours certain undertakings or the production of certain goods in comparison with other undertakings in a comparable legal and factual situation in the light of the objective pursued by the measure concerned.\(^{64}\)

As confirmed by the doctrine and case law, the selectivity element is probably the most challenging and difficult requirement and, as such, deserves special attention. In order to be identified as prohibited State aid, a tax measure must be selective, i.e. granted to specific undertakings or benefitting certain types of production. In order to confirm whether or not a national measure qualifies as selective, it has to benefit certain undertakings in


54. In the 2004 Report, supra n. 25, the EU Commission focused on the concept of advantage in the context of alternative taxation methods (as opposed to traditional analytical tax methods) and, in particular, the cost-plus method applied in cross-border intra-group transactions. As explained by the EU Commission, the use of the cost-plus method can give rise to an advantage with the effect of reducing overall tax liability if it does not take into account the economic reality of the transactions (i.e. some costs are not included to obtain an appropriate arm’s length profit).

55. Germany v. Commission (C-156/98), 1-6857.


60. British Aggregates (T-210/02 RENV), para. 46.


63. British Aggregates (T-210/02 RENV), para. 46. AG Opinion in Gibraltar (C-106/09 P and C-107/09 P), para. 45.

comparison to others, which, given the purpose of the arrangement, are in a comparable legal and factual situation.\(^6\) Pursuant to the 1998 Notice, “the selective advantage may derive from an exception to the tax provisions of a legislative, regulatory or administrative nature or from a discretionary practice on the part of the tax authorities”.\(^6\)

In a nutshell, selectivity could exist as soon as there is discrimination, i.e. the application of a different tax treatment to identical situations. In this respect, selectivity is an exception to the general system applicable to all economic actors, and its test is best characterized as a principle of equality test (i.e. a determination of whether or not the undertakings subject to different tax treatment are deemed to be in a legally and factually comparable situation).

Measures characterized as selective could, however, be justified by “the nature or general scheme of the system”, which would allow qualification as State aid to be avoided. In this respect, a general tax measurement – even if it implies a loss of resources for the state and an advantage to companies – could be justified and classified as not being aid if it benefits all companies located in the national territory without distinction.\(^6\)

As such, in the event a measure at first appears to be general, it would be necessary to examine whether or not it benefits certain undertakings or activities while excluding others. In this respect, it is often difficult to draw a clear line between measures that are public subsidies and those derived from the general economy of the state. On the one hand, any tax modifying the system causes all, or a category of taxpayers, to be relieved of an obligation imposed by the common regime.\(^6\) On the other hand, if the situations are, at first glance, different, it would be normal not to treat those different situations identically. The fact that certain undertakings or certain sectors could benefit more than others from some of these tax measures does not necessarily mean that they would fall within the scope of the competition rules applicable to State aid.

As indicated in the 2016 Notice, “to clarify the notion of selectivity under State aid law, it is useful to distinguish between (i) material and (ii) regional selectivity”.

4.2.3.1. Material selectivity

Material selectivity implies that a measure is de jure or de facto selective, i.e. only applicable to certain undertakings or to certain sectors of the economy of a Member State.

De jure selectivity is easily assessed. The process consists in analysing the legal framework of a tax measure and the conditions set out by the legal provision to determine if the measure will only benefit certain undertakings (for example, with particular features, such as size, period of incorporation (i.e. only companies incorporated between period N and N+1 would benefit from such a regime), whether it is part of a group, etc.).

De facto selectivity is more difficult to assess, as a factual analysis will require determining whether or not a measure is selective. In fact, legal provisions are, in principle, general, and thus applicable to all undertakings. Further to an analysis in concreto, however, it is possible to establish that the final objective of the measure may, in essence, favour only a specific group of undertakings. As confirmed in Gibraltar,\(^6\) although a tax measure (for example, the corporate tax regime) is general in nature, a combination of certain requirements resulting in non-taxation of offshore companies may lead to a specific group of undertakings being privileged. In addition to the case law, the EU Commission has illustrated de facto selectivity by way of examples in its notices,\(^7\) which could ease the process of determining the material selectivity of a measure (for example, thresholds, turnover, types of intra-group transactions and date of incorporation).

