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# Arm's Length Principle – European Union's Attempt to Unify the Rules of Transfer Pricing Taxation in Relation to State Aid Case Law

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**Abstract:** Transfer pricing and the taxation of intra-group transactions are not currently harmonized within the Member States through EU legislative acts, and the regulation of them depends on national laws, international tax treaties, and soft law-instruments. This regulatory environment causes problems especially with the interpretation of the Arm’s Length Principle, which is a quasi-legal instrument, used to determine whether an intra-group transaction price reflects a market-based outcome. This affects corporate income taxation within the Member States, and has led to the European Commission take multiple actions against national tax rulings on the basis that they constitute state aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union. To help the issues around transfer pricing, the Commission has given a Proposal for a Council Directive on transfer pricing, COM(2023)529 final, 2023/0322(CNS).

The research approach in the thesis is the legal doctrinal method, and the main research question is how the incorporation of the ALP into EU law through the planned Transfer Pricing Directive would affect the current legal environment around transfer pricing and corporate income taxation within the Union, and would it reduce the amount of state aid litigations. Other relevant themes are the Arm’s Length Principle’s current role as a quasi-legal instrument and how it is interpreted in state aid assessments regarding transfer pricing tax rulings. The aim of the thesis is to create an overall picture of the current regulatory environment around the subject of transfer pricing within the EU and the future of it. Throughout the thesis a European law perspective is held when approaching the topics.

The thesis concludes in finding that the current lack of unified regulation between the Member States creates different legal issues and tax uncertainty to multinational enterprises, and presents possible ways to prevent and remove these issues even if the planned directive is not implemented into the national legislations of the Member States.

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## List of Abbreviations

| | |
|---|---|
| ALP | Arm's Length Principle |
| APA | Advance Pricing Arrangement |
| BEFIT | Business in Europe: Framework for Income Taxation |
| CJEU | Court of Justice of the European Union |
| CUP | Comparable Uncontrolled Price |
| ECJ | European Court of Justice |
| EU | European Union |
| MAP | Mutual Agreement Procedure |
| MNE | Multinational Enterprise |
| NGO | Non-Governmental Organization |
| OECD | Organization for Economic Cooperation and Development |
| PSM | Transactional Profit Split Method |
| RPM | Resale Price Method |
| TEU | Treaty on European Union |
| TFEU | Treaty on the Functioning of the European Union |
| TNMM | Transactional Net Margin Method |

# 1 Introduction

## 1.1 Background

Transfer pricing refers to the process of setting prices for transactions between associated enterprises.[1] These intragroup transactions make up a significant part of global trade, consisting of transfers of goods, services, intangibles, and capital.[2] According to different studies, it is estimated that roughly 60 % of the global trade in the world is conducted between associated enterprises. Therefore, transfer pricing makes up approximately half of the transactions executed. Although transfer pricing makes up a majority of the global trade, the topic is less regulated than most other forms of transactions. The regulatory environment differs between different states, and usually consists of a mix of national regulations, international tax treaties, and soft law instruments. This forces multinational enterprises (MNEs) and national tax administrations to operate in a fragmented area.[3]

Most countries follow the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Transfer Pricing Guidelines) set by the Organization for Economic Cooperation and Development (OECD). The OECD Model Tax Convention on Income and on Capital (Model Tax Convention) includes an important guideline for setting transfer prices between associated enterprises called the Arm's Length Principle (ALP), which can be found in Article 9 of the Convention. The ALP is based on an idea that the right price would be the price two independent parties would agree on if there was not an existing community of interest. The right price is conducted by comparing profits, prices, and margins of controlled transactions to similar uncontrolled transactions. The similarity of the cases is determined by factors such as the circumstances and conditions of the transaction.[4] However, these OECD regulations do not hold a binding legal value regardless of being internationally recognized. [5]

Cross-border taxation of transfer pricing is an extensively complicated matter within the European Union (EU). The field is not universally regulated by EU legislation and therefore

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[1] Proposal for a Council Directive on transfer pricing, COM/2023/529, p. 1.
[2] European Commission: Proposal for Harmonized Transfer Pricing Rules in the EU.
[3] Tuominen 2018, p. 436.
[4] Feinschreiber – Kent 2012, p. 12.
[5] Karjalainen – Raunio 2018, p. 33.

prone to attract issues leading to expensive and time-consuming litigations. The area ties together different national legal systems and public and private sectors, making it even more complicated. Within the Union's area, transfer pricing rules and taxation systems depend heavily on each Member States' national regulations, bi- or multilateral tax treaties, and international principles, which often are adopted and applied inconsistently.[6] Because the corporate income taxation systems differ between the Member States, there is a high risk of double taxation.

Another issue relating to transfer pricing within the Union's area are national tax rulings, when they are used to accept advance pricing agreements (APAs), and if the tax base ends up being too low compared to comparable situations without an APA, there is a possibility that the tax ruling constitutes state aid.[7] State aid is prohibited within the Union's single market, and the prohibition can be found in Article 107 of the Treaty on the Functioning of the European Union (TFEU). The state aid investigations have led to multiple disputes between the European Commission, Member States, and MNEs.

Additionally, besides being problematic to lawful corporations, this regulative environment leaves space for those using transfer pricing transactions purely for tax avoidance and aggressive tax planning.[8] There is significant proof that corporate tax evasion and base erosion are a major problem within the EU. However, the precise amount of lost tax revenue cannot be calculated. Reasons behind this are a lack of information and estimates in several Member States, and the hidden nature of tax evasion. In late 2015 and early 2016, the European Parliamentary Research Service constituted research, where the amount of tax revenue lost due to aggressive corporate tax planning was estimated to be around 50-70 billion euros annually. When adding other problems with tax regime, e.g., tax arrangements, inefficiencies in tax collection, and other acts lowering the tax revenue, it was estimated that the tax revenue loss from corporate tax avoidance was around 160-190 billion euros.[9] This highlights the size of the problem and volume of the losses, as both estimates were rather conservative and the study was conducted almost a decade ago, meaning that the true amount of tax revenue lost annually is likely to be higher today.

[6] Karjalainen – Raunio 2018, p. 4.
[7] Miladinovic 2022, pp. 11-12.
[8] Omari: 'Transfer Pricing – The Inevitable Outcome of Globalisation and Trade Development'.
[9] European Parliament: Legislative Train 04.2025, 2019.

The scattered regulatory environment calls for better and more unified regulation. It has been clear for a long time that a more unified approach is needed although direct taxation is an area where the Member States enjoy broad sovereignty. To fix this matter, the Commission has proposed a Directive on transfer pricing (COM/2023/529) final 2023/0322(CNS) (Transfer Pricing Directive). This directive would make transfer pricing regulated by EU law and unify the rules surrounding it, and consequently, decreasing the current issues around transfer pricing taxation. The directive would set the ALP and the OECD Guidelines to be legally binding within the Member States, therefore setting a harmonized standard for transfer prices. The directive has been accepted by the Council, and the Member States have until the end of year 2025 to implement it into their national legal systems. However, there are several concerns around the implementation of the directive proposal, so its entry into force in its current form is not guaranteed.[10]

## 1.2 Research Questions and Focus

The main research question of this thesis is how the incorporation of the ALP into EU law through the planned Transfer Pricing Directive would affect the current legal environment around transfer pricing and corporate income taxation within the Union, and would it reduce the amount of state aid litigations. Other relevant themes are the ALP's current role as a quasi-legal[11] instrument and how the ALP is interpreted in state aid assessment regarding transfer pricing taxation. Furthermore, the major changes to the regulatory environment brought by the planned implementation of the Transfer Pricing Directive are examined.

Throughout the thesis a European perspective will be held instead of focusing on the matter from the perspective of specific Member States. However, to gain a better understanding there are examples given regarding either an international setting outside of the EU or the Member States.

The OECD Guidelines and Model Tax Convention are a topic of focus throughout the thesis as they currently form a crucial part of the international transfer pricing rules, are the original source of the ALP, and the proposed Transfer Pricing Directive is based on the OECD Guidelines.

[10] KPMG Issue 553, 2024.
[11] *Quasi-legal: soft law.*

Additionally, the thesis' overall aim is to provide a general overview of at what state the regulative environment of transfer pricing taxation is at currently within the European Union, and to highlight some of the problems that exist in the non-unified regulative field.

## 1.3 Method and Sources

For the research method of the thesis, legal doctrinal, i.e. the interpretation and systematization of the existing legal order,[12] was chosen as the research focuses on the examination of the current legal and regulatory environment, and systemizing the hierarchy between different international and domestic regulations and guidelines. Legal doctrinal is used to find both the *'de lege lata'*, i.e. the current state of legislation, and the *'de lege ferenda'*, i.e. the ideal state of legislation.[13] Additionally, the scope of *de lege lata* has been extended in time to explain some brief history behind the regulations to gain a better understanding where the current regulative environment originates from.

For the sources, a mix of primary and secondary EU law, international soft law instruments, case law, and literature have been used. National legislation of certain Member States is referred to in certain topics where necessary to understand and gain a deeper insight of the topic. However, the emphasis of national legislation is minor as the focus is on the EU perspective. The relevant Case law is judgements of the Court of Justice of the European Union (CJEU), with cases decided on by the General Court and by the European Court of Justice (ECJ).[14] Academic literature, articles, expert reviews, and different internet sources have been used to explain the topics further, gain a deeper understanding, and to explore different perspectives.

Additionally, due to the nature of transfer pricing being topic that combines not only law and taxation, but also financial sciences, sources with a business discipline approach have been used to explain some topics further. However, the financial sciences approach and mathematical evaluation of the topics have been left out of the scope of the thesis, as it is a legal study and in no means tries to present insights or observations in the field of financial

[12] Aarnio, 1988, p. 48.
[13] Määttä 2015, p. 151.
[14] *CJEU consists of two courts: the General Court and the Court of Justice. The Court of Justice handles appeals against judgements of the General Court, and is the apex of the CJEU as it is the highest juridical authority in cases dealing with EU law.* – Cour De Justice: General Court. Cour De Justice: Court of Justice.

sciences. The few sources with more of a financial sciences approach are there to support the topic of the thesis, not to take away from the legal study.

## 1.4 Scope and Structure

Chapter 1 offers a general introduction to the topic of the thesis and the choices regarding method, structure, scope, and sources. Chapter 2 focuses on transfer pricing by introducing the main terms, regulations, important related concepts, and the process itself, with also an overview of the taxation matters related to it. Chapter 3 focuses to the Arm's Length Principle and the legal nature of it. Chapter 4 gives an introduction to state aid and how it occurs within the field of transfer pricing.

As Chapters 2-4 lay down the theoretical base of the thesis and the key concepts, in Chapter 5 the focus shifts to case law. In the Chapter, different cases will be first overviewed and later analyzed together in reflection to the topic of the thesis in the last sub-chapter.

Chapter 6 introduces thoroughly the Commission's Proposal for a Directive on Transfer Pricing and overviews aspects such as the aim and contents of the proposed directive, and how it would change the legal environment within the Union.

Chapter 7 includes concluding thoughts and ties together the observations presented throughout the thesis, and provides answers and results to the research question and main themes.

The author understands that the scope of the thesis may seem broad, but thinks that to understand properly the research, it is necessary to lay down a proper foundation by defining and examining the different areas the research topic is based on.

The topic of the thesis was chosen, as the planned transfer pricing tax reform by the Transfer Pricing Directive Proposal makes it current. There are multiple issues and defects within the area of transfer pricing regulation and taxation within the EU. Additionally, the relation to state aid case law was chosen, as transfer pricing and state aid have an unexpected connection. To tie together transfer pricing and state aid can first seem from afar, as the topics are not in direct contact or assimilated together in many contexts. However, when uncovering the main concepts and theory necessary for the topics, a pattern can be found. In addition, these issues and case law have been a subject of increasing public debate and interest in recent years.

Lastly the author wants to note, that as the field of transfer pricing taxation is constantly evolving, becoming more global, and does not have unified regulative rules, there are numerous opportunities for future research.

# 2 Transfer Pricing

## 2.1 Introduction to Transfer Pricing Taxation

Transfer pricing refers to the transaction price when one division of a multinational enterprise provides goods, services or intellectual property to another division. In particular, it refers to the price used in a transaction where goods or services are provided by associated enterprises located in different countries, therefore making it a subject cross-border taxation.[15]

As a term, transfer pricing can have multiple meanings based on the context but here the term is approached from the same perspective as the European Union does. Additionally, transfer pricing can be viewed as an act but in this context, it is viewed more as a mechanism to price transactions between corporate entities that belong to the same company group. These intra-group transactions are not currently harmonized by EU legislation.[16]

Member States in European Union have always had a broad sovereignty with direct taxation. The EU has been guiding and governing the field of transfer pricing, but the Member States have kept their right to set their own domestic legislation. Additionally, most of the Member States follow the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations by the OECD.[17]

The Guidelines are updated on a regular basis[18] and are an important guide when conducting international intra-group transactions. They are followed by all 38 OECD Member States and by multiple non-member countries. Multiple countries have adopted the Guidelines into their national legislation as they are or with minor changes.[19] In the non-member countries, the extend of adopting and following the guidelines may vary.[20] However, the OECD Guidelines are not legally binding.[21] Despite this, the Guidelines have become an international standard in transfer pricing even in non-member countries of the OECD. This highlights the

[15] European Commission: Transfer Pricing in the EU.
[16] European Commission: Proposal for Harmonized Transfer Pricing Rules in the EU.
[17] European Commission: Transfer Pricing in the EU.
[18] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 1.
[19] Karjalainen – Raunio 2018, p. 33.
[20] OECD: Transfer Pricing Country Profiles. 2023.
[21] Tuominen 2018, p. 438.

importance of the Guidelines but also the fact that they are internationally recognized and accepted, and have become the main source of international transfer pricing rules.[22]

Although transfer pricing transactions can occur in a fully domestic setting, in practice the main interest of tax administrations is on international transactions. This is due to the nature of the distribution of tax revenue – only with international transactions tax revenue is distributed between two or more countries.[23]

Transfer pricing is a controversial taxation matter where national tax administrations are forced to balance between collecting the right amount of tax revenue and remaining competitive with their corporate income taxation system in the eyes of MNEs. Transfer pricing is regulated by national laws, and bi- or multilateral tax treaties conducted between countries. National legal rules are often more detailed than international tax treaties. However, tax treaties are legally binding agreements concluded between countries, and in most cases will overpower national legislation in case of conflict.[24] This is the case for example in the Finnish legal system. Most of the tax treaties between countries are based on the OECD Model Tax Convention on Income and on Capital.[25] Furthermore, although rare, some countries outside of the Union's area do not have transfer pricing regulations at all. For example, this is the case in Brunei Darussalam and the Cayman Islands.[26]

Because there are no common internationally binding rules for transfer pricing, the national taxation systems are prone to problems or even failure from a fiscal point of view. Cross-border taxation is a difficult subject to begin with, but when combined with transfer pricing, which takes place in private corporate settings, the prices do not always reflect the real, independent market value as there are no free-market powers that set the right price.[27] This hands MNEs an opportunity to manipulate transfer prices and enables profit shifting. In practice, tax payments can be lowered by raising the price of input materials and reciprocally lowering the export prices to either reduce profits or create losses in the accounting of the transaction. To help determine the right price for a transaction and therefore the right amount

[22] Karjalainen – Raunio 2018, p. 33.
[23] Karjalainen – Raunio 2018, p. 1.
[24] Karjalainen – Raunio 2018, p. 4.
[25] Karjalainen – Raunio 2018, pp. 4-10.
[26] KPMG 2014, pp. 3, 6.
[27] Miladinovic 2022, pp. 40-41.

of tax revenue, most countries have adopted the ALP, which will be discussed in detail later in the Chapter 3.[28]

To gain a better understanding of the transfer pricing taxation rules, it must be noted how most national corporate taxation systems are built. They were not necessarily made for MNEs, and are more focused on taxing corporations as individual companies. This means that the taxation of profit is done in a way that does not take into account whether the corporate entity is a standalone entity or part of a bigger corporate group, and that the taxation is done independently on each taxpayers' profit. Although this is not always the case, the systems are built on an idea that works better with independent corporate entities and sort of forgets that there are bigger groups functioning in the field as well. This creates problems as standalone corporations are influenced by the market conditions, but associated enterprises are not affected by them when conducting transactions as the transactions are concluded in a closed market without market price negotiation, hence the usage of the ALP.[29]

