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Grand Duchy of Luxembourg and Engie v European Commission: (another?) mortal wound in the Commission's campaign

Introduction

The Commission's tax ruling campaign informally began in 2013 and blossomed into full negative decisions against several Member States between 2015 and 2018. But on 5 December 2023, the European Court of Justice (ECJ) put another wound in the Commission's campaign when it found that Luxembourg had not given unlawful aid to Engie.[1] Along with the wounds inflicted by the ECJ in its decisions in *Amazon*[2] and *Fiat*,[3] one wonders if the campaign is now already dead. The Commission has definitively lost its three cases against Luxembourg in respect of Amazon, Engie and Fiat (all at the ECJ level); and against the Netherlands in respect of Starbucks[4] (it lost at General Court (GC) level and did not appeal). All that remains is *Apple*, and even then, the Commission is limping towards that judgment having already lost at the GC[5] and, despite an optimistic Advocate General (AG) opinion in the case,[6] looks certain to lose at the ECJ in light of the decision in *Engie* on which this note will focus.

After summarising the facts of the case, this note will discuss the Commission's decision, GC's decision, the AG's opinion and the ECJ judgment in turn. The discussion will then turn to the consequential and contentious aspects of the judgment, namely, the impact of the case on *Apple*, the proposed deferential approach to misapplications from the AG and ECJ and how costly the litigation has been.

Background

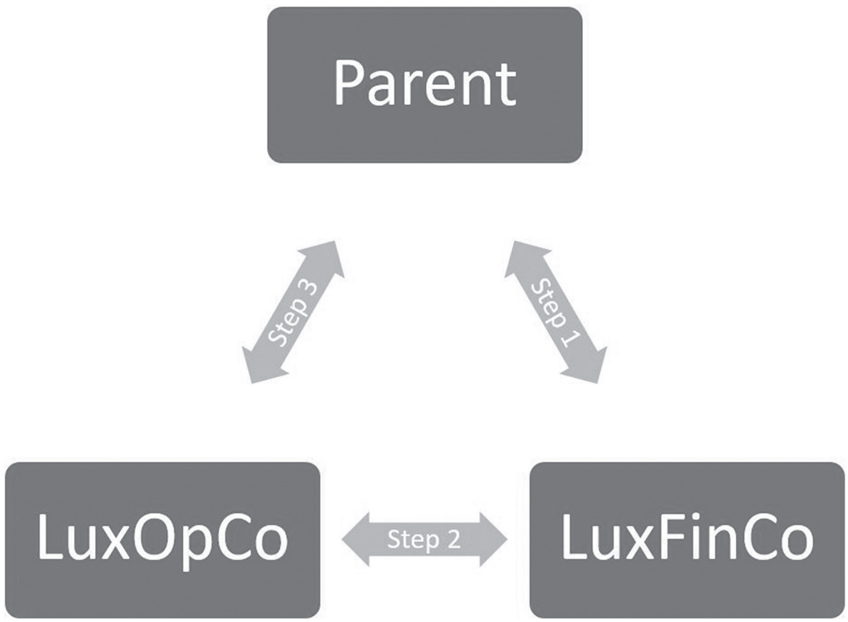
The structure

The *Engie* case concerned two intra group financing transactions—involving two parent companies, two intermediate financing subsidiaries and two operating subsidiaries. The parent

[1] *Grand Duchy of Luxembourg and Engie v European Commission* (Joined Cases C-451/21 P and C-454/21 P) EU:C:2023:948.
[2] *European Commission v Grand Duchy of Luxembourg and Amazon* (C-457/21 P) EU:C:2023:985.
[3] *Fiat Chrysler and Ireland v European Commission; Grand Duchy of Luxembourg v European Commission* (Joined Cases C-885/19 P and C-898/19 P) EU:C:2022:859; [2022] S.T.C. 2166.
[4] *Netherlands and Starbucks Corp v European Commission* (Joined Cases T-760/15 and T-636/16) EU:T:2019:669; [2019] S.T.C. 2323.
[5] *Ireland, Luxembourg, Apple Sales International and Apple Operations Europe v European Commission* (Joined Cases T-778/16 and T-892/16) EU:T:2020:338; 22 I.T.L. Rep. 815.
[6] Opinion of Advocate General Pitruzzella in *European Commission v Ireland and Apple* (C-465/20 P) EU:C:2023:840.

companies transferred business activities (in the first intra group transaction, it was activities in the liquefied natural gas sector, in the second, it was financing and treasury management services). For ease of illustration, this note will present the structure in generic terms.[7] The transactions involved three key steps:

- Step 1: The Parent gives funding (by way of a Prepaid Forward Sales contract) to a Finance Company (LuxFinCo) subsidiary (which provides funding to the Operating subsidiary (LuxOpCo)).
- Step 2: LuxFinCo provides to LuxOpCo a 15-year interest free convertible loan, known as a Zero-intérêts Obligation Remboursable en Actions (ZORA).
- Step 3: LuxOpCo purchases business activities from the Parent (with the funds from the loan).