In addition, in order to assess the material selectivity of measures mitigating the normal taxation of undertakings, the ECJ has developed a three-step process, as illustrated in the Gibraltar\(^7\) and Italian Cooperatives (Paint Graphos) cases.\(^7\) In this respect: \(^7\)

to classify a domestic tax measure as ‘selective’, it is necessary to begin by identifying […] the common or ‘normal’ regime applicable in the Member State concerned. It is in relation to this common or ‘normal’ tax regime that it is necessary, secondly, to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it differentiates between economic operators who, in light of the objective assigned to the tax system of the Member State concerned, are in a comparable factual and legal situation.

Step 1: Identification of a reference legal system

The measure challenged as potentially selective must be, in principle, part of a common or normal regime applicable to all undertakings of the Member State concerned. The reference system comprises of a consistent set of rules “defining not only the scope of that system, but also the conditions under which the system applies, the rights and obligations of undertakings subject to it and the technicalities of the functioning of the system”.\(^7\) In the tax context, the first step in assessing the material selectivity of a measure is to identify the common or normal tax regime (the “system of reference”) in the state concerned.

Step 2: Existence of a derogation

After having determined the reference legal system, a comparison of the challenged measure with other measures is made in order to determine whether or not there

67. AT ECI, 8 Nov. 2001, Case C-143/99, Adria-Wien Pipeline and Wietersdorfer & Peggaure Zemetnwerke, ECJ Case Law IBFD.
69. AG Opinion in Gibraltar (C-106/09 P and C-107/09 P), I-11113.
70. 2004 Report, supra n. 23 and 2016 Notice, supra n. 32.
72. Paint Graphos (C-78/08 – C-80/08), para. 45.
73. Id.
74. 2016 Notice, supra n. 32.
has been a derogation from the reference system. Should the measure derogate by differentiating between economic operators who are, in principle and in light of the reference system, in a comparable factual legal situation it would be considered selective provided it is not justified (see step 3). With regard to a tax measure, the existence of a derogation (for example, tax breaks) from the corporate tax regime (i.e. the reference system), having the effect of favouring certain undertakings by comparison to other undertakings that are in a comparable factual and legal situation, will qualify as prima facie selective. 73

**Step 3: Is the derogation justified?**

The third (and final) step is to determine whether or not the derogating measure, as determined under step 2, results from the nature or general scheme of the taxation system of which it forms a part.

In principle, a measure derogating from the reference legal system should qualify as prima facie selective. There is an exception, however, or safeguard with regard to selectivity. If the measure is justified by the nature or general scheme of the system, it should qualify as non-selective. As mentioned in the *Paint Graphos* case,76 a measure which creates an exception to the application of the general tax system may be justified if it results directly from the basic or guiding principles of that tax system. 78 Conversely, “an objective that is unrelated to the tax system,”79 such as the reference rather than the full territory of the state body of the local state body adopting the measure, i.e. by virtue of the Constitution and/or public laws, there is a recognized administrative and political status of such discretionary actions, such as the issuance of an advance pricing agreement or an advance tax agreement that confers an advantage on a taxpayer by way of an exception, deviation or departure from the normal scheme of taxation, may mean that the individual application of a general measure takes on the features of a selective measure, unless this can be characterized as the simple management of tax revenue by reference to objective criteria forming part of the “normal” tax system. 83

**4.2.3.2. Regional selectivity**

As a general principle, a measure applying to undertakings established across the whole territory of the state would, in principle, not qualify as State aid. As a result, the ECJ was initially of the view that any measure conferred on undertakings active in part of a national territory should be considered as selective. As confirmed in *Azores* (Case C-88/03), however, measures (tax measures in the case in question) with a regional or local scope may not be considered as selective to the extent that certain requirements are met.

The Advocate General, in his Opinion, set out three different scenarios to determine whether a tax measure could be considered as selective – as further set out in the 2016 Notice:

1. Scenario one: There is regional selectivity where the national government unilaterally grants a tax advantage (for example, a lower tax rate) to undertakings located in a region of a Member State;

2. Scenario two: Symmetrical devolution of tax powers. 86 There is no regional selectivity when a tax measure is granted by local authorities at a particular level (regions, districts or others) of a Member State (who) have the same autonomous power in law to decide the applicable tax rate within their territory; 87 and

