EUROPEAN
COMMISSION

Brussels, 21.10.2015
C(2015) 7152 final

COMMISSION DECISION

of 21.10.2015

ON STATE AID SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat

(Text with EEA relevance)

(Only the FR version is authentic)

In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […]		PUBLIC VERSION This document is made available for information purposes only.

COMMISSION DECISION

of 21.10.2015

ON STATE AID SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat

(Text with EEA relevance)

(Only the FR version is authentic)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2)[1] thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above[2] and having regard to their comments,

Whereas:

1. PROCEDURE

(1) By letter of 19 June 2013, the Commission sent an information request to the Grand Duchy of Luxembourg requesting detailed information on the country's tax ruling practice[3].

(2) By letter of 17 July 2013, the Luxembourg authorities responded in general terms to that letter and provided part of the requested information. In particular, the response contained a description of the legal principles and national rules that bind the

[1] With effect from 1 December 2009, Articles 87 and 88 of the EC Treaty have become Articles 107 and 108, respectively, of the TFEU; the two sets of provisions are, in substance, identical. For the purposes of this Decision, references to Articles 107 and 108 of the TFEU should be understood as references to Articles 87 and 88, respectively, of the EC Treaty where appropriate. The TFEU also introduced certain changes in terminology, such as the replacement of 'Community' by 'Union' and 'common market' by 'internal market'. The terminology of the TFEU will be used in this Decision.

[2] OJ C 369, 17.10.2014, p. 37.

[3] That letter was sent under reference number HT.4020 - Pratiques en matière de ruling fiscal.

Luxembourg tax administration (*Administration des contributions directes*) when issuing tax rulings[4], the procedure to obtain a tax ruling, the information that needs to be submitted by the taxpayer and whether the rulings issued by the tax administration are published. The Luxembourg authorities did not respond to the Commission's request to provide a list of tax rulings issued in 2010, 2011 and 2012 by its tax administration, including other relevant information such as the name of the companies, the activity of the companies, the date of the rulings, the duration of the rulings and the type of transaction covered by the rulings.

(3) By letter of 30 August 2013, the Commission sent a reminder to the Luxembourg authorities requesting that a list of tax rulings issued in 2010, 2011 and 2012 be provided[5].

(4) By letters of 20 and 23 September 2013, the Luxembourg authorities expressed their regret that certain information regarding the Commission's request for information had appeared in the press. In addition, they questioned the legal basis for the Commission's request for information.

(5) By letter of 2 October 2013, the Commission replied to the Luxembourg authorities, indicating the legal basis for its *ex officio* investigation into Luxembourg's tax ruling practice and granting a further extension of the deadline to submit the requested list of tax rulings.

(6) On 11 October 2013, a meeting was held between the Luxembourg authorities and the Commission, followed by a letter from the Luxembourg authorities dated 14 October 2013 where those authorities expressed their doubts that the legal basis invoked by the Commission could cover the wide and general nature of the information request. The Commission replied to that letter by letter of 15 October 2013.

(7) A further exchange of letters took place between the Luxembourg authorities (letters dated 11 November and 2 December 2013) and the Commission (letters dated 14 November and 12 December 2013), in which the Luxembourg authorities explained that due to the formation of a new government they could not respond to the Commission's request for information. Accordingly, the Commission granted an extension of the deadline to reply until 15 January 2014, including in both letters a reference to the fact that the Commission could be obliged to adopt an information injunction decision in case of non-compliance with its information request.

(8) By letter of 15 January 2014, the Luxembourg authorities submitted 22 tax rulings relating to the period 2010-2013, but the taxpayers' names had been redacted from those rulings. According to the Luxembourg authorities, those 22 rulings – one of which related to an advance pricing arrangement with a company referred to as "FFT" (hereinafter: the "FFT APA" or the "contested tax ruling") – were representative of the Luxembourg tax ruling practice.

(9) The FFT APA contained the following documents[6]::

[4] In its letters, the Luxembourg authorities refer to the term "décision anticipative" as opposed to "tax ruling". Both terms, however, refer to the same type of procedure giving the taxpayer some degree of certainty regarding how the corporate income tax law will be applied in a given set of circumstances. In this Decision, the term "tax ruling" will be used, but it is meant to have the same meaning as "decision anticipative".

[5] This letter was sent under case number SA.37267 (2013/CP) – Pratiques en matière de ruling fiscal – LU.

(a) a letter by [the tax advisor][*] on behalf of its client FFT dated 14 March 2012, containing a request for the agreement of the Luxembourg tax administration on an advance transfer pricing arrangement;

(b) a transfer pricing report containing a transfer pricing analysis, prepared by the tax advisor in support of FFT's APA request (hereinafter: the "transfer pricing report");

(c) a letter by the Luxembourg tax administration dated 3 September 2012 by which that administration agreed to the transfer pricing arrangement proposed by the tax advisor.

(10) By letter of 7 March 2014, the Commission requested the Luxembourg authorities to confirm that the taxpayer referred to as "FFT" in the FFT APA was "Fiat Finance and Trade Ltd". The Commission also indicated that, based on the information submitted, it could not exclude that the FFT APA represented incompatible State aid in favour of FFT. The Commission requested the Luxembourg authorities to provide additional information which would be relevant for the assessment of the FFT APA. As the Luxembourg authorities did not reply to that letter, the Commission sent a reminder on 7 April 2014[7].

(11) On 24 April 2014, the Luxembourg authorities replied to the letter of 7 March 2014 and confirmed that they had no additional relevant information necessary for the assessment of the FFT APA. As regards the question whether FFT referred to Fiat Finance and Trade Ltd, the Luxembourg authorities referred to secrecy provisions under Luxembourg law and argued that those provisions prohibited them from confirming the identity of the taxpayer in question.

(12) On 24 March 2014, the Commission issued an information injunction decision on the basis of Article 10 of Regulation (EC) No 659/1999[8], requesting from the Luxembourg authorities the list of tax rulings referred to in Recital (2).

(13) On 11 June 2014, the Commission adopted the decision to initiate the formal investigation procedure under Article 108(2) TFEU on the FFT APA (hereinafter: the "Opening Decision")[9]. The Opening Decision was combined with an information injunction decision, enjoining Luxembourg to provide within one month of receipt of the letter all documents, information and data needed for the assessment of the existence and compatibility of the potential aid measure. In particular, the Commission required Luxembourg to confirm the identity of the beneficiary of the measure.

---

6 The Luxembourg authorities had blackened selected information, in particular the names of companies and subsidiaries.

* Parts of this text have been hidden so as not to divulge confidential information; those parts are enclosed in square brackets.

7 As regards the Commission investigation on FFT, the Commission opened a new case number and sent the reminder of 7 April 2014 and all following communication under case number SA.38375 (2014/CP) – Luxembourg – Aide présumée à FFT.

8 Regulation (EC) No. 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (OJ L 83, 27.3.1999, p.1). Regulation (EC) No. 659/1999 is repealed by Regulation (EU) No. 2015/1589 with effect from 14 October 2015) OJ L 248, 24.9.2015, p. 9). All the procedural steps taken during the course of the proceedings were adopted under Regulation (EC) No. 659/1999. Any reference to regulation (EC) No. 659/1999 may be construed as a reference to Regulation (EU) No. 2015/1589 and should be read in accordance with the correlation table in Annex II to the latter regulation.

9 OJ C 369, 17.10.2014, p. 37.

(14) By letter of 14 July 2014, Luxembourg submitted its comments on the Opening Decision. It also indicated that as the Commission could not identify any State aid measure, it did not have to answer the questions of the Opening Decision or the information injunction.

(15) On 14 August 2014, the Commission requested Luxembourg to provide the missing information referred to in the Opening Decision and the information injunction. The Commission also asked Luxembourg to authorise the Commission to address its outstanding questions directly to FFT in accordance with Article 6a of Regulation (EC) No. 659/1999.

(16) On 3 September 2014, Luxembourg provided a partial reply to the outstanding questions and indicated that part of the requested information constitutes business secrets of FFT which is not in the possession of the Luxembourg authorities. Luxembourg further confirmed that FFT indeed refers to the company "Fiat Finance and Trade Ltd." and it authorised the Commission to address its questions to FFT directly.

(17) On 17 October 2014, the Opening Decision was published in the Official Journal of the European Union[10]. The Commission invited interested parties to submit their comments on the measure. By letter of 30 October 2014, it received comments from FFT.

(18) On 22 December 2014, Luxembourg submitted a list of beneficiaries of tax rulings to comply with the request for information in the Commission's letter of 19 June 2013. That document lists the rulings issued by the Luxembourg tax administration during the years 2010 to 2012.

(19) By letter of 5 January 2015, Luxembourg submitted its comments on third party comments on the Opening Decision.

(20) On 12 February 2015, the Commission adopted a decision informing Luxembourg that, in accordance with Article 6a of Regulation (EC) No. 659/1999, it had identified that the formal investigation procedure on the contested ruling was ineffective to date. On this basis, and with the authorisation of Luxembourg[11], the Commission could address its questions to FFT directly.

(21) By letters of 20 February 2015, the Commission sent an information request to Luxembourg and FFT. The information request sent to FFT was based on Article 6a(6) of Regulation (EC) No. 659/1999.

(22) By letter of 24 February 2015, Luxembourg replied to the Commission's decision of 12 February 2015, expressing its surprise as to the development of the procedure in this case and its doubts as to the appropriateness to declare the procedure ineffective given the large amount of information Luxembourg provided to the Commission in the course of the investigation.

(23) By emails of 26 February and 3 March 2015, FFT asked for some clarifications on the request for information and an extension of the deadline to respond, which was granted by the Commission by email of 5 March 2015.

(24) By letter of 5 March 2015, the Commission replied to Luxembourg's letter of 24 February 2015.

10 OJ C 369, 17.10.2014, p. 37.
11 See recital (16).

(25) On 23 March 2015[12], the Commission requested Luxembourg, in response to the list of tax rulings provided by its authorities on 22 December 2014, to provide additional information regarding the rulings listed for the years 2010 to 2012. In particular, the Commission requested that Luxembourg specify which of the rulings listed concern a treasury function and which of the rulings listed concern non-integrated or stand-alone companies. The Commission also requested Luxembourg to provide a number of the rulings concerning specific corporate groups.

(26) By letter of 24 March 2015, Luxembourg replied to the Commission's request for information of 20 February 2015[13].

(27) By letter of 31 March 2015, FFT replied to the Commission's request for information of 20 February 2015. The submission contained, *inter alia*, the transfer pricing policy guidelines of the Fiat group.

(28) On 23 April 2015, Luxembourg submitted additional information on 1 900 rulings of the rulings listed in its response of 22 December 2014. Luxembourg indicated that three of the rulings listed concern a treasury function, two of which were granted in 2010 and one of which was granted in 2011. On 23 March 2015, the Commission requested two of those rulings because they concerned companies listed in Commission's request of 23 March 2015.

(29) On 27 April 2015, a meeting took place between FFT, the Luxembourg authorities and the Commission.

(30) On 4 June 2015, Luxembourg submitted the additional information requested by the Commission on 23 March 2015 on 5 327 of the rulings listed in its response of 22 December 2014. In particular, Luxembourg indicated that ten more rulings concern treasury functions […]. In addition, a ruling concerning company G was provided to the Commission on 25 June 2015.

(31) On 18 June 2015, Luxembourg provided a ruling concerning company E (ruling of 2011).

(32) By letter of 10 July 2015, Luxembourg advanced a line of argumentation according to which the Commission, in case of a final negative decision, should be prevented from recovering any aid from the beneficiary retroactively, i.e. from the date of the tax ruling.

(33) On 15 July 2015, a meeting took place between the Chief Financial Officer of Fiat Chrysler Automobiles N.V., the successor of Fiat S.p.A., the Luxembourg authorities and the Commission.

2. DESCRIPTION OF THE AID MEASURE

2.1. Description of the beneficiary

(34) FFT is part of the Fiat group. At the time of the contested tax ruling, the Fiat group was composed of Fiat S.p.A., incorporated in Italy with its head office in Turin, and all companies controlled by Fiat S.p.A. (hereinafter collectively referred to as "Fiat" or "Fiat group"). Following a merger of Fiat S.p.A. with and into Fiat Investments

[12] Under case number SA.37267 – Pratiques en matières de ruling fiscal - Luxembourg

[13] The letter of 24 March 2015 was provided to the Commission on 24 March 2014 and again on 26 March 2015.

N.V. on 12 October 2014, Fiat Chrysler Automobiles N.V. became the successor of Fiat S.p.A.[14]

(35) Fiat carries out industrial and financial services activities in the automobile sector. The Commission refers to recitals (20) and (21) of the Opening Decision for a more detailed description of Fiat's activities.