There are two important aspects to the transactions. The first is that, on conversion of the loan into equity, LuxOpCo pays shares to LuxFinCo representing the nominal amount of the loan *plus*, essentially, all the profits (known as "ZORA accretions") made by LuxOpCo during the course of the loan (minus a very small margin, on which more will be said below). This has the effect of stripping virtually all value out of LuxOpCo. This is a different means of financing from a traditional loan whereby interest is due every year. Instead, no interest is due on the loan, but the profits accumulate before being due back to the loan provider when the loan is converted into shares.

[7] For further detail on the first transaction for instance, see Decision 2019/421 on State aid SA.44888 (2016/C) (ex 2016/NN) implemented by Luxembourg in favour of Engie [2019] OJ L78/1, recitals 23–27.

The second aspect which needs to be appreciated is that, in return for the Parent providing the funds to LuxFinCo (at Step 1), the Parent gets the rights to the converted shares of LuxOpCo. This has the effect of sending all the value of LuxOpCo back into the hands of the Parent (via LuxFinCo). Technically, the Parent cancels these shares,[8] which makes sense given that it already holds 100% of the shares in LuxOpCo. On cancellation, a capital gain accrues in its accounts.

The overall effect is that the Parent provides the funding that LuxOpCo then uses to purchase the business from the Parent, which, should LuxOpCo make a profit, goes back into the hands of the Parent. In other words, the Parent receives the profits it would have received had it simply engaged in the activities itself.

The rulings

By way of the tax rulings agreed with Luxembourg between 2008 and 2014, the following tax treatment is assigned to the three companies:[9]

- First, LuxOpCo gets a deduction every year for the vast majority of the profit it makes as that profit represents a cost of the finance provided to fund its activities. As such, the profit is treated, for tax purposes, like an interest payment, justified by the fact that on conversion, LuxOpCo will have to pay back the shares with the amounts including both the nominal and the profits. This deduction wipes out almost all of LuxOpCo's taxable profits, except for a very small margin of its activities (less than 1% of the profit actually realised by LuxOpCo from its commercial activities).[10] This margin, which is agreed with the Luxembourg tax authority, is calculated on the basis of balance sheet values or at least on the basis of turnover (meaning that it would pay tax even in the event of a loss).[11]
- Secondly, the Parent, when it eventually receives the shares in LuxOpCo, does not pay any tax on the transaction (which is recorded as a capital gain in its accounts). Luxembourg operates a participation exemption, which covers capital gains, dividends and liquidation proceeds for Luxembourg entities which hold at least 10% of the shares in a Luxembourg entity for at least a year (art.166 of loi du 4 décembre 1967, concernant l'impôt sur le revenue (LIR)). There is nothing per se odd about this participation exemption—in the UK for instance, the Substantial Shareholding Exemption would exempt from tax a disposal by a parent of its subsidiary's shares.
- Thirdly, LuxFinCo does not pay any tax because it does not make any profit—any profit it makes on the convertible loan is offset by the cost of servicing the Forward contract.

[8] Decision 2019/421 on State aid in favour of Engie [2019] OJ L78/1, recital 26 fn.26.
[9] Decision 2019/421 on State aid in favour of Engie [2019] OJ L78/1, recitals 28–77.
[10] Decision 2019/421 on State aid in favour of Engie [2019] OJ L 78/1, recital 24.
[11] Opinion in *Engie v European Commission; Luxembourg v European Commission* (Joined Cases C-454/21 P and C-451/21) EU:C:2023:383 at [AG40].

As mentioned earlier, this structure allows the Parent to receive the profits it would have received had it simply engaged in the activities itself. But the effect of the structure is that the Parent *does not* have to pay tax on those profits.

Commission and GC decisions

In order to prove that there has been unlawful aid, the key criterion in tax cases is whether there is a "selective advantage" provided. A three-stage test is used to determine whether this arises.[12] First, the reference framework must be determined—this is the "normal" taxation which would apply to taxpayers in the situation of the taxpayer concerned. Secondly, it is assessed whether there has been a derogation from this "normal" taxation in favour of the taxpayer, such favouritism not being available to other taxpayers in comparable (in light of the objective pursued by the measure concerned) legal and factual circumstances. The third is whether such favouritism is nevertheless justified in light of the nature or scheme of the tax system. Given that the analysis of selectivity hinges on the selection of the appropriate reference framework, the determination of what is "normal" is critical.[13]

In its decision finding that the rulings granted State aid to Engie, the Commission adopted four lines of reasoning with three different reference frameworks: one, a broad reference framework in the form of the Luxembourg corporate tax system; two, a narrow framework composed of the participation exemption (LIR art.166) and the provision of Luxembourg law which deems there to be tax on profit distributions even if the monies are not formally distributed (LIR art.164); three, Luxembourg's general anti-abuse rule (Steueranpassungsgesetz (StAnpG) art.6). In respect of each, the Commission found a derogation in that the profits of the operating companies went untaxed both in the hands of the subsidiaries and in the hands of the parents. In respect of the first two reference frameworks, the core argument of the Commission was that there was a link between LIR art.166 and art.164—the participation exemption in LIR art.166 was only available as a matter of Luxembourg law where the profits had previously been taxed by virtue of LIR art.164.[14]