From a fiscal point of view, the idea behind transfer pricing is to share MNEs profits and losses between countries similarly, as they would have if two independent enterprises had conducted the transaction. The transfer pricing regulations prevent tax base eroding and double taxation of profits, as tax revenue gets shared as if it would when two independent enterprises would be engaging in business activities.[30] The planning of transfer prices requires good knowledge of national regulations and international transfer pricing principles. In most countries, MNEs are obliged to document, monitor, and report to national tax administrations their compliance with transfer pricing guidelines and principles when executing transactions.[31]

## 2.2 History of Transfer Pricing

The history of transfer pricing dates to the time after the World War I, when transfer pricing started to become more common. The reason behind the increased intra-group transactions were that MNEs were looking for ways to reduce their tax burden as the taxes collected became notably higher to fund the warfare. To prevent MNEs from taking their business to

[28] Furusawa – Ishikawa – Choi 2020.
[29] Miladinovic 2022, pp. 11-12.
[30] Tuominen 2018, pp. 441-443.
[31] Karjalainen – Raunio 2018, pp. 2-3.

countries with lower tax rates, different governments started to enter into force transfer pricing regulations around that time.[32]

International transfer pricing rules are fairly recent as intra-group transactions used to rely purely on domestic regulations until the late 1970's. In 1979, the OECD declared its Transfer Pricing and Multinational Enterprises, which was a report by the OECD's Committee of Fiscal Affairs, evaluating problems faced by MNEs in transfer pricing and taxation matters. The report was followed by the Transfer Pricing Guidelines, published in 1995. The Guidelines included five different parts: the Arm's Length Principle, transfer pricing methods, comparability analysis, administrative approaches to avoid and resolve disputes, and guidelines for documentation.[33]

Nowadays transfer pricing transactions are an important part of global trade and make up a major part of transactions worldwide. They form a relevant part of corporate income taxation of international group companies.[34]

## 2.3 Some Relevant Concepts in Transfer Pricing

### 2.3.1 Associated Enterprises and Independent Enterprises

Associated enterprises have different definitions within different countries' national legislations. Usually in tax treaties they are defined as when a company takes part in the control, management, or capital of another company or companies in a direct or indirect manner or when all companies in the same corporate group do this in relation to other companies. A similar definition is also adopted in the OECD Model Tax Convention in Article 9(1a). This means that the companies influence each other's actions and business strategy, and function as a unified entity as multiple corporate entities function under the same standard management, ownership, or control.[35] One example of associated enterprises are corporate groups, where one company acts as a parent company, and has subsidiary corporations either in the same country or in different countries, which it controls on some level.[36]

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[32] Karjalainen – Raunio 2018, p. 2.
[33] Feinschreiber – Kent 2012, p. 3.
[34] Karjalainen – Raunio 2018, pp. 2-3.
[35] ITAXA: Associated Enterprises.
[36] Kyläkallio – Iirola – Kyläkallio 2024, pp. 1150.

In the EU, the definition differs between Member States' national legislation especially with the notion of control. The notion of control means that an enterprise needs to hold a certain number of shares of another enterprise to meet the control criteria and for the enterprises to be 'associated'. The Member States require either a 25% or 50% shareholding threshold for the notion to be fulfilled. The non-unified notion of control leads to tax uncertainty, higher costs, and legal disputes to enterprises but also makes cross-border transactions harder and increases the risk of double taxation.[37]

According to the OECD Transfer Pricing Guidelines, associated enterprises are not affected by the external market forces when they conduct transactions with each other. When independent enterprises do conduct transaction, the market forces affect and guide their financial and commercial relations. The Guidelines do not elaborate, what is meant by terms such as "market forces" or "financial and commercial relations".[38]

When discussing associated enterprises on an international level, the definition and notion of control differs between states. Therefore, it is safe to assume that in the context of international corporate taxation the term should be considered with a broad meaning.

### 2.3.2 Competent Authority

Competent authority is a term used in international tax conventions and in the OECD Model Tax Convention and Transfer Pricing Guidelines to refer to the correct tax authority in each state.[39] In more precise meaning, it refers to the official body in each state that is entrusted with the enforcing and managing of tax treaties and additionally, solving tax disputes that arise from the application of these treaties. Usually, the competent authority is the national tax administration. It supervises the tax treaties' proper application in practice and proper interpretation. When there is a dispute or uncertainty in a taxation matter on how the treaty provisions should be understood, or there is a possibility of double taxation, the competent authority seeks to find a solution for the matter. [40]

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[37] Proposal for a Council Directive on transfer pricing COM/2023/529. p. 2.
[38] Feinschreiber – Kent 2012, p. 9.
[39] Revenue Irish Tax and Customs 2024.
[40] ITAXA: Competent Authority. 2024.

### 2.3.3 Permanent Establishment

The concept of permanent establishment is an important factor in international business income taxation as it determines the right place for taxation. The definition of permanent establishment can be found in Article 5(1) of the OECD Model Tax Convention, where permanent establishment is stated to be a fixed place of business from where the business activities of the company are fully or partially operated from. According to the Article, permanent establishment can be the place where the company is managed, location of a branch, an office, a factory or workshop, or in case of companies operating with natural resources, the place where the resources are extracted from. However, there are some exceptions where the permanent establishment can be set elsewhere.[41]

In relation to transfer pricing, determining the right place for the permanent establishment is important as it gives the country where the permanent establishment is located the right to tax a foreign enterprise of its profits. Because international transfer pricing involves setting a price for a transaction between associated enterprises located in different tax jurisdictions, the place of permanent establishment determines which countries' tax authorities are involved. The importance of permanent establishment should not be ignored because by determining the right tax jurisdiction, it also sets the place for international tax litigation if disputes arise, affects profit attribution, and tax compliance.[42]

## 2.4 Shortly of the Different Transfer Pricing Methods and OECD's Preferred Methods

There are multiple ways to calculate a transfer price in an intra-group transaction. To calculate the price that is correct and at arm's length, certain transfer pricing methods are used. The different transfer pricing methods are a mechanism to determine what is the correct price for a controlled intra-group transaction by comparing the price to comparable uncontrolled transactions.[43]

The method used should be chosen by reflecting the current situation and circumstances as each method is not compatible with every situation. In the OECD Guidelines, there are five

[41] Malmgrén – Myrsky 2017, pp. 106-107.
[42] Erasmus: 'What is a Permanent Establishment, and How is Its Significance in Transfer Pricing'. 2024.
[43] United Nations 2021, p. 123.

different methods that MNEs can use to determine whether the financial or commercial relationship between the parties involved in the transaction are compatible with the Arm's Length Principle. However, MNEs can use different methods if they follow ALP but are advised to use the traditional methods.[44]

The traditional transaction methods recognized by the OECD are the comparable uncontrolled price method (CUP method), the resale price method (RPM), and the cost-plus method (CPM). These methods are the most commonly used. Methods of transactional profit are the transactional profit split method (PSM) and the transactional net margin method (TNMM). These las two methods are newer ones. The OECD has made a significant effort to advance transfer pricing methods further compared to the traditional methods as they are not the most effective for determining the correct transfer price.[45]

With traditional transaction methods, the price of the transaction is the subject of analyzing. Consequently, in these methods the fixed prices set between independent enterprises and associated enterprises are compared. With the CUP method, comparing the controlled transaction price with uncontrolled transactions with comparable circumstances indicates whether the transaction price chosen by the associated enterprises is at arm's length. Additionally, the CUP method can be suitable for calculating the interest of a loan or a royalty.[46]

The RPM focuses on analyzing the price of an article charged from an independent enterprise by another enterprise.  The price determines an arm's length gross margin that is enough to cover the costs of sales, general and administrative expenses, and on top of that, to also make an appropriate earning.[47] Therefore, with the RPM the element that is compared is the gross profit margin[48] and not the price of the transaction itself.

The CPM is suitable for transactions involving a sale of tangible assets or services rendered. The method starts from inspecting the costs set by the supplier in a controlled transaction of property or services to a related buyer. A suitable cost-plus mark-up[49] is added to the cost, and an appropriate gross profit will be calculated based on the functions performed, assets

[44] Tuominen 2018, pp. 438-439, 452.
[45] Feinschreiber – Kent 2012, p. 4.
[46] United Nations 2021, p. 128.
[47] United Nations 2021, pp. 135-136.
[48] *Gross profit is calculated by deducting the cost of goods sold from net sales*. United Nations 2021, p. 137.
[49] *A cost-plus mark-up means a profit margin which is added on top of direct and indirect costs of providing services or property*. ITAXA: Cost-plus Markup. 2022.

used, assumed risks, and market conditions. CPM evaluated the arm's length of the transaction by comparing the controlled transaction's gross profit mark-up to a comparable uncontrolled transactions' gross profit mark-up.[50]

The transactional profit methods are less direct in comparison with the traditional transaction methods. Instead of the transfer price of an individual transaction, the methods analyze the profits earned from a controlled transaction. These methods are more suitable in situations where there are no transactions with comparable price that are conducted between two independent enterprises to compare to.[51]

The PSM is a complex method of determining the right transfer price. With PSM, the first step is to determine the relevant profits or losses in relation to the transaction. Next, the profits or losses are split between the parties on an economically valid basis to reach an arm's length transfer price. Usually, the split reflects the amount of each parties' contribution, i.e. functions performed, assets used, and risks assumed.[52]

The TNMM inspects the net profit margin in relation to an appropriate base, i.e. sales, assets, costs, which the taxpayer collects from a controlled transaction. The net profit margin is compared to a comparable net profit margin from an uncontrolled transaction. Different profit level indicators can be used when calculating the price with TNMM. [53]

The transactional profit methods are rarely used by enterprises when determining the actual transfer price. However, they are commonly used by taxpayers due to practical reasons as it might be easier to find comparable transactions to use with the transactional profit methods rather than with the traditional profit methods.[54]

Additionally, the methods can be categorized by how they analyze transactions from the supply and demand perspective. The CUP method and the PSM consider both sides of the transactions, i.e., supply and demand. The RPM, the TNMM, and the CPM take only into consideration either supply or demand side of the transaction.[55]

[50] United Nations 2021, pp. 146-149.
[51] Tuominen 2018, pp. 438-439.
[52] United Nations 2021, p. 178.
[53] United Nations 2021, pp. 156-157.
[54] United Nations 2021, pp. 168.
[55] Tuominen 2018, pp. 438-439.

If an enterprise sets a transfer price without using any of the transfer pricing methods, that does not automatically mean that the price would not reflect the real market outcome and the ALP. Additionally, in some cases when calculating the transfer price, enterprises do have lawful reasons to report losses at arm's length. [56] An observation can be made that calculating the correct transfer price is a complex process and should be approached from the circumstances of each transaction, as the methods and their applicability are situation-specific.

## 2.5 Transfer Pricing Double Taxation in the European Union

### 2.5.1 Double Taxation

Double taxation means taxing the same income twice. The possibility of double taxation exists because of the unharmonized taxation rules and tax sovereignty of states.[57] The risk of double taxation relating to transfer pricing actualizes when a corporate group is conducting business in multiple countries and intra-group transactions are done across borderlines.

There are two kinds of double taxation: legal[58] and economic. In legal double taxation two or more states collect taxes from the taxpayer of the same income. With economic double taxation the same income is taxed from two different taxpayers. In the context of transfer pricing, economic double taxation is the possible way for double taxation to happen. The same income can be taxed from two different companies, but also from the head office and a permanent establishment.[59] Transfer pricing adjustments made by a national tax authority increases the risk of double taxation. In that context, double taxation can occur when one tax administration makes an upward adjustment to the taxable profits, and the other tax administration involved does not make a corresponding downward adjustment.[60] States enter international tax treaties to avoid the need for adjustments.[61] However, the tax rates in the countries involved may differ as the direct taxation is not unified within the EU.[62]

In most states, there is national legislation that removes the possibility of double taxation, or the states take part in tax treaties which eliminate double taxation between two or more

[56] United Nations 2021, p. 123.
[57] Haase 2024, p. 7.
[58] Also known as juridical double taxation.
[59] The Danish Customs and Tax Administration: C.D.11.15.1, 2024.
[60] ITAXA: Economic Double Taxation. 2022.
[61] Turner 2013, p. 46.
[62] Directorate General for Internal Market, Industry, Entrepreneurship and SMEs: Double Taxation.

states. There are two main methods that are recognized in the international treaty law for avoiding double taxation: the exemption method and the tax credit method. The exemption method is built on the general principle known in economics and taxation that the tax burden affects the enterprises competitive position and therefore all enterprises functioning in the market should be taxed under equal tax conditions. In practice it means that the domestic tax on foreign income is not taxed. With the tax credit method, the enterprises' country of residence exempts the foreign income in question from tax to the same extent that the other country taxes the enterprise by reducing its own tax. In general, the EU law allows Member States to decide themselves which method they choose to use.[63]

### 2.5.2 Transfer Pricing Adjustment

A transfer pricing adjustment or a primary adjustment is a process where a national tax administration can adjust the transfer price between related parties to make the price reflect the ALP, meaning that the price is adjusted to reflect what it would have been between two independent enterprises.[64] It is an upward or downward modification of the reported profits of an enterprise. When making a primary adjustment, the other tax authority involved may need to perform a corresponding adjustment. This ensures that the intra-group transactions do not end up being double taxed.[65]

Performing an adjustment is necessary in a situation, where the taxed income is less or losses are greater than what they would have been if the transfer pricing process would have been executed in accordance with the ALP. This gives national tax administrations the opportunity to tax the transaction as if it was at an arm's length. Tax administrations may review the transfer price in advance, in real time or after the transaction. When the price is checked in advance, it is usually from the initiative of the enterprise, when the enterprise asks for guidance, a preliminary tax ruling or wants to conclude an advance pricing agreement (APA). When the price is checked afterwards, it happens through a tax audit process.[66]

Tax audit is a procedure, where the business or individual tax will be examined by the national tax authority in order to ensure that the tax laws are being followed accordingly and

[63] Haase 2024, pp. 3-4.
[64] Klepacz 2024.
[65] ITAXA: Primary Adjustment. 2022.
[66] Karjalainen – Raunio 2018, pp. 12, 353.

that the amount of taxes paid, and the profit reported is the real amount that needs to be collected and taxed.[67]

In conclusion, not following the ALP when setting the transfer price leads to adjustments to the tax liability. In some cases, the consequence might be additional interest on top of the original tax and penalties.[68]

### 2.5.3 Dispute Resolution and Removal of Double Taxation

#### 2.5.3.1 Arbitration Convention

The EU Member States have agreed on a Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC) (Arbitration Convention). The Convention is a multinational tax convention between the Member States and not part of official EU law.[69] The aim of the Convention is to control transfer pricing counter-adjustments to avoid double taxation. As stated before, in practice double taxation can occur in a situation where branches of a corporate group are located in different EU Member States, and they are being taxed by two or more tax administrations, and one makes an upward adjustment to the reported profits, and the other does not do a downward adjustment to match.[70] These types of adjustments are made when one of the national tax authorities involved decides that the transfer price is not according to the ALP, and therefore it chooses to make an upward adjustment on the taxable income. This is also known as a primary adjustment.[71] Consequently, other tax authority or authorities involved need to make a matching downward adjustment.

When the enterprise involved notices double taxation occurring, it can present its case to the tax authorities involved, regardless of what national laws or tax treaties allow or advice, by invoking the Arbitration Convention. If the problem cannot be solved, the tax authorities need to find a mutual agreement with the authorities of the EU Member State where the

[67] Tax Foundation: Audit.
[68] Cooper 2017, pp. 29-30.
[69] Karjalainen – Raunio 2018, pp. 10-12.
[70] European Union: Elimination of Double Taxation (Arbitration). 2017.
[71] The Danish Customs and Tax Administration: C.D.11.15.1, 2024.

enterprise is being taxed. However, if the tax authorities are unable to solve the double taxation through a mutual agreement process (MAP), they can present the case to the Advisory Commission.[72]

The Advisory Commission is set up via request and consists of the tax authorities of the Member States involved and three independent persons from a list drafted and nominated by the EU Member States. One of those persons will act as the Chair. The authorities will agree on Rules of Functioning and the Advisory Commission is obliged to give its opinion within half a year. The Advisory Committee will investigate whether the transfer price taxation is in accordance with the ALP.[73]

According to Article 12(1) of the Arbitration Convention, national authorities will make their decision based on the opinion of the Advisory Committee. However, if they are still unable to reach an agreement, they shall be obliged to follow the opinion given by the Advisory Committee.