(36) FFT provides treasury services and financing to the Fiat group companies based (mainly) in Europe (excluding Italy) and also manages several cash pool structures for the Fiat group companies based in the United Kingdom, Denmark, Belgium, the Netherlands, Switzerland, Austria, Germany and Spain. FFT operates from Luxembourg, where its head-office is located, and through two branches, one based in London, United Kingdom and one in Madrid, Spain.

(37) The transfer pricing report provided by Luxembourg to the Commission on 15 January 2014 contains the information about FFT, summarised in recitals (38) to (51)[15].

(38) Fiat decided to centralise its financial and treasury functions, where all funding, corporate finance, bank relationship, foreign exchange and interest rate risk management, cash pooling, money market operations, cash balances management, collection and payment initiation are performed by "the treasury companies".

(39) The treasury companies are organised as follows:

Fiat Finance S.p.A. (hereinafter "FF") is the Italian-based treasury company in charge of the coordination of the financing operation for the Fiat group companies based in Italy;

– FFT performs treasury functions for the Fiat group companies based in Europe (excluding Italy);

– Fiat Finance North America, Inc. (hereinafter "FFNA") performs treasury functions for the US-based Fiat group companies;

– Fiat Finance Canada Ltd. (hereinafter "FFC") performs treasury functions for the Canada-based Fiat group companies;

– Fiat Finanças Brasil Ltda (hereinafter "FFB") performs treasury functions for the Brazilian-based Fiat group companies.

(40) Cross-border intra-group transactions in which FFT is involved may be grouped into two main categories:

– Transactions between treasury companies (Intra-Sector)

  - T1 – intercompany loans from FFT to FF: FFT sources of funding rely on bonds, banks credit lines and intercompany deposits

  - T2 – intercompany loans from FFNA to FFT: FFNA sources of funding mostly rely on bond issued with guarantee;

– Transactions between treasury companies and the Fiat group companies (Intra-group)

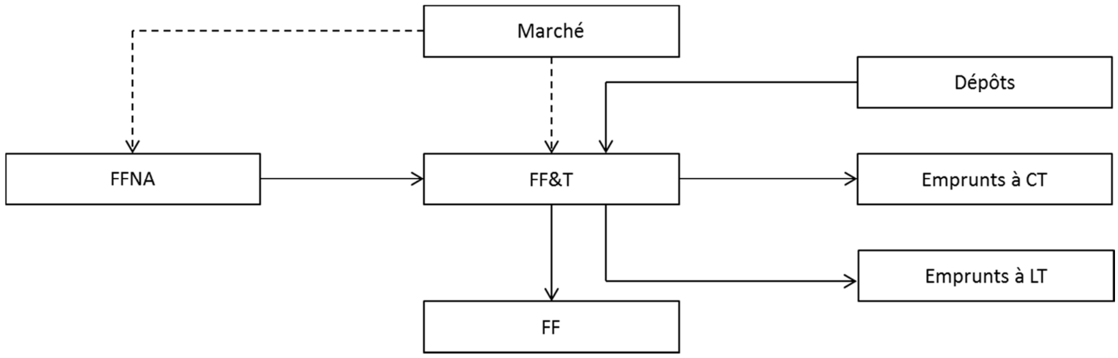
[14] See Annual Report of Fiat Chrysler Automobiles for the financial year 2014. References in this Decision to Fiat S.p.A. may be construed as references to Fiat Chrysler Automobiles N.V. and vice versa.

[15] The transfer pricing report refers at some points to FFT and at other points to "FF&T" when referring to the same entity.

- T3 – transactions (loans/deposits) between FFT and the group companies located in other countries (mostly European);
- T4 – guarantees provided by Fiat S.p.A[16] on the bonds issued by FFT and FFNA, bilateral credit lines and ad hoc Financing Programs (i.e. Billets de Trésorerie in France for FFT).

(41) Figure 1 illustrates the financing operations (from T1 to T3)

Figure 1*: Main cross-border Intra-group transactions*



(42) As regards functions performed, FFT is involved in market funding and liquidity investments; relations with financial market actors; financial coordination and consultancy services to the group companies; cash management services to the group companies; short term ("S/T") and medium term ("M/T") inter-company funding; and coordination with the other treasury companies.

(43) As regards market funding and liquidity investments, FFT raises funds to make them available to support the operations and growth of the group companies and invest them accordingly. In relation to the management of financial risks, FFT follows the guidelines established by the relevant internal group policies (foreign exchange risk and interest rate risk). FFT funding comes from instruments such as bond issuance (via a "Global Medium Term Note" or the "GMTN" Programme in which FFT, together with FFNA and FFC, is an issuer), bank term loans, committed and uncommitted credit lines, etc. For liquidity management, FFT invests surplus cash with top-ranked banking institutions or highly-rated liquidity funds.

(44) With regard to the exposure to currency risk, FFT manages foreign exchange exposure mainly by using forward foreign exchange contracts and currency swaps. Interest rate exposure is substantially linked to the different duration of liabilities and assets and management. FFT mainly employs Interest Rate Swaps (hereinafter: "IRS") and Forward Rate Agreements (hereinafter: "FRA").

(45) With regard to relations with financial market actors, FFT, in coordination with FF, deals with the financial markets and institutions to provide them with group information and data which supports the group's creditworthiness and financial position.

(46) Within financial coordination and consultancy services to the group companies, FFT is responsible for providing financial assistance to the group companies, examining

[16] The description of the functions carried out "by Fiat S.p.A." contained in the version of the contested tax ruling submitted by Luxembourg as described in the Opening Decision was partially blackened out. The phrase "by Fiat S.p.A." was added to this description based on the non-edited version of that ruling, provided by Luxembourg on 24 March 2014.

their financial needs, identifying the best financial solution, setting up the financial contracts and monitoring the performance of the financial products with respect to the needs of the group companies.

(47) The cash flows, funding requirements and liquidity of the group companies are monitored by FFT to optimise the efficiency and effectiveness of the management of the group's capital resources. FFT manages cash pooling structures in the United Kingdom, Denmark, Belgium, the Netherlands, Switzerland, Austria, Germany, and Spain. On a daily basis, balances by country are centralised into a central FFT master account to manage the whole financial position. More specifically, during the day group companies accounts (held with banks) collect and pay as per normal activity. At the end of the day, account balances of the group companies have a positive or negative position. In both cases, account balances are automatically covered by the FFT master account open in every country. Then, through manual transfers, the amounts of different country master accounts are redirected (in or out) in a single master account. Therefore, on a daily basis, the group companies' current accounts are reset to zero. Depending on the daily current account position, group companies' participants in the cash pooling schemes will be credited or debited for interest calculated following an intercompany pricing grid.

(48) The interest rate on intra-group loans is set as the sum of the group's weighted average cost of capital ("WACC") and a margin. The deposit interest rate is set at the risk-free rate increased by a margin on short term deposits with banks as defined by the group liquidity policy.

(49) Regarding S/T and M/T inter-company funding and coordination with the other treasury companies, FFT proceeds as follows: for the former, FFT makes available to the group companies funds which have been sourced in large volumes at wholesale conditions on regulated markets (bonds market) or through negotiation with financial institutions; for the latter, transfers of funds are recurrent between the treasury companies to meet the financial requests of the group companies without recurring to the market, when the overall financial position of the group is positive.

(50) The main risks generally faced by the treasury companies outlined in the transfer pricing report are as follows:

– Market risk: FFT regularly assesses its exposure to interest rate and foreign exchange risk (to be fully hedged) and hedges those risks through the use of derivative financial instruments in accordance with the group risk management policies. The instruments used for those hedges are mainly plain vanilla currency swaps, forward contracts and interest rate swaps.

– Credit risk relative to bank deposits or other similar short term investments: the transfer pricing report asserts that this risk is mitigated as FFT deals only with major financial institutions and diversifies the allocation of cash. Group assets are not exposed to this risk, since the group has interest to financially support all the group companies[17]; over time, there would not have been any insolvency cases within the group; group companies do not register allowances for doubtful accounts for group debt.

– Counterparty risk relative to the derivative assets held with third parties (banks): this risk is mitigated since FFT deals only with major financial

[17] The transfer pricing report does not contain a justification for this statement.

institutions and the derivative business is allocated among many institutions. Group assets are not exposed to this risk for the reasons mentioned above.

– Operational risk: FFT performs its financial operations in line with the guidelines and procedures set by Fiat S.p.A. Financial activities are constantly monitored and subject to risk management control procedures to avoid any failure in the daily process.

(51) FFT manages a significant amount of financial assets, which are mainly related to intercompany loans, account receivables from group companies and, in a smaller portion, to bank deposits. FFT uses IT systems, which are necessary to perform the day-to-day operations and to monitor financial market performance.

2.2. The contested tax ruling

(52) This Decision concerns the FFT APA, a tax ruling on transfer pricing granted by Luxembourg to FFT by letter of 3 September 2012. The contested tax ruling endorses a method for arriving at a profit allocation to FFT within the Fiat group, as proposed by the latter's tax advisor, and enables FFT to determine its corporate income tax liability to Luxembourg on a yearly basis.

2.2.1. The FFT APA

(53) The documents provided by Luxembourg to the Commission as constituting all the essential elements to support the contested tax ruling consist of the two letters and the transfer pricing report referred to in recital (9).

(54) By letter of 3 September 2012, the Luxembourg tax administration confirmed that "*the transfer pricing analysis hereafter has been realized in accordance with the Circular 164/2 of the 28 January 2011 and respects the arm's length principle*" (sic). In other words, the Luxembourg tax administration accepted that the tax advisor's transfer pricing analysis in the transfer pricing report resulted in an arm's length remuneration for the functions performed and the risk borne by FFT. The "arm's length remuneration" of FFT, as established in the transfer pricing report and accepted by the contested tax ruling, is as follows: "*the transfer pricing study determines an appropriate remuneration on the capital at risk and the capital aimed at remunerating the functions performed by the company of EUR 2.542 million on which a range of +/- 10% is envisaged.*" On the net profits earned by FFT on the basis of this remuneration, the standard corporate tax rate in Luxembourg of 28.80 % is applied. The letter further states that the decision of the tax administration is binding for 5 years (i.e. from tax year 2012 to tax year 2016)[18].

2.2.2. The transfer pricing report

(55) According to the transfer pricing report, the method considered as most appropriate to determine the taxable profit of FFT within the Fiat group is the transactional net margin method (hereinafter: "TNMM"). According to the tax advisor, the TNMM is particularly adequate when, within the transaction, there is one party not making valuable and unique contributions and since, according to the tax advisor, FFT performs only financial services, this method is the most appropriate to determine arm's length pricing in line with the OECD TP Guidelines. Moreover, since FFT

[18] However, the contested tax ruling will terminate if the facts or circumstances described in the application were incomplete or inaccurate, if key elements of the actual transactions differ from the description provided in the request for information or if the advanced pricing agreement is no longer compliant with national or international law.

performs its functions to the Fiat group companies only, which do not receive any similar type of services by third parties, an internal comparison is not possible. Consequently, the tax advisor considers an external comparison more appropriate by identifying the net margins that would have been earned in comparable transactions by independent enterprises[19].

(56) In the transfer pricing report, the tax advisor determines the remuneration due to FFT, which constitutes the taxable profit, by reference to the capital needed by FFT to perform its functions and to bear its risks, in relation to the assets in use[20].

(57) That remuneration is determined as follows: (i) estimate of FFT's "capital at risk"; (ii) identification of FFT's capital used to perform the functions and to support the financial investments; (iii) estimate of the expected remuneration of FFT's "capital at risk" by using the Capital Asset Pricing Model (hereinafter: "CAPM")[21] and identification of the return to reward the capital used to perform the functions; and (iv) calculate the overall profitability to be left to FFT to remunerate the risks borne and the functions performed by combining the results of steps (i) to (iii).

(58) As regards step (i), on the basis of the functional analysis contained in the transfer pricing report, the tax advisor considers FFT to bear the following risks: operational, credit and counterparty risks, while the tax advisor considers the exchange rate risk FFT bears to be nil. Applying the Basel II framework[22] by analogy[23], the tax advisor estimated the minimum capital required for FFT to cover the following risks: operational, counterparty, exchange rate and credit risk, as follows:

– Operational risk: 15%*(creditor interests accrued on bank deposits – debtor interest accrued on bank loans)

– Counterpart risk: 20%*6%*(future exposure + positive fair value of derivatives)

– Credit risk: 20%*6%*third party account receivables (year average)

(59) The result of those calculations is what the tax advisor refers to as FFT's "capital at risk", which corresponds to FFT's hypothetical regulatory capital under the Basel II framework as applied by FFT's tax advisor, summarised in Table 1.