3. Scenario three: Asymmetrical devolution of taxing powers. 86 If only certain infra-state authorities have sufficient autonomy from the central government to decide the applicable tax rate within their territory, each of the following three requirements would have to be met in order to have the region in question be considered the reference rather than the full territory of the state:

(a) **institutional autonomy** of the local state body adopting the measure, i.e. by virtue of the Constitution and/or public laws, there is a recognized administrative and political status of such...
a local body distinct from the national government;
(b) **procedural autonomy** of the local state body giving it sufficient powers to adopt a measure, i.e. through a legal process free from any intervention of the national government; and
(c) **economic and financial autonomy** in the sense of being financially responsible for the decision regarding such a measure, i.e. it supports the risks itself and does not receive a subsidy or aid from the national government or other local governments in the event of losses as a direct consequence of the prior adoption of a measure.

These above requirements have been confirmed in other cases, in particular **UGT-Rioja** (Joined Cases C-428/06 to C-434/06).88

4.2.4. **Element (4): Harmful to competition and trade**

4.2.4.1. Distortion of competition and effect on trade

State aid control constitutes a basic pillar of EU competition law. In order to prevent any distortion upon adoption of a national measure that might cause damage to other competitors in the same market, the European authorities assess whether the measure (i) distorts or threatens to distort competition and (ii) affects trade between Member States. These two elements are per se distinct and necessary in determining if a measure constitutes aid. “In practice, however, these criteria are often treated jointly in the assessment of State aid as they are, as a rule, considered inextricably linked”.89 Moreover, they have a broad scope, and practice reveals that there is a presumption that any State aid that would strengthen a firm’s position compared with other competitors would imply a harmful effect on EU trade.

According to the Commission, in confirming the existence of State aid, such a prerequisite “is always met where some or all of the aid recipients are multinational companies operating in sectors open to competition”.90 This was confirmed by the EU Commission in the Apple, Starbucks and Fiat investigations, wherein it was stated that where the recipient is “a globally active firm, operating in sectors open to competition...”,91 was considered as affecting trade between Member States and/or would distort or threaten to distort competition and have the potential to affect intra-Union trade.92

In addition, and to avoid a measure falling within the scope of this fourth condition, Member States have pleaded that the reasoning behind adopting a fiscal measure was to offset a disadvantageous situation in which the national undertakings face fiscal pressures greater than those of other Member States. The idea that a Member State would seek to approximate, through unilateral measures, the conditions of competition in a particular sector of the economy relative to those prevailing in other Member States cannot deprive the measures in question of their character as aid. Therefore, a comparison cannot be established with regard to other Member States, but solely at a national level, between undertakings in the “same playing field/sector. This is to avoid an opportunity for Member States to compete with each other, which might lead to harmful tax competition.

To summarize the aforementioned development, and as confirmed by ECJ and EU Commission decisions, it seems that both requirements under the fourth criterion are rarely considered because there is a presumption that as soon as an advantage is granted by national authorities to certain undertakings, it will automatically be harmful to competition and EU trade.

4.2.4.2. The de minimis rule exception

The de minimis rule was introduced in order to exempt small amounts of aid, i.e. those considered too low to have a negative impact on competition and trade. Such a rule sets a ceiling below which aid is deemed not to fall within the scope of article 107(1) of the TFEU. Such aid is therefore exempt from the notification requirement in article 108(3) of the TFEU.

This exception is the result of an evolution in the approach taken by the EU Commission further to its 1992 communication.93 In 2001, a regulation was adopted and further replaced in 2007,94 which provides that aid not exceeding EUR 200,000 over a period of three years would not be considered as affecting trade between Member States and/or would not distort or threaten to distort competition according to article 107(1) of the TFEU. In this respect, the de minimis rule has given Member States the opportunity to adopt fiscal measures95 that would have been identified as State aid had they not fallen below the ceiling.