The Arbitration Convention has its defects but the main problem with it has been the long timeframes it takes to resolve tax disputes as the Convention has no set deadlines for actions taken to solve a dispute. A taxpayer may be deemed to lose the right to arbitration under the Arbitration Convention if it has manipulated or attempted to manipulate taxable profits in different Member States.[74]

#### 2.5.3.2 Directive on Tax Dispute Resolution Mechanisms in the European Union

To help resolve disputes within taxation, the Council adopted the Directive 2017/1852 on Tax Dispute Resolution Mechanisms in the European Union (Tax Dispute Directive). The Tax Dispute Directive is built on the Arbitration Convention, as its scope is broader than the Convention's, and it was supposed to replace the Convention. However, currently the Arbitration Convention is still in force. The Tax Dispute Directive applies to all taxpayers that are subject to income taxes and capital taxes that fall under the scope of bilateral tax treaties and the Arbitration Convention, meaning that it applies to businesses and individuals. The

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[72] European Union: Elimination of Double Taxation (Arbitration). 2017.
[73] Karjalainen – Raunio 2018, pp. 10-12.
[74] Karjalainen – Raunio 2018, pp. 10-12.

directive covers mainly double taxation issues.[75] This may reduce the need for the Convention, as the directive is more effective in removing and preventing double taxation.[76]

In the directive, dispute resolution can be divided into three different stages: the complaint stage, the MAP stage, and the dispute resolution stage. The stages are quite similar with the Arbitration Convention and therefore further discussion of them has been excluded from the scope of the thesis.

#### 2.5.3.3 Mutual Agreement Procedure

A mutual agreement procedure is the first step of a dispute settlement procedure within the EU Member States when a transfer pricing dispute arises.[77] MAP originates from the OECD Model Tax Convention's Article 25, and is also part of the Arbitration Convention and the Dispute Resolution Directive as stated earlier.

According to Article 25 of the Model Tax Convention, when a taxpayer considers that the income is being double taxed, they can present the case to the national tax authorities involved regardless of what is written into the national legislation. This needs to be done during the next three years following the first notification of the act in taxation that is not compatible with the Convention. If the tax authority notices that there is in fact a problem with the taxation and is unable to solve it by themselves, they need to solve the problem together with the other foreign tax authority or authorities involved. The authorities will seek for a mutual agreement on removing the double taxation. The authorities can either communicate directly or through a joint commission, that includes the authorities or their representatives, in order to find an agreement.

According to Article 25 of the Model Tax Convention, if an agreement between the tax authorities is not reached within two years after collecting all the relevant information, the problem can become a subject of arbitration if the taxpayer requests so in writing. However, arbitration procedure is not possible if the issue has already been decided on by a court or an

[75] European Commission: Dispute Resolution Mechanism.
[76] European Union: Elimination of Double Taxation (Arbitration). 2017.
[77] European Commission: Statistics on Pending APAs and MAPs in the EU.

administrative tribunal from either country. A mutual agreement which implements the arbitration decision becomes binding for all states involved unless if the taxpayer does not accept the decision.

## 2.6 Advance Pricing Agreements

An advance pricing agreement is an agreement between the taxpayer and the national tax authority of transfer price methods used in an intra-group transaction within the corporate group. APAs can be bilateral or multilateral and are usually initiated by the corporate entity.[78] An APA gives certainty in advance on the transfer pricing methodology used, and reduces the possibility and need for tax audits of such transactions.[79]

In an APA, the criteria for the transfer pricing process of a certain business enterprise's intra-group transactions are determined for a specific period in the future. An APA is agreed upon by the taxpayer, and the criteria may determine the transfer pricing method, comparable data, and different adjustments and critical assumptions.[80] An APA needs to be exact enough to solve the transfer pricing question. However, in an APA the price of a certain transaction is rarely set, and the APA needs to be general and broad enough to be applicable for the time period of multiple years. Bilateral APAs are usually based on the OECD Model Tax Convention's guide for the mutual agreement process, especially on Article 25(3) of the Convention, and additionally on the possible tax treaties between countries involved. There are no specific instructions for multilateral APAs but they can also get their basis from Article 25 of the Convention, and from tax treaties, if there is international tax treaty provisions on the mutual agreement procedure between the countries involved.[81]

With all kinds of expected controlled transactions, it is possible for the corporate group to seek for a bilateral or multilateral APA within the European Union. When applying for an APA, the application needs to clarify to the right tax authorities that the transfer price that has been proposed on the application is accordingly to the ALP. As APAs can be bilateral or multilateral, the scope and nature of the agreement may vary from case to case. The needed information is dependent on the right authorities involved and the complexity and scope of the transaction itself. In a pragmatic setting, the tax authority and the applicant may

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[78] Karjalainen – Raunio 2018, pp. 410-411.
[79] European Commission: Statistics on Pending APAs and MAPs in the EU.
[80] The Danish Customs and Tax Administration: C.D.11.15.3.1, 2024.
[81] Karjalainen – Raunio 2018, pp. 410-418.

decide together on the necessary documentation and information needed. In cross-border transactions, the tax authorities may require different information as the transfer pricing systems vary from country to country.[82]

In the application seeking for an APA, the information needed is the following: the enterprise and market needs to be described, the controlled transaction needs to be explained in detail including comparability analysis[83] and functional analysis[84], the proposed transfer pricing method and how it will be implemented, the critical assumptions, and an annual report on compliance with the conditions of the arrangement. The amount of information needs to reflect the size of the enterprise and the complexity of the transaction.[85]

The application process can be closed if the enterprise wants to withdraw from it. The withdrawal can be done at any time by the applicant, even after the tax authorities involved have reached an agreement on the APA draft. After accepting the draft, the tax authorities will discuss it with the applicant. If the applicant at this point approves the APA proposal, the APA will enter into force. After the APA enters into force and is signed, the applicant is obliged to follow the terms and conditions of the APA.[86]

There are no general rules on for how long an APA is valid. However, usually they are valid for five years at a time. When the time period, that APA is in force, is coming to an end and the MNE wants to extend it, they should contact the correct authorities to negotiate whether the APA can be extended. This is usually possible in practice if the circumstances have not changed radically.[87]

An APA needs to be done beforehand as it can only be done before conducting a controlled transaction, meaning that if a transaction has already been carried out, it usually cannot be the subject of an APA. However, there is a possibility for a so-called roll back, where the APA is used for tax purposes of previous years that have not yet been taxed. A roll back can only be done if there is not significant change in circumstances of the corporate entity.[88] The

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[82] The Danish Customs and Tax Administration: C.D.11.15.3.5, 2024.
[83] *Comparability analysis: A systematic evaluation of whether the terms and conditions of the intra-group transaction are comparable with an uncontrolled transaction conducted at arm's length*. ITAXA: Comparability Analysis. 2022.
[84] *Functional analysis: An examination of the functions that are performed, assets used, and risks assumed in the intra-group transaction.* Erasmus: 'Guide to Functional Analysis in Transfer Pricing'. 2024.
[85] The Danish Customs and Tax Administration: C.D.11.15.3.5, 2024.
[86] The Danish Customs and Tax Administration: C.D.11.15.3.7, 2024.
[87] Karjalainen – Raunio 2018, pp. 410-411.
[88] Karjalainen – Raunio 2018, 1pp. 410-411.

retroactive effect may be suitable in situations, where the MNE or the tax authorities involved view the APA and the transfer pricing models planned for the future more fit for past income assessments as well. In such cases, all the tax authorities involved need to agree on using the APA retroactively for this time period and additionally, to agree on the amount of profit in question.[89]

The main advantage of an APA is the avoidance of double taxation as it ensures that the national tax authorities accept the transfer pricing principles during the timeline when the APA is applied, and therefore the outcome, i.e. the taxable profits. Another benefit from an APA is the tax certainty it gives to the corporate group as usually the transactions covered by it will not end up being the subject of tax audit and therefore, there is less work involved.[90]

From the perspective of the corporate group involved, APAs require more resources. To be beneficial and worth the input, an APA should be done for the time period of several years, and it should solve multiple questions around the transfer pricing process.[91] However, compared to the benefits, security, and reliability an APA gives to the corporate group, this is usually not an issue. Although APAs are valid only for a certain time, the time can usually be extended rapidly if the conditions have not changed in a significant way.[92]

Although they come with multiple advances, not all countries are willing to take part in APAs as they demand a lot more from the national tax authority. In some States, APAs are limited to only interpretative and substantive issues. APAs are widely recognized, and within the European Union, the European Commission encourages to use bilateral APAs within the single market to avoid double taxation. Furthermore, not all states have national legislation regarding APAs, but this does not prevent them from entering APAs. For example, this is the current situation in Finland.[93]

### 2.6.2 Critical Assumptions in Advance Pricing Agreement

Critical assumptions are the facts that are necessary for the continued validity of an APA. They can be, for example, any facts or circumstances relating to the applicant, their industry,

[89] The Danish Customs and Tax Administration: C.D.11.15.3.11, 2024.
[90] Karjalainen – Raunio 2018, pp. 410-411.
[91] Karjalainen – Raunio 2018, p. 411.
[92] The Danish Customs and Tax Administration: C.D.11.15.3.1, 2024.
[93] Karjalainen – Raunio 2018, p. 411.

third parties, or the general economic conditions going on within the markets. These form the foundation of an APA as they need to be thoroughly planned.

For example, a critical assumption related to the applicant can be the structure of the MNE or the broadness of the transaction. A critical assumption relating to other aspects can be changes in interest rates, new legislation, or unexpected change in business volume. Usually, an APA will include terms on that the enterprise needs to inform the tax authorities if there is a change in the state of the critical assumptions or that they are no longer met during the period. The effect the changed critical assumptions have on the continuity of an APA varies from situation to another, but usually after changes in circumstances, the tax authorities will negotiate more and aim for a new agreement. A change in critical assumptions does not affect the continuity of an APA itself but for an APA to be changed and carried out further in the future, all parties need to be interested in adjusting it to fit the new circumstances.[94]

## 2.7 Tax Havens and Loss of Tax Revenue to non-Member States

From a fiscal point of view, transfer pricing is about sharing tax revenue between two or more states and to do this in a way that avoids double taxation. This makes tax treaties between countries extremely important. As aforementioned, there are rules for transfer pricing in national laws in most countries. The national rules are also applicable when there is transfer pricing process conducted between two or more states that do not have a tax treaty. This makes the process easier, but the rules are there to also ensure that the national tax revenue is not lost to tax havens and other countries with a lower-than-average corporate income tax.[95]

The term ‘tax haven’ was first used for states that offer low-tax regimes to attract more business into the country. Later, the term has been used for states where the jurisdiction does not function accordingly to the tax good governance principles and other jurisdictions. This is due to the country’s aim to attract investment and tax bases.[96] Although there is no exhaustive definition for a tax haven, they have similarities that can be used to determine whether a state is one.

[94] The Danish Customs and Tax Administration: C.D.11.15.3.8, 2024.
[95] Karjalainen – Raunio 2018, p. 2.
[96] European Parliament: PE 621.872 – May 2018.

Typical for tax havens is that they do not have a corporate income tax or that the tax is significantly lower compared to most other countries. Other factors tax havens have in common can be lack of international cooperation when it comes to taxation and secrecy jurisdictions. The terms tax haven, offshore financial centre, and secrecy jurisdiction are often mixed and used together as they all have similarities such as nonexistent or low taxation, tax secrecy and even fictitious residences. However, each of these emphasize a particular characteristic: low-tax countries emphasize the fact that there is no tax or a minimal tax, secrecy jurisdictions emphasize the anonymity of financial deals and assets ownership, and offshore centres emphasize the foreign location. The main elements making country a tax haven is the lack of exchanging information of their taxpayers with other tax administrations and governments, minimal or non-existent reporting on the owners of assets or financial deals, minimal or no taxation on income and assets of non-residents, tax advantages to non-residents, and not upholding minimum standards of corporate governance and accountability.[97]

European Union is constantly working to promote and establish tax good governance mechanisms, global tax transparency, and fair taxation to fight tax evasion and avoidance, and tax fraud. The EU has fixed a list of non-cooperative jurisdictions for tax purposes. The listing criteria was fair taxation, tax transparency, and measures against base erosion and profit shifting. The list was adopted by the Council in October 2024, and currently includes 11 countries: American Samoa, Anguilla, Fiji, Guam, Palau, Panama, Russia, Samoa, Trinidad and Tobago, US Virgin Islands, and Vanuatu. There is also a list of countries that cooperate with the EU but have pending commitments. These countries are under the EU screening process, but once a country meets all its commitments, EU will remove it from the list.[98]

## 2.8 Customs Law and Transfer Pricing

When discussing transfer pricing within the European Union, it is impossible to ignore the customs law in the Union. The EU was built on the idea, that within its area, there is a well-working internal market.[99] Therefore, the four freedoms were established. The four freedoms are the freedom to move freely goods, services, capital, and labour within the Union's area.

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[97] European Parliament: PE 621.872 – May 2018.
[98] European Council, Council of the European Union: EU List of Non-Cooperative Jurisdictions for Tax Purposes, 2024.
[99] Tuominen 2018, p. 439.

These four freedoms have their legal basis in the Founding Agreements of the EU and can be found in multiple articles of said treaties, for example in Article 26 of the TFEU.

Another important legal regulation is the right of establishment, which in some contexts is also known as the freedom of establishment. The right of establishment is a key factor in the working internal market. Its legal basis is in Article 49 of the TFEU. The right of establishment means, that all restrictions against nationals of another Member State on the freedom to establish in another Member State are prohibited. This includes restrictions to establishing agencies, branches or subsidiaries, and being self-employed, setting up or managing undertakings in another Member State. There are several other articles illustrating the same rule or creating space for it in the TFEU, which are Article 55 (similar treatment to all Member State nationals besides their nationality in another Member State), Article 26 (internal market), and Article 56 and Article 62 (freedom to provide services).

These regulative rules create basis for all business activities conducted within the Union and make establishing and running different kinds of business branches or subsidiaries possible. Giving citizens the right to do business more freely is essential for the internal market. Another necessity is removing tariffs within the Union when goods cross border from one Member State to another. This allows goods to move freely throughout the Union. The tariff rules also include common legislation for when trade goes beyond the Union's borders, and for such situations, there is a common customs tariff.[100]

However, from a legislative perspective custom law in the EU and transfer pricing are not in contact. The customs law is not a tax measure, but a trade policy measure. It differs from transfer pricing, as transfer pricing is not regulated by the EU law and is based on national legislations of the Member States, whereas customs law is regulated by the EU.[101] Furthermore, the goal with customs law and transfer pricing rules may be seen as somewhat similar – intercompany cross-border transactions are based on internationally recognized objective principles, and both recognize that the price should not be affected by the relationship of the parties.[102] The functioning behind the EU customs law is to ensure that the EU has a working and competent internal market, and that trade between the Member States is treated similarly. Reaching this state would be impossible without common regulations within the EU.

[100] Tuominen 2018, pp. 493-494.
[101] Tuominen 2018, pp. 441-443.
[102] Tuominen 2018, pp. 441-443.

# 3 Arm’s Length Principle

## 3.1 Introduction to the Arm’s Length Principle

The Arm’s Length Principle is an internationally recognized pricing standard originating from the OECD Model Tax Convention.[103] In short, the principle means that the financial gains derived from a controlled transactions of the corporate enterprises involved should have the same value as if the enterprises did not have a community of interests.[104] Therefore, the price set for the transaction needs to be identical to transaction prices that would be used when conducting similar transactions between enterprises that are not part of the same corporate group or in any relation outside of the transaction.

Article 9 of the Convention is built around ALP.[105] In the Article, the ALP is defined as: “where an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly”. The ALP views group companies through the separate entity approach, meaning that each of the enterprises are viewed to be separate actors and independent of the group.[106]

The ALP is in no means a new principle and can be dated all the way to the OECD’s publications from 1979. ALP is based on market forces, at least in theory. These forces being supply and demand, making the transfer price acceptable to each party involved. The taxational point of the ALP is that it ensures that the taxable compensation of the transaction is set accordingly to the real market price.[107]

[103] Merciega 2022.
[104] Navarro 2017, p. 25.
[105] Karjalainen – Raunio 2018, pp. 5-8.
[106] Vero: Transfer Pricing of Intra-Group Financial Transaction.
[107] Tuominen 2018, p. 436.