Table 1: ***FFT's minimum capital requirement (in EUR thousand)***

Minimum capital requirement	**2011**
Operational risk	938
Counterparty risk	2 603
Exchange rate risk	0

19 Recital (44) to (46) of the Opening Decision provide a further explanation of the justifications advanced by the tax advisor in the choice of the TNMM to determine the taxable profit of FFT.

20 See recital (51).

21 The CAPM is used to estimate a theoretical required rate of return on assets, more specifically on equity. Recitals (39) to (42) of the Opening Decision provide a detailed explanation of the CAPM.

22 Basel Committee on Banking Supervision, *International Convergence of Capital Measurement and Capital Standards A Revised Framework*, June 2004 (hereinafter: "Basel II framework").

23 Since FFT is not a regulated entity, the tax advisor's interpretation of the Basel II framework to FFT for the purpose of obtaining the contested tax ruling was neither reviewed nor validated by a financial institutions regulator.

Credit risk	24.982
Minimum capital required by Basel II framework	28.523

(60) As regards step (ii), what is referred to in the transfer pricing report as "the capital used to perform the functions"[24] is estimated by deducting the portion of FFT's minimum capital required by the Basel II framework as estimated by the tax advisor and FFT's capital used to support the financial investments in FFNA and FFC from FFT's total equity.

(61) According to FFT's tax advisor, as of the end of 2011, FFT's equity amounted to EUR 287.5 million, of which:

– EUR 28.5 million is the minimum capital required by Basel II framework to bear the risks borne by FFT ("Minimum equity at risk" [25]);

– EUR 165.2 million is used to offset FFT's participation interests in FFNA and FFC[26] ("Equity supporting the financial investments in FFNA and FFC"); and

– EUR 93.7 million is the capital used to perform the functions ("Equity backing the functions performed" [27]).

(62) Table 2 provides a breakdown of FFT's total equity as presented by the tax advisor in the transfer pricing report:

Table 2: ***FFT equity breakdown (in EUR thousand)***

FFT equity breakdown by the tax advisor	Equity 2011
Minimum equity at risk	28.523
Equity supporting the financial investments in FFNA and FFC	165.244
Equity backing the functions performed	93.71
Total Equity	287.477

(63) As regards step (iii), first, the tax advisor proposes to remunerate the portion of FFT's equity it designates as "Minimum equity at risk", which corresponds to FFT's hypothetical regulatory capital as determined by the tax advisor in step (i), by estimating a return on equity investors would expect to receive ("Expected Return Pre-Tax"), using the CAPM, whereby:

24 "Capital used to perform the functions" does not seem to correspond to any specifically defined regulatory category of capital.

25 The terms "capital at risk", "Minimum capital requirement", "Minimum capital required by Basel II framework", "Minimum equity at risk" and "minimum capital" are used interchangeably throughout the transfer pricing report but refer to the same concept, namely, FFT's hypothetical regulatory capital as estimated by the tax advisor by applying the Basel II framework by analogy.

26 FFT's equity has been reduced by the value of the participations in FFNA and FFC, the latter being remunerated with dividends.

27 "Equity backing the functions performed" is another denomination by the tax advisor when referring to "the capital used to perform functions", which the tax advisor introduced in the report.

Expected Return Pre-Tax = (Risk Free Rate + ß x Equity Risk Premium)/(1-tax rate)

(64) In application of the CAPM, FFT's tax advisor used the following variables:

– Risk free rate of 2.85 % (10 years German Government Bond "Bund", 2011 year average);

– Beta (ß) of 0.29 estimated[28] on the basis of set of 66 comparable companies performing financial services, provided by the Damoradan website[29];

– Equity risk premium of 5 % for Luxembourg provided by the Damoradan website (July 2011 update).

– Luxembourg tax rate of 28.80 %;

(65) Applying those variables to the formula in recital (63), FFT's tax advisor arrives at a pre-tax "*expected return on equity, investors would expect to receive for the risks taken*" of 6.05 %.

(66) Table 3 lists the companies FFT's tax advisor selected as comparable companies operating independently in the financial sector and their betas for the calculation of the beta for use in the CAPM.

Table 3: *List of comparable companies engaged in financial services (Source: Damodaran)*

Company Name	Beta
ING Groep NV (EXTAM:INGA)	3.00
UBS AG (SWX:UBSN)	1.80
Wüstenrot & Württembergische AG (XTRA:WUW)	0.41
Deutsche Börse AG (XTRA:DB1)	1.28
Oslo Bors VPS Holding ASA (OTCNO:OSLO)	0.13
London Stock Exchange Group (LSE:LSE)	1.24
Fimalac SA (ENXTPA:FIM)	0.68
International Personal FinancePlc (LSE:IPF)	1.92
GrenkeLeasing AG (XTRA:GLJ)	0.55
Mittel S.p.A (CM:MIT)	0.93
GlobeOp Financial Services SA (LSE:GO)	0.56
KBC Ancora (ENXTBR:KBCA)	3.61
Aktiv Kapital ASA (OB:AIK)	0.25
IG Group Holdings Plc (LSE:IGG)	0.75
IFG Group plc (LSE: IFP)	1.11
Conafi Prestito S.p.A. (CM:CNP)	0.74
NEOVIA Financial Plc (AIM:NEC)	0.60
H&T Group Plc (AIM:HAT)	-0.11
Hesse Newman Capital AG (XTRA:RTM)	0.29
Acta Holding ASA (OB:ACTA)	1.70
Manx Financial Group PLC (AIM:MFX)	0.30
PLUS Markets Group plc (AIM:PMK)	-0.05
Law Debenture Corp. Plc (LSE:LVVDB)	0.95

[28] The 25th percentile of betas was employed by the tax advisor in the CAPM calculation, since it considered FFT to bear limited risks.

[29] Data compiled by Professor A. Damoradan, retrievable at http://pages.stern.nyu.edu/~adamodar/

Hypoport AG (DB:HYQ)	0.70
Perrot Duval Holding SA (SWX:PEDP)	0.16
Albemarie & Bond Holdings plc (AIM:ABM)	0.21
MCB Finance Group plc (AIM:MCRB)	NA
Brightside Group plc (AIM:BRT)	0.11
DF Deutsche Forfait AG (DB:DE6)	0.83
Autobank AG (DB:AW2)	NA
Ambrian capital plc (AIM:AMBR)	0.83
Gruppo MutuiOnline S.p.A (CM:MOL)	0.77
Park Group plc (AIM:PKG)	0.09
OVB Holding AG (XTRA:O4B)	-0.19
Albis Leasing AG (DB:ALG)	0.57
Hellenic Exchanges SA (ATSE:EXAE)	1.42
FORIS AG (XTRA:FRS)	0.20
Creon Corporation Plc (AIM:CRO)	2.03
Investeringsselskabet Luxor A/S (CPSE:LUXOR B)	0.50
Univerma AG	NA
OFL AnlagenLeasing AG (DB:OFL)	0.86
Ideal GroupSA (ATSE:INTEK)	NA
Nøtterø SpareBank (OB:NTSG)	0.20
Apulia Prontoprestitio S.p.A. (CM:APP)	1.07
Ultimate Finance Group plc (AIM:UFG)	0.54
Dresdner Factoring AG (XTRA:D2F)	0.42
Heidelberger Beteiligungsholding AG (DB:IPO)	0.14
ABC Arbitrage SA (ENXTPA:ABCA)	0.48
Baydonhill plc (AIM:BHL)	0.04
London Capital Group Holdings plc (AIM:LCG)	0.72
Imarex ASA (OB:IMAREX)	0.48
Toscana Finanza S.p.A. (CM:TF)	0.49
Banca Finnat Euramerica S.p.A. (CM:BFE)	0.79
S&U plc (LSE:SUS)	0.27
Bolsas y Mercados Españoles SA(CATS:BME)	0.97
Banca IFIS S.p.A. (CM:IF)	0.69
Paris Orleans SA (ENXTPA:PAOR)	0.60
SNS Reaal NV (ENXTAM:SR)	2.37
Close Brothers Group plc (LSE:CBG)	0.94
Provident Fiancial plc (LSE:PFG)	0.35
Pohola Bank plc (HLSE:POH1S)	1.43
Investec plc (LSE:INVP)	1.73
Banque Nationale de Belgique SA (ENXTBR:BNB)	0.49
Credit Suisse Group (SWX:CSGN)	1.43
Deutsche Bank AG (DB:DBK)	1.98
Schweizerische Nationalbank (SWX:SNBN)	0.22

(67) Table 4 shows the “arm’s length range” of betas of the selected comparable companies at which FFT’s tax advisor arrives.

Table 4: ***Arm’s length range of betas of comparable companies***

Arm’s length range	Beta
Number of companies	66
MAX	3.61
90 Percentile	1.79
75 Percentile	1.04
Median	0.64
25 Percentile	0.29
10 Percentile	0.13
MIN	0.19

(68) Second, FFT’s tax advisor proposes to remunerate the portion of FFT’s equity it designates as “Equity backing the functions performed” in Table 2, which corresponds to “the capital used to perform the functions” identified in step (ii), by using the market interest rate applied to short term deposits[30], which, according to FFT’s tax advisor, is equal to 0.87 %.

(69) FFT’s tax advisor further proposes not to remunerate the portion of FFT’s equity it designated as supporting FFT’s financial investments in FFNA and FFC, referred to as “Equity supporting the financial investments in FFNA and FFC” in Table 2, that is, to have a zero remuneration for the purposes of taxation.

(70) Finally, in relation to step (iv), the tax advisor calculates the overall remuneration due to FFT for its financing and treasury activities and the risks it bears. That remuneration consists of the following components derived from steps (i) to (iii) above:

– a “risk remuneration”, which is calculated by multiplying FFT’s hypothetical regulatory capital of EUR 28.5 million, estimated by the tax advisor by applying the Basel II framework by analogy in step (ii), by the pre-tax expected return of 6.05 %, estimated by the tax advisor using the CAPM in step (iii); and

– a “functions remuneration”, which is calculated by multiplying what the tax advisor designates as FFT’s capital used to perform the functions of EUR 93.71 million in step (ii), by the market interest rate applied to short term deposits, which the tax advisor considers to be 0.87 % in step (iii).

(71) Table 5 provides for the tax advisor’s estimate of the overall profitability to be left to FFT for Luxembourg tax purposes,

30 2011 year average Eonia (Euro OverNight Index Average).

Table 5: ***Estimate of the taxable base of FFT (in EUR thousand)***

Capital remuneration	**EBT 2011**
Risk remuneration	1.726
Functions remuneration	816
Remuneration of equity supporting participations in FFNA and FFC[31]	0
Total EBT	2.542

(72) The resulting amount of EUR 2.542 million corresponds to the amount in the contested tax ruling that the Luxembourg tax administration deems to constitute an arm's length remuneration[32].

(73) Table 6 summarises the conclusions of FFT's tax advisor following steps (i) to (iv) above.

Table 6: ***Computation recap of the minimum capital requirement and impact on the result before taxes of FFT***

Minimum Capital Requirement	FFT 2011	
(amounts in EUR thousand)		
Operational Risk	938	a
Counterpart Risk	2.603	b
Exchange rate Risk	0	c
Credit Risk	24.982	d
Minimum Capital Requirement	28.523	e= a+b+c+d
Capital offset by participation interest	165.244	x
Excess Capital	93.710	f=g-e-x
Equity	287.477	g
Net Profit Indicator		
Expected return on capital	6.05%	h
Short term interest rate	0.87%	i
Capital remuneration		
Risk remuneration	1.726	k=h*e
Functions remuneration	816	j=i*f

31 Participation refers to an investment in the shares i.e. equity of a company.

32 Recital (54).

Total EBT (Earnings before tax)	2.542	l=k+j

a = 15%*(financial revenues on bank deposit - financial charges from bank loans)

b = 20%*6%*(future exposure + positive fair value of derivatives with third parties)

c = 100% covered by derivatives

d = 20%*6%*account receivables with third parties (year average)

h = estimated by using CAPM

i = 2011 year average EONIA
To be noted: the main assumption is that there is no credit/counterparty risk on operations with Group companies

2.3. Description of the Luxembourg rules on transfer pricing

(74) The tax ruling in favour of FFT was issued on the basis of Article 164(3) of the Luxembourg Income Tax Code (*loi modifiée du 4.12.1967 concernant l'impôt sur le revenu*, hereinafter "L.I.R") and Circular L.I.R. n° 164/2 of 28 January 2010 (hereinafter "the Circular")[33].

