# *Fiat Chrysler Finance Europe and Ireland v Commission:*
# a summary of the ECJ decision

*On 8 November 2022, the European Court of Justice (**ECJ**) (in a Grand Chamber composition) adopted its final judgment in the Fiat State aid case. The ECJ set aside the General Court (**GC**) judgment, and annulled the Commission's decision. The ECJ rejected the Commission's approach of assessing Fiat's tax ruling against a self-defined standard which would flow directly from the arm's length principle (**ALP**) rather than from national (tax) law. The ECJ further concluded that if the examination carried out under Art. 107(1) TFEU was not based exclusively on national law, the autonomy of EU Member States in the field of direct taxation could not be ensured. Finally, the ECJ also rejected the idea of an EU law ALP that exists independently of its incorporation in national law.*

*This briefing summarises the GC's judgment before exploring the ECJ's judgment in more detail.*

## The General Court judgment

*(Case T-755/15 Grand Duchy of Luxembourg and Fiat Chrysler Finance Europe v European Commission (24 September 2019))*

*The structure*

Fiat Finance and Trade Ltd (***Fiat***), a Luxembourg company, provided treasury services and financing to the Fiat/Chrysler group companies established in Europe.

*The tax ruling under consideration*

In 2012, the Luxembourg tax authorities concluded a tax ruling with Fiat that endorsed the transactional net margin method (***TNMM***) for allocating profits to Fiat. Such profit allocation served as the basis for determining Fiat's annual Luxembourg corporate income tax (***CIT***) liability. The TNMM was determined by taking into account net margins earned by comparable companies operating independently in the financial sector and determined Fiat's profits by remunerating it based on the risks borne and functions performed. The ruling was valid for five years.

*The Commission decision*

In its 2015 decision, the Commission challenged the method endorsed in the ruling for determining Fiat's profits, noting that there were several errors in the methodological choices and in the choices of parameters and adjustments that did not lead to an arm's length outcome. The Commission concluded that the tax ruling had conferred a selective advantage on Fiat in that it had resulted in a lower Luxembourg CIT liability, principally, under the general Luxembourg CIT system as compared to stand-alone companies and, as a subsidiary point, under the Luxembourg tax regime comprising only group companies.

*Action for annulment*

Fiat, Luxembourg and Ireland brought an action before the GC for the annulment of the Commission's decision. They challenged the following points in the decision:

(i) the Commission infringed the rules on the allocation of powers between the Commission and the EU Member States, and its analysis led to EU tax harmonisation in disguise;

(ii) the Commission was wrong in concluding that the tax ruling at issue conferred an advantage because it did not comply with the ALP, was contrary to Article 107 TFEU and was contrary to the obligation to state reasons and in breach of the principles of legal certainty and protection of legitimate expectations;

(iii) the Commission's selectivity analysis was erroneous;

(iv) the Commission's finding that the tax ruling restricted competition and distorted trade between Member States was erroneous;

(v) the Commission should take into consideration the effect of the tax ruling on the whole group as any tax advantage from which Fiat benefits in Luxembourg is 'neutralised' by higher taxes in other EU Member States; and

(vi) the Commission breached the principle of legal certainty and infringed the rights of the defence, by ordering that the aid at issue be recovered.

*The GC judgment*

In 2019, the GC ruled in favour of the Commission.

The GC rejected the first plea put forth by Fiat and Luxembourg, noting that the Commission had the power to monitor compliance with Article 107 TFEU and that it did not exceed its powers when it examined whether the tax ruling granted to Fiat constituted State aid.

As regards the first part of the second plea on the absence of an advantage, the GC considered whether, for the finding that there is an advantage, the Commission was entitled to analyse the tax ruling at issue in the light of the ALP. In this regard, the GC noted that:

(i) the ALP was a tool for checking whether intra-group transactions were remunerated as though they had been negotiated between independent parties;

(ii) such tool was used in the context of the examination carried out under Article 107(1) TFEU; and

(iii) when the Commission examined whether the TNMM specifically led to an outcome that was in line with the ALP, it didn't exceed its powers.

As regards the second part of the second plea regarding the incorrect method of calculation in the determination of Fiat's remuneration, the GC concluded that the parameters for the application of the TNMM were, as the Commission claimed, incorrect. As a result. Fiat's remuneration and hence its taxable profits in Luxembourg were lower. Therefore, the ruling conferred an advantage on Fiat because it resulted in a lower CIT liability as compared to the CIT liability that Fiat should have paid under Luxembourg tax law.