The right price that is compatible with the ALP can be determined by examining financial indicators.[108] This can be done by comparing markups of cost, net profit indicators, and the gross margin data collected from transactions with identical or relatively similar situations both from controlled and uncontrolled transactions.[109] To depict that the intercompany transaction has been made with a real market price, i.e. the price of the transaction reflects what the price would have been if the transaction was conducted by independent enterprises, and that the situation and circumstances around the transaction did not affect how the price was set, the taxpayer has various transfer pricing methods available to depict that the transfer price and the following taxable profit are at 'arm's length'.[110]

## 3.2 The OECD Transfer Pricing Guidelines and Legal Nature of the Arm's Length Principle

The OECD Transfer Pricing Guidelines target the issue of comparability in transfer pricing. This is done by following the transfer pricing methods when setting the right price for an intra-group transaction. Additionally, the Guidelines aim for a balance between setting the task of finding the right transfer price and tax revenue between the taxpayer and national tax administration. The Guidelines set Article 9(1) to be the basis of comparability analysis, therefore making the ALP the foundation principle in the process.[111]

Globally, the ALP is a recognized and an accepted standard, especially in international tax treaty law. It could even be argued that the principle has a placement in customary international law.[112] Despite this, within the EU, the legal emphasis of the principle is not binding. The ALP has not been written into EU law, which makes it more of a soft law instrument in the EU area regardless of it being internationally recognized. The principle is limited to provide a direction to the right result, but nothing more.

Therefore, the ALP is not an autonomous principle and in order to be applied in a tax ruling, it needs to exist in the national tax system. Consequently, if it does exist in the national tax system, it will be interpreted as it is defined there.[113] Although the Member States agree to some extent on how the ALP should be interpreted in transfer pricing taxation, only the

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[108] Feinschreiber - Kent 2012, p. 12
[109] Navarro 2017, p. 25.
[110] Tuominen 2018, p. 438.
[111] Feinschreiber – Kent 2012, p. 11.
[112] Miladinovic 2022, pp. 11-14.
[113] Nicolaides 2022.

national tax system can be taken into consideration when giving tax rulings, as there are no common legal rules on the ALP on the EU level that have been referred into the national tax systems and laws. Even the CJEU has confirmed this approach in its judgements on certain state aid cases, for example the joined Cases C-451/21 P and C-454/21P (Engie), and the Case C-457/21 P (Commission v Amazon and others).

Because of the ALP's nature of being a quasi-legal instrument, the definition and application of the principle may vary as there is no detailed guidance on how it should be applied in practice. There is a difference between how government officials, such as tax administrative bodies, view the principle compared to how private organizations and corporate entities view it. Additionally, from the European Union's point of view, the biggest problem with the utilization of the ALP in action is how the interpretation differs between the EU and the Member States.[114] However, especially in the OECD Member States, the ALP is usually defined as it is written into the OECD Guidelines.[115]

The OECD Guidelines do not set specific demands on what should or should not be included in a transfer pricing process between two or more associated enterprises. This leads to a situation, where the ALP becomes a very subjective standard of valuation, rather than an objective guideline. Additionally, the OECD takes into account that the outcome of transfer pricing may not reflect market forces and consequently market forces may not reflect the ALP. To satisfy the ALP, the OECD Member States have agreed that they are able to adjust the reported profits, which taxation is based on, when taxing associated enterprises by making transfer pricing adjustments. [116]

In practice, because the OECD Guidelines do not include a theory on how to form transfer prices between associated enterprises, a guidance of the interpretation and application of the ALP is much needed. Currently, the interpretation of the ALP is done in a way, where MNEs apply one of the transfer pricing methods and then give reasons to why the specific method got chosen and justify the outcome, i.e. the price.[117]

A conclusion can be made, that the ALP is more of a guiding tool or a frame for the right outcome, and not something that is applied in a literal form as the ALP is a principle and not

[114] Navarro 2017, p. 25.
[115] Sander – Scherer – Schmiel 2024.
[116] Tuominen 2018, pp. 438-439.
[117] Sander – Scherer – Scmiel 2024, pp. 1, 9.

a regulative norm. The ALP is used to guide for the juridically right outcome when finding the right taxable price. Although legally a quasi-legal instrument, the ALP is not only a useful tool, but rather the backbone of the current transfer pricing tax system in most countries. It embodies the basic rule, which needs to be followed for taxation to be effective, fair, transparent, and accurate.

## 3.3 Disadvantages of the Arm's Length Principle and the OECD Guidelines

The ALP is not immune to errors. There are certain compensation issues that rise from the usage of the principle, although the principle was first set in order to avoid such issues.

First of all, the OECD acknowledges that in certain situations it is harder to set the right price. For example, tax administrations and taxpayers may have trouble with determining the right transfer price when the transaction is between MNEs that deal with integrated production of very specialized goods or with unique immaterial. Additionally, a difficult situation may arise when the transaction is between MNEs that provide services as the nature of the object of the transaction is harder to price. In such cases, the OECD recommends using the transactional profit split method.[118]

In addition, the OECD Transfer Pricing Guidelines suggest that the contribution analysis and residual analysis are used as an alternative way to determine whether the transaction is at arm's length. Some transactions may have such a unique nature that they cannot be subject to the comparability analysis. For such situations, the Guidelines suggest, that when there is a limited or no amount of data available, making the comparison difficult, the associated enterprises will consider the assets they use and predicted risk.[119]

According to some, the ALP lacks theoretical foundation to begin with, which causes problems in practice. It can be viewed as a tool in a mix of other instruments.[120] However, in this thesis the economic theory of the ALP has been excluded from the topic. An observation can

[118] Feinschreiber – Kent 2012, pp. 12-15.
[119] Feinschreiber – Kent 2012, pp. 12-15.
[120] Sander – Scherer – Schmiel 2024.

be made, that the ALP has its shortcomings as it is heavily based on the comparability analysis in a field where finding a comparable transaction can turn out to be hard or sometimes even impossible.

Furthermore, under oligopolistic conditions the ALP works poorly for its indented use. An oligopolistic market occurs in a situation, where the competition is limited to only a few sellers providing the same or similar goods or services, and which are unable to ignore the actions of the other party or parties operating on the market as all of them take up a high percentage of the market.[121] It is acknowledged by the OECD that under such circumstances the application of the ALP in transfer pricing is complicated, and it sees it as a possible situation to excuse tax administrations and MNEs from using the ALP as there is no comparable transaction or transactions which could be used to determine the right transfer price.[122]

In international public conversation on transfer pricing, NGOs have criticized how the ALP enables MNEs to move profits to countries with low tax rates as the principle does not take sufficient account of the fundamental characteristic of a group, i.e. its functioning as a single economic entity.[123] This can be considered a major flaw with the principle, as it fails to notice the basic nature of MNEs by not considering them as a group and therefore treating associated enterprises as independent enterprises. Consequently, the principle is seen as a significant cause and driver of tax avoidance.[124]

The ALP imposes an administrative burden on MNEs, increasing the workload coming from the transaction. It forces the MNE to collect and provide vast amounts of data and reports, sometimes overlapping with their interest of confidentiality as such data is usually for internal use and not public.[125]

Overall, the OECD Guidelines lack examples forcing all parties to operate just based on the concise information provided. However, the outcomes are not considered to be unexpected, although the MNEs are often not prepared for the outcome. The ALP can be seen as a principle that is not very flexible. Although the ALP is not a new principle, there is not a sufficient amount of case law on it.

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[121] Monash University: Monash Business School, Marketing, Marketing Dictionary: Oligopolistic Competition.
[122] Feinschreiber – Kent 2012, p. 14.
[123] Karjalainen – Raunio, 2018. pp. 46-48.
[124] Sander – Scherer – Schmiel. 2024
[125] Feinschreiber – Kent 2012, p. 14.

Despite the critique the ALP faces, the OECD defends the principle and still views it as the best guiding principle when determining transfer pricing rules and reasons this through the international recognition and effectiveness of the principle.[126]

In relation to state aid cases, the scattered interpretation of the ALP has led to numerous tax disputes between the European Commission and the Member States' national tax administrations. The ALP causes problems with its open-ended nature of interpretation as it is a legal principle and not a set legal rule with a highly definitive meaning. As the ALP is the most used indicator to determine whether a transfer price is correct and consequently leads to the calculation of the correct amount of tax, the interpretation of the principle is the main cause of legal disputes when it comes to the state aid cases on transfer pricing tax rulings. To be competent in attracting businesses to their area, countries sometimes accept transfer prices that are not in accordance with the ALP and consequently may end up granting a selective aid in the form of a lower tax ruling to an MNE. However, this is probably not going to be the legal environment forever, as making ALP a regulative and legally binding principle is under works.[127] This topic will be discussed later in greater detail in the Chapters 5 and 6.

[126] Karjalainen – Raunio, 2018. pp. 46-48.
[127] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 4.

# 4 State Aid

## 4.1 Introduction to State Aid

The European Union has adopted competition law rules and principles prohibiting actions that favour a certain corporate entity or a business over others within the Union's economic area. Any aid granted by a Member State directly or through any state resource in any form that distorts competition within the area of the Union by favouring a certain corporate entity or the production of certain goods is prohibited in the internal market.[128] One of these rules is the prohibition of Member States giving out state aid, which may lead to uncertain and unfair outcomes in the internal markets by giving one entity distortive advantage over the others competing in the same field.[129] The definition of state aid comes from Article 107 of the TFEU. According to Article 107(1) of the TFEU, "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".

The wording of the Article hints, that it should be interpreted broadly as it prohibits "any aid granted" and includes the state but also different state resources as well. For example, these state resources can include tax administrations, making it prohibited to give out selective tax benefits and tax deductions, or to complete taxation of certain companies with a lower tax rate than average. Therefore, state aid that is not compatible within the internal markets can occur with taxation. These are indirect measures, as no direct aid is granted but the tax burden is made lighter.[130]

For an advantage to be considered state aid, it needs to fulfill a certain criterion. First, there needs to be an intervention by the state itself or through resources of the state, which can be done by various different forms, e.g. tax reliefs, grants, government holdings of the company, guarantees, or even by providing goods and services on better terms than to others. Second, the governmental intervention gives the receiver and advantage on a selective basis, resulting to a competition that has already or may be manipulated in the future. Third condition for an action to be considered state aid is that the intervention conducted affects or is

[128] European Union: Notion of State aid. 2019.
[129] European Commission: State Aid Overview.
[130] Bobby 2017, p. 192.

likely to affect trade between Member States.[131] When determining whether a benefit is state aid, a key factor is whether it is selective or not.[132] According to these conditions, it is clear, that for a governmental intervention to be considered state aid it does not need to affect the trade within the Union's internal market but only the possibility for that to happen is enough. This indicates that the Article should have a broad interpretation.

However, there are exceptions to the state aid rules, which can be found in Article 107(2) and (3) of the TFEU. The exceptions include e.g., a governmental aid having a social character, an aid to help in situations where damage has occurred by an unexpected factor such as a natural disaster, or an aid to promote execution of important projects of common European interest are allowed. It is certain that either the aid needs to have basis in promoting common good and common interests or in something abnormal and exceptional, such as the occurrence of a natural disaster or a pandemic. For example, during and after the coronavirus pandemic, the Member States supported citizens and corporate entities by giving out different governmental aids due to the viruses' effect on the economic area.[133] The European Union recognizes, that in some situations and circumstances, governmental interventions are necessary in order to keep up a functioning and fair economy. Therefore, the EU has left space for the type of state aid that is compatible with the internal markets.

## 4.2 The Commissions Procedure with State Aid Cases

The European Commission is responsible together with the CJEU on ensuring that the EU law is applied properly and followed in each Member State.[134] Additionally, the Commission governs that the Member States interpret and enforce legal norms in a way that is compatible with the EU legislation. If a Member State fails to respect these obligations, the Commission can take the case to be decided in front of the ECJ under the Article 258 of the TFEU.[135]

Each case will be reviewed by the Commission together with the Member State in question, according to Article 108(1) of the TFEU. The state aid control requires a beforehand notification of every new aid that is to be given, and any aid given out without the authorization

[131] European Commission: State Aid Procedures.
[132] Miladinovic 2022, pp. 11-12.
[133] European Commission: State Aid Rules and Coronavirus.
[134] European Union: European Commission.
[135] Raitio – Tuominen 2020. pp. 107, 110-111.

given by the Commission is deemed to be unlawful. Member States must wait for the Commission's decision before granting aid.[136] An investigation by the Commission can be also sparked by the Commission's own initiative or by a complaint made by a third-party. In the investigation, there are three possible outcomes: a positive decision, a conditional decision, and a negative decision. A positive decision means, that the Commission does not consider there to be any prohibited aid or aid of any kind. A conditional decision is made in a case, where the circumstances make giving the aid compatible with internal markets but without these circumstances the aid would be deemed illegal state aid. A negative decision is for situations, where the aid fulfills the state aid criteria. Each Commission decision is evaluated by the General Court, and if an appeal is made, the competent court is the ECJ.[137] However, there is a possibility that no decision will be reached if the case is closed by the Member State withdrawing the notification.

When suspecting state aid, the Commission will use a method called the 'three-step analysis' to determine the selectivity of the measure. For example, in the Case C-465/20 P (Commission v Ireland and Apple), the three-step analysis was described in a following way: "(i) identification of the appropriate reference system; (ii) assessment as to whether the measures at issue constituted a derogation from that system; and (iii) assessment as to whether such a derogation is justified by the nature and general scheme of that system".[138] A similar definition can be found in the Commission's Notices[139], indicating that the Commission is keen to use the analysis system to determine the selectivity of an aid.

There is no legal timeframe or deadline for the investigation executed by the Commission, and the investigation comes to an end once the Commission acquires its final decision. The length of the investigation is based on many factors as the objective is to be as thorough as possible. The time taken by the investigation depends on how complex and webbed the case itself is, the provided information's nature and how well the Member State involved operates to help to solve the case.[140]

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[136] European Commission: State Aid Procedures.
[137] Bobby 2017, p. 192.
[138] C-465/20 P Commission v Ireland and Apple, para. 298.
[139] Commissions Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01).
[140] European Commission: State Aid Procedures.

If a payment has already been made and the Commission reaches a negative decision, the Commission demands the Member State to recollect the benefit with interest from the receiver of the benefit. In such circumstances, the commission opens a 'recovery case' to enforce the decisions implementation. Therefore, if the Member State involved does not cooperate like demanded on the decision before the deadline, the Commission can refer the case to the ECJ without conducting any punitive action under Article 258 of the TFEU. The objective of the recovery action is to take back the advantage or benefit received by the company to re-establish the internal market to its original state before the aid. The recovery of the aid can take up to maximum of ten years.[141]

## 4.3 State Aid in Transfer Pricing

In transfer pricing, a situation where taxation leads to prohibited state aid usually occurs when a tax ruling is used to confirm a transfer pricing arrangement, such as an APA. Because transfer pricing includes the act of allocating taxable profits between subsidiaries of a corporate group, it can easily lead to tax rulings where state aid rules apply. If a tax authority of a state accepts a calculation of taxable basis provided by a company, where the compensation of a subsidiary does not reflect the normal conditions of competition, the tax treatment is considered to be state aid as it is favourable to the receiver.[142]

Based on the various decisions given by the Commission on cases regarding transfer pricing taxation and state aid, the relevant aspect from the state aid perspective was that the tax ruling at issue was prone to endorse an outcome that would unlikely be reached when applying the national law, and that it can be considered a selective benefit, especially if it lowers the taxpayer's tax responsibility when comparing to other companies with an identical legal or factual position.[143] This unlikeliness of the tax ruling's endorsed outcome was deemed to be the key factor when determining where the line between regular taxation and state aid is to be drawn. Therefore, a conclusion can be made that with transfer pricing tax rulings for the ruling to be considered to fulfil the state aid criteria, the most important factors are a selective nature of the ruling and an unexpected outcome in taxation.

[141] European Commission: State Aid Procedures.
[142] Miladinovic 2022, p. 12.
[143] Miladinovic 2022, pp. 55-57.