2.3.1. Article 164 of the Luxembourg Income Tax Code

(75) Article 164(3) L.I.R. provides: "*Taxable income comprises hidden profit distributions. A hidden profit distribution arises in particular when a shareholder, a stockholder or an interested party receives either directly or indirectly benefits from a company or an association which he normally would not have received if he had not been a shareholder, a stockholder or an interested party*." That provision establishes the "arm's length principle" under Luxembourg tax law, according to which transactions between intra-group companies should be remunerated as if they were agreed to by independent companies negotiating under comparable circumstances at arm's length.

2.3.2. Circular L.I.R. n° 164/2

(76) Article 164(3) L.I.R. is further clarified by the Circular. The Circular is structured as follows: Section 1 defines the terms "group financing companies"[34], "intra-group financing transactions"[35] and "associated enterprises"[36].

(77) Section 2, titled "General Information", first defines the intra group-services to which the Circular applies, as follows: "*An intra-group service (including an intra-group financing transaction) has been rendered if, in comparable circumstances, an independent enterprise had been willing to pay another independent enterprise to carry out that activity, or if it had carried out that activity itself.*" Section 2 further contains a description of the arm's length principle as set out in the OECD TP Guidelines and transposed into domestic law. In this regard, the Circular states that "*[w]here an intra-group service has been rendered, as with other types of intra-group transfers, one should ascertain whether an arm's length price is charged for*

[33] Available at: http://www.impotsdirects.public.lu/legislation/legi11/Circulaire_L_I_R__n___164-2_du_28_janvier_2011.pdf

[34] "Group financing companies" should be taken to refer to entities which mainly conduct intra-group financing transactions to the exclusion of the holding of participations (p. 1 of the Circular).

[35] "Intra-group financing transactions" refer to any activity consisting of the granting of loans or advancing money to associated enterprises, refinanced by funds and financial instruments such as public offerings, private loans, advanced money or bank loans (p. 1 of the Circular).

[36] "Associated enterprises" are two enterprises where one enterprise participates directly or indirectly in the management, control or capital of the other or if the same persons participate directly or indirectly in the management, control or capital of both enterprises (p. 1 of the Circular).

such service, i.e. a price corresponding to the price which would have been charged and agreed to by independent enterprises in comparable circumstances."[37]

(78) As regards the reference to "comparable circumstances", the Circular provides that the comparability analysis should include factors such as "*the characteristics of the goods or services being transferred, the functions performed by the parties involved, the terms and conditions of the contract, the economic circumstances of the parties and the business strategies pursued by those parties.*"[38]

(79) Section 3 of the Circular contains explanations on how to determine an arm's length remuneration specifically in the case of intra-group financing companies. The function of intra-group financing companies that determine the remuneration of each enterprise should, according to the Circular, be comparable to the functions performed by independent financial institutions subject to the supervision of the *Commission de Surveillance du Secteur Financier*. Thus, the arm's length remuneration for the functions performed (taking into account assets used and risks assumed) "*should be based on the remuneration requested by those financial institutions for comparable credit transactions.*"[39]

(80) Furthermore, financial institutions, before granting a loan or advancing money, perform a risk analysis, which includes an analysis of the financial risk related to the transaction, the borrower risk, the business risk and the structural risk. In addition, as regards the expenses relating to granting loans, the additional costs should take into account, among other things, "*additional expenses generated by solvency requirements, additional expenses related to credit risk, processing fees or additional expenses related to foreign exchange risk.*"[40] The credit risk is determined based on the terms and conditions of the loan agreement and based on the outcome of the risk analysis.

(81) Finally, according to the Circular, independent financial service providers generally set their remuneration based either on the loan amount or on the actual market value of the assets under management. Also, following the example of independent service providers, "*group financing companies carrying out intra-group transactions should perform a risk analysis before granting a loan to an associated enterprise. They should also take into consideration any other factor which may influence the determination of their transfer prices.*"[41]

(82) Section 4 of the Circular provides that the tax authorities shall only issue binding advice if the company concerned has a real presence in Luxembourg. Section 4 then lists a number of requirements that need to be satisfied for a group financing company to have real presence. It further provides that the company should maintain an adequate level of equity with regard to the functions performed (taking into account assets used and risks assumed). According to the Circular, the equity should amount to at least 1 percent of the nominal value of the loan(s) granted or EUR 2 million without any further indication.

(83) The Circular also contains rules as to what information and documents need to be submitted to obtain a binding advice from the tax administration. As such, the request for a binding advice needs to include *inter alia* "*a transfer pricing report in*

[37] The Circular, p. 2.
[38] The Circular, p. 2.
[39] The Circular, p. 2.
[40] The Circular, p. 3.
[41] The Circular, p. 4.

line with the transfer pricing guidelines issued by the OECD and including a comprehensive description of the proposed methodology, as well as detailed information and analysis in support of this methodology, for instance the identification of comparables and the expected range of results."[42] Finally, the Circular specifies that a tax ruling is usually valid for a maximum of 5 years unless the facts and circumstances change or unless the legal provisions on which the ruling was based are modified or if one of the key characteristics of the transaction is altered[43].

2.4. Description of the OECD guidance on transfer pricing

(84) The Organisation for Economic Cooperation and Development (hereinafter "OECD") provides guidance on taxation for its member countries. The OECD's guidance on transfer pricing can be found in its Transfer Pricing Guidelines (hereinafter the "OECD TP Guidelines"), which is a non-binding legal instrument providing guidance on transfer prices[44].

(85) Transfer prices refer to prices charged for commercial transactions between various parts of the same corporate group. Multinational companies have a financial incentive to allocate as little profit as possible to jurisdictions where those profits are subject to higher taxation. This could lead to exaggerated transfer prices which should not be accepted as a basis for calculating taxable income. To avoid this problem, tax administrations should only accept transfer prices between intra-group companies that are remunerated as if they were agreed to by independent companies negotiating under comparable circumstances at arm's length[45]. This is known as the "arm's length principle".

(86) The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD member countries and an increasing number of non-member countries. Article 9 provides: *"[Where] conditions are made or imposed between the two [associated] 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.*"

(87) On 27 June 1995, the OECD's Committee on Fiscal Affairs adopted transfer pricing guidelines in their original version[46], which were substantially updated in July 2010[47]. Given their non-binding nature, the tax administrations of the OECD member countries are simply encouraged to follow the Guidelines. However, in general, the OECD TP Guidelines serve as a focal point and exert a clear influence on the tax practices of OECD member (and even non-member) countries. Moreover, in

---

[42] The Circular, p. 7.

[43] The Circular, pp. 5 to 8.

[44] Tax administrations of OECD member countries are encouraged to follow the Guidelines. However, in general, the OECD TP Guidelines serve as a focal point and exert a clear influence on the tax practices of OECD member (and even non-member) countries.

[45] Tax administrations and legislators are aware of this problem and tax legislation generally allows the tax administration to correct tax declarations of integrated companies that incorrectly apply transfer prices, by substituting prices which correspond to a reliable approximation of those agreed to by independent companies negotiating under comparable circumstances at arm's length.

[46] Transfer Pricing Guidelines for multinational enterprises and tax administrations, OECD, July 1995

[47] Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, OECD, July 2010

numerous OECD member countries those guidelines have been given the force of law or serve as a reference for the purpose of interpreting domestic tax law. To the extent the Commission cites the OECD TP Guidelines in the present Decision, it does so because those guidelines are an existing manual in the area of transfer pricing that are the result of expert discussions in the context of the OECD and elaborate on techniques aimed to address common challenges of the application of the arm's length principle to concrete situations. The OECD TP Guidelines therefore provide useful guidance to tax administrations and multinational enterprises on the application of the arm's length principle. They also capture the international consensus on transfer pricing.

(88) The OECD TP Guidelines provide five methods to approximate an arm's length pricing of transactions and profit allocation between companies of the same corporate group: (i) the comparable uncontrolled price method (hereinafter "CUP"); (ii) the cost plus method; (iii) the resale minus method; (iv) the TNMM and (v) the transactional profit split method. The OECD TP Guidelines draw a distinction between traditional transaction methods (the first three methods) and transactional profit methods (the last two methods). Multinational corporations retain the freedom to apply methods not described in those guidelines to establish transfer prices provided those prices satisfy the arm's length principle.

(89) The CUP and the TNMM are relevant for the present Decision and, therefore, are described in more detail in recitals (90) to (92).

(90) The CUP method compares the price charged for the transfer of property or services in a controlled transaction (i.e. a transaction between two enterprises that are associated enterprises with respect to each other) to the price charged for the transfer of property or services in a comparable uncontrolled transaction (i.e. a transaction between enterprises that are independent enterprises with respect to each other), conducted under comparable circumstances.

(91) The TNMM is one of the "indirect methods" to approximate an arm's length pricing of transactions and profit allocation between companies of the same corporate group. It approximates what would be an arm's length profit for an entire activity, rather than for identified transactions. It does not seek to establish the price of goods sold, but estimates the profits independent companies could be expected to make on an activity, such as the activity of selling goods. It does this by taking an appropriate base ("a profit level indicator"), such as costs, turnover or fixed investment, and applying a profit ratio reflecting that observed in comparable uncontrolled transactions to that base.

(92) Because the TNMM does not set a price for individual transactions, the taxable profit of an entity estimated using the TNMM might not have a direct effect on the taxable profit of another entity of the same corporate group. The method is therefore different to using, for example, the CUP, where transfer pricing establishes the price of a specific good or service which is then recorded in the taxable profit for the same amount by the group company selling and the group company buying the particular good or service.

2.5. Additional information submitted after the opening of the formal investigation procedure

2.5.1. Luxembourg's Letter of 3 September 2014

(93) In response to the questions in the Opening Decision, Luxembourg informed the Commission that credit limits are not applied within the Fiat group.

(94) Luxembourg also provided information regarding the average pricing of FFT's intra-group borrowing and lending for the years 2011 to 2013. The interest rate applicable to intra-group loans provided by FFT is […], and was set at Euribor plus [6-9%] at the end of 2011. The average interest rate received on the current account balances with group companies for the years 2012 and 2013 are [6-9%] and [6-9%] respectively. On intra-group deposits, FFT paid on average [0-3%], [0-3%] and [0-3%] in 2011, 2012 and 2013 respectively (these figures are average all-in rates).

(95) Luxembourg additionally expressed views regarding the remuneration of capital agreed in the contested tax ruling. In particular, Luxembourg indicated that the remuneration of the capital invested in participations consists of dividends and that dividends, by their very nature, are not subject to a transfer pricing analysis, as they are received by a company only in its role of shareholder. Dividends are therefore not to be taken into account in the importance of the functions performed and the risks assumed.

(96) Luxembourg further explained that the acquisition of the participations of FFT was financed in its totality through own funds and that this mode of financing automatically means that those funds are no longer available to cover other risks borne by FFT.

(97) Luxembourg also referred to Article 57 of Directive 2006/48/CE relating to the taking up and pursuit of the business of credit institutions[48], according to which the non-consolidated funds of credit institutions have to exclude participations in other credit institutions, which account for more than 10 % of the capital of those institutions.

(98) Luxembourg further referred to the basic indicator approach under the Basel II framework, which provides the figure of 15 % to be applied to the average of three periods of positive annual gross income.

2.5.2. Luxembourg's Letter of 24 March 2015

(99) In response to the request by the Commission to provide examples of rulings addressed to other taxpayers in a similar situation as FFT, Luxembourg indicated in its letter of 24 March 2015 that the FFT's situation is very specific. The reason for this would be that FFT operates as a financing company raising funds on the market, contrary to most of the financing companies in Luxembourg, which lend on with a margin funds that have been provided to them by other group companies.

(100) Moreover, according to the Luxembourg tax administration the situation of each taxpayer is sufficiently specific to not make possible any comparison with the situation of other taxpayers. That would be the reason why the Luxembourg national law only provides for a general provision to provide a framework for transfer pricing (article 164 L.I.R.) so as to allow the tax administration to capture in the most precise manner the economic reality of each tax case, be it covered by a ruling or not.

[48] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), OJ L 177, 30.6.2006, p. 1.

(101) Luxembourg also provided the tax base of FFT for the period 2009 to 2013 based on the tax declarations of FFT[49], as reproduced in Table 7.

Table 7 *FFT's tax base for years 2009 to 2013*

Tax base of FFT	in EUR
2009	2 643 424
2010	2 424 869
2011	2 600 416
2012	1 684 103
2013	2 095 969

(102) Luxembourg indicated that it is apparent from FFT's 2013 tax declaration that the doubt expressed in recital (64) of the Opening Decision, that the tax base is set to a fixed range from EUR 2 288 000 to EUR 2 796 000, is not substantiated. It is clear that the contested tax ruling only agreed to the methodology and that the market parameters vary.