In respect of the third plea concerning selectivity, the GC rejected the plea that the tax ruling at issue had been granted based on an aid scheme. As the tax ruling constituted individual aid, the identification of the advantage was in principle sufficient to support the presumption that the tax ruling was selective.

The GC further noted that the Commission also assessed selectivity on a stand-alone basis using the three-step method (reference framework, derogation, justification). Also on that basis, the GC concluded that the Commission was correct in concluding that the tax ruling was selective. The Commission correctly found that the tax ruling derogated from the reference system (both the general CIT system under the Commission's primary line of reasoning and from the ALP as incorporated under Luxembourg tax law under its subsidiary line of reasoning). Such derogation was, in the GC's view, not justifiable.

The GC also rejected the pleas of Fiat and Luxembourg that (i) the Commission had failed to establish that there was a restriction of competition and (ii) the recovery of the aid breached the principle of legal certainty or infringe the rights of the defence.

Fiat and Ireland appealed the GC judgment.

**The European Court of Justice judgment**

*(Joined Cases C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe and Ireland v Commission (8 November 2022))*

The ECJ started its analysis by reiterating that actions by EU Member States in areas not harmonised by EU law are not excluded from the reach of the EU State aid rules. This is not in itself surprising. Subsequently, the ECJ listed the four criteria that must be met under Article 107(1) TFEU in order for a measure to qualify as State aid, following which it focused its analysis on the concept of "*selective advantage*". The ECJ stated that in order to classify a national measure as 'selective', the Commission must identify the reference system following an exchange of arguments with the EU Member State concerned. Such identification must follow from an objective examination of the content, the structure and the specific effects of the applicable rules. The ECJ clarified that since the reference system is the starting point for assessing selectivity, any errors in identifying it impair the selectivity analysis. As a second step, the Commission must demonstrate that the national measure constitutes a derogation from the identified reference system.

*Jurisdiction of the ECJ*

The ECJ rejected the Commission's argument that Ireland was challenging the GC's factual findings in respect of Luxembourg law. According to the ECJ, the question whether the GC correctly defined the reference system and correctly applied a legal test, such as the ALP, is a question of law over which the ECJ has jurisdiction.

*Identification of the reference system*

The ECJ ruled that by dismissing certain relevant provisions of Luxembourg national law, the Commission applied an ALP different from that defined under Luxembourg law. According to the ECJ, the Commission identified the objective pursued by the general CIT system in Luxembourg (namely the taxation of the profits of all companies irrespective of whether they were standalone or integrated companies) and the "*abstract expression*" thereof but failed to take into account how that objective had been incorporated into Luxembourg law when examining the tax ruling in question.

*Autonomy of EU Member States in relation to direct taxation*

The ECJ further ruled that the acceptance by the GC that the Commission may rely on rules that do not form part of national law when identifying the reference system constituted a breach to the autonomy of EU Member States in the field of direct taxation. The Commission noted the lack of harmonisation at EU level as regards the methods and criteria for determining an outcome that is consistent with the ALP and the significant differences as to how the OECD members apply the ALP in practice. According to the ECJ, however, even assuming that there was consensus in relation to the application of the ALP in international taxation, only national law is relevant when determining if transactions must be examined in light of the ALP, noting that this was an expression of the principle of legality in EU law.

*No independent EU law ALP*

The ECJ further clarified that its judgment in the *Belgium and Forum 187 v. Commission* case did not support the existence of an EU law ALP that exists independently of its incorporation in national law. According to the ECJ, in that case, Belgium had incorporated the OECD cost-plus method in its national law, which is why it was appropriate for the ECJ to rely on the ALP.

*Assessment of the ALP by the Commission*

Finally, the ECJ offered some further guidance as to how a derogation from the ALP must be established. According to the ECJ, to the extent that an EU Member State has chosen to apply the ALP in order to establish the transfer prices of integrated companies, the Commission must assess whether the parameters of the ALP in 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*". The ECJ therefore appears to leave the door open to a more calibrated assessment by the Commission (aligned with the *Commission v. Gibraltar* case) where the Commission would need to show that the ALP incorporated in domestic law is applied in a manner that is manifestly inconsistent with its objective.

*Procedure*

The ECJ joined the cases of Fiat and Ireland for purposes of the judgment. Since the GC judgment was set aside based on the grounds submitted by Ireland, the ECJ did not rule on Fiat's appeal.

*Conclusion*

The ECJ concluded that the confirmation by the GC of the Commission's approach in identifying the reference system constituted an error of law, which invalidated both the primary and the subsidiary line of reasoning.