THE COURT OF JUSTICE OF THE EUROPEAN UNION OVERTURNS EUROPEAN COMMISSION DECISION THAT LUXEMBOURG GRANTED ILLEGAL STATE AID TO FIAT IN TRANSFER PRICING RULING

On 8 November 2022, the Court of Justice of the European Union ("CJEU") set aside the EU General Court's judgment of 2019 and annulled the Commission's decision of 2015 that had held that Luxembourg had granted unlawful State aid to a Luxembourg Fiat group company by accepting the transfer pricing methodology proposed by Fiat in a Ruling procedure in relation to intra-group financing transactions. In particular, the Commission had challenged the transfer pricing analysis used to determine the arm's length remuneration recognized to the intragroup financing companies focusing, inter alia, on the choice of the transfer pricing method, the profitability indicator, and the selection of comparable companies.

The EU's highest court judgement overturns the decision of the EU General Court which held that the arm's length principle is a "general principle of equal treatment in taxation which falls within the scope of Article 107(1)TFEU" irrespective of whether or not, or to what extent, it is incorporated in national tax legislation. In this respect, it is worth noting that the tax law in Luxembourg incorporates (a version of) the arm's length principle.

However, the CJEU found that the Commission had applied its own version of the arm's length principle and that "its analytical framework did not include all the relevant norms implementing the arm's length principle under Luxembourg law". The CJEU pointed out (para. 93): "It is true, as the parties all agree, that the national law applicable to companies in Luxembourg is intended, as regards the taxation of integrated companies, to bring about a reliable approximation of the market price. While that objective corresponds, in general terms, to that of the arm's length principle, the fact remains that, in the absence of harmonisation in EU law, the specific detailed rules for the application of that principle are defined by national law and must be taken into account in order to identify the reference framework for the purposes of determining the existence of a selective advantage." In other words, in the examination of the existence of a selective economic advantage, the CJEU did not accept the Commission's use of an overarching EU arm's length principle. Instead, the CJEU required that the existence of a selective advantage must arise from a departure from the reference system i.e. the domestic tax system.

The judgment does not, however, rule out the possibility that direct tax measures, such as tax rulings granted by the Member States, may be classified as a State aid in cases where all the conditions are proven to be fulfilled. Thus, Member States must exercise their competence in the field of direct taxation in compliance with EU law and, in particular, with the rules established by the TFEU Treaty on State aid. In this respect, paragraphs 119-122 of the judgement set a framework for the Commission to review transfer pricing rulings under EU State aid rules stating that: "the Commission must […] be able to establish that the parameters laid down by national law are manifestly inconsistent with the objective of non-discriminatory taxation of all resident companies, whether integrated or not, pursued by the national tax system, by systematically leading to an undervaluation of the transfer prices applicable to integrated companies or to certain of them, such as finance companies, as compared to market prices for comparable transactions carried out by non-integrated companies."

On the judgement, a Statement by the Executive Vice-President of the European Commission affirmed that "Even if the Commission's decision was annulled, the judgment gives important guidance on the application of EU State aid rules in the area of taxation. The Court confirmed that action by Member States in areas that are not subject to harmonization by EU law is not excluded from the scope of the Treaty provisions on the monitoring of State aid".

The Maisto e Associati team advising Fiat alongside Sullivan & Cromwell was led by Guglielmo Maisto and included Aurelio Massimiano and Mirko Severi.

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