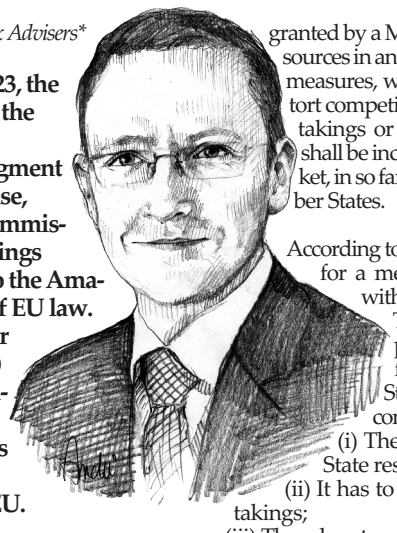
CJEU annuls the EU Commission's State Aid Decision in the Amazon Case

*By Oliver R. HOOR, ATOZ Tax Advisers**



On 14 December 2023, the Court of Justice of the European Union ("CJEU") delivered its judgment in the Amazon State aid case, concluding that the EU Commission's review of the tax rulings granted by Luxembourg to the Amazon group was in breach of EU law. This article provides a clear and concise overview of (i) the fact pattern of the Amazon case, (ii) how the concept of State aid applies in the field of taxation and (iii) the decision of the CJEU.

Introduction

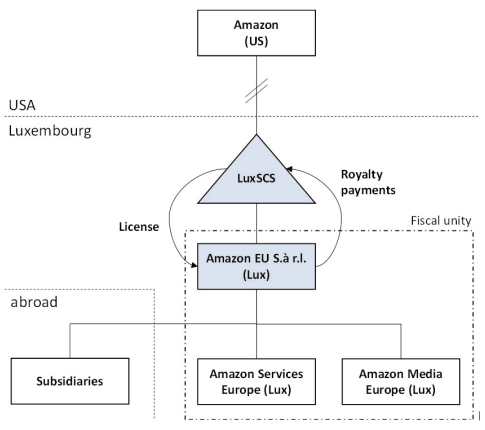
According to the decision of the EU Commission of 4 October 2017, Luxembourg granted illegal State aid to Amazon and should collect circa EUR 250m of taxes from Amazon, a fairly large US multinational group that focuses on e-commerce, cloud computing, online advertising, digital streaming and artificial intelligence.

In the Amazon case, the EU Commission challenged the tax treatment confirmed in two tax rulings obtained by the group in 2003. Here, the Luxembourg tax authorities ("LTA") confirmed in particular the appropriateness of royalty payments made by a Luxembourg company. As such, this State aid case is linked to transfer pricing. The EU Commission found that the royalty payments for the use of intangible assets artificially diminished the tax base of the paying Luxembourg company and, thus, that of the Amazon group in Luxembourg and Europe.

Following the decision of the EU Commission, Amazon and Luxembourg brought actions before the General Court of the European Union which held that the Commission had not demonstrated to the requisite legal standard that the Amazon group subsidiary concerned had benefited from an undue reduction in its tax burden (see judgement of 12 May 2021, Luxembourg and Amazon EU S.à r.l. and Amazon.com vs. Commission, T-816/17 and T-318/18). It further held that Luxembourg had not granted a selective advantage in favour of that subsidiary and therefore annulled the decision of the EU Commission.The EU Commission then brought an appeal before the CJEU.

The Amazon case at a glance

The European structure of the Amazon group during the relevant period is depicted in the following chart:



A Luxembourg limited partnership ("LuxSCS") owned the participation in Amazon EU S.à r.l. that is subject to Luxembourg corporate income tax ("CIT") and municipal business tax ("MBT").

LuxSCS granted a license to Amazon EU S.à r.l. The royalty payments made by Amazon EU S.à r.l. were deductible for CIT and MBT purposes.

Amazon EU S.à r.l. and its Luxembourg subsidiaries Amazon Services Europe and Amazon Media Europe formed a fiscal unity. Hence, the taxable income of the three entities would be consolidated at the level of Amazon EU S.à r.l.

In the Amazon State aid case, the EU Commission challenged the appropriateness of the royalties paid by Amazon EU S.à r.l. (i.e. the Commission found the royalty payments too high).

How to determine the existence of State aid in the field of taxation?

1. The concept of State Aid

According to Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU"), any aid granted by a Member State or through State resources in any form whatsoever, including tax measures, which distorts or threatens to distort competition by favouring certain undertakings or the provision of certain goods shall be incompatible with the internal market, in so far as it affects trade between Member States.

According to the settled case-law of the CJEU, for a measure to be categorized as aid within the meaning of Article 107(1) TFEU, all conditions set out in that provision must be fulfilled. Hence, for a measure to be categorized as State aid, the following cumulative conditions have to be met:
(i) The measure has to be granted by State resources;
(ii) It has to confer an advantage to undertakings;
(iii) The advantage has to be selective; and
(iv) The measure has to affect trade between Member States and to distort or threaten to distort competition.(1)

State aid cases in tax matters usually fail because it cannot be evidenced that an advantage granted to an undertaking is of a selective nature.