A decision in an intra-group transfer pricing case which is not in line with the ALP is deemed to be a selective measure leading to benefits others would not gain under similar circumstances.[144] Because intra-group transactions are not guided by the market powers, the ALP is used to determine a market price in a situation where there is no proper market. The ALP's aim is to ensure that all corporate entities are getting the same treatment. Therefore, it can almost be seen as a certain implementation of Article 107(1) of the TFEU, where uneven treatment of corporate entities is prohibited through positive or negative actions. Consequently, this leads to a juridical situation where even if the Member State has not adopted the ALP, it almost becomes indirectly incorporated to its national system through the TFEU Article 107(1).[145] This is an interesting phenomenon because as stated before, the ALP is not a legally binding principle, but rather a guideline. However, this can be seen as an indicator of two things; first, the implementation of the ALP to the national jurisdiction of Member States through the Transfer Pricing Directive would not necessarily be a major change, and secondly, it has been long-overdue that the principle gets to be a part of written and legally binding legislation.

According to the European Commission, the ALP is not a need but a necessity for a well-functioning and state aid preventable corporate income tax system. The high value of the ALP as a principle in the Commission's eyes may be due to the similarities with the state aid criterion. Possibly this is causing the Commission to view ALP as an important instrument when identifying state aid cases. The Commission's view on transfer pricing taxation and state aid cases adds to this, as it also highlights the selectivity criteria in state aid identification which is in line with ALP.[146]

The Commissions interest on fiscal state aid can be considered recent as it has been increasing over the last decade. It challenges the Member States' tax measures in direct taxation, which has always been an area of broad sovereignty for the Member States. States around the world are constantly trying to attract businesses and get them to invest in the country as this is necessary for their economy. The most attractive investors are MNEs, which can be attracted to establish business operations in the state by low tax rates. This race between states on which states can provide the best tax conditions for MNEs has raised concerns in

[144] Miladinovic 2022, pp. 52-53.
[145] Miladinovic 2022, pp. 11-15.
[146] Miladinovic 2022, pp. 11-15.

the Commission. To discard such concerns, the Commission has given different conclusions where certain tax treatment or suspiciously low tax rates in tax rulings given by Member States to international corporate entities are deemed to be illegal state aid.

However, these Commission decisions have sparked controversial responses from both Member States and MNEs. The most common argument against these state aid decisions is that the Commission is acting in a manner that is both one-sided and without proper authority.[147] As indicated before, the Member States have always had a broad sovereignty when it comes to their direct taxation rules. This is an area, where two different interests collide, and adjustments need to be made in order to maintain competent tax levels in Member State but to also establish equal and functioning trade withing the Union.[148]

[147] Bobby 2017, p. 186.
[148] Miladinovic 2022, p. 11.

# 5 Case Law

## 5.1 Introduction

The Court of Justice of the European Union has given several judgments on whether a tax ruling in the context of transfer pricing constitutes state aid in the past years. The importance of these judgements does not only come from the case law perspective, but also the publicity they gained and the responses they sparked. Some of the judgements were not only deemed to be important and gained a vast amount of attention in Europe, but outside of Europe as well, especially in the United States. The reason why the United States became so interested in the Commission decisions was that there are multiple multinational enterprises originating from the United States that are doing business within the European Union's area.[149]

Therefore, the international weight of fiscal decision-making, legislation, and ruling does not only affect the EU but the whole global market. Taxation is a powerful way to control the market and the corporate world, and to steer them to different directions. The international tax law seems to be on the verge of change with new regulations being set,[150] and the CJEU's rulings support that observation. However, the current legal situation gives a lot of weight to case law as the regulatory environment lacks common guidelines. Reviewing the case law around the matter can reveal multiple trends and concepts that can help other enterprises and Member States to avoid litigation.[151]

Next, four different cases of the newer case law will be overviewed briefly and then analyzed together. From a group of multiple cases, the following were chosen as they demonstrate the issues presented and to support the observations and findings of this thesis. There will be short introductions and overviews of the cases. However, the descriptions are not intended to be exhaustive, as only the most relevant points have been covered in the overviews. The economic and numerical evaluation of the cases, for example with transfer prices, has been limited outside the scope of the thesis, as the point is to review the case law from a legal point of view. After the brief case overviews, observations of the cases and case law in general will be presented and discussed in detail in the last sub-chapter.

[149] Bobby 2017, pp.186, 215.
[150] Sander – Scherer – Schmiel 2024.
[151] Bobby 2017, p. 215.

## 5.2 Fiat Chrysler Finance Europe v European Commission

Joined Cases T-755/15 and T-759/15 (Luxembourg and Fiat v Commission), became one of the major cases on the Commission's usage of the ALP as a tool in a state aid assessment, ruled by the General Court. In the Case, Ireland intervened in support of the Grand Duchy of Luxembourg. The Case gained a significant amount of publicity and later was taken in front of the ECJ. The ECJ gave its final ruling on the joined Cases C-885/19 P and C-898/19 P (Fiat Chrysler Finance v Commission, later the '*Fiat Case*') in November 2022.

The tax ruling at issue was related to Fiat Chrysler Finance Europe's[152] (later 'FFT') intragroup transactions, where it was providing financing and treasury services to the Fiat/Chrysler automobile group (later 'Fiat/Chrysler Group') companies in Europe, which it was part of. FFT's head office was in Luxembourg, where it operated from at the time.[153]

The tax ruling leading to the court dispute was given in September 2012, when a tax adviser of FFT requested a tax ruling from the Luxembourg tax authorities for an approval of an APA. The Luxembourg tax authorities then issued a favourable decision to FFT, stating in their decision that they accept a method for determining the FFT's compensation for providing financial services to other Fiat/Chrysler group companies. This enabled FFT to calculate its corporate income tax liability in Luxembourg. The agreement was set to be binding for five years.[154]

In June 2013, the European Commission asked the Grand Duchy of Luxembourg for information on its national tax rulings practice. Later, the Commission decided on starting an investigation procedure regarding the tax ruling at issue under Article 108(2) of the TFEU. The Commission gave its contested Decision,[155] where it stated that the tax ruling at issue was incompatible with the internal market as operating aid, and met the definition of state aid within the meaning of Article 107 of the TFEU. Additionally, the Commission noted that the Grand Duchy of Luxembourg had failed to notify it of any plan to grant such aid like

[152] *At the time of the tax ruling the company was called 'Fiat Finance and Trade Ltd', but for clarity and consistency in the text, the name of the company at the time of the judgement will be used with the abbreviation 'FFT'.*
[153] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 8.
[154] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 9-10.
[155] Commission Decision (EU) 2016/2326 of 21 October 2015 on State aid SA.38375 (2014/C ex 2014/NN)

Article 108(3) of the TFEU obligates it, nor had followed the standstill obligation. The Commission ordered to recover the full aid. FFT and the Grand Duchy of Luxembourg brought actions for the annulment of the Commission's Decision.[156]

The General Court decided in its ruling to dismiss both actions, and upheld the Commission's approach. The General Court agreed with the Commission's approach on the reasoning that regardless of whether the ALP is integrated into the national law or not, when the tax system pursues the aim of taxing the profits of all resident enterprises, the application of ALP for the purposes of setting the reference system is justified.[157]

There were two appeals on the General Court's judgement, made by FFT and Ireland, which were later joined together. In the judgement, the Grand Chamber clarified further when tax rulings given in Member States endorsing methodologies for configurating transfer prices may fulfil the meaning of state aid according to Article 107(1) of the TFEU.

First, the Court clarified that when analyzing tax measures from the EU state aid law perspective, the examination of the term relating to selective advantage needs to identify the reference system, which in case of taxation is the 'normal' tax system of the Member State in question. This should be followed by a demonstration of how the tax measure is a derogation from that regime, and to which extend it is different from comparable legal and factual situations and treatment of comparable taxpayers without finding a justification within the tax system in question. According to the Court, the determination of the reference system must be done by exchanging arguments with the state involved and be objective. In the areas of law which are unharmonized by EU law, it needs to be done by only referencing to the national law of the Member State in question. Therefore, based on its competence and fiscal autonomy, it should be the Member State concerned that determines the characteristics forming the tax, which define the 'normal' tax regime. This tax regime forms the reference system that is used when analyzing the condition of selectivity. The determination of the taxable event and the basis of assessment are included.[158]

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[156] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 5-10, 14-24, 25.
[157] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 89.
[158] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 67-74.

Therefore, the Court was left to first examine whether the General Court had made an error when using the methodology used by the Commission in determining the reference system.[159]

The Court noted, that when defining the appropriate reference system, the Commission had failed to use the normal national tax system of Luxembourg as a reference, and it had applied the ALP differently than how it is under the national law. According to the Court, the Commission had failed to examine the tax ruling in the light of the ALP in the form it exists in the national law, especially regarding intra-group companies.[160]

The Court stated that the General Court had made a mistake in applying Article 107(1) of the TFEU by endorsing the Commission's approach on the question of the reference system used. According to the Court, the General Court had erred when accepting that the Commission relies on rules that are not part of the Luxembourg's legal system, and had breached the provisions of the TFEU, in particular of Articles 114(2) and 115.[161]

The Court noted, that because there is no harmonizing EU law, the methods and criteria of what should be considered an arm's length outcome should be left for consideration of the Member States. The Court added that only national regulations are relevant for whether a transaction should follow the ALP and whether the transfer prices deviate from it.[162]

The Court noted that the Commission had failed to take into account the rules for determining whether an outcome is at an arm's length which had been provided by the Grand Duchy of Luxembourg. The Commission had failed to note the rules when defining the reference system and determining whether there was a selective aid granted.[163]

Last, in its reasoning the Court stated that unlike the approach chosen in the joined Cases C-182/03 and C-217/03, (Belgium and Forum 187 v Commission), the Court does not support the idea that the ALP is applicable where a national tax system taxes intra-group companies and independent enterprises in the same way, regardless of whether the ALP is incorporated into the national law and how it is defined there.[164]

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[159] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 85, 89-90.
[160] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 11, 91-92.
[161] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 92, 117.
[162] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 96.
[163] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 99, 122.
[164] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, para. 102.

The Grand Chamber set aside the General Court's judgement and annulled the Decision at issue.[165]

## 5.3 Netherlands v European Commission

In September 2019, the General Court gave another important judgement on the joined Cases T-760/15 and T-636/16 (Starbucks v Commission, later the '*Starbucks Case*'), setting another important case law example. Ireland intervened in support of the Kingdom of the Netherlands.[166]

The enterprise in question was Starbuck Manufacturing Emea BV (later 'SMBV'), which was a subsidiary of the Starbucks group, that concluded different production and distribution activities within the Starbucks group. Starbucks Corp., which had its headquarters in the United States, controlled the companies in the Starbucks group. In April 2008, SMBV and the Netherlands tax authorities agreed on an APA, the purpose of which was to determine the remuneration received by SMBV for its activities in the Starbucks group and a royalty SMBV had to pay to another entity in the Starbucks group for using its intellectual property rights. The remuneration was supposed to set annually the taxable profit of SMBV for the purposes of corporate income tax payable in the Netherlands.[167]

In October 2015, the Commission gave its Decision,[168] where it classified the APA as state aid measure and ordered to recover the aid. The Kingdom of the Netherlands brought an annulment action against the Decision and so did the Starbucks Corp. together with SMBV. The Cases were joined for the purpose of the Judgement.[169]

Like in the Fiat Case, the Court pointed out first that the Member States need to exercise their legislation in accordance with the EU law and state aid rules even on areas that are not harmonized by EU law such as in this case, taxation. This gave the Commission the competence to determine, whether a national tax ruling can be deemed state aid. The Court noted that the Commission could use the ALP when examining the tax ruling's accordance with Article 107(1) of the TFEU. Having regards to the Netherlands national corporate income

[165] C-885/19 P and C-898/19 P Fiat Chrysler Finance Europe v Commission, Judgement para. 2-3.
[166] T-760/15 and T-636/16 Starbucks v Commission, para. 73-74.
[167] T-760/15 and T-636/16 Starbucks v Commission, para. 1, 12-14, 16.
[168] Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN).
[169] T-760/15 and T-636/16 Starbucks v Commission, para. 2, 20.

taxation laws, the ALP was part of the tools that fall under the Commission's competence under Article 107(1) of the TFEU as it is written into the domestic laws.[170]

However, the Court stated that the Commission had failed to demonstrate that the APA had given an advantage by reducing SMBV's tax liability for the purposes of Article 107(1) of the TFEU. The Court rejected the Commission's reasoning that was given to demonstrate that the transfer pricing method used did not have an arm's length outcome, and therefore resulted into an advantage on SMBV. This was on the grounds that the Commission had failed to demonstrate further the methodological errors it had found in the APA, which led to the Decision of the Commission that the methodology used could not lead to an arm's length outcome and that they led to reduced taxable profit compared to what would otherwise be the tax burden under the national legal rules with an enterprise in a comparable factual position operating under market conditions. Nevertheless, the Commission had failed to provide such evidence in the Court's opinion. The Court observed that the Commission had not demonstrated properly that the TNMM used for determining transfer pricing in the APA in question necessarily led to an advantage in the form of a too low result. [171]

Additionally, the Court stated that the Commission's finding of the APA not analyzing the royalty paid by SMBV to another enterprise in the Starbuck group for the use of its intellectual property rights was not sufficient to demonstrate that the royalty was not according to the ALP. Regarding the royalty, the Court found that the Commission had not demonstrated that it formed an advantage within the meaning of Article 107(1) of the TFEU.[172]

At last, the Court examined the Commission's subsidiary reasoning, where it argued that the TNMM could be deemed to be an appropriate method to use in the transfer pricing arrangement in question, but that the APA constituted an advantage to SMBV because the detailed rules for the use of the TNMM accepted the APA were incorrect. The Court observed that the Commission had failed to demonstrate how the various errors, that it claimed to have found in the detailed rules of the use of the TNMM, had conferred an advantage to SMBV.[173]

Therefore, the Court annulled the Commission's Decision.[174]

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[170] T-760/15 and T-636/16 Starbucks v Commission, para. 7, 136-156,158-160, 197-199.
[171] T-760/15 and T-636/16 Starbucks v Commission, para. 186-196, 206-216, 403, 501, 548-549
[172] T-760/15 and T-636/16 Starbucks v Commission, para. 188, 190, 192, 200-205, 240, 359, 371-373
[173] T-760/15 and T-636/16 Starbucks v Commission, para. 405-406, 432-433, 538, 548-549.
[174]T-760/15 and T-636/16 Starbucks v Commission, para. 561 and the Court Decision.

## 5.4 European Commission v Amazon.com and Others

Case C-457/21 P (Commission v Amazon, later the '*Amazon Case'*) was yet another case regarding transfer pricing taxation and state aid. Ireland intervened in the Case siding with the Grand Duchy and Amazon Group.[175] The joined Cases T-816/17 and T-318/18 (Luxembourg and Amazon v Commission), were the first stage for the dispute in CJEU ruled by the General Court.