4.3. The procedure

The EU Commission, in particular the DG for competition, is responsible for enforcing State aid rules. The EU Commission has been granted the power to control and verify the compatibility of a state measure in order to ensure the functioning of the internal market. Articles

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88. PT: ECJ, 11 Sept. 2008, Joined Cases C-428/06 – C-434/06, Unión General de Trabajadores de La Rioja (UGT-Rioja) and Others v. Juntas Generales del Territorio Histórico de Vizcaya and Others, [2008], ECLR I-6747, ECJ Case Law IBFD.
90. 2004 Report, supra n. 25, at 7-22.
4.3.1.1. Notification and authorization of aid

The State aid procedure provides for ex ante notification to the EU Commission of any new measure (except where it falls under the de minimis exception). A Member State planning to grant a measure that likely entails State aid must first notify, and then have the measure approved by, the EU Commission ("standstill" clause). Although there is no clear indication of when a Member State should notify the EU Commission of the measure, the Regulation provides that it should be given early enough, along with any necessary information, to allow sufficient time for the EU Commission to perform its preliminary examination and/or formal investigation.

The preliminary examination is the first phase of the administrative procedure. During this two-month phase, the EU Commission has to review the measure and decide whether (i) it does not constitute aid per se, (ii) it is aid but does not raise any objections, i.e. it is compatible with the internal market, or (iii) there are doubts as to its compatibility with the internal market and a formal investigation is required. Under (i) and (ii) above, the measure would thus be considered acceptable and the Member State would be allowed to implement it.

If the EU Commission has any doubts about the measure, i.e. scenario (iii) above, the second phase of the administrative procedure is initiated through a formal investigation that could take more than a year before publication of the final decision of the EU Commission. During such a process, the Member State and any interested parties have the opportunity to submit their observations within, in principle, a one-month period following the decision to initiate such a procedure. Once the investigation is finalized, the EU Commission has to adopt a final position as to whether the measure (i) does not constitute aid, (ii) is aid but is compatible with the internal market (positive decision), or (iii) is not compatible with the internal market (negative decision).

4.3.1.2. Unlawful existing aid

Any aid granted in breach of the "standstill" clause would be considered unlawful. In this event, the EU Commission would have to open an examination either on its own initiative or further to a complaint submitted by an outside source (i.e. an interested party or another party who may have information of alleged, unlawful aid). During the examination process, the EU Commission would be in a position to require any information it needs from the Member State concerned. Once the process is finalized, the EU Commission would have the same three choices outlined in section 4.3.1.1. If doubts are raised as to the compatibility of the aid with the tenets of the internal market, the EU Commission would have to initiate a formal investigation procedure.

Once the examination process and, ultimately, the formal investigation procedure is complete, the EU Commission could require the Member State to suspend the alleged unlawful aid until its final decision (also known as a "suspension injunction"). With regard to tax matters, there has been debate in the doctrine as to whether the suspension injunction is effective, as tax aids are, in principle, "not directly granted to the recipients at a certain moment, but operate over the year". By way of an example, aid in the form of a tax base reduction could only apply once the taxpayers effectively have a tax base and are thus liable for taxes (i.e. upon the assessment and collection of taxes).

If, following the formal investigation procedure, the alleged aid is considered incompatible with the tenets of the internal market, the EU Commission would, in principle, have to order the Member State to take all necessary measures to recover the unlawful State aid from the beneficiary of the aid. This means that the beneficiary company (either the company itself or its shareholder(s)) would, in principle, have to pay back the unlawful aid. Such an amount would correspond to the aid initially received, plus annually compounded interest for the period from the date on which the incompatible aid was at the disposal of the beneficiary companies until the date of its recovery at a rate fixed by the EU Commission.

The purpose of such a recovery process is to restore balance between competitors in the internal market, but should only be applicable to the extent that it does not breach the fundamental principles of EU law and is performed within ten years. This period commences on the day on which the unlawful aid was granted, but could be suspended by any action taken by the EU Commission or a Member State. In addition, the suspension would remain effective as long as a procedure remains pending before an EU body.

In the Fiat decision of 21 October 2015 (published on 9 June 2016), the EU Commission concluded that the