2. Focusing on selectivity

According to the CJEU case law, Article 107(1) TFEU requires a determination whether, within the context of a particular legal system, a measure constitutes an advantage for certain undertakings in comparison with others in a comparable legal and factual situation.(2)

For that purpose, the CJEU developed the following three-step analysis to determine whether a particular tax measure is selective:
(i) Identification of the reference legal system (e.g. the Luxembourg corporate tax system);
(ii) Assessment as to whether the measure derogates from that common regime in as much as it differentiates between economic operators who, in the light of the objective assigned to the tax system, are in a comparable factual and legal situation ("comparability test"). In other words, it must be analysed whether the tax treatment of a taxpayer is more beneficial than that of other undertakings that are factually and legally in a similar situation; and
(iii) According to the jurisprudence of the CJEU, a measure found to be selective on the basis of the "comparability test" can still be found to fall outside the scope of the State aid rules if it is justified by the nature or the general scheme of the tax system ("justification test").

3. Considerations regarding the Amazon case

The Luxembourg legislator explicitly formalised the application of the arm's length principle under Luxembourg tax law as from 1 January 2015 with the implementation of a new version of Article 56 of the Luxembourg Income Tax Law ("LITL"). Hence, when the tax rulings have been granted to Amazon back in 2003, the arm's length principle did not explicitly apply under Luxembourg tax law.

As from 1 January 2017, a new Article 56bis of the LITL has been implemented that complements Article 56 and includes some of the fundamental principles included in chapter I of the OECD Transfer Pricing Guidelines. This might be interpreted as the intention of the Luxembourg legislator to express the importance of the OECD Transfer Pricing Guidelines, even though the Luxembourg tax authorities always relied on these guidelines when considering the appropriateness of transfer prices.

However, Article 164 (3) of the LITL provides that hidden dividend distribution (that are, broadly speaking, advantages that a company shifts to its shareholders that would not be granted to third parties) may not reduce the taxable income of a Luxembourg company. Hence, the royalty payments had to be benchmarked against what might be expected in transactions between third parties to determine if an advantage was shifted to LuxSCS.

Nevertheless, one must not forget the context in 2003 when the available transfer pricing guidance has been in its infancy. Assessing the transfer pricing of a 2003 transaction based on the current version of the OECD Transfer Pricing Guidelines (that have been significantly extended and amended over the last two decades) would be inappropriate.

Moreover, as stated in Paragraph 1.13 of Chapter I of the OECD Transfer Pricing Guidelines "*it should also be recalled at this point that transfer pricing is not an exact science but does require the exercise of judgement on the part of both the tax administration and taxpayer*." Thus, even the application of the current version of the OECD Transfer Pricing Guidelines leaves some leeway with respect to the application of the arm's length principle and requires some experience on the part of the practitioner.

Hence, no selective advantage should have been granted to Amazon and there should be no illegal State aid present in the Amazon case.

Decision of the CJEU

The CJEU emphasized that the determination of the reference system is of particular importance in the case of tax measures since the existence of an economic advantage for the purposes of Article 107 (1) of the TFEU may be established only when compared with 'normal' taxation.

The CJEU further highlights that outside the spheres in which EU tax law has been harmonised, it is the Member State concerned which determines, by exercising its own competence in the matter of direct taxation and with due regard for its fiscal autonomy, the characteristics constituting the tax, which define, in principle, the reference system or the 'normal' tax regime, from which it is necessary to analyse the condition relating to selectivity. Hence, only the national law applicable in the Member State concerned must be taken into account in order to identify the reference system for direct taxation, that identification being itself an essential prerequisite for assessing not only the existence of an advantage but also whether it is selective in nature.

The present case concerns the question of the legality of a tax ruling adopted by the Luxembourg tax authorities and based on the determination of the transfer price in the light of the arm's length principle.

The CJEU upholds the judgement under appeal despite the Court considers that the General Court wrongly recognised the arm's length principle as having general application within the context of the implementation of EU State aid rules.

In fact, since the arm's length principle has no autonomous existence in EU law, the EU Commission may rely on it only if it is incorporated into the national tax law concerned (here, Luxembourg domestic tax law).

Moreover, contrary to the findings of the General Court, the OECD Transfer Pricing Guidelines could be of practical importance in the case only if Luxembourg tax law made explicit reference to them.

The CJEU concluded therefore that the EU Commission had wrongly determined the 'reference system', which is the first step in analysing a national measure to be able to categorise it as State aid.

However, regardless of those errors of law and the incorrect conclusion of the General Court (according to which the reference system determined by Luxembourg tax law enshrined the arm's length principle at the time the tax rulings at issue were obtained), the CJEU upholds the judgment under appeal, since the EU Commission decision had to be annulled in any event because of the incorrect definition of the reference system, rather than for the reasons given by the General Court.

Conclusion

In the Amazon case, the CJEU decided in favour of the taxpayer and Luxembourg, and annulled the State aid decision of the EU Commission.

The EU Commission launched its investigation into the tax ruling practices of EU Member States back in June 2013, which has led to unprecedented legal uncertainty over the past decade. The question is whether, in hindsight, it was worth it, given that legal uncertainty is bad for business and investment.The Amazon State aid case is another example of the EU Commission's failure to respect EU law and the sovereignty of EU Member States in tax matters. The CJEU came to the same conclusion in the Engie and the Fiat cases. Similarly, in the Starbucks and Apple cases, the General Court did not find State aid.

Considering that the CJEU seems to leave quite some leeway to Member States when it comes to the interpretation of the arm's length principle, the question arises if the more recent Directive Proposal on transfer pricing – aiming at the implementation of the arm's length principle in EU law – is motivated by the EU Commission's ambition to become the authoritative instance for the interpretation of the arm's length principle and the OECD Transfer Pricing Guidelines in the EU.

Ultimately, the CJEU's decision is a positive sign for the rule of law and legal certainty. On this basis, it seems unlikely that the EU Commission will be successful in other State aid cases (in tax matters).

** Oliver R. HOOR is a Tax Partner (Head of Transfer Pricing and the German Desk) with ATOZ Tax Advisers (Taxand Luxembourg).*

The author may be contacted at: oliver.hoor@atoz.lu

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1) See Claire Micheau and Gauthier Charles de la Brousse "Case Studies of Tax Issues on Selectivity: Analysis of the Patent Box Scheme and the Reduced Taxation of Foreign-Source Interest Income" in "State Aid and Tax Law", Kluwer Law International, Netherlands 2013, p. 167.
2) See, for example, CJEU, *British Aggregates v. Commission of the European Communities*, Case No. C-387/06P (2008) ECR I-10515, para. 82; CJEU, *Kingdom of Spain v. Commission of the European Communities*, Case No. C-409/00 (2003) ECR I-1487, para. 47; CJEU, *Portuguese Republic v. Commission of the European Communities*, Case No. C-88/03 (2006) ECR I-7115, para 54; see Claire Micheau and Gauthier Charles de la Brousse "Case Studies of Tax Issues on Selectivity: Analysis of the Patent Box Scheme and the Reduced Taxation of Foreign-Source Interest Income" in "State Aid and Tax Law", Kluwer Law International, Netherlands 2013, p. 168.

TABLEAU DE BORD AGEFI Luxembourg	29-Dec-2023	30-Dec-2022	DIFF %		
ONE YEAR					
Dow 30 (DJI)	37.689,54	33.147,25	13,70%		
S&P 500 (GSPC)	4.769,83	3.839,50	24,23%		
Euro Stoxx 50	4.521,65	3.793,62	19,19%		
DAX (GDAXI)	16.751,64	13.923,59	20,31%		
CAC 40 (FCHI)	7.543,18	6.473,76	16,52%		
FTSE 100 (FTSE)	7.733,20	7.451,70	3,78%		
Nikkei 225 (N225)	33.464,17	28.041,48	19,34%		
Shanghai (SHCOMP)	2.974,94	3.089,26	-3,70%		
US Fed Funds Rate	5,33%	0,09%	5,24%		
3 Month US Treasury Rate	5,40%	4,42%	0,98%		
5 Year US Treasury Rate	3,84%	3,99%	-0,15%		
Banque centrale européenne (BCE), taux refi	4,50%	2,50%	2,00%		
Eurozone obligations d'Etat 5 ans	2,36%	3,02%	-0,66%		
Pétrole brut (coût de production) : 1 litre=	0,4084	0,4716	-13,42%	€	West Texas Intermediate (prix en euro par litre)
Gaz naturel : 1 m3=	0,0805	0,1481	-45,66%	€	Natural Gas, Henry Hub-I (prix en euro par m3)
Gaz naturel : 1MWh=	7,7620	14,2846	-45,66%	€	Natural Gas, Henry Hub-I (prix en euro par MWh)
Gaz naturel : 1 MMbtu=	2,5100	4,4800	-43,97%	$	Natural Gas, Henry Hub-I (prix en $ par MMbtu)
Or : 1 Kg=	60.094,23	54.783,02	9,69%	€	
Or : 1 oz=	2.062,90	1.823,90	13,10%	$	
Argent : 1 Kg=	691,28	719,67	-3,94%	€	
Argent : 1 oz=	23,73	23,96	-0,96%	$	

Ce tableau de bord, une exclusivité d'AGEFI Luxembourg, permet au lecteur :
1° de voir les returns des principaux actifs et indices financiers pour l'année en cours
2° de voir sur une page les principaux indices boursiers et taux d'intérêts
3° de connaître le coût de production de plusieurs produits d'énergie en euro, à comparer avec le prix au détail
4° de connaître le prix de l'or et de l'argent en kilo et en euros