(103) Finally, at the request of the Commission, Luxembourg also provided all past rulings of Fiat group companies obtained from the Luxembourg tax administration.

(104) First, a ruling request dated 9 December 2009, which was approved by the Luxembourg tax administration, requested an agreement on the tax base of FFT […].

(105) Second, the Luxembourg tax administration issued two letters on 3 September 2012. The first is the contested tax ruling, based on a ruling request dated 14 March 2012, as indicated in recital (9). That ruling request was provided to the Commission anew and in full with Luxembourg's letter of 24 March 2015, including information that had been previously redacted by Luxembourg in its initial submission of that ruling to the Commission.

(106) A second almost identical letter, was issued in response to a parallel ruling request submitted […] to the Luxembourg tax administration on 18 April 2012 concerning a company named [F], which seems to correspond to FFT in an alternative structure of the group treasury companies. In that second ruling request, the functions of [company F] are described in an identical manner to the functions of FFT in the request of 14 March 2012. In this alternative structure, the only difference would be that the company would only have a branch in the UK and would not have any branch in Spain, and that [company F] would not own [any subsidiaries].

(107) The second ruling request, supported with a transfer pricing report, contains a conclusion presented in the same manner as the FFT ruling request (reproduced in recital (54)). However, the outcome of the transfer pricing analysis is significantly different. The arm's length remuneration of [company F], as established in the transfer pricing report, is as follows: "*The transfer pricing study determines an appropriate remuneration on (i) the capital at risk of EUR 44.6 million and (ii) the capital aimed at remunerating the functions performed by the company of EUR 8.8 million on which a range of +/- 10% is envisaged.*"

49 These figures have been provided by Luxembourg in their submission of 24 March 2015. The tax base figures do not entirely match the reported taxable profits in the accounts.

(108) Both rulings were reported on the list provided by Luxembourg to the Commission on 4 June 2015 of tax rulings covering a treasury function (see recital (29)).

(109) Third, two other ruling requests […] approved by the Luxembourg tax administration were also provided to the Commission. Those ruling requests dated from 2002 and 2012 and cover other aspects of the Fiat group structure in Luxembourg. Those rulings are not assessed in this Decision.

2.5.3. Fiat's Submission of 31 March 2015

2.5.3.1. Information on Fiat group companies in direct relation with FFT

(110) Fiat recalled that FFT is owned approximately 40 % by Fiat S.p.A. and approximately 60 % by FF, which in turn is a wholly-owned subsidiary of Fiat S.p.A[50]. FFT in turn holds 100 % of FFNA and FFC[51]. Fiat also recalled that FFT is one of the treasury companies of the Fiat group, as listed in recital (39).

(111) At the request of the Commission, Fiat provided detailed financial data on the group treasury companies. In particular, Fiat provided the annual report for the years 2011 to 2013 of FFT, FF, FFNA, FFC and FFB. Fiat also provided a description of the functions of the group treasury companies. According to that information, FF has 52 employees, out of which [20-30] are working for the treasury department and [10-20] in accounting. FFT has 14 employees, composed of one director, [0-10] front office employees (the front office is based in the United Kingdom), [0-10] back office employees and [0-10] accounting and control employees. FFNA has 5 employees and FFC has limited activities.

(112) According to the submission of Fiat, the book value of the subsidiaries of FFT (FFNA and FFC) […]. The annual report of FFT states that both FFNA and FFC have been acquired from Fiat S.p.A. and FF in 2011. Starting from 2011, FFT prepared consolidated financial statements in Luxembourg.

(113) FF and FFT are the treasury companies for the euro-area. Financial figures for FF and FFT for the period 2010-2013 based on the provided annual reports are presented in Tables 8 and 9[52].

Table 8 ***FFT's financial figures for years 2010 to 2013 (in EUR thousand)***

Financial figures of FFT	2010	2011	2012	2013
Interest and similar income	613,561	650,641	664,707	736,561
Thereof from group companies	*605,880*	*626,806*	*648,497*	*731,462*
Other income	72,292	76,910	29,185	10,125
TOTAL INCOME	685,853	727,551	693,892	746,686
Operating expense and amortisation	3,419	3,655	2,926	2,499
Interest payable and other financial charges	625,078	640,207	631,854	666,246

50 See recital (21) of the Opening Decision.
51 See recital (24) of the Opening Decision.
52 See recital (51) of the Opening Decision for the financial figures of FFT for the period 2009-2011 presented in the transfer pricing report. In Table 8 reference is made to terminology used in the annual report and the submission of 31 March 2015 by Fiat, which might not perfectly correspond to the terminology used by the tax advisor in the transfer pricing report.

Thereof to group companies	*59,409*	55,520	*38,041*	*20,268*
Thereof on bonds and other notes	*551,229*	*574,561*	*592,099*	*643,853*
Commission on Guarantees on bonds paid to Fiat S.p.A.[53]	3,161	2,851	2,702	3,006
Other expense	51,709	78,211	54,702	72,805
TOTAL EXPENSE (excl. corporate tax)	683,367	724,924	692,185	745,032
Profit before corporate tax	2,485	2,627	1,707	1,652
Tax	748	776	491	508
Net profit	1,737	1,851	1,217	1,146

Shareholders' equity	285,625	287,477	288,693	289,839
Amounts owned to group companies	4,354,692	2,275,578	1,530,146	1,661,930
Debt securities issued	7,716,844	7,746,301	9,116,345	11,030,180
Other liabilities (bank debt, accruals,,,)	2,470,513	446,444	144,671	158,865
TOTAL LIABILITIES AND EQUITY	14,827,674	10,755,800	11,079,855	13,140,814

Amounts owned by group companies	11,869,312	7,387,279	7,950,092	9,637,038
Cash and transferrable securities	2,705,622	3,028,255	2,853,245	3,221,203
Participation in affiliated undertakings	0	165,244	164,244	165,244
Other assets (fixed assets, accruals,..)	252,740	175,022	112,274	117,329
TOTAL ASSETS	14,827,674	10,755,800	11,079,855	13,140,814

(114) FFT issued guarantees in favour of group companies to different banks for a total amount of EUR 2 560 802, EUR 10 772 314 and EUR 10 155 339 at the end of 2011, 2012 and 2013 respectively.

Table 9 ***FF's financial figures for years 2010 to 2013 (in EUR thousand)***

Financial figures of FF				
	2010	2011	2012	2013
Financial income	552,090	752,007	676,177	722,610
Thereof from group companies	*528,267*	*672,225*	*655,576*	*711,218*
Other income (dividends, financial gains on derivatives, exchange rates...)	29,708	18,962	18,117	8,935
Revenue from services to group	6,410	7,616	2,336	2,027
Operating expense	14,616	13,332	8,594	9,280
Financial expense	550,331	729,851	654,763	706,825
Thereof to group companies	*523,123*	*698,009*	*625,216*	*687,712*
Profit before corporate tax	23,261	35,402	33,273	17,466
Tax	5,968	10,112	8,822	6,952
Net profit	17,292	25,290	24,450	10,514

Shareholders' equity	271,047	268,610	268,837	256,053
Liabilities	14,878,871	12,567,582	11,277,171	12,758,761

[53] It has been specified by Luxembourg that for the years 2011-2013 the guarantee fee is paid to Fiat S.p.A., for 2010 this information was not specified in the annual report.

Financial assets	9,267,614	8,201,011	9,164,768	9,905,386
Cash and transferrable securities	5,519,622	4,349,837	2,201,190	2,928,409
Participation in affiliated undertakings	358,362	264,116	160,833	160,833
Other assets (fixed assets, accruals,..)	4,320	21,228	19,217	20,186
TOTAL ASSETS	15,149,918	12,836,192	11,546,008	13,014,814h

(115) FF's participation in affiliated undertakings at the end of 2013 (and at the end of 2012) consisted of a participation in FFT for EUR 157 269 000 (representing 60 % of the share capital of FFT), in FFB for EUR 2 013 000 and non-controlling interests in other group companies for EUR 725 000. At the end of 2011, 100 % of the shares of FFT was recorded in the participations of FF for EUR 262 102 000. At the end of 2010, before the sale of FFNA and FFC to FFT in 2011, the participations of FF consisted of EUR 7 213 000 in FFC, EUR 262 077 000 in FFT, EUR 87 055 in FFNA and EUR 2 013 000 in FFB, totalling EUR 358 million of participations in fully-controlled Fiat subsidiaries in 2010, as reported in the Table 8.

2.5.3.2. Detailed information on FFT's assets and liabilities

(116) Fiat provided the names of the 61 group counterparties with which FFT had relationships over the period 2011-2013. It provided average outstanding positions between FFT and its group counterparties for the six largest creditors and debtors for the years 2011, 2012 and 2013. This information for year 2013 is reproduced in Table 10 (the column of interest over average balance has been added by the Commission).

Table 10: ***FFT's counterparties over 2013 (in EUR thousand)***[**]

Assets	Average Outstanding	Interest Received	Interest divided by average outstanding
Fiat group counterparty 1	[10 000 000]	[500 000]	[...]
Fiat group counterparty 2	[150 000]	[10 000]	[...]
Fiat group counterparty 3	[150 000]	[10 000]	[...]
Fiat group counterparty 4	[100 000]	[5 000]	[...]
Fiat group counterparty 5	[50 000]	[4 000]	[...]
Fiat group counterparty 6	[20 000]	[3 000]	[...]

Liabilities	Average Outstanding	Interest Paid	Interest divided by average outstanding
Fiat group counterparty 7	[450 000]	[10 000]	[...]
Fiat group counterparty 8	[250 000]	[400]	[...]
Fiat group counterparty 9	[200 000]	[1 000]	[...]
Fiat group counterparty 10	[50 000]	[200]	[...]
Fiat group counterparty 11	[50 000]	[150]	[...]
Fiat group counterparty 12	[50 000]	[150]	[...]

(117) Fiat also provided information on issuance of debt by FFT since 2009 under the EMTN[54], which is the main source of funding of FFT, as well as issuance prospectus.

** The numbers that are enclosed in square brackets should be read in combination with the prefix "around". These numbers are rounded to a multiple of 50, 500, 5 000, 50 000, 500 000 or 5 000 000

FFT proceeded to 14 issues over that period with maturities up to 7 years. FFT issued both euro denominated notes with coupons ranging from 5.75 % to 7.75 % (except for one issuance at 9 %) and Swiss franc denominated notes with coupons ranging from 4 % to 5 %.

(118) The information submitted by Fiat shows the maturity of the intra-group financing transactions. At the end of 2013, EUR 12 613 000 out of the total of EUR 12 858 000 of receivables (presenting the cash and loans to group companies in Table 9) had a contractual maturity shorter than one year.

(119) The information provided on individual intra-group transactions shows that many transactions are overnight. However, FFT also concludes transactions with different maturities […]. FFT provides loans to the group in different forms […]. Almost all deposits had a maturity of […] at the end of 2013. The notes issues had different maturities, […].

(120) Fiat also provided the Group Liquidity Policy document referred to in the transfer pricing report underlying the ruling request. The document sets out internal rules for investments of cash by the group. […]

2.5.3.3. Information on the Fiat group's transfer pricing policy

(121) In its letter of 20 February 2015, the Commission requested Fiat to explain which mechanism was used to achieve a net result equal to a stable proportion of equity over 2009, 2010 and 2011 (as is apparent from Table 4 in recital (51) of the Opening Decision), despite important variation in assets, liabilities and financial charges and revenues.

(122) Fiat provided a document titled "Transfer Pricing Policy" in response to that request to explain the pricing of intra-group loans and deposits. The Transfer Pricing Policy document clarifies that Fiat sets the prices of intra-group loans provided by the group treasury companies in such a way so as to achieve a pre-determined return for the treasury companies.

(123) The functions described as performed by FFT and the risk assumed are identical to the description in the transfer pricing report, as reproduced in recitals (38) to (51), with the exception of some information. […] the Transfer Pricing Policy document relates to the credit risk and counterparty risk, which is described in the ruling request as non-existent concerning group assets, whereas the document qualifies this risk as "limited".

(124) The Transfer Pricing Policy document explains that for estimating the pricing of intra-group transactions the following steps are taken. […] the amount of the intra-group loans to be financed is estimated. […], on that basis a margin is estimated to be applied to intra-group loans by dividing the sum of the target return to which the operating costs are added, by the total loans to be financed. Finally, this margin is added to the costs of funding of the treasury companies to obtain an estimate of the intra-group loan pricing.