97. If, within the legal period, no decision has been notified to the Member State, the measure should be considered as authorized by the EU Commission.
98. In principle, within a period of 18 months.
100. An example of such a general principal may, in exceptional circumstances, be the principle of the protection of legitimate expectations. The EU Commission and the ECJ have recognized that this principle precludes recovery of incompatible aid, for example, in ES: ECI, 19 Dec. 2013, Case C-274/12 P, Telefónica SA v. European Commission, [2013] ECR, p. 852.
101. Art. 17 Regulation.
102. EU Commission decision on Fiat, supra n. 91.
advance pricing agreement granted by the Luxembourg tax authorities to Fiat Finance & Trade Ltd, in relation to the transfer pricing methodology applicable to its financing activities, constituted an unlawful tax aid that was incompatible with the internal market. As a result, Luxembourg was ordered to recover from Fiat the unlawful aid without indicating any amount for the recovery. In fact, the EU Commission indicated that the calculation of the tax aid and its methodology should be determined by Luxembourg, and then communicated within a two-month period following notification of the decision. This illustrates the fact that, despite the obligation that Member States have to recover unlawful State aid, they still have the power to enforce the recovery of aid, in particular to decide not only on the methodology to recover the aid, but also its amount. Nonetheless, by ordering Member States to recover the unlawful tax aid with regard to prior years, as part of its new approach to ongoing State aid investigations, the EU Commission is creating legal uncertainty that was not foreseeable by taxpayers and Member States. It could then be asked whether or not recent EU Commission actions in the area of taxation constitute a breach of one of the general principles of the European Union, i.e. the principle of legal certainty requiring that “EU rules enable those concerned to know precisely the extent of the obligations imposed on them, and that those persons be able to ascertain unequivocally what their rights and obligations are and take steps accordingly”. 103

4.3.2. European courts

In the event of a negative decision from the EU Commission, the Member State concerned and/or any interested party to whom the decision is of direct and individual concern could bring, before the General Court, an action for annulment of the decision. Pursuant to article 263 of the TFEU, such an action should be filed within two months of the publication of the decision, or of its notification to the plaintiff, or, in the absence thereof, of the day on which it came to the knowledge of the latter, as the case may be. Accordingly, the General Court would examine the legality of the EU Commission’s decision by analysing several factors, such as the correct application of the law, whether there was misuse of powers or an infringement of procedural rules, as well as whether the facts were misinterpreted. As a result of such action, the EU Commission’s decision would either be annulled with retroactive effect, or confirmed. An appeal against the General Court’s decision would still be available, but only with regard to points of law. 104

As a result, annulment is a powerful tool for Member States wishing to challenge the EU Commission’s decision on whether the measure constitutes aid within the meaning of article 107 of the TFEU and is compatible with the market. At the end of 2015, Luxembourg and the Netherlands, respectively, filed actions for annulment of the Fiat105 and Starbucks106 decisions, pursuant to which the EU Commission considered that the two countries had granted unlawful tax arrangements to particular taxpayers. More recently, Belgium also brought an annulment action with regard to the Excess profit ruling system decision,107 pursuant to which the EU Commission decided that the Belgian system constituted illegal fiscal state. There is, for the time being, no clear indication of when final decisions from the ECJ are forthcoming. It could take several years.

5. Recap of Open Tax Cases and State Aid Investigations: Conclusion

Since 2013, the EU Commission has carried out in-depth investigations into many tax regimes applicable in various Member States. Initially, only a few countries came under EU scrutiny, such investigations relating to whether certain tax practices in the context of aggressive tax planning were in line with State aid rules. Such enquiries were extended by the end of 2014 to all Member States, who were asked to provide information concerning their tax ruling practices, together with a list of tax rulings issued from 2010 to 2013. According to Commissioner Vestager,108 the EU Commission is currently reviewing more than 1,000 tax rulings issued by Member States. Further investigations could thus be opened if the EU Commission considers that State aid might have been illegally granted by way of tax rulings.109 On 19 September 2016,110 the EU Commission announced the opening of a formal investigation procedure into Luxembourg’s tax rulings granted to the GDF Suez group (now Engie) relating to financing activities and, in particular, the tax treatment of interest-free convertible instruments (ZORAs). This decision does not challenge Luxembourg’s overall tax regime, but rather its inconsistent application of tax rulings, which could represent State aid. A final decision is not expected for several months, as the EU Commission still has to give its final decisions on the Amazon and McDonald’s cases, two multinational companies of US groups who have been granted Luxembourg tax rulings relating to transfer pricing of royalties paid (Amazon) and a tax exemption for royalties attributed to a US branch of a Luxembourg company (McDonald’s).