The GC went on to agree with the Commission that, as a matter of Luxembourg law, the Parent should only have been entitled to the participation exemption where the income was previously taxed elsewhere in the group.[15] There were two aspects to this. First, LIR art.164 imposed tax on profit distributions (this is technically not correct, as AG Kokott would later highlight).[16] The ZORA accretions, as per the Commission[17] and the GC,[18] ought to have been recognised as profit distributions in the hands of the subsidiaries and hence taxed. Secondly, LIR art.166 should only have granted the holding companies the participation exemption where the distribution to them

[12] *Adria Wien Pipeline GmbH v Finanzlandesdirektion fur Karnten* (C-143/99) EU:C:2001:598; [2001] E.C.R. I-8365 at [41]–[42]; *Ministero dell'Economia e delle Finanze v Paint Graphos Sarl* (C-78/08, C-79/08 and C-80/08) EU:C:2011:550; [2011] S.T.C. 2303 at [49] and [65].
[13] *Fiat* (C-885/19 P and C-898/19 P) EU:C:2022:859 at [69].
[14] Decision 2019/421 on State aid in favour of Engie [2019] OJ L78/1, recital 218 in particular.
[15] See, in particular, *Luxembourg v Commission* (Joined Cases T-516/18 and T-525/18) EU:T:2021:251 at [292]–[296] and [300].
[16] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG95].
[17] Commission Decision 2019/421 on State aid in favour of Engie [2019] OJ L78/1, recital 93.
[18] *Luxembourg* (T-516/18 and T-525/18) EU:T:2021:251 at [300].

had been previously taxed at the subsidiary level. As such, the Court agreed with the Commission that there was a link between arts 164 and 166. This was said to accord with the purpose of art.166 which was to prevent double taxation (as interpreted by the 1965 Conseil d'État opinion).[19] Presumably the logic of that argument is that double taxation is only prevented where the transaction has been taxed at least once. In the present case, there was no risk of double taxation, as there was no tax at the subsidiary level, and hence art.166 should have had no application. The link between the two was also said to be captured by Luxembourg's evidence in a letter to the Commission in 2018 wherein it said that income covered by art.166 would also be covered by art.164.[20] A purposive interpretation of the statute thus prevailed despite the fact that there was no express link between the two provisions.[21]

Furthermore, the Court agreed that the Luxembourg general anti-abuse rule should have bitten the transaction according to the Commission's analysis of the administrative and judicial practice on the application of StAnpG art.6.[22] The GC, in essence, agreed that the non-payment of tax on profits would not have been possible if an alternative means of financing had been used (for instance through an equity instrument or a loan).

AG Kokott

AG Kokott is one of the most respected and influential figures in EU tax law. Not content with merely being an extremely important figure at the ECJ, she also holds an adjunct professorial role at the University of St Gallen (where she held a chair before becoming an AG) and is an excellent tax scholar, writing significant books on international and EU tax law in 2022 for instance.[23] She was not given the chance to make her views on the tax ruling cases officially known when the *Fiat* case came to the ECJ—that opportunity went to AG Pikamäe.[24] But having waited on the side-lines, she was finally called upon for the *Engie* case and, for interested spectators, it was certainly worth the wait.

Five years prior, AG Kokott had weighed in on the Commission's tax ruling campaign at the International Fiscal Association's annual congress. She had suggested that tax authorities ought to have "some margin of error, discretion, when it comes to interpreting their national law"[25] (something which I had been flagging for some time before).[26] *Engie* was the opportunity for her to put flesh on the bones of that argument. As she identified, at the heart of the tax ruling cases was an assumption that a misapplication of the tax rules, deliberate or innocent, by the tax authorities could result in State aid.[27] Such a misapplication could arise not just where the tax

[19] *Luxembourg* (T-516/18 and T-525/18) EU:T:2021:251 at [296].
[20] *Luxembourg* (T-516/18 and T-525/18) EU:T:2021:251 at [295].
[21] *Luxembourg* (T-516/18 and T-525/18) EU:T:2021:251 at [292].
[22] *Luxembourg* (T-516/18 and T-525/18) EU:T:2021:251 at [384]–[478].
[23] See for instance her recent books: Juliane Kokott, *EU Tax Law* (Oxford: Hart, 2022); Juliane Kokott and Pasquale Pistone, *Taxpayers in International Law* (Oxford: Hart, 2022).
[24] Opinion of Advocate General Pikamäe in *Fiat and Ireland v Commission* (C-885/19 P and C-898/19 P) EU:C:2021:1028.
[25] Jack Schickler, "EU Judges Cautious Over State Aid Cases, Court Official Says", *Law360*, 5 September 2018.
[26] See, Stephen Daly, "The authority to get it wrong and AG Kokott's comments" (7 September 2018), *https://taxatlincolnox.wordpress.com/2018/09/07/the-authority-to-get-it-wrong-and-ag-kokotts-comments/*. The argument is fully fleshed out in Stephen Daly, "Power to Get it Wrong" (2021) 137(2) L.Q.R. 280.
[27] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG89].