(125) The Transfer Pricing Policy document illustrates this method of pricing intra-group loans by using 2012 figures. Regarding the expected return on capital, it is estimated for 2012 at [4-7%] for FF and FFT on a consolidated basis. The document contains estimates of beta for the European Union for 2012, as well as risk free rates and risk

[54] EMTN stands for Euro Medium Term Note.

premiums for Italy and Luxembourg presented separately, and presents the following estimated expected return on capital figures on that basis:

Table 11: ***Information in the internal Transfer Pricing Policy document***

Arm's length range	Beta
Number of companies	75
75 Percentile	1.22
Median	0.80
25 Percentile	0.34

Variable and expected RoE[55]	Italy	Luxembourg
Risk free rate	1.57%	1.57%
Tax rate	31.4%	28.8%
Equity risk premium	7.73%	6.00%
RoE - 75 Percentile	16.09%	12.52%
RoE - Median	11.27%	8.92%
RoE - 25 Percentile	6.16%	5.10%

(126) The document further distinguishes between pre-defined term loans, established in the past, for which it is not possible to change pricing conditions and floating revisable intra-group loans. […]

2.5.4. Luxembourg's Letter of 10 July 2015

(127) In its letter of 10 July 2015, Luxembourg argues that the Commission would violate the principle of legal certainty should it order recovery from the alleged aid beneficiary in its decision closing the formal investigation procedure. It refers to previous Commission decisions on fiscal aid schemes in this respect where the Commission accepted that that principle could prevent recovery[56] and where the Commission allowed a transitory period on the basis of legitimate expectations[57].

(128) In addition, Luxembourg argues that, given that in transfer pricing the exact arm's length price cannot or does not need to be determined under OECD rules, it is not possible to order recovery of an exact aid amount. Moreover, Luxembourg argues that given the novel character of the aid measure and, in line with previous decisions,

[55] Return on equity.

[56] Commission Decision 2014/200/EU of 17 July 2013 on State aid SA.21233 (C/11 ex NN/11 ex CP 137/06) implemented by Spain – Spanish tax lease scheme.

[57] Commission Decision of 13 November 2007 on State aid granted by Belgium in favour of Belgian coordination centres and modifying Decision 2003/757/EC, OJ 2008 L 90.

the Commission should not order recovery pursuant to the principle of legitimate expectations[58].

3. GROUNDS FOR INITIATING THE PROCEDURE

(129) The Commission decided to initiate the formal investigation procedure because it took the preliminary view that the contested tax ruling grants State aid to FFT within the meaning of Article 107(1) of the TFEU that is incompatible with the internal market.

(130) In particular, the Commission expressed doubts that the contested tax ruling complied with the arm's length principle. This was based on the considerations, presented in recitals (131) to (137).

(131) First, the ruling seemed to agree to a fixed tax base of EUR 2.542 million (+/- 10 %) with respect to FFT's activities in Luxembourg that could only vary marginally and remains stable even if FFT, for example, significantly increased its activities underlying the determination of the tax base.

(132) Second, the Commission expressed doubts as to the appropriateness of the method chosen by FFT's tax advisor to estimate the latter's remuneration for the functions performed by it. The tax advisor used the TNMM, an indirect method, in its transfer pricing analysis to calculate that remuneration, but, according to the Commission, the use of direct methods and, in particular, the use of the CUP method should be preferred in cases where comparable transactions can be observed on the market. In that respect, the Commission noted that Chrysler, the US company of the Fiat group, relies directly on capital market funding for its operations and some of those transactions are comparable to those carried out by FFT.

(133) Third, as regards the use of the CAPM to estimate the required equity returns, the Commission expressed doubts that the CAPM had been correctly applied by FFT's tax advisor. It pointed out that the two components which determine FFT's remuneration on the basis of the CAPM, i.e. the amount of capital remunerated and the level of remuneration applied to that capital amount, were set at a too low level.

(134) As regards the amount of capital remunerated, the tax ruling accepted that the CAPM was only applied to a fraction of the capital, labelled "equity at risk", whereas the equity injected into FFNA and FFC was deducted from the equity to be remunerated without any plausible explanation[59]. In addition, the calculation of the "equity at risk" seemed to lead to a too low taxable basis, as it did not include intra-group assets, again without any convincing justification. In its Opening Decision, the Commission questioned the assumption that there was no credit risk on transactions with group companies. The Commission also expressed doubts as to the calculation of the minimum capital requirements for counterparty and credit risk. In particular, the choice of a relatively low risk weight factor of 20 % for the counterparty risk was not justified, nor what would happen if the regulatory framework were to change in a meaningful manner. The tax advisor's transfer pricing report does not contain any explanation why the "difference between creditor interests accrued on bank deposits and debtor interests accrued on bank loans" is a good indication of operational risk

58 Commission Decision 2006/621/EC of 2 August 2004 on State aid implemented by France in favour of France Télécom.

59 This is explained in the transfer pricing report by the fact that the investments in FFNA and FFC would be remunerated with dividends.

and it does not explain the risk weighting at 15 %. Similarly, that report does not set out why the counterparty risk is multiplied by 6 % instead of 8 %, given that the minimum capital requirement for counterparty risk under the Basel II framework, to which the transfer pricing report makes explicit reference, is 8 %.

(135) As regards the level of remuneration applied to that capital, the Commission expressed doubts on the determination of the beta as it seemed too low compared to other companies performing financial services. It also expressed doubts on the tax advisor's choice of the 25th percentile and not the median for the calculation of the beta.

(136) Fourth, as regards the expected return on equity on the capital considered as excess capital in the ruling request, the Commission expressed doubts that the contested tax ruling agreed to the use of a very low rate of 0.87 % without any justification.

(137) Given that the transfer pricing analysis accepted by the contested tax ruling did not appear to comply with the arm's length principle, the Commission reached the preliminary conclusion that that ruling conferred an advantage on FFT. That advantage was considered to be obtained every year and on-going, when the annual tax liability calculated on the basis of that ruling was accepted by the Luxembourg tax administration. According to the Commission, that advantage was also granted in a selective manner, as it constituted a deviation from administrative practice specifically favouring FFT as compared to companies in a similar legal and factual situation.

(138) With all other conditions of Article 107(1) of the TFEU being fulfilled and no apparent compatibility ground, the Commission reached the preliminary conclusion that the contested tax ruling constituted incompatible State aid. On those grounds, the Commission decided to initiate the procedure laid down in Article 108(2) of the TFEU with respect to that tax ruling.

(139) In addition, in its Opening Decision the Commission enjoined Luxembourg to provide all documents, information and data needed for the assessment of the existence and compatibility of the contested measure pursuant to Article 10(3) of Regulation (EC) No. 659/1999. In the event that Luxembourg did not fully provide all information requested, it invited Luxembourg to agree on the basis of Article 6(a)(2)(b) of Regulation 659/1999 that the Commission will request the beneficiary of the contested measure, i.e. FFT, to provide the requested information.

4. COMMENTS FROM LUXEMBOURG

(140) Luxembourg submitted its comments to the Opening Decision on 19 July 2014. Luxembourg argues, first, that the procedure is flawed and, second, that the Commission committed substantive errors in the Opening Decision.

4.1. Comments from Luxembourg on the Commission procedure

(141) As regards the procedure, Luxembourg alleges that the proper procedure for issuing the information injunction has not been followed in the present case, in that Regulation (EC) No. 659/1999 does not allow the Commission to issue injunctions in a decision to initiate the formal investigation procedure. Before such an injunction can be issued, the procedure provided for in Article 10 of Regulation (EC) No. 659/1999 should have been followed.

(142) Luxembourg further claims that, as regards the information requested under the injunction decision, the Commission did not explain why the disclosure of the name of the beneficiary was necessary to assess the measure under State aid rules. Given the numerous leaks and careless statements by the Commission in public, Luxembourg could not disclose the name at that stage. In addition, the injunction decision did not specify any other specific information to be provided, whereas the Commission's own Manual of Procedure provides that an injunction must explain clearly which information is required for the investigation.

(143) Luxembourg alleges also that, as the Opening Decision does not explain how the contested tax ruling constitutes aid, it is impossible for it to implement the standstill obligation. FFT is required to submit a tax return and given that the Commission has not specified what the right methodology is to calculate FFT's tax liability in the Opening Decision, the Luxembourg tax administration will proceed on the basis of the methodology agreed on in the tax ruling.

(144) Luxembourg argues further that the Commission infringed the principles of sincere cooperation, impartiality and good administration by, for instance, not responding to its offers to meet so as to allow the Luxembourg authorities to explain the methodology used in the contested tax ruling.

(145) Luxembourg contests the decision by the Commission to split the procedure relating to FFT (with a new case number SA.38375) from the general investigation into the tax ruling practices of Luxembourg under case number SA.37267. Given that Luxembourg had appealed the information injunction adopted by the Commission under SA.37267 before the General Court, the Commission could thereby artificially circumvent an annulment of the information injunction under SA.37267 by having opened a new case.

(146) Finally, Luxembourg claims that the Commission misused its powers by confusing the exercise of discretion with the mere interpretation of a rule of ordinary law. In particular, the FFT tax ruling does not constitute an exercise of discretion by the Luxembourg tax administration, but is in line with Article 164(3) L.I.R. and the Circular. According to Luxembourg, when applying those provisions it is inevitable that they will need to be interpreted in the light of the facts of each case to arrive at solutions that are determined by and based on their specific circumstances. The Commission is ignoring that distinction between discretion, on the one hand, and the interpretation of rules that include abstract legal terms and that subsequently need to be applied to the case at issue, on the other. Moreover, by replacing the national authorities in the interpretation of Luxembourg law, the Commission infringes the competence of the Member States in the field of direct taxation.

(147) According to Luxembourg, given that its tax administration did not exercise discretion in the case of FFT, the Commission failed to prove that the contested tax ruling derogated from normal administrative practice. Luxembourg explains that its administrative action is based on the principles of legality and equality, thereby ensuring the same treatment for all taxpayers whose situations are essentially the same. Luxembourg contends that the Opening Decision is only examined in the light of the OECD TP Guidelines and not in the light of Luxembourg's administrative practice.

4.2. Comments from Luxembourg on substantive errors in the Opening Decision

(148) As a general matter, Luxembourg claims that the Commission committed a substantive error by taking as the reference system against which to find a selective advantage the arm's length principle as enshrined in the OECD TP Guidelines and not national law and practice.

(149) In addition, Luxembourg claims the Commission to have misinterpreted the OECD TP Guidelines. At paragraph 65 of the Opening Decision, the Commission seems to establish a hierarchy of transfer pricing methods when it argues that the use of direct methods, namely the CUP, is preferable to the use of indirect methods, such as the TNMM. The Commission thereby disregards the fact that since 2010 the OECD TP Guidelines no longer consider a hierarchy of methods consistent with current requirements and practice. In reference to paragraph 1.13 of the OECD TP Guidelines, Luxembourg indicates that the OECD TP Guidelines acknowledge that "*transfer pricing is not an exact science*" and "*that the choice of methodology for establishing arm's length transfer pricing will often not be unambiguously clear*". Given that FFT's tax advisor considered the choice of the TNMM as justified and applied Article 164 L.I.R., the Luxembourg tax administration merely confirmed that that analysis was legally correct.

(150) According to Luxembourg, the Commission recognises that the interpretation and application of the arm's length principle varies from one tax administration to another and between tax administrations and business[60], so it cannot, on the one hand, allow different interpretations and applications of the arm's length principle and, on the other hand, take the view that there is only one correct method that Luxembourg should have applied when using the arm's length principle.

(151) Furthermore, Luxembourg criticises the Commission for not applying the relevant national law provision, namely Article 164(3) L.I.R. and the resulting administrative practice, to the case at hand, but instead taking as a reference only the OECD TP Guidelines. In doing so, it decides on the calculation method it considers most appropriate whereas Luxembourg law precisely does not provide for the use of specific transfer pricing methods. The Commission therefore entirely disregards Luxembourg's legal framework and administrative practice in this area. In addition, for the purposes of the selectivity analysis, the Commission does not provide a comparison between the tax treatment of FFT and that of other companies in a similar legal and factual situation in Luxembourg.

(152) As regards the Commission's doubts expressed in the Opening Decision, Luxembourg criticises the Commission for focusing too much and one-sidedly on the alleged tax strategy of Fiat at group level, without considering that Fiat, being a group, may have had other reasons for setting up its structure in the manner it did.