104. Art. 256 TFEU.
In 2015, the EU Commission issued its first two decisions, which considered that Luxembourg and the Netherlands had granted selective tax advantages to Fiat (now Fiat Chrysler Automobile) and Starbucks, respectively. At the beginning of 2016, a third decision considered that the excess profit tax scheme implemented by Belgium, which had benefited at least 35 multinationals, was unlawful aid. More recently, it was found that Ireland had granted illegal State aid to Apple and was ordered to recover in full aid estimated at more than EUR 13 billion plus interest. The EU Commission, to date, has found that illegal State aid has been granted in each of the cases formally investigated.

Despite the fact that any measure resulting in a selective reduction of tax can potentially be identified as State aid, it appears that the EU Commission has primarily focused its investigations on the application of transfer pricing rules and the allocation of profits, targeting multinational companies of US groups. Moreover, according to its recent decisions, the EU Commission has adopted a new approach that departs not only from prior ECJ cases, but also the law on State aid. The EU Commission has examined, with regard to tax measures, whether a “selective advantage” was granted without assessing separately the existence of an “advantage” and “selectivity”, both concepts being not only distinct, but also essential in order for a measure to be identified as State aid. By collapsing these two concepts, the result could be the creation of a new rule if the ECJ confirms the EU Commission’s position in these ongoing cases. This could create legal uncertainty for EU Member States and their taxpayers. It might also be arguable that the EU Commission is going beyond its prerogatives by creating a new set of rules and acting as a supranational tax authority.

Moreover, the EU Commission’s approach to the current State aid investigations seems to undermine the sovereignty of Member States in the direct tax field, essentially condemning the practice of tax rulings (even though it has been confirmed that the tax ruling practice is, as such, perfectly legal, provided it complies with State aid rules). It also has an impact at an international level and, in particular, for the United States, which has shared its concerns with regard to this new approach and the considerable implications it could have for the US government directly and for US companies. These concerns were addressed in a letter in February 2016 from the US Secretary of the Treasury to the EU Commission’s President and were confirmed with the publication, on 24 August 2016, by the US Department of Treasury of a White Paper entitled, “The European Commission’s recent State aid investigations of transfer pricing rulings”. Amongst the concerns raised, the US is of the view that the EU Commission, through its new approach, (i) is behaving like a supranational tax authority, (ii) is acting inconsistently with international standards (for example, the arm’s length principle as set out by the OECD Transfer Pricing Guidelines) and (iii) is undermining the international tax system, in particular, the multilateral progress made under the OECD BEPS Project, which has set out measures to avoid corporate tax avoidance and double non-taxation situations.

In light of the above, the EU Commission’s new approach in the field of taxation could have a significant impact in practice for Member States, leading to uncertainty for taxpayers who are already being confronted with constantly evolving taxes (in particular in light of recent changes at the international level, for example, the OECD BEPS Project). Finally, it might be questioned whether the recent unprecedented actions of the EU Commission are politically motivated, representing an opportunity for EU institutions to interfere in a field that is highly protected by Member States with the attendant risk of breaching

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### Table of Calculated Tax Relief

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<td>Apple</td>
<td>Profit allocation methods</td>
<td>Yes (final decision on 30 August 2016)</td>
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<td>Fiat</td>
<td>Transfer pricing arrangement</td>
<td>Yes (final decision on 21 October 2015)</td>
<td>Luxembourg</td>
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<td>Starbucks</td>
<td>Transfer pricing arrangement</td>
<td>Yes (final decision on 21 October 2015)</td>
<td>Netherlands</td>
<td>Filed on 23 December 2015</td>
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<tr>
<td>Minimum of 35 multinational enterprises</td>
<td>Excess profits tax scheme</td>
<td>Yes (final decision on 11 January 2016)</td>
<td>Belgium</td>
<td>Filed on 22 March 2016</td>
</tr>
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</table>

1. IE: ECJ, Pending Case T-778/16, Ireland v. Commission (action brought by the Ireland seeking to annul the Apple decision).

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### Table of Recent State Aid Investigations

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<td>McDonald’s</td>
<td>Double non-taxation</td>
<td>Yes (3 December 2015)</td>
<td>Luxembourg</td>
<td>Not published</td>
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<td>GDZ Suez (now Engie)</td>
<td>Double non-taxation</td>
<td>Yes (19 September 2016)</td>
<td>Luxembourg</td>
<td>Not published</td>
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</tbody>
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well-established EU principles. In other words, does the end justify the means? The issue now is whether the ECJ will follow the EU Commission’s approach, which, if confirmed, would depart from its own long-standing methodology.