authority provides a ruling which incorrectly confirms particular tax consequences, but also potentially any time a tax assessment is finalised on an erroneous basis.[28] Taken to its logical conclusion, the Commission would "consequently become a de facto supreme inspector of taxes", as it would be entitled to check all tax assessments, and the Courts of Justice of the European Union (CJEU) "de facto supreme tax courts" by dint of reviewing the Commission's quasi tax assessment decisions.[29] This is something that the Commission and CJEU are not well equipped to manage, as evidenced, according to AG Kokott, by the fact that the GC in the *Engie* case had already misunderstood the function of art.164 (it is not a levying provision, as the Court suggested, but rather defines the basis of assessment).[30] To perform this role effectively would require in-depth understanding of national tax laws. But even AG Kokott, with her significant expertise in the domestic tax law of some EU Member States, EU tax law and international tax Law, did not "claim to possess" the requisite knowledge (a comment which might be understood as words of caution towards the judges).[31] The Commission and CJEU might have to engage in the arduous task of analysing the literature about domestic law and case law to determine the correct approach.[32] A further deleterious consequence of overly intrusive State aid rules would be the negative impact on legal certainty for taxpayers.[33]

In order to avoid these problems, AG Kokott instead proposed that potential misapplications of domestic tax rules should "be reviewed only on the basis of a restricted standard of review that is limited to a plausibility check".[34] Only those misapplications, whether through tax rulings or other tax assessments, which are "manifestly erroneous" in the sense that the misapplication could not be "plausibly explained to a third party, such as the Commission or the Courts of the European Union, and are therefore equally evident to the taxpayer concerned" could constitute a selective advantage.[35] She found support for this approach by way of analogy with the line of ECJ cases[36] concerning "manifestly discriminatory" tax provisions (which are equally contrary to the State aid rules).[37] A manifestly erroneous misapplication also operates in a manifestly discriminatory manner.

Applying this deferential standard to the case at hand, AG Kokott went on to find that the rulings did not in fact manifestly depart from Luxembourg tax law. In respect of the narrow reference framework, AG Kokott highlighted firstly, that LIR arts 164 and 166 contain no express link (in fact they refer to "different types of taxpayer").[38] Secondly, art.166 transposed the EU Parent Subsidiary Directive which also did not contain a link.[39] Thirdly, by finding that StAnpG

[28] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG96].
[29] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG96].
[30] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG93]–[AG95].
[31] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG115].
[32] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG92].
[33] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG100].
[34] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG101].
[35] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG92].
[36] *European Commission v Gibraltar; Spain v European Commission* (Joined Cases C-106/09 P and C-107/09 P) EU:C:2011:732; [2012] S.T.C. 305; *Commission v Poland* (C-562/19 P) EU:C:2021:201; [2021] 3 C.M.L.R. 6; *Commission v Hungary* (C-596/19 P) EU:C:2021:202; [2021] 3 C.M.L.R. 7.
[37] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG91]–[AG92].
[38] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG109].
[39] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG110].

art.6 applied, it could be inferred that the Court and Commission had doubts about the link between LIR arts 164 and 166.[40] But a misapplication by the tax authority of those provisions could not constitute an art.6 abuse (the latter focuses on the actions of the taxpayer, not the collusion of the tax authority).[41] In respect of the StAnpG art.6 framework, AG Kokott suggested that the argument in favour of deference is even stronger given that there is "necessarily some leeway in the application of general anti-abuse rules"[42] as a determination of abuse is "highly dependent on the individual case"[43] and it is "probably that the application of an anti-abuse rule is mandatory in very few cases".[44] Against this background, AG Kokott argued that the Commission did not seriously engage with case law or administrative practice in determining the scope of what amounted to "abuse"[45] and only looked "in general terms" at how the conditions for the application of StAnpG art.6 should apply.[46] She ultimately found that it was not manifest that StAnpG art.6 should have been applied, nor was it manifest that the interpretation of the Commission and GC followed from Luxembourg law.[47] That interpretation concerned what would happen if different means of financing had been used, and if a different result would occur, that would prove that Engie's structure was abusive. But the finding of inappropriateness is a non-sequitur. The inappropriateness of the structure would still have to be proved,[48] but convertible financing instruments are common in corporate structures and do not actually generate non-taxation (reiterating the point that the operating companies are subject to tax, but on a very small margin which had been negotiated with the Luxembourg tax authority).[49] In any event, it was not clear that a different result would have been achieved without the intervening intermediary companies.[50]