Amazon.com, Inc., registered in the United States, and the companies under its control formed the 'Amazon group'. Starting from 2006, the Amazon group had two companies in Luxembourg, which pursued its commercial activities in Europe. The companies were called Amazon Europe Holding Technologie SCS (later 'LuxSCS') and its subsidiary, Amazon EU Sàrl (later 'LuxOpCo'). LuxSCS had the right to use specific intellectual property rights and to sub-license the intangible assets in question through different agreements with the American entities. LuxSCS conducted a license agreement with LuxOpCo, where LuxOpCo was using the intangible assets and set to pay royalty to LuxSCS in return. In 2014, the arrangement became no longer applicable as the Amazon group conducted a restructuring within the group. In 2003, the Luxembourg tax authorities gave Amazon group a tax ruling confirming the tax treatment of LuxSCS and LucOpCo for the purposes of corporate income tax in Luxembourg. This was done by the request of the Amazon group. The tax ruling confirmed, that LuxSCS was not to pay corporate income tax in Luxembourg due to its legal form and set a method for calculating the amount of annual royalty that was to be paid under the license agreement by LuxOpCo to LuxSCS.[176]

In October 2017, the European Commission gave its Decision[177] stating that the tax ruling and its annual implementation through the years 2006 to 2014 constituted an aid for the Amazon group that was within the meaning of Article 107 of the TFEU. In its Decision, the Commission stated that the method of calculating the royalty did not lead to an arm's length outcome as it was too high, therefore artificially reducing the tax base of LuxOpCo.[178]

The Grand Duchy of Luxembourg and the Amazon group took two actions of annulment against the Commission's Decision to the General Court. The General Court gave its judgement in 2021, annulling the Commission's Decision on the grounds that the Commission

[175] T-760/15 and T-636/16 Starbucks v Commission, para. 6.
[176] C-457/21 P Commission v Amazon, para. 2, sections 1-12
[177] Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C ex 2014/NN).
[178] C-457/21 P Commission v Amazon, para. 2, sections 16-17, 49

had failed to properly demonstrate the existence of an advantage within the meaning of Article 107(1) of the TFEU. The Commission appealed and the Case was brought before the Court of Justice.[179]

The Court of Justice examined first whether the General Court had erred in its view that the Commission had failed to demonstrate whether there was an advantage within the meaning of Article 107(1) of the TFEU and the reasoning behind it, which was the interpretation and application of the ALP. The Commission argued in its appeal that the General Court had erred in the interpretation and application of the ALP, and consequently the reference system used was not reliable and the existence of an advantage was not established.[180]

The Court recalled that the ALP cannot be applied for the purposes of examining tax measures in the context of Article 107(1) of the TFEU if it is not recognized by the national law. Therefore, the Court found that the General Court had erred in law with its finding stating that the Commission could in general apply the ALP when implementing Article 107(1) of the TFEU without the ALP being incorporated into the national law. The General Court had referred in its judgement to the OECD Guidelines as having a 'certain practical significance' when examining whether the ALP had been followed. The Court of Justice found that the General Court had made an error with this, as the OECD Guidelines are not binding to the Member States of the OECD and as it did not examine whether the Commission had made sure if those guidelines were written into the Luxembourg tax law. Therefore, the Court concluded that the analysis on the condition that there was a selective advantage for the purposes of Article 107(1) of the TFEU made by the General Court was erred, as it was based on an incorrect determination of the relevant reference system. The Court then decided to dismiss the entire appeal by a substitution of grounds.[181]

First, the Court stated that in order to determine the advantage for the benefit of the Amazon group, the Commission had applied the ALP like it had been part of EU law, despite that it is not, and that in the Fiat Case the Court specifically stated that in the EU law there is not currently an autonomous ALP that can be applied irrespective of whether the principle is incorporated in the national law.[182]

[179] C-457/21 P Commission v Amazon, para. 3-4, 10-11.
[180] C-457/21 P Commission v Amazon, para. 17-23.
[181] C-457/21 P Commission v Amazon, para. 17-23, 33-51.
[182] C-457/21 P Commission v Amazon, para. 53.

Second, the Court referred yet again to the Fiat Case and stated that as the Luxembourg tax law at the time of the original tax ruling did not explicitly refer or include the ALP, the principle could not be the basis of determining whether there was a selective advantage within the meaning of Article 107(1) of the TFEU. Even the Commission itself had recognized that this was legal status at the time and that the ALP could not therefore be applied retroactively.[183]

Moreover, due to this the Court found that the Commission had breached the prohibition recalled in the Fiat Case of not having the right to take into account parameters and rules outside of the national tax system at issue, if those rules are not referenced in the tax system. In this specific case meaning the OECD Guidelines.[184]

The Court found that the Commission had failed to establish the existence of an advantage formed to the Amazon group within the meaning of Article 107(1) of the TFEU and that the General Court was fully entitled to its finding regarding that. The Court stated that the Commission had made a mistake with the identification of the reference framework which it used to analyze the tax ruling at issue, which depraved all of the reasoning it presented in support of the claim that there was a selective advantage. Therefore, the Court annulled the Commission's Decision, and dismissed its appeal as whole. The Court dismissed the Commission's appeal on the grounds, that the Commission had made an error by applying the ALP in its Decision when the ALP was not incorporated into the Luxembourg tax law at the time of the tax ruling.[185]

## 5.5 European Commission v Ireland and Others

Case C-465/20 P (Commission v Ireland and Apple, later the '*Apple Case*'), was a judgement given by the Court of Justice on another state aid transfer pricing dispute regarding an APA in September 2024. The Republic of Poland and the EFTA Surveillance Authority intervened to support the forms of order sought by the Commission, and the Grand Duchy of Luxembourg sided with Ireland.[186] Before the ECJ, the Case went to the General Court, where the Cases T-778/16 and T-892/16 (Ireland and Apple v Commission), were joined together.

[183] C-457/21 P Commission v Amazon, para. 54-55.
[184] C-457/21 P Commission v Amazon, para. 56.
[185] C-457/21 P Commission v Amazon, para. 58-59.
[186] C-465/20 P Commission v Ireland and Apple, para. 51.

At the time of the Case, Apple Inc., established in the United States, controlled different companies incorporated in Ireland within the Apple Group through its fully owned subsidiary Apple Operations International. Apple Operations International owned the subsidiary called Apple Operations Europe (later 'AOE'), which owned the subsidiary Apple Sales International (later 'ASI'). AOE and ASI were incorporated in Ireland but were not tax residents there. Both companies had a branch in Ireland, which did not form a separate legal personality.[187]

AOE and ASI had a cost-sharing agreement with Apple Inc, where they were granted royalty-free licenses (later 'IP licenses') to use Apple Group's intellectual property rights. For example, the use consisted of the manufacture and sale of certain products concerned in all territories, excluding North and South America.[188]

The national taxation law regarding companies in force at the time stated that non-resident enterprises were liable to tax when it comes to trading income originating directly or indirectly from an active branch located in Ireland. The Irish tax authorities received requests from the predecessors of AOE and ASI for determination of their chargeable profits to be clarified. The Irish tax authorities gave a first tax ruling in 1991, which was later revised at the request of the ASI and the AOE, and a second tax ruling was given in 2007.[189]

Commission started an investigation on the tax rulings in 2014, and gave its Decision.[190] The Commission found in the Decision that the tax rulings had led to a reduction of the tax base of both ASI and AOE, and that the rulings had given an advantage to both companies. The Commission proved the existence of a selective advantage caused by a derogation from the reference framework. The Commission found that the tax rulings made it possible for AOE and ASI to reduce their amount of tax payable in Ireland during years 1991 to 2014, and that the reduced amount of taxes gave those two companies an advantage compared to other enterprises in similar situation. Specifically, the Commission found that the tax rulings made ASI's and AOE's annual profits in Ireland differ from a reliable approximation of what an arm's length outcome would be by allocating the intellectual property licenses held by ASI and AOE outside of Ireland.[191]

[187] C-465/20 P Commission v Ireland and Apple, para. 3-4, 9.
[188] C-465/20 P Commission v Ireland and Apple, para. 6-8
[189] C-465/20 P Commission v Ireland and Apple, para. 12-14, 34.
[190] Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C ex 2014/NN).
[191] C-465/20 P Commission v Ireland and Apple, para. 23-45.

ASI, AOE, and Ireland brought action for annulment of the Decision in front of the General Court. The General Court stated that the Commission was not successful in proving that there was an advantage for the purposes of Article 107(1) of the TFEU, and annulled the Decision. The Court stated that the Commission had the burden to demonstrate that those tax rulings had created a selective advantage in the context of state aid control. The Court annulled the Commission's primary, subsidiary and alternative lines of reasoning on grounds relating to the Commission's assessments of what was considered normal taxation under the national law and the assessments of the functioning within the Apple Group. The Commission appealed and the Case was taken to the Court of Justice.[192]

First, the Court of Justice pointed out that to deem a tax measure selective on the grounds of Article 107(1) of the TFEU, the Commission must first determine a reference system, and then demonstrate how the tax measure is a derogation from that reference system in a way that it differs from the treatment other enterprises in a similar factual situation would have had. Otherwise, the existence of an advantage for the purposes of Article 107(1) of the TFEU is impossible, because an advantage that is described in the Article can only be found through comparing it to the right reference system i.e. the 'normal' taxation. The determination of the 'normal' tax regime is left to the competence of each Member State, as the area is not harmonized by EU law. However, this does not mean that there could not be a possibility of the reference framework being incompatible with the EU legislation on state aid, if the national tax system has been designed according to discriminatory parameters that escape that law.[193]

The Court stated that to allocate the profit in accordance with the ALP and the separate entity approach, the Irish tax authorities were supposed to see if the profit derived from the licenses held by AOE and ASI did not have to be attributed to their branches in Ireland. According to the Commission, the failure to verify those provisions led to lower tax burden and therefore to a selective advantage on the companies. The ALP is implemented into the Irish tax legislation, and the Court gave the Commission a permission to challenge the way the General Court had established the reference framework from the Irish law.[194]

[192] C-465/20 P Commission v Ireland and Apple, para. 48-49, 59-64.
[193] C-465/20 P Commission v Ireland and Apple, para. 74-85, 296.
[194] C-465/20 P Commission v Ireland and Apple, para. 120, 170, 173-178.

Furthermore, the Court examined whether the Commission's Decision had been misinterpreted in General Court, because the General Court had stated that the Commission's primary line of reasoning was relying on the lack of employees and physical presence of the ASI's and AOE's head offices on an 'exclusion' approach, which was conflicted with the Irish tax rules. The Commission had based its reasoning on an idea, that the application of the reference provisions demanded to determine the profit allocation method in advance and that the method had to lead to an outcome compatible with the ALP. The provisions did not define the profit allocation method. The General Court had added to this, that the 'normal' taxation is to be defined by the national laws and used as a reference point when establishing whether there is an advantage. The General Court had noted, that if those national tax rules require to treat non-resident enterprises in the same manner as resident enterprises, the Commission has the right to examine, if the level of profit allocated to non-resident companies and accepted by the national tax authorities, corresponds to what it would be under normal market conditions.[195]

The Court of Justice stated that the Commission was correct to use the ALP as a tool to determine whether the profit of ASI and AOE were at the same level as in normal market conditions, especially, when it relied on the OECD's approach for the purpose to apply those provisions. The Commission had inspected the functions performed by the head offices and their Irish branches in relation to the IP licenses to determine AOE's and ASI's taxable profit in Ireland in relation to the ALP. The Commission had found a lack of functions in relation to the IP licenses in the head offices, and that the Irish branches had an active role, due to the fact that they have taken on many of the tasks and risks associated with the management and operation of these licenses. Additionally, the Commission had found that the head offices lacked in practice the capacity to perform those functions. Therefore, the Commission's reasoning did not only revolve around the lack of functioning from the head offices in relation to the IP licenses but also on the analysis of functions by the branches. In the Commission's findings, the head offices did not have employees nor presence outside the branches in Ireland. The Commission had stated that the IP licenses and profit had to be allocated to the branches as there were no active nor critical functions performed or risks assumed on the head offices end, and on the other hand, there were functions performed, and risks assumed by the branches. Based on this, the Court found that the General Court had made a mistake

[195] C-465/20 P Commission v Ireland and Apple, para. 110-112, 124, 128-131.

with its founding stating that the Commission had restricted itself to an 'exclusion' approach in its primary reasoning, which was an incorrect interpretation of the Commission's Decision.[196]

The Court found that the Commission was right in its argument on that the evidence was insufficient on the allocation of profit from the use of the IP licenses to the Irish branches, and that the General Court had been mistaken on comparing the functions performed by the branches in relation to the IP licenses to the functions performed by Apple Inc. in relation to the IP of the Apple Group, rather than to the functions performed by the head offices in reality in connection with the IP licenses.[197]

Additionally, the Court found that the General Court had set an excessive burden of proof for the Commission, when it required the Commission to demonstrate the existence of business decisions which were not mentioned in the board minutes of the companies.[198]

Therefore, the Court set aside the General Court's judgement under appeal on the parts that upheld the objections raised against the primary argument concerning the existence of a selective advantage and consequently annulled the Commission's Decision.[199]

The Court found that the Commission had succeeded in proving that the profit retrieved by the use of Apple Group's IP licenses should have been given to the Irish branches when calculating ASI's and AOE's annual chargeable profits in Ireland. According to the Court, the Commission had succeeded on demonstrating that ASI and AOE did in fact enjoy favourable tax treatment as the prices were not at arm's length and incompatible with the reference system. This treatment had not been justified by the nature of the Irish tax system. Moreover, according to the Court, the Commission was not mistaken when it found that Ireland had given up tax revenue from AOE and ASI because the tax rulings endorsed methods that allocated profits in a way that created an outcome that differenced from what separate entities would have had under normal market conditions. The tax rulings were deemed to reduce the chargeable profit of AOE and ASI in order to apply the reference provisions, and therefore reduced the corporate tax required to pay in Ireland when comparing it to comparable situations at an arm's length. Because the measures lowered the charges that are

[196] C-465/20 P Commission v Ireland and Apple, para. 203, 277.
[197] C-465/20 P Commission v Ireland and Apple, para. 206-215, 217-222.
[198] C-465/20 P Commission v Ireland and Apple, para. 183-193, 243-245.
[199] C-465/20 P Commission v Ireland and Apple, para. 259.

normally included in the budget of a company, and therefore constituted an advantage granted through state resources, they met the definition of state aid under Article 107(1) of the TFEU.[200]

Lastly, the Court rejected all the pleas on breach of the principles of legal certainty and the protection of legitimate expectations, and pleas on whether the Commission had exceeded its power and interfered with the Competence of Member States consequently violating the principle of their fiscal autonomy.[201]

The Court of Justice dismissed entirely the actions for annulment that were brought before the General Court and therefore the Commission's Decision was upheld.[202]

## 5.6 Observations of the Case Law

First and foremost, an observation must be made, that the disputes around transfer pricing taxation and whether it constitutes state aid are utterly complicated. The cases presented above each demonstrate the core issue which is the lack of common rules that leads to different interpretations of the legal norms and guiding principles. The different interpretation and application of the ALP, national laws, and the state aid prohibition Article 107(1) of the TFEU together constitute an environment, where even the CJEU has problem navigating. This conclusion is supported by the fact, how in some of the cases, such as the Fiat Case and Apple Case, the Court of Justice's view differed from the General Court's decision. However, these appeals and scaling the dispute in different courts leads to very important pieces of case law, although not in a very pleasant and fast way to the parties involved.

The Commission's approach is clearly different than the CJEU's, as the Commission's purpose in the Union is different. The Commission's interest is on its duty to govern that the Member States interpret and apply their national laws in accordance with the EU law. Although the Commission does not exceed its power by governing that, with the identification of state aid, it has trouble determining how and on what legal rules it can base its assessment on. However, the case law has been very clarifying on that matter for example in the Fiat Case and Starbucks Case.

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[200] C-465/20 P Commission v Ireland and Apple, para. 305-311, 315-222.
[201] C-465/20 P Commission v Ireland and Apple, para. 352-364.
[202] C-465/20 P Commission v Ireland and Apple, para. 397.

In the Starbucks Case, the General Court stated that as the ALP was written into the national tax laws, the Commission had the right to use it as a tool under Article 107(1) of the TFEU. However, in the Fiat Case the court found that ALP is not an autonomous principle, and it can be only applied if its provided in the national tax laws and even then the interpretation and application is only restricted on how the principle exists in the national law.[203] In the case, the Court noted that the Commission had applied the ALP in a way that differed from the interpretation of the principle in the national law of Luxembourg.[204]

Therefore, although the ALP is considered to be an important guiding principle and the international pricing standard for transfer pricing, it does not hold an actual value in front of the CJEU in that way. In the Fiat case, the ECJ's decision could be seen to protect the fiscal sovereignty of the Member States and therefore, restricts the Commission's attempt to use state aid investigation as a way to interfere in tax matters.[205] This obviously is an unpleasant outcome for the Commission, as it has been more active in state aid investigations in the past few years while trying to steer the taxation of MNEs to a more strict policy. Notably, with transfer pricing, the Commission's approach has been to focus on the tax treatment of transactions, rather than on the tax treatment of companies.[206] This explains the Commission's interest to use the ALP.

In some of the case overviews, for example with the Fiat and Apple cases, the importance of the 'normal' tax system was highlighted, as it forms the basis of the state aid assessment, which requires that compared to that normal tax system, the tax ruling is selective, unjustified, and a derogation from that system. This approach was set in case law in the Case C-88/03 (Portugal v Commission).[207] In each case the Commission used the three-step analysis in its state aid assessment especially on whether there was an advantage or a selectivity. The three-step analysis seems to be an effective and well-functioning way of state aid assessment, but it must be noted, that in disputes like the ones presented here, when it is based on finding a reference system and the if the tax ruling is a derogation from that reference system, the additional use of the ALP in that assessment seems appropriate.