(153) First, the Luxembourg tax authorities did certainly not agree to a "fixed tax base" as alleged in recital (64) of the Opening Decision. FFT's taxable revenue depends on the amount of loans granted and the transfer pricing report only establishes a bracket in terms of basis points for the margin to be achieved.

(154) Second, with respect to the amount of equity required and the Commission's doubts in that respect, Luxembourg considers the choice of the "Basel II" framework to

60 Luxembourg refers in this regard to the Communication of 4 June 2014 from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the period July 2012 to January 2014, COM(2014) 315 final.

constitute a reasonable choice, as does the choice to exclude holdings. With respect to the latter choice, Luxembourg claims that it was logical that financial holdings should be excluded from the calculations, since they have no part in an exercise that is restricted to transfer pricing on intra-group loans. Furthermore, according to the transfer pricing report, the amount used to finance the holdings is EUR 165 244 000, which is equivalent to the sale price of the holdings by FFT and hence, according Luxembourg, cannot be open to criticism. In addition, since the revenue for holdings is tax exempt under Luxembourg law, the related costs, such as interest charges, are not deductible. Finally, as holdings are paid through dividends from subsidiaries, the amount of which can vary according to the results of the subsidiaries and their reinvestment requirements, the notion of a margin to be applied to that flow of revenue makes no commercial sense.

(155) Third, Luxembourg claims that the exclusion of intra-group debts from the calculation is also justified given that FFT's debts are backed by an explicit guarantee for FFT lenders. Considering the industrial strategy, the commercial interests and the reputational risk of a possible bankruptcy, the risk of default of FFT is very low and the "open" amount of EUR 93 710 000 more than sufficient to cover that risk.

(156) Fourth, Luxembourg criticises the Commission for calling into question the way in which the beta was calculated for the determination of the risk premium. Firstly, such calculations are not a purely mathematical calculation and different results can be justified, so that the results arrive at in the transfer pricing report are entirely justifiable and sound. Secondly, even assuming that the Commission arrived at different results, it still has to be examined whether that places FFT at an advantage compared with other undertakings established in Luxembourg. Thirdly, even under an alternative assessment, where the risk premium calculated for FFT is compared with the payment made to shareholders of the quoted company giving a percentage of 3.5–4 % which is considerably lower than the 6.05 % risk premium calculated for FFT, the comparison shows that the risk premium of 6.05 % is entirely justifiable and fully complies with the requirements of Article 164 L.I.R.

(157) Finally, Luxembourg claims that given that the tax ruling practice in Luxembourg has been explicitly confirmed by the Code of Conduct Group (Business Taxation) to be consistent with the OECD Code of Conduct and Guidelines, the principle of legitimate expectations means that FFT should be able to rely on the tax ruling of 3 September 2012 for its full period of validity, namely five years.

5. COMMENTS FROM INTERESTED PARTIES

(158) FFT sent its comments to the Opening Decision on 30 October 2014. The comments arrived in two separate documents.

5.1. FFT's first set of comments

(159) FFT's first set of comments is divided in two parts. Part one sets out why FFT believes that the Commission misapplied the OECD transfer pricing principles to the FFT APA. Part two describes why the Opening Decision fails to meet the required legal standard to establish selectivity under Article 107(1) of the TFEU.

5.1.1. Misapplication of the OECD principles

(160) First, contrary to the assertion of the Commission in the Opening Decision, FFT submits that there was no agreement with the Luxembourg tax administration on a

fixed taxable income. The agreement related only to a method to remunerate the treasury functions performed by FFT and, each year following 2011, FFT has updated all of the parameters used to estimate its capital at risk and return on equity to calculate its target profit. Moreover, the FFT APA is only valid for a period of five years, provided the facts and circumstances on which the APA is based do not change, which is a period of validity consistent with the ruling practice in other Member States.

(161) Second, there is nothing objectionable to the fact that FFT's tax advisor chose the TNMM, given that no internal comparables to the transactions carried out by FFT exist that could be used for applying a CUP method. That is because (i) FFT does not grant loans to third parties and (ii) Fiat group companies do not receive similar loans from third parties. FFT refers to paragraph 2.2 of the OECD TP Guidelines according to which the method selection should always aim at finding the most appropriate method. FFT further refers to paragraph 2.4 of the OECD TP Guidelines, according to which there are situations where transactional profit methods are found to be more appropriate than traditional transaction methods.

(162) According to FFT, if the tax advisor had used the pricing of its bonds in the application of the CUP method to set the transfer prices applied to the loans to the group companies, FFT would have incurred losses, because it would not have recovered the cost of the liquidity to cover any financial needs of the group. FFT constitutes a less complex entity with respect to the other group companies whose margins may be tested with the TNMM. This method is used with increasing frequency in transfer pricing analyses and the 2010 OECD TP Guidelines do not provide for a hierarchy between methods.

(163) Additionally, according to FFT, equity often may be the result of historical decisions linked to the operations of a company and may not have a direct link with the level of equity necessary to sustain the risks of the company's activity.

(164) Finally, FFT notes that the OECD TP Guidelines acknowledge that transfer pricing is not an exact science. It refers to paragraph 1.13 of the OECD TP Guidelines in this respect, more precisely, to the following consideration: "*It is important not to lose sight of the objective to find a reasonable estimate of an arm's length outcome based on reliable information. It should also be recalled at this point that transfer pricing is not an exact science but does require the exercise of judgment on the part of both the tax administration and taxpayer*". FFT indicates that they have nevertheless used their best efforts to estimate an arm's length remuneration for their activities.

(165) Third, as regards the adequacy of FFT's equity, FFT has to evidence that its equity is sufficient to support the risks it assumes in respect of its financing activity. No specific guidance is given by the Circular to determine the appropriate level of equity at risk and, therefore, FFT decided to analyse its equity to ascertain what proportion of capital was necessary to perform its activities and to bear its risks by making reference to the Basel II framework. Also the Circular compares companies performing intermediary financing activities with independent financial institutions. The Circular also requires taxpayers performing intra-group financing transactions to have sufficient equity to support their financing risks from such transactions. To the contrary, holding activities are not considered for the purpose of the FFT APA which is why it was justified to exclude FFT's shareholdings from its equity at risk. Besides, the amount of equity equivalent to the investment in FFT's subsidiaries has been excluded since it reflects non-portfolio investments in affiliates that are

remunerated through dividends. However, dividends are not subject to transfer pricing analyses as they do not entail any consideration of the significance of the functions performed or of the risks borne. Such deduction is also consistent with the Basel II framework[61] and Article 57 of Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions (the Capital Requirement Directive, hereinafter: "CRD III")[62].

(166) Fourth, with respect to the Commission's analysis of the treatment of intra-group receivables and the fact that the FFT APA disregards all assets other than third party assets, FFT submits that the group credit rating is already incorporated in the group cost of funding sourced by FFT. As FFT and all associated group companies have a credit rating equivalent to Fiat S.p.A.[63], there is no additional credit risk to FFT from lending to its associated group companies. Therefore, the interest rate charged by FFT to its associated group companies is set as the sum of the (i) group cost of funding, plus: (ii) the guarantee fees which it pays to Fiat S.p.A.; (iii) the operational costs it incurs to be able to provide its own services to its affiliates; (iv) the "negative carry" which arises because significant sums borrowed by FFT have to be kept on short-term deposit, at lower rates of interest, to meet group liquidity needs at short notice; and (v) the capital remuneration for risks incurred, which are consistent with the functions assumed by FFT in the management of the group treasury.

(167) Fifth, according to FFT, it was justified to use the 6 % coefficient applied to its risk-weighted assets (hereinafter "RWAs") as it corresponds to FFT's understanding of the Basel II framework transposed to non-bank financial institutions in certain EU jurisdictions (for instance, Italy) by local regulatory authorities in accordance with the CRD. Moreover, since the asset exposure of FFT to third parties consists mainly of bank deposits, the 20 % risk weighting was applied consistently with the Standardized Approach of the Basel II framework.[64] Similarly, as regards the 15 % risk weighting applied for operational risk, FFTs refers the Commission to the Basic Indicator Approach, where, according to Paragraph 649 of the Basel II framework,

---

61 The following section is quoted: "*49(xv). It has been concluded that the following deductions should be made from the capital base for the purpose of calculating the risk-weighted capital ratio. The deductions will consist of: […] Investments in subsidiaries engaged in banking and financial activities which are not consolidated in national systems. The normal practice will be to consolidate subsidiaries for the purpose of assessing the capital adequacy of banking groups. Where this is not done, deduction is essential to prevent the multiple use of the same capital resources in different parts of the group. The deduction for such investments will be made in accordance with paragraph 37 above. The assets representing the investments in subsidiary companies whose capital had been deducted from that of the parent would not be included in total assets for the purposes of computing the ratio.*"

62 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, OJ L 177, 30.6.2006, p. 1, as amended. Article 57 provides that unconsolidated own funds of a credit institution exclude "(1) holdings in other credit and financial institutions amounting to more than 10 % of their capital".

63 The reason for this being the high level of integration of the group businesses and because of Fiat S.p.A.'s historical support for its subsidiaries. According to FFT, credit agencies employ group consolidated accounts to assess Fiat S.p.A's credit rating.

64 FFT deals only with major financial institutions located in the Euro area countries, essentially where "Option 1" (the option that allows reference to the rating of the Sovereign instead of the bank's own rating) has been validated by national supervisors. Furthermore, CRD III grants a 0 % risk weighting for sovereigns that issue bonds in their own currency whatever their rating (Annex VI, part 1, 1.2, (4)). Therefore, according to FFT's and [the tax advisor]'s understanding of the Basel II framework and the CRD rules, a risk weight of one notch less than the one applying to the sovereign in which the banks operate could be applied to the banks under consideration. Such an application of the Basel II framework leads to the selection of the 20 % risk weighting for FFT's exposures to banks. This reasoning is applied both for credit and counterparty risks for FFT's exposure towards the banks.

such a coefficient should be applied. Similarly, under the same Basic Indicator Approach, the gross income is to be computed as the net interest income plus net non-interest income gross of any provision, or operating expenses, but excluding exceptional profits. Given that FFT has no non-interest income, the reference to creditor interest accrued on bank deposits, net of the debtor interest accrued on bank loans, is justified as the best approximation of the operational risk of FFT. As regards any possible change of the regulatory framework, FFT submits that also under the Basel III framework[65] and Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms[66] ("CRD IV"), the relevant criteria are still valid.

(168) Sixth, as regards the Commission's doubt on the beta used, FFT submits that even when excluding certain comparables (such as national banks), the arm's length range stays almost exactly the same. Since FFT acts as a treasury company and cannot be assimilated to a bank, betas of financing companies are considered by FFT and [the tax advisor] to be the most appropriate comparable. Moreover, the Circular makes a clear reference to financial service providers. On that basis, it is reasonable to consider a set of companies active in the financial services industry to determine an appropriate beta. With respect to the adoption of the 25th percentile of the arm's length range, this is in line with the OECD TP Guidelines that consider that all points within the arm's length range provide for arm's length prices/profits. In addition, FFT is considered to bear limited risks as it works exclusively for group companies, group activities are very integrated and the parent company has every interest to support the activities of its affiliates.

(169) Seventh, FFT does not concur with the Commission's doubt that the 0.87 % return on equity is too low. The excess capital, i.e. the capital that is not necessary to cover the risks assumed by FFT on its financing activity, is either on-lent in case another group company needs additional funding or used to fund operating expenses incurred by FFT while rendering financial services. As such, it should be remunerated in line with short-term liquidity investments.

5.1.2. The Commission's selectivity analysis

(170) FFT submits that even if the Commission's analysis of the compliance with the arm's length principle was correct, the Opening Decision provides no evidence of FFT being treated more advantageously than any other Luxembourg taxpayer in a comparable legal and factual situation to FFT. The Opening Decision does not contain any comparison of the position of FFT with other Luxembourg taxpayers, such as the 21 other taxpayers whose APAs have been reviewed by the Commission.

(171) FFT was entitled to an APA from the Luxembourg tax administration, like any other Luxembourg taxpayer having a real presence in Luxembourg.

(172) Moreover, given that the aggregate Luxembourg corporate income tax rate for FFT was 28.8 % (for the financial year 2011), while in Italy the headline corporate tax rate is approximately 33 %, a higher profit earned by FFT would have resulted in higher deductible costs in Italy, since the majority of the FFT loans are to Fiat Finance S.p.A. Hence, it is not clear what kind of "aid" the group as a whole

[65] Basel Committee on Banking Supervision, International regulatory framework for banks (Basel III).

[66] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, p. 338.

therefore obtained if FFT reported a lower profit in Luxembourg and hence was entitled to lower interest deductions in Italy.

5.2. FFT's second set of comments

5.2.1. The APA does not confer an "advantage"

(173) FFT's second set comments start off by explaining the importance of APAs in general and their acceptance both as a part of the general tax system, as well as their endorsement by the Luxembourg tax system. The FFT APA follows the guidance contained in the Circular and does not depart from the Luxembourg general tax system. The 5 year duration of the FFT APA is in line with the standard length of APAs concluded in other Member States.

(174) Luxembourg transfer pricing rules, which are the basis on which the Circular has been issued, are part of the general tax system, as they apply between related group companies engaged in the carrying out of intercompany transactions. Luxembourg transfer pricing rules do not derogate from the general tax system, as they respect in practice the OECD TP Guidelines and are aimed at identifying an arm's length profit.

(175) As regards the doubt of the Commission expressed in the Opening Decision on the choice of the transfer pricing methodology, FFT submits that the TNMM is a generally accepted OECD approved methodology that is consistent with the general tax system in Luxembourg. The wide use of the TNMM has been acknowledged by the Commission, as well as the fact that its application can raise complexities.[67] There is a lack of guidance on certain detailed aspects, but the Commission claims the right to resolve controversial transfer pricing issues based on its own view as to how the TNMM should be applied in this case. In addition, FFT's tax profit is aligned with the statutory profit which further confirms that the use of the TNMM did not provide any economic advantage to FFT.

(176) According to FFT, tax authorities should be allowed a certain margin of appreciation when applying the TNMM, which, as far as the determination of the taxable profit is concerned, never leads to one single outcome, but to the identification of a range of valid results. Accordingly, the difference between the taxable income obtained by FFT (and accepted by the Luxembourg tax authorities) and the alleged taxable income according to the Commission should not be considered an advantage for State aid purposes. Such an advantage only arises where the measure amounts to a flagrant departure from standard transfer pricing rules and goes beyond the margin of appreciation of the tax administration[68]. Otherwise, the Commission would interfere with the taxing powers of a Member State.

(177) Finally, when assessing whether an advantage exists, FFT alleges that the Commission should have considered the overall "group" effect. To that effect, no advantage exists for the Fiat group because any increase of the taxable base in Luxembourg is offset in full by an increased tax deduction in other European

[67] FFT supports this point by making reference to § 5.3.2. of the Commission Communication on Company Taxation in the Internal Market, COM(2001) 582 final of 23 October 2011.

[68] In this context, FFT makes reference to the Commission decision on Umicore (Commission decision of 26.5.2010 on State aid granted to Umicore S.A., C 76/2003 (ex NN 68/2003)) where the Commission stated that a tax advantage must be "out of proportion" in order to fall within the scope of State aid scrutiny.

countries (in the latest years mainly in Italy). According to FFT, this effect has been recognised in a number of Commission decisions.[69]

5.2.2. *Lack of selectivity*

(178) According to FFT, the reference system to assess selectivity can only include companies being subject to transfer pricing rules, i.e. dealing exclusively with related parties. This is recognised in the Commission decision on *Groepsrentebox*,[70] which states with respect to debt financing activities that related companies are not in a legal and factual situation comparable to that of unrelated companies. Thus, to demonstrate selectivity, the Commission would have to prove that FFT obtained an APA under conditions which are different from those of other Luxembourg group entities engaged in financing activities. However, the Circular explains that APAs are available to all finance group companies. Therefore, there is no selectivity.

(179) The Commission generally accepts tax rulings as a means to provide taxpayers with legal certainty and predictability vis-à-vis their tax position. Tax rulings issued by the Luxembourg tax administration are not discretionary, since they follow the principles of the Circular, which specifically refers to the arm's length principle as defined in Article 9 of the OECD Model Tax Convention and provides guidance and clarifications with regard to the minimum equity requirements and transfer pricing analysis that a Luxembourg company performing an intra-group financing activity has to meet. Thus, the margin of appreciation of the Luxembourg tax administration, if any, is limited by the guidance offered in the Circular. In addition, this limited margin of appreciation left to the tax administration is inherent to the application of the OECD TP Guidelines. This, in itself, cannot trigger the presence of State aid. Furthermore, FFT submits that the FFT APA is subject to periodical review with a maximum period of validity of five years.

(180) FFT further argues that the Commission has not demonstrated that the application of the TNMM method in the FFT APA diverges from other rulings concluded by companies in situations comparable to FFT. According to FFT, there is no doubt that a comparable undertaking in a similar situation to FFT would have been able to request a ruling and to determine its taxable profits on the basis of the TNMM. Since FFT and comparable undertakings are subject to the same tax regime, it also becomes immaterial to establish whether the transfer pricing methodology applied to FFT was compliant with the OECD TP Guidelines (which it was in any event).

5.2.3. *FFT's factual situation differs substantially from the decisions on Coordination Centres*

(181) According to FFT, the Opening Decision illustrates a number of noteworthy differences vis-à-vis previous decisions in which the Commission challenged the application of a transfer pricing methodology (namely cost-plus) as being the tax measure that gave rise to the selective advantage.[71] In those decisions, the regime

---

69 Notably Commission Decision of 28 October 2009 on State aid C 10/07 (ex NN 13/07) implemented by Hungary for tax deductions for intra-group interest decisions (hereinafter "*Hungarian group interest tax regime decision*").

70 Commission decision of 8 July 2009 on State aid C 4/2007 (ex N 465/2006) on the *Groepsrentebox scheme* which the Netherlands is planning to implement, OJ L 288, 04.11.2009 (hereinafter "*Groepsrentebox decision*").

71 Commission Decision of 24 June 2003 on the aid scheme implemented by Belgium – Tax ruling system for United States foreign sales corporations, OJ 2004, L 23/14; Commission Decision of 17 February 2003 on the aid scheme implemented by Belgium for coordination centres established in Belgium, OJ 2003 L 282/25; Commission Decision of 16 October 2002 on the State aid scheme C 49/2001 (ex NN

was available only to those taxpayers that met certain requirements, whereas in the Opening Decision the Commission challenges solely the application of the TNMM, i.e., the specific determination of the taxable profits, in the context of an APA procedure available to all Luxembourg taxpayers engaged in related party financing.

(182) Moreover, in those decisions the income determined under the cost-plus method could depart substantially from the statutory profit, which is not the case for FFT, whose income determined under the TNMM methodology is in line with the accounting result of the company itself. Similarly, the application of the transfer pricing methodology in the earlier decisions was manifestly not in line with OECD TP Guidelines. In the present case, there is no breach of the OECD TP Guidelines. However, unlike the decisions on coordination centres, there is also no clear transfer pricing guidance in the OECD TP Guidelines about some of the activities performed by FFT (such as the performance of financial and treasury activities).

(183) FFT further alleges that the Commission also did not consider that the FFT APA was based on an economic study in line with the OECD TP Guidelines which shows that the profit determination was not arbitrary and that the Luxembourg tax authorities did not exercise any discretion.

6. COMMENTS FROM LUXEMBOURG ON THIRD PARTY COMMENTS

(184) By letter of 5 January 2015, Luxembourg expressed its complete agreement to the observations of Fiat.

7. ASSESSMENT OF THE CONTESTED MEASURE

7.1. Existence of aid

(185) 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 provision of certain goods shall be incompatible with the internal market, in so far as it affects trade between Member States.

(186) According to settled case-law, for a measure to be categorised as aid within the meaning of Article 107(1) of the TFEU, all the conditions set out in that provision must be fulfilled.[72] It is thus well-established that, for a measure to be categorised as State aid within the meaning of that provision, there must, first, be an intervention by the State or through State resources; second, the intervention must be liable to affect trade between Member States; third, it must confer a selective advantage on an undertaking and, fourth, it must distort or threaten to distort competition.[73]

(187) As regards the first condition for a finding of aid, the contested ruling was issued by the "*Administration des contributions directes*", which is part of the tax administration of the Grand Duchy of Luxembourg. That ruling entails an acceptance

---

46/2000) – Coordination Centres – implemented by Luxembourg, OJ 2003, L 170/20; Commission Decision of 13 May 2003 on the aid scheme implemented by France for headquarters and logistics centres, OJ 2004, L 23/1; Commission Decision of 5 September 2002 on the aid scheme implemented by Germany for control and coordination centres, OJ 2003 L 177/17.

[72] See Case C-399/08 P *Commission v Deutsche Post* ECLI:EU:C:2010:481, paragraph 38 and the case-law cited therein.

[73] See Case C-399/08 P *Commission v Deutsche Post* ECLI:EU:C:2010:481, paragraph 39 and the case-law cited therein.

by the Luxembourg tax administration of a method of profit allocation to FFT within the Fiat group, proposed by the latter's tax advisor, which binds that tax administration for a period of five years, on the basis of which FFT determines its corporate income tax liability to Luxembourg on a yearly basis. The contested ruling is therefore imputable to Luxemburg.

(188) As regards the measure's financing through State resources, the Court of Justice has consistently held that a measure by which the public authorities grant to certain undertakings a tax exemption which, although not involving a positive transfer of State resources, places the persons to whom it applies in a more favourable financial situation than other taxpayers constitutes State aid.[74] In section 7.2 below the Commission will demonstrate that the contested ruling results in a lowering of FFT's tax liability to Luxembourg by deviating from the tax that FFT would otherwise be obliged to pay under the general Luxembourg corporate tax system. Consequently, the contested ruling should be considered to give rise to a loss of State resources, since any reduction of tax for FFT results in a loss of tax revenue that would otherwise have been available to Luxembourg.

(189) As regards the second condition for a finding of aid, FFT is part of the Fiat group, a globally active entity operating in all Member States of the Union, so that any aid in its favour is liable to affect intra-Union trade. Similarly, a measure granted by the State is considered to distort or threaten to distort competition when it is liable to improve the competitive position of the recipient compared to other undertakings with which it competes[75]. To the extent the contested ruling relieves FFT of a tax liability it would otherwise have been obliged to pay under the general Luxembourg corporate income tax system, that ruling distorts or threatens to distort competition by strengthening the financial position FFT and the Fiat group, so that the fourth condition for a finding of aid is also fulfilled in the present case.

(190) As regards the third condition for a finding of aid, the Commission will demonstrate in section 7.2 why it considers the contested ruling to confer a selective advantage on FFT, in so far as it results in lowering its tax liability in Luxembourg by deviating from the tax FFT would be due under the ordinary tax system, therefore fulfilling all the conditions for a finding of aid under Article 107(1) of the TFEU.

7.2. Existence of a selective advantage

(191) According to settled case-law, "*Article 107, paragraph 1 of the Treaty requires it to be determined whether, under a particular statutory scheme, a State measure is such as to favour 'certain undertakings or the production of certain goods' in comparison with others which, in the light of the objective pursued by the scheme in question, are in a comparable legal and factual situation. If it is, the measure concerned fulfils the condition of selectivity*"[76].

(192) In fiscal cases, the Court of Justice has devised a three-step analysis to determine whether a particular tax measure is selective[77]. First, the common or normal tax regime applicable in the Member State is identified: "the reference system". Second, it is determined whether the tax measure in question constitutes a derogation from

---

[74] See Joined Cases C-106/09 P and C-107/09 P *Commission v. Government of Gibraltar and United Kingdom* ECLI:EU:C:2011:732, paragraph 72 and the case-law cited therein.

[75] See Case 730/79 *Phillip Morris* ECLI:EU:C:1980:209, paragraph 11 and Joined Cases T-298/97, T-312/97 etc. *Alzetta* ECLI:EU:T:2000:151, paragraph 80.

[76] See C-172/03 *Heiser* ECLI:EU:C:2005:130, paragraph 40.

[77] See Joined Cases C-78/08 to C-80/08 *Paint Graphos* ECLI:EU:C:2009:417.

that system, in so far as it differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. If the measure constitutes a derogation from the reference system, it is then established, in the third step of the analysis, whether that measure is justified by the nature or the general scheme of the reference system. A tax measure which constitutes a derogation to the application of the reference system may be justified if the Member State concerned can show that that measure results directly from the basic or guiding principles of that tax system[78]. If that is the case, the tax measure is not selective. The burden of proof in that third step lies with the Member State.

7.2.1. Determination of the reference system

7.2.1.1. Reference system composed of the general Luxembourg corporate tax system

(193) As a general rule, for the purposes of the selectivity analysis a reference system is composed of a consistent set of rules that apply on the basis of objective criteria to all undertakings falling within its scope as defined by its objective.

(194) In the present case, the Commission considers the reference system to be the general Luxembourg corporate income tax system, which has as its objective the taxation of profits of all companies subject to tax in Luxembourg[79]. The Luxembourg corporate income tax system