Even if the deferential standard would not be adopted by the CJEU in respect of the narrow reference framework, AG Kokott nevertheless found that there was no non-manifest misapplication. First, the wording cannot be read as suggesting a link between LIR arts 164 and 166.[51] Secondly, the provisions serve different purposes which are not necessarily connected.[52] Thirdly, the evidence from Luxembourg (Luxembourg's 2018 letter and the 1965 Opinion) on which the Commission relied for its interpretation was ambiguous.[53]

[40] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG111].
[41] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG112].
[42] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG146].
[43] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG147].
[44] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG149].
[45] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG152].
[46] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG153].
[47] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG155].
[48] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG157].
[49] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG159].
[50] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG158].
[51] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG116].
[52] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG117]–[AG119].
[53] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG121]–[AG122]. The ECJ (*Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [129]–[130]) went on to agree with Kokott's interpretation of the Luxembourg evidence on this point. See the first paragraph in ECJ decision below.

ECJ decision

The ECJ overturned the GC's judgment and dismissed the Commission's case in its entirety (rather than reverting it back to the GC for a new determination in light of the correct approach to the State aid rules as illuminated in the ECJ's judgment[54]).

Most interested onlookers would have been keen to see if the ECJ would endorse Kokott's deferential standard of review. But it did not explicitly do so. Instead, the Court began its analysis by reiterating what was said in *Fiat* that the determination of fundamental characteristics of Member State's tax codes is left to the discretion of Member States,[55] except in those areas that have been harmonised at the EU level.[56] The point is reinforced by the principle of legality, by way of which taxpayers will only be subject to taxation on the basis of national tax laws, thereby heading off the possibility of uncodified supranational tax laws.[57] Given the deference to Member States in respect of determining their tax bases (and the duty of sincere cooperation as set out in TEU art.4(3)), the Court found that the evidence from Member States as to how their own laws should be interpreted should be taken in good faith. The Commission should only depart from that analysis where it has consistent and reliable evidence (from case law and administrative practice) to the contrary.[58] So whilst this is not quite the same as Kokott's approach, which forgives all but the most manifestly erroneous misapplications of domestic law, it arrives in a similar region by requiring the Commission to provide clear evidence of an improper ruling.

But the Commission and GC did not adopt a literal interpretation of Luxembourg law, nor did they accept Luxembourg's evidence. Luxembourg had explained in its 2018 letter to the Commission that there was no link between art.164 and art.166, so the Commission's reading of that letter was selective and incorrect.[59] As for the 1965 opinion, it did not follow that a purpose of avoiding double taxation also conversely looked to prevent double non-taxation.[60] Instead, both the Commission and GC adopted a purposive interpretation of the legislation, which the ECJ found was not "valid".[61]

As for the Commission's argument that StAnpG art.6 should have applied to the transactions, the ECJ found against the Commission for essentially the same reasons. Picking up on the AG's assessment, art.6 was drafted in very broad terms and so a simple, but misconceived, application of that provision would capture a whole range of legitimate activities.[62] What the Commission ought to have done is looked to Luxembourg case law and administration practice on the

[54] In order to do so, the Court had to demonstrate that the other arguments put forward initially by the Commission would also fail. Thus, the Court had to address the lines of reasoning which were predicated on a broader reference framework. See *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [174]–[188]. Such a reference framework omits LIR art.166 which deliberately removes certain income from taxation and as such is erroneous.
[55] *Fiat* (C-885/19 P and C-898/19 P) EU:C:2022:859 at [73].
[56] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [112]–[113].
[57] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [119]. The point was also made by the author in an earlier article: Stephen Daly, "The constitutional implications of an EU arm's length principle" (2020) 60(2/3) *European Taxation* 70.
[58] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [121]–[123].
[59] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [129].
[60] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [130].
[61] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [128].
[62] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [153].

applicability of StAnpG art.6.[63] It could not devise its own interpretation of the provision—that would be contrary to fiscal autonomy.[64] But, as pointed out by the AG, the Commission only looked at a high level of generality at Luxembourg case law and administrative practice.[65]

Some fig leaves?

But it was not all bad news for the Commission. The ECJ left open two possible arguments that Luxembourg may have granted State aid which the Commission could pursue. First, it would be open to the Commission to argue that the participation exemption in LIR art.166, insofar as it exempts profits generated through ZORAs which have not already been taxed, could itself give rise to State aid.[66] This is a controversial suggestion, because selectivity analysis in State aid law customarily begins by analysing whether there has been a derogation from a reference framework. But what if there is no derogation and yet the domestic tax rules appear to naturally favour some taxpayers over others (as the ECJ suggests here in respect of the participation exemption)? There is only one direct precedent on the matter—*Gibraltar*[67] and the ECJ in *Engie* expressly endorsed it.[68] In *Gibraltar*, the corporate tax rules would have benefitted offshore entities over onshore entities because the tax on companies was imposed principally on the basis of employees and business premises in the jurisdiction. Given that offshore entities had no staff or assets in Gibraltar, they would basically pay no tax. The ECJ found that the Gibraltar tax rules granted State aid—not because these tax rules constituted a derogation from the reference framework but because "their very application results in a different tax burden for different undertakings".[69] In the context of the participation exemption, it could be argued accordingly that the Luxembourg tax base was calibrated to selectively advantage holding companies who used, through intermediaries, ZORAs to reduce tax liability.[70]