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[203] Nicolaides 2022.
[204] Faxing – Ahtiainen 2024.
[205] Dimitrova – Goebel 2023.
[206] Nicolaides 2016.
[207] C-88/03 Portugal v Commission, para. 56.

Each national tax ruling leading to a state aid investigation was about accepting an advance pricing arrangement. This does not necessarily mean that the APAs are the issue here, as they come with multiple benefits as stated earlier. An APA needs to be improperly agreed or applied to constitute state aid.[208] This can also indicate a lack of common rules in transfer pricing.

The fragmented regulatory environment around transfer pricing causes problems, because some group companies have subsidiaries for the sole purpose of avoiding making purchases on the open market, if the subsidiary can produce something at lower cost or lower price.[209] Therefore, to MNEs, being able to conduct transfer pricing transactions is important. Most areas of tax are mechanical, and quite straightforward to apply. Transfer pricing differs from this, mainly due to the ALP. Additionally, state aid is an area that falls under competition law as its purpose is to prohibit market distortions.[210]

With each case, at least one state intervened, which indicates an interest on behalf of the Member States. Additionally, the litigations around whether a transfer pricing tax ruling constitutes state aid have gained a significant amount of publicity, indicating a public interest. This is in no means surprising, as the rulings interest not only the Member States and national tax administrations, but also businesses, making it a field that unifies public and private operators.

From a practical point of view, it should be noted, how long the disputes are. For example, the longest time from the original tax ruling given in 1991 to the final judgement given by the ECJ in 2024, the Apple Case took approximately 33 years to unfold. These timeframes are not in accordance with tax certainty, when a tax ruling can be taken to court years or even decades later. However, with the Apple case it needs to be noted that the original tax rulings came to the Commission's knowledge in 2013 through public information because the national tax administration did not inform it.[211]

Additionally, the litigations end up being costly as they often take a considerable amount of time and create administrative costs. On top of that, when state aid is determined, the national tax administration needs to recollect the aid. Even though with MNEs the amount of state

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[208] Martin – Bettge 2020.
[209] Nicolaide state aid uncovered 2016
[210] Martin – Bettge 2020.
[211] Äimä 2024, p. 636.

aid that will be collected back after a ruling is often quite small compared to the profit the business creates, it still can be a big non-predictable cost that the business will face. For example, Apple was made to pay over 13 billion euros in unpaid tax and interest.[212] This constitutes a huge amount of state aid but also a huge amount of funds that needs to be collected. In the Commission's Decision's, if the if the main corporate enterprise would fail to repay the aid, it required the corporate group as a whole to conclude the repayment.[213]

However, although unpleasant and costly, the litigation is not always unpredictable according to the ECJ. In the Apple case, The ECJ stressed that according to established case law, enterprises receiving aid cannot have a legitimate expectation that the aid is lawful unless it has not been granted under state aid procedures.[214] This can be understood in a way, that according to the ECJ, enterprises need to be aware as well as the national tax administrations that a lower tax burden may lead to unpleasant surprises.

Although each case had its own setting of circumstances, they all had similarities. However, it should be noted how the Apple case differs from the rest as it was more of a case of profit attribution and not so much about traditional transfer pricing. Nevertheless, the Apple Case should be included in the important case law as it is a huge win for the Commission's state aid agenda.[215]

One may ask whether the ALP is more of a tax law principle or a competition law principle. The only answer is that it is definitely both as it operates in both fields. The objective of the ALP seems more taxational at first glance but when diving deeper into the principle, an aim with the nature of competition law can be found. These two areas of jurisdiction respect each other in a way that is necessary for them to function together. Common taxation comes from the aims of competition law and vice versa, as taxation can be a powerful tool to control and steer competition.[216]

For an objective assessment, Article 107(1) of the TFEU on prohibition of state aid should be overviewed and whether the Article itself is prone to attract problems. The history behind the state aid prohibition is longer than the existence of the modern European Union itself, as

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[212] European Parliament: PE 760.501 – February 2025.
[213] *e.g. see for reference*: Commission Decision (EU) 2016/2326 of 21 October 2015 on State aid SA.38375 (2014/C ex 2014/NN).
[214] Äimä 2024, p. 636.
[215] Finley – Stewart 2024.
[216] Miladinovic 2022, pp. 11-15.

the prohibition of aids granted by states can be found in one of the founding treaties of the Union, the Treaty establishing the European Economic Community (EEC), also known as the Treaty of Rome, signed in 1957. In the original 1957 version of the treaty, the state aid prohibition can be found in Article 92(1) almost in an identical form as it is written down in the TFEU today. Simply, the long history of the prohibition cannot itself lead to a conclusion that it could not be problematic, but taking into consideration the history of the prohibition of state aid, the principles of the EU, and functioning of the internal market, state aid prohibition is crucial. Additionally, the general prohibition of state aid in Article 107(1) TFEU should be quite self-explanatory to the Member States and their tax administrations.

Leaning to the fact that state aid prohibition is crucial and APAs are accepted regularly within the Union without them leading to state aid investigations, a conclusion can be made based on the case law, that the problem is the interpretation and application of the ALP. When the ALP, or market-based outcome, is the basic tool in determining whether a transfer price on an APA, which then affects the calculation of tax base, is on the right level, the logical way to fix the issue on different tax rulings is to set common rules on how the ALP should be interpret and applied. This can be done by setting ways on finding the market-based outcome. This is exactly what the Commission is aiming to do with the Transfer Pricing Directive. This would be within the interest of the Commission but also the Member States and MNEs.

If something should be learnt from these cases, it is that MNE's should consider how their tax structures look not only to the national tax authority but also to others with the competence to analyze and question the application of national law.[217] This adds an extra burden on MNEs, and is prone to add a lack of trust to national tax administrations and their tax ruling, thus making operating business within the Union unattractive. This, once again, is another example of why a more unified regulatory environment is needed. The Transfer Pricing Directive aims to tackle these problems, giving more certainty with tax rulings and cutting back costs around transfer pricing.

[217] Anderson – Baeten – Carden – Motta – Johnson – Zukakishvili 2024.

# 6 The Directive Proposal on Transfer Pricing

## 6.1 Background of the Directive Proposal

To clarify the transfer pricing rules within the European Union, the Council proposed a Directive on Transfer Pricing COM/2023/529 in September of 2023. The directive contains a new set of regulation with the aim to harmonize transfer pricing rules and process within the Union. As the Commission had just taken multiple transfer pricing tax rulings to be evaluated in front of the CJEU, which it claimed to constitute state aid, the legal circumstances were tense around the topic of transfer pricing leading to the directive proposal. This, among other factors, pushed further the need to unify rules around business taxation, and so came to be the BEFIT package. The BEFIT package, or ‘Business in Europe: Framework for Income Taxation’, is a package of different new regulations around business taxation with the intention to put forward certain common approaches within the EU. It is the second big separate proposal with common rules for computing the tax base of major groups of companies within the Union.[218]

The current international standard revolves around the ALP and the OECD Guidelines. The rationalization behind the Transfer Pricing Directive Proposal comes from the fact that major part of the EU Member States are also member countries of the OECD and therefore are keen to follow its guidelines. Although majority of the EU Member States are partaking in the Guidelines, they are not universally harmonized within the Union through legislative acts. Therefore, the juridical role and interpretation of the OECD Transfer Pricing Guidelines vary between the Member States. The main principles are approached in somewhat similar manner, but the legislation is dependent on domestic laws, leading to a scattered interpretation.[219]

Tax certainty and clear tax base is a major concern and need for national tax administrations, but also for businesses operating within the Union. From enterprises’ point of view, tax certainty is seen as more important than a lower tax rate, because tax certainty itself reduces costs and enables a less-complicated environment to operate and plan transactions, business operations, and taxation in. The issues threatening tax certainty has increased within the area

[218] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 1.
[219] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 2.

of the single market, as there has been multiple international tax reforms around corporate taxation over the previous years.[220]

The Member States have different control criteria, which leads to MNEs having uncertainty with taxation, high expenses, legal disputes, and overall it makes cross-border transfer pricing more complicated than necessary with high risks of over-taxation or double taxation.[221] Additionally, as the MNEs are forced to determine whether transfer prices are at an arm's length level by managing studies and updating relevant documentation, cross-border transfer pricing comes with high compliance costs. When added to the risk of being double taxed, this makes cross-border business operations expensive.[222]

Because transfer pricing is quite subjective compared to other areas of taxation, it is very likely to lead to disputes between the different tax administrations involved. Tax administrations do not always share a common goal or view on the interpretation of transfer pricing rules. The most common dispute between tax administrations is when preventing double taxation, the other tax administration needs to do a primary adjustment, and the other should correspond to that by doing a downward adjustment. This forces the second tax administration to reduce its tax base in relation to what the first one is collecting in taxes, which is usually an option tax administration are not very keen to take.[223]

In conclusion, these so-called tax barriers make operating cross-border business activities more complicated and affect negatively the functioning of the EU single market. They decrease the chance to achieve the full potential and efficiency gains. Consequently, the single market is not as competitive as it could be.[224]

Additionally, the current regulative environment around transfer pricing enables profit shifting and tax avoidance through aggressive tax planning schemes. In these schemes, MNEs plan their taxation in a way where the carried taxes are not according to the real profit received. This can be done by cycling taxes and profits through different countries and different corporations. Due to non-unified legislation, transfer pricing is an area that can be easily

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220 Proposal for a Council Directive on transfer pricing COM/2023/529, p. 1.
221 Proposal for a Council Directive on transfer pricing COM/2023/529, pp. 1-4.
222 Proposal for a Council Directive on transfer pricing COM/2023/529, p. 2.
223 Proposal for a Council Directive on transfer pricing COM/2023/529, pp. 2-3.
224 Proposal for a Council Directive on transfer pricing COM/2023/529, p. 3.

manipulated to shift profit and to serve aggressive tax planning schemes.[225] However, as stated before, the ALP is will not remove tax avoidance completely.

As Member States have considerable freedom to interpret their national legislation and in the absence of a common approach to transfer pricing, it is possible that companies are not treated with the same tax rules based on their location and activities in the Union.

Currently, the directive is set to become binding from 1st of January 2026 and therefore should be implemented into the national law of each Member State by then. However, the date can possibly be too ambitious, as the Member States need to unanimously agree on the directive and the reception the directive proposal has so far gained has been controversial.

## 6.2 Aim of the Directive Proposal

The aim of the Transfer Pricing Directive Proposal is to simplify the taxational rules, increase tax certainty, reduce the risk of litigation, lower high compliance costs, and reduce double taxation. Additionally, these adjustments in the legal base will help the single market to be more effective, competitive, and desirable area to conduct business in.[226]

Moreover, the aim is to further the common approaches in EU Member States' tax authorities when interpretating and applying transfer pricing rules, consequently making transfer pricing taxation easier to all parties involved. This goal is set to be met through the directive's objective to include the ALP into EU law, unifying the most important transfer pricing rules and additionally clarifying the OECD Transfer Pricing Guidelines role and status. Furthermore, the directive is set to enable the possibility to establish common legally binding rules on certain transfer pricing subjects following the OECD Transfer Pricing Guidelines' framework. Additionally, common transfer pricing rules based on the OECD Guidelines is deemed to add to business enterprises' flexibility when operating within the single market, decrease distortions, aggressive tax planning and tax avoidance, and add to increasing a level playing field in the internal market.[227]

[225] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 2.
[226] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 3.
[227] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 4.

## 6.3 Changes to the Legal Environment within the European Union the Directive Would Bring

The proposed directive has 22 articles in total, of which all of them will not fit into the scope of the thesis and therefore only the most relevant ones will be examined in the following.

According to Article 2 of the directive proposal, the directive is set to be applied to all tax-payers, that are either registered or subject to tax in at least one Member State.

One of the major changes to legal environment would be the implementation of the Arm's Length Principle into the EU law, meaning that therefore it could be interpreted and applied like it is laid down in the directive proposal. Therefore, unlike the current perspective addressed in case law, such as in the Fiat Case, the actors in transfer pricing disputes would not be bind to the current national interpretations of the ALP when issues arise.

The ALP is defined in a following way in Article 3(1): "the international standard that prescribes that associated enterprises must transact with each other as if they were independent third parties. In other words, the transactions between two associated enterprises should reflect the outcome that would have been achieved if the parties were not related i.e. if the parties were independent of each other and the outcome (price or margins) was determined by (open) market forces".

Additionally, the arm's length result is defined in Article 3(2) as "the outcome of a controlled transaction if the conditions made or imposed between the associated enterprises in their commercial or financial relations had been those which would have been made between independent enterprises". Article 3(3) has the following definition for the arm's length range: "a range of figures that is acceptable for establishing whether the conditions of a controlled transaction are at arm's length and that are derived from applying the same transfer pricing method to multiple comparable data".

Article 4 has the general rule on the application of the ALP. Article 4(1) sets requirements for the Member States to ensure that "where an enterprise engages in one or more commercial or financial cross-border transactions with an associated enterprise, such enterprise determines the amount of its taxable profits in a manner that is consistent with the arm's length principle". Article 4(2) obliges Member States to ensure that " where the conditions made or imposed in commercial or financial cross-border transactions between associated enterprises are not consistent with the arm's length principle, then any amount of profits that would have accrued to either one of the enterprises and been taxable to that enterprise in a Member State if the conditions of the transactions had been consistent with the arm's length principle, but have not accrued to that enterprise due to the non-arm's length conditions, are to be included in the taxable profits of that enterprise and taxed accordingly". Consequently, these clarifications on the definition of the arm's length outcome and how the principle itself should be interpreted, could reduce litigations and uncertainty around the topic in general.

Article 5 lays down a full definition for associated enterprises, therefore removing the notion of control differences between the Member States, by stating in that the threshold of 25% shareholding is enough to meet the control criteria. Moreover, as discussed before how the OECD Guidelines do not give an explanation to 'independent enterprises', Article 3(5) states that they are "not associated enterprises within the meaning of Article 5".

As explained before, primary and corresponding adjustments in cross-border taxation cause disputes easily. Therefore, Article 6 obligates the Member States to ensure that after a primary adjustment they make a corresponding to prevent double taxation in certain situations. Additionally, Article 6(3) has a 'fast-track' procedure, ensuring that Member States can do the corresponding adjustment within 180 days. The fast-track procedure would apply only when certain conditions are met laid down in the Article.[228] The fast-track procedure is hoped to replace MAP under circumstances, where the primary adjustment was clearly made for well-founded reasons.[229] This would not only reduce uncertainty and disputes, but also reduce double taxation.

Article 8 obligates the Member States to identify the commercial or financial relations, especially with associated enterprises, thus making transfer pricing more transparent. Article 9 lays down transfer pricing methods, which are the same as the OECD's preferred methods; CUP-method, RPM, CPM, TNMM, and PSM. However, the Article allows the use of other methods, when necessary, under certain exceptional conditions. Article 10 obligates to choose the most appropriate transfer pricing method. Article 11 has rules for the comparability analysis used to evaluate, whether a controlled transaction is at arm's length. Article 12 sets the rules for determination of the arm's length range. Article 13 sets a requirement

[228] Puro 2023. p. 624.
[229] European Parliament: PE 760.349 – July 2024, p. 9.

for the Member States to ensure that enterprises can confirm by providing information that they have applied an arm's length price in their transactions.

All these articles not only reduce uncertainty, litigation, and compliance costs, but help beforehand the actors in transfer pricing taxation to avoid such problems by unifying the regulative base and provisions.

Lastly, Article 14 has a provision on the application of the ALP. Article 14(1) obligates the Member States to ensure that when implementing the directive into their national legislation, they should include provisions which ensure that the transfer pricing rules are applied in a manner that is consistent with the OECD Guidelines. Additionally, the directive proposal states that when applying the ALP in the Member States, the latest version of the OECD Transfer Pricing Guidelines is binding.[230] This does not only clarify the role of the OECD Guidelines as an important source of guidance with transfer pricing, but also makes them binding.

When comparing the directive proposal to the OECD Guidelines, the directive seems to be stricter regarding the obligation of applying the most appropriate transfer pricing method and the burden of proof when applying other methods.[231] Another difference between the proposal and the OECD Guidelines is the language used when defining the ALP. In the directive proposal, there are broad terms used which may lead to different interpretations. For example, instead of the term "commercial or financial relations" used in the Guidelines, the proposal uses the term "transactions".[232] The directive proposal also sets more obligations to the Member States to ensure that appropriate transfer prices are being used.

In the proposed Transfer Pricing Directive, there is no problem-solving mechanism included. However, the directive itself is aiming to reduce disputes and double taxation as whole, additionally reducing the need to use problem solving mechanism with unified transfer pricing rules. The Arbitration Convention is complementary to the directive proposal.[233]

[230] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 17.
[231] Loyens Loeff: 'EC proposes harmonized TP rules and 'fast-track' procedure'. 2023.
[232] Aron – Arsenovich – Bakker – Anuschka 2024.
[233] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 5.

If transfer pricing becomes regulated on the level of the EU law, it will give greater power to the Commission, as it could challenge national practices that differ from the OECD Guidelines.[234] However, the main change would be the CJEU would become competent to deal with cases concerning transfer pricing disputes within the Member States. The ECJ would become the highest court to rule on matters falling under the scope of the directive, and therefore the national courts would need to refer unclear cases to the CJEU.[235] This would create new case law and clarify matters around transfer pricing.

New case law on the transfer pricing matters and the interpretation of the provisions set in the proposal would be much needed, because although the proposal would clarify some matters, the interaction between existing national transfer pricing legislation within the Member States may need clarification.[236] Additionally, administrative guidance would likely be needed. However, on the long run, a more unified approach would likely solve some existing questions around transfer pricing rules.

With state aid and the ALP, it seems to be unclear whether the directive would immediately help with the issues in the legal environment.[237] However, a unified interpretation of the ALP should help national tax administrations to overview and examine transfer prices better and enable them to ensure that there is an arm's length outcome when giving tax rulings and accepting APAs. Furthermore, new case law arising from the changed legal environment would clear the issue.  On the long run, this should reduce the state aid litigations.

### 6.3.1 Legal Basis of the Directive Proposal and Compatibility with Other EU Principles

The legal basis of regulatory rules on taxation can be found in Article 115 of the TFEU. According to the article, the Council can set directives in order to approximate laws, regulations and administrative provisions of the EU Member States that have a direct impact on the establishment or functioning of the single market. However, before issuing a new directive, the Council needs to consult the European Parliament and the Economic and Social Committee. The article does not make a direct reference to taxation matters but it can be viewed as a broadly applicable since it covers all legislation affecting the single market. The

[234] Faxing – Ahtiainen 2024.
[235] Helminen 2024, pp. 14-15.
[236] Felici 2024, p. 149.
[237] Faxing – Ahtiainen 2024.

proposal for a transfer pricing reform needs to be a directive and not a regulation as the legal basis is in Article 115 of the TFEU.[238]

Additionally, one of the main principles within the EU is Principle of the Primacy,[239] which means that when EU law and national law of a Member State are in conflict, the EU law will prevail. The principle is important as it ensures that the EU law is effective and applied in a unified way within the Member States. The principle was developed through CJEU case law, most importantly through the Cases C-26/62 (Van Gend Loos) and C-6/64 (Costa v E.N.E.L.). In these and multiple other cases, the CJEU has stated that the primacy of EU law is to be applied to all national legislative acts regardless of whether they were adopted prior or after the EU act concerned. The principle only applies on areas of legislation where the Member States have given sovereignty to the Union.[240] Therefore it applies to taxation as well as it is a relevant topic in the single market.

According to Article 288 of the TFEU, a directive is legally binding to the Member States but the method of how the result will be achieved has been left for the national authorities to decide. In practice, this means that the directive needs to be implemented into national law within a predetermined period of time, but the Member State have the opportunity to choose how it will be done as long as the aim and content of the directive stay the same.[241]

The directive aligns with the Subsidiarity Principle, which can be found in Article 5 of the TEU. According to the Article, the Union should interfere with areas that do not fall under its exclusive competence only when the Member States cannot reach the sufficient level, either in central, regional, or local level and when the proposed action can be better achieved on EU level. Additionally, the Union should not interfere any further to the subject than necessary. However, because transfer pricing has a cross-border nature to it, it needs to be regulated at the Union level, and consequently it makes the proposed Transfer Pricing Directive aligned with the Subsidiary Principle. According to the directive proposal, the Commission sees that an individual uncoordinated individual action from the Member States will only add fragmentation in the area of transfer pricing regulation while failing to meet the aims indented. Moreover, the Principle of Subsidiary requires EU to only take action if it is a more effective way to fix the lacking state of legal status than if a Member State would try

[238] Proposal for a Council Directive on transfer pricing COM/2023/529, pp. 6-7.
[239] *Also known as 'Precedence' or 'Supremacy'.*
[240] European Union: Primacy of EU law.
[241] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 6.

to fix the status.[242] Therefore, a unified and common legislative act would clarify and clear the situation more efficient and be more likely to reach the indented objective.[243]

The directive is aligned with the Principle of Proportionality, which can be found in TEU in Article 5. According to the article, the measures of the Union need to be suitable, fair, and necessary in order to achieve the desired objective and given the situation. The measures taken need to be in accord with the given situation and the Union's competences and acts need to be within the limits of the competence it has been granted by the Member States. The actions should not exceed the necessary level needed to achieve the aim. If the Member States argue that this principle has been breached, they can challenge the validity of the action taken in front of the CJEU.[244] In the directive, the transfer pricing principles come with a unified approach, and it offers specific targeted regulations for certain valuable transactions. The ALP, which already is a commonly applied principle within the Member States, and other rules creating a more unified and less-fragmented application of transfer pricing rules in order to decrease the number of disputes and work towards other common goals seems to be compatible with the Principle of Proportionality. The directive does not breach this principle, as it does not go beyond what is needed.[245]

### 6.3.2 The Directive Proposal and Compatibility with Existing EU Legislation

Since there is no existing European Union legislation around transfer pricing, there was no ex-post evaluation or fitness checks that were conducted during the process of drafting the directive proposal. The impact assessment of the Transfer Pricing Directive was conducted together with the whole BEFIT initiative, which the Transfer Pricing Directive is part of. The Commission did consult expert sources and overviewed public information during the proposal preparation. The Commission also consulted the OECD Secretariat as the directive proposal is heavily dependent on the OECD Transfer Pricing Guidelines.[246]

The directive aligns completely with the already existing policies in direct taxation and legal framework within the European Union, as well as with the goals the Union has for the single

[242] European Union: Principle of Proportionality.
[243] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 7.
[244] European Union: Principle of Proportionality.
[245] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 7.
[246] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 7.

market. It is a logical progression from the Commission's and the Union's objectives within tax policy to create an efficient and unified tax framework, that can deliver solid profits and conducts to growth. The directive also aligns with the goal to establish more tax certainty and a level playing field for businesses operating within the EU, while making sure that the Member States have stable and equal corporate tax revenues. Additionally, the directive also aligns with multiple EU directives, conventions, and other objectives to unify the tax base and decrease base erosion.[247]

To assure the effectiveness of the directive, the Commission will evaluate it every five years in the future after its implementation into national legislations.[248]

### 6.3.3 Conclusions on the Legal Basis and Implementation of the Transfer Pricing Directive

When reflecting to this, it seems that the implementation of the Transfer Pricing Directive would be considerably easy from the Union's point of view, and would not require any major changes within the EU legislation. A conclusion can be made, that this kind of a regulative reform has been the aim of the Union and the Commission for years, as the necessary steps to establish a needed base for the directive proposal have been taken already in the past. The only concerning question regarding the matter is, whether the Member States are ready to take this major step towards a common tax base and at the same time to hand over some of their sovereignty in direct taxation to the European Union.

The directive proposal has not gotten a lot of feedback from the Member States, which have been giving mainly feedback on the BEFIT package.[249] As before mentioned, in practice the problem may be the set schedule when the directive needs to be implemented. The set deadline is at the end of the year 2025, and some parties have expressed their concern about not being able to implement such a big tax reform in the set time.[250] The legal systems in all of the Member States may not be ready for a reform this big, and it may be necessary to perform some adjustments to their national legislation, even on a constitutional level. Additionally,

[247] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 4.
[248] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 9.
[249] Faxing – Ahtiainen 2024.
[250] Valtiovarainministeriö: 'Hallitus suhtautuu varauksella yritysten tuloverotusta EU:ssa koskevaan BEFIT-kehitykseen'. 2023.

the directive proposal may contradict with other treaty provisions between the Member States.[251]

The directive proposal requires the Member States to unanimously accept it as it is on the area of direct taxation, which the Member States have sovereignty for. To waive sovereignty to the Union on taxation matters is still a controversial subject in most of the Member States.[252] Furthermore, the Member States have not given sufficient support for the proposal, especially with the potential limitations on the Member States' tax sovereignty. Therefore, there is some uncertainty whether the proposal will come into force at the beginning of 2026 and whether changes need to be made.[253]

The Member States need to provide information to the Commission of their implementation of the directive, as well as data on the functioning of the directive annually.[254] If a Member State fails or refuses to implement a directive in set time, there will be sanctions imposed on them after the Commission evaluates the situation. The rules of the competence given to the Commission on the enforcement of the EU law can be found in Article 17 of the TEU. The Commission monitors the application of EU law, whether its primary or secondary law. When the Commission notes that a Member State is failing to apply EU law properly, it can send them a 'letter of formal notice'. A letter of formal notice gives the member state the opportunity to reply to the Commission, and present their observations of the situation. If the Commission still thinks that there is an ongoing violation of EU rules, it will send a reasoned opinion to the Member State in question, which has a set deadline on when the Member State has to comply with EU law. If the Member State fails to do so, the next step for the Commission is to bring the case before the CJEU like Article 258 of the TFEU states. If the CJEU notices a violation and the Member State fails to comply the judgement even after a second Court proceeding, a financial penalty may be set. If the breach is about implementing a directive, the CJEU can impose a financial penalty when giving its first judgement.[255]

Based on the concerns and problems with implementation and contents of the directive proposal, it is interesting to see whether all the Member States want or manage to implement

[251] Felici 2024, p. 149.
[252] Felici 2024, p. 149.
[253] Loyens Loeff: proposed EU Transfer Pricing Directive. 2025.
[254] Proposal for a Council Directive on transfer pricing COM/2023/529, p. 9.
[255] European Union: Enforcement of EU Law.

the directive in time and whether the competence of the EU will be challenged in front of the CJEU.

# 7 Concluding Thougths

The aim of the research was to provide a general overview of the state of the regulatory environment in the EU around transfer pricing and corporate income taxation in transfer pricing, and to highlight some of the problems that currently exist due to them not being harmonized by EU law. The current regulatory environment is complex and outdated in a way that does not serve its purpose in a single market context. The different levels of national legislation, international treaties, EU law, and quasi-legal instruments form a complex web of rules, which all the operators have trouble navigating. Clearly, the way of arranging transfer pricing rules, that functions well for independent states, does not work as smoothly with the single market. Instead, a more unified approach set by EU legislation would serve a better purpose. Moreover, the single market would make unifying the legal environment easier than between states that have no association with each other.

In conclusion of the transfer pricing process, after choosing the transfer pricing method, the ALP is used as a tool to determine whether the transaction has an arm's length outcome, i.e. the price of the transaction is similar to a market-based result. Therefore, the chosen transfer pricing method and the ALP affect the amount of taxable profit, which also forms the tax base. However, if that tax base is less than what it would be with an independent enterprise, and the national tax administration gives a tax ruling where it accepts the transfer price when an MNE seeks for an advance approval in the form of an APA, the tax ruling may constitute state aid within the meaning of Article 107(1) of the TFEU. Even when the ALP is used to examine the transfer price, this may happen, because the interpretations of the ALP and methods of calculating the transfer price differ between the Member States. It is concerning that these outcomes are possible with APAs, as the main reason to conduct an APA is tax certainty. Therefore, it seems almost paradoxical that an APA can lead to a state aid investigation, litigation, and recovery of the state aid even after years.

Additionally, cross-border intra-group transactions are costly, and the regulatory environment makes them unnecessarily complicated as there is a lack of tax certainty, and a threat of disputes and double taxation throughout the process. This all comes down to the different interpretations and the general non-binding legal nature of the ALP, and the non-unified regulatory environment within the EU. However, the probability of a state aid assessment of a tax ruling with lawful corporations is assumed to be quite low, although it forces MNEs and national tax administrations to be more careful when calculating the right transfer price.

When reflecting the matter in the light of the observations made throughout the thesis, a change in the regulatory environment is much needed not only to clarify the rules around transfer pricing and taxation, but to also clarify the Commission's state aid approach. Like stated by the ECJ in the Fiat Case, the ALP is not an autonomous principle, and it can only be applied if it is provided in the national tax laws and consequently, the interpretation and application is restricted on how the principle exists in the national law in question. This creates problems for the Commission, as it uses the ALP as an indicator of whether the transfer price at issue reflects a market-based outcome in state aid investigations. This has led to unexpected results in case law both for the Commission and the opposing side.

Consequently, the interchangeable interpretations of the ALP between the Member States may lead to different results when used in state aid assessments, setting the Member States and their national tax administrations, but also the MNEs at risk of getting different treatment. Therefore, the Commission's aim to implement the principle into national legal systems in a harmonized manner through the Transfer Pricing Directive Proposal would enable it to assess possible state aid cases better. Currently, the Member States and MNEs view the Commission's state aid approach on transfer pricing taxation unpredictable, although the state aid prohibition itself is not the problem. Therefore, including the ALP into EU legislation would presumably reduce state aid litigations in the future.

The ALP itself has some defects as stated earlier in the thesis, but it is currently the most convenient tool to confirm that an intra-group transaction price reflects a market outcome. The current issues with the interchangeable interpretation due to the quasi-legal nature of the principle could be fixed by setting harmonized binding regulations on the transfer pricing process and the taxation of those transactions. The main regulation needed on the EU level would be making the ALP legally binding in a harmonized way, setting rules for the transfer pricing methods, and the primary adjustments and counter-adjustments in taxation. The role of the ALP and the OECD Guidelines needs to be clarified, as they form the international standard already followed by the Member States to some extent. The issues around the scattered interpretation of the ALP seem almost like a pointless struggle, as it is an internationally recognized standard. Therefore, the main issue seems to be that the ALP is a quasi-legal instrument and not a legal norm from the EU perspective.

To conclude and answer the main research question set out in the Chapter 1.2 on how the incorporation of the ALP into EU law through the proposed Transfer Pricing Directive would affect the current legal environment around transfer pricing and taxation of those transactions, and would it reduce the amount of state aid litigations, the answer is simple; introducing the ALP into EU legislation would clarify the legal environment and consequently, reduce the issues related to the current scattered regulatory environment and therefore, would likely reduce the need for state aid litigations in the long term.

The implementation of the directive proposal could temporarily increase the amount of transfer pricing cases taken to the CJEU, as new legislation often needs to be clarified through case law and the proposal would give the CJEU power to rule on transfer pricing taxation matters. However, in the long term it could possibly reduce the number of litigations as unified rules would make operating in the field simpler. Additionally, because the proposal is derived from the OECD Guidelines and Model Tax Convention, many of its concepts are already known and therefore may not need as much clarification.

However, the implementation of the directive in its current form and in the set time seems unlikely, although this does not remove the fact that a similar reform is needed. If the Member States are not ready to hand some of their sovereignty over to the Union in corporate income taxation matters, a possibility to conclude a similar reform in the field of transfer pricing could be to modify the current directive proposal in a way, that does not interfere with the tax sovereignty of the Member States as much. For example, this change on the proposed directive could be reducing the amount of power the directive proposal plans on giving to the Commission and the CJEU in taxation matters, or only setting regulations on the transfer pricing methods used, unifying the interpretation of the ALP, and setting common rules for transfer price adjustments as there already is in international tax treaties. This would reduce the issues around transfer pricing, taxation, and state aid cases, without interfering with taxation on an extensive manner.

Although the Transfer Pricing Directive falls on an area of sovereignty of the Member States and has its possible problems with implementation, a question can be asked, whether the change would be so major that it outweighs the benefits that would follow from a unified regulatory environment. As the proposal's aim is to reduce tax uncertainty, base erosion, and compliance costs, establish the legal status of the OECD Guidelines and the ALP into a legally binding form, reduce double taxation, tax disputes and litigations, and overall clear the regulative environment and make the single market a better area to operate business in, the proposal seems fair. To establish a level playing field to all operators within transfer pricing and corporate income taxation, not only shared rights are needed but also shared regulatory standards.