Secondly, the ECJ suggested that the small margin of the operating companies (of less than 1% of its profits) *which was* taxable in Luxembourg could have been determined contrary to the State aid rules.[71] Very few details of this aspect of the rulings are provided in the publicly available materials, but the AG strongly hinted that the fact that this determination was negotiated and

[63] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [155].
[64] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [154]–[155].
[65] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [158]. See Advocate General Kokott in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [158].
[66] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [144] and [176]. AG Kokott was, however, keen to highlight that many countries offer group relief like the participation exemption and it is up to countries how they wish to offer group relief. And in the case of the income in Luxembourg, this does not go untaxed, but what occurred was that the operating margin was taxed on a negotiated basis: Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG126]–[AG131].
[67] *Gibraltar* (C-106/09 P and C-107/09 P) EU:C:2011:732.
[68] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [144] and [176].
[69] *Gibraltar* (C-106/09 P and C-107/09 P) EU:C:2011:732 at [93].
[70] Ruth Mason has proposed a cogent and coherent framework for analysing tax provisions which are facially neutral but de facto advantage certain entities over others: Ruth Mason, "Identifying Illegal Subsidies" (2019) 69 *American University Law Review* 101. She has suggested such a framework could be used to analyse the issues which have arisen in the *Apple* case: Ruth Mason, "The AG's Opinion in Apple: Two Steps Forward, One Step Back" (2023) 112 *Tax Notes International* 1315, 1319–1320.
[71] See *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [13], [20] and [172].

that it was not based on a determination of profits but instead on balance sheet values or turnover may indicate that there was a departure from the ordinary tax rules.[72]

What is slightly jarring about the limitation period with respect to the State aid rules is that it pauses from the moment that any action is taken by the Commission with regard to the unlawful aid.[73] Thus, whilst the limitation period is 10 years,[74] this 10 year period looks back from the moment that the Commission first began its investigations.[75] In other words, the Commission can look back as far now as it did when it began its investigations. So the Commission could start a new investigation into Engie and *Luxembourg* and assess whether either of these new arguments has merit.

Discussion

Immediate implications

The judgment is surely to be welcomed by Member States, as it limits the ability of the Commission to intrude into tax administration, and for taxpayers, who will feel more confident that their past tax affairs will not be relitigated at a supranational level years, or perhaps decades, after a tax return has been submitted. It will have significant implications for the only remaining live tax ruling case (there are a series of pending investigations),[76] namely *Apple*. Ireland, for its part, has consistently claimed that its branch profit allocation rules took account only of the actual activities conducted by Apple's Permanent Establishments in Ireland, this assessment being apparently supported by an opinion provided by a former Irish High Court (and GC) judge.[77] This means a one-sided analysis of the functions performed by the PEs, rather than a two-sided comparative analysis of the activities of the PEs and their head offices. In its case against Ireland and Apple, the Commission does not cite Irish case law and administrative practice which contradicts the Irish side's analysis. The Commission itself (and GC) had recognised that there was no consistent approach which could be inferred from the Irish Revenue Commissioner's administrative practice.[78] Meanwhile, the only relevant Irish cases that have been cited so far are *Murphy v Dataproducts Ltd*,[79] where interest on an investment fund in Switzerland was found not to be taxable in Ireland because the Irish PE of the non-resident Dutch company that owned

[72] Opinion in *Engie* (C-454/21 P and C-451/21) EU:C:2023:383 at [AG32] and [AG82]–[AG85].

[73] Regulation 2015/1589 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union [2015] OJ L248/9, art.17(2). See further, Stephen Daly, "Fiat v Commission: A Misconception at the Heart of the Tax Ruling Cases" (2023) 86(6) *Modern Law Review* 1489, 1490–1491.

[74] Regulation 2015/1589 [2015] OJ L 248/9 art.17(1).

[75] To support this interpretation, see for instance *Tirrenia di Navigazione v Commission* (T-601/20) [2022] EU:T:2022:302 where an investigation was opened in 1999 with a first decision in 2005. The GC annulled this decision in 2009. The investigation reopened thereafter with a second decision in 2020. The GC confirmed the legality of Commission's approach in 2022.

[76] See European Commission, "Tax Rulings" at *https://competition-policy.ec.europa.eu/state-aid/tax-rulings_en*.

[77] Decision 2017/1283 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple (notified under document C(2017) 5605) [2017] OJ L187/1, recitals 199–201.

[78] Decision 2017/1283 [2017] OJ L187/1, recital 403; *Ireland, Luxembourg, Apple Sales International and Apple Operations Europe v European Commission* (Joined Cases T-778/16 and T-892/16) EU:T:2020:338 at [479]; 22 I.T.L. Rep. 815.

[79] *Murphy v Dataproducts Ltd* [1988] I.R. 10.

the investment fund did not control the bank account,[80] and *Belville Holdings Ltd v Cronin*,[81] where it was held that Irish law required that a notional charge for management fees between associated entities should be accounted for in such an amount that would be "within the realm of being a bona fide transaction".[82] These hardly provide clear and consistent evidence that Irish law adopts a two-sided comparative approach to determining PE profits (for instance, in *Dataproducts*, the High Court was not particularly concerned with determining the relative functions of the Dutch head office and the Irish PE, but rather whether the latter *did* control the bank account), or that there should be arm's length adjustments ("within the realm of a bona fide transaction" in *Belville Holdings* looks far more porous and inexact than the arm's length principle).

Taking a step back, the Commission must surely be dumbfounded to have received such a hostile reception at the ECJ, particularly if one understands the context of the tax rulings which were granted in Luxembourg at the time of the *Amazon*, *Engie* and *Fiat* cases (all cases which have now been lost at the ECJ level). Until 2013, which is when the majority of the rulings were granted to Amazon, Engie and Fiat, there was just one tax official responsible for granting rulings, Marius Kohl, or, "Monsieur Ruling".[83] During Kohl's tenure some 40% of tax rulings were approved within the day of application.[84] In the context of transfer pricing, he was asked how he verified whether a company's pricing information was accurate, and in response, he licked his thumb and held it up in the air.[85] This poor administrative practice has been remedied since—authority for granting rulings no longer rests with a single individual and annual reports summarising anonymised rulings are published.[86] Nevertheless, poor or improper administrative practices do impact other Member States and the EU should have a role to play in monitoring and reforming poor tax administration. To that end, I have argued that there ought to be a supranational means of holding tax authorities to account over their failure to properly apply tax rules in the EU and that a robust form of accountability to achieve this could be embedded in open method of coordination initiatives.[87]

Deference

An institutional framework for reforming tax administration would be one solution to the problem. However, litigation and enforcement of State aid rules is another worthy mechanism for managing improper tax collection practices. Should such an approach continue to be adopted, there is much merit in Kokott's suggestion of a deferential standard. The deferential approach would catch the

[80] *Murphy* [1988] I.R. 10 at 13.
[81] *Belville Holdings Ltd v Cronin* [1985] I.R. 465.
[82] *Belville Holdings* [1985] I.R. 465 at 470 (Carroll J).
[83] Matthew Karnitschnig and Robin van Daalen, "Business-Friendly Bureaucrat Helped Build Tax Haven in Luxembourg" *Wall Street Journal*, 21 October 2014.
[84] Omri Marian, "The State Administration of International Tax Avoidance" (2017) 7 *Harvard Business Law Review* 101, 217.
[85] Karnitschnig and van Daalen, "Business-Friendly Bureaucrat" *Wall Street Journal*, 2014.
[86] Règlement grand-ducal du 23 décembre 2014 relatif à la procédure applicable aux decisions anticipées rendues en matière d'impôts directs et instituant la Commission des decisions anticipées, art.7 as noted in Leandra Lederman, "Lux in the Time of Confidential Tax Rulings" (unpublished Working Paper 2021, kindly shared with the author).
[87] Stephen Daly, "The OMC, intelligent accountability and monitoring national tax authorities" (2022) 85(5) *Modern Law Review* 1109.

most pernicious of sweetheart deals which rest upon a manifestly erroneous interpretation and application of domestic tax law. The negotiated tax liability of the operating companies in *Engie* might well be a case in point. Of course, that I would be sympathetic to Kokott's approach should come as little surprise. Since 2018,[88] I have argued that the tax ruling campaign has been based on the assumption that a misapplication of the tax rules can amount to State aid and that this assumption is both wrong and undesirable. Like Kokott, I identified that there is no obvious line between certain problematic tax rulings and any other activities undertaken by tax authorities in managing compliance, which could result in the Commission "adopting a supervisory role far more general than that which would operate simply in relation to a handful of problematic rulings" and even become a "supranational tax authority".[89] But at the same time, I recognised, like Kokott, that there must be some form of oversight given that what the tax authority *does* (whether through rulings or even failing to investigate suspicious tax returns) can be a means of giving advantages to certain favoured taxpayers. As a result, I also recommended a deferential standard of review. Rather than focusing on whether a ruling (or other tax administration action) was manifestly erroneous, I suggested that an underpayment of tax caused by an unlawful administrative action (as judged by domestic administrative law standards) could be a selective advantage.[90]

The ECJ, of course, does not explicitly endorse AG Kokott's deferential standard and instead arrives at a similar point by virtue of requiring consistent and reliable evidence to rebut a Member State's evidence. Both look for manifest misapplications of the rules, but in the ECJ's case, evidence of such manifest errors can be deduced by consulting evidence of case law and administrative practice. As such, it is an evidentiary as opposed to a legal standard which the Court adopts.

Whilst welcoming a deferential standard, whether as a matter of law or evidence, I have to say that I have some misgivings about the proposed approach which focuses only on obvious misapplications. It appears underinclusive of the sort of impropriety that ought to be regulated. To recall, what is particularly concerning is the prospect of tax authorities giving sweetheart deals to favoured taxpayers. But not all sweetheart deals involve *manifest* errors. Take those instances where there are a series of interpretations that can be adopted to the legislation, some of which are more plausible than others, but none are outlandish. These are omnipresent in taxation, but the transfer pricing rules can serve as a useful case study. Whilst there are five main transfer pricing approaches recommended by the OECD, these give a range of answers (which could be very different depending on the context).[91] What if a tax authority deliberately accepted the most taxpayer-friendly option in the range, which was not outlandish, because that taxpayer had promised to increase investment in the jurisdiction if they received favourable treatment? This seems to be the paradigm example of the sort of conduct that the rules should regulate (individual concessions to a selected undertaking which distorts investment choices), but there has not been a *manifest* error. If on the other hand administrative law were consulted, then this

[88] Stephen Daly, "The authority to get it wrong and AG Kokott's comments" (2018); Ruth Mason and Stephen Daly, "State Aid: The General Court Decision in Apple" (2020) 99 *Tax Notes International* 1317, 1330; Stephen Daly, "Power to Get it Wrong" (2021) 137(2) L.Q.R. 280.
[89] Daly, "Power to Get it Wrong" (2021) 137(2) L.Q.R. 280, 287–288.
[90] Daly, "Power to Get it Wrong" (2021) 137(2) L.Q.R. 280, 293–299.
[91] As acknowledged by the OECD, see OECD, "Action 8-10 Transfer Pricing", *https://www.oecd.org/tax/beps/beps-actions/actions8-10/.*

could well result in the action being caught by the State aid rules. In Ireland, for instance, this would amount to unlawful administrative action because the decision-making was tainted by an irrelevant consideration.[92] As such, the ECJ should broaden its approach, or, if the intention was to also catch such instances of impropriety through its "consistent and reliable evidence" approach, to make this clear.

Costs

There is one final point worth making about the judgment and this is in respect of costs. At the conclusion of the judgment, the ECJ ordered the Commission to pay Luxembourg's costs, Engie's costs and the costs of the GC proceedings.[93] A similar outcome arose in the *Amazon* case[94] and the *Fiat* case.[95] These adverse costs are, of course, in addition to the costs incurred by the Commission. The sums involved as a result must be enormous. And those sums ultimately come from Member States. Of course, these are just one side of the ledger—on the other side, we could look at all the positive changes that have been made to tax administration and the substantive tax rules since the Commission begin its tax ruling investigations in 2013. Administrative practices have been reformed (as with Luxembourg, as noted already) and there is vastly more information exchanged between tax authorities.[96] The substantive tax rules have become significantly more stringent—loopholes, such as the double Irish,[97] have been closed, BEPS recommendations have been implemented,[98] the Tax Cuts and Jobs Act 2017 effectively introduced a minimum tax on US multinationals[99] and a global minimum corporate tax rate of 15% has been agreed.[100] There is certainly a correlation between these changes and the tax ruling campaign. But given the sums involved, Member States might need more than correlative evidence for reassurance.

Stephen Daly[*]

[92] See Daly, "Power to Get it Wrong" (2021) 137(2) L.Q.R. 280, 301–302.
[93] *Luxembourg and Engie* (C-451/21 P and C-454/21 P) EU:C:2023:948 at [189]–[191].
[94] *Amazon* (C-457/21 P) EU:C:2023:985 at [60]–[62].
[95] *Fiat* (C-885/19 P and C-898/19 P) EU:C:2022:859 at [126]–[129].
[96] European Commission, "Administrative cooperation in (direct) taxation in the EU", *https://taxation-customs.ec.europa.eu/taxation-1/tax-co-operation-and-control/general-overview/enhanced-administrative-cooperation-field-direct-taxation_en*.
[97] See David Stewart, "Ireland Targets "Stateless" Companies in 2014 Budget" (2013) 72 *Tax Notes International* 212.
[98] In the EU for instance, several BEPS changes were mandated by Council Directive (EU) 2016/1164 of 12 July 2016 Laying Down Rules Against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market [2016] OJ L193/1.
[99] Bloomberg, "Global Intangible Low-Taxed Income (GILTI)" (3 January 2023), *https://pro.bloombergtax.com/brief/how-to-calculate-gilti-tax-on-foreign-earnings/*.
[100] This has been agreed by EU Member States: Council of the EU, "International taxation: Council reaches agreement on a minimum level of taxation for largest corporations" (12 December 2022), *https://www.consilium.europa.eu/en/press/press-releases/2022/12/12/international-taxation-council-reaches-agreement-on-aminimum-level-of-taxation-for-largest-corporations/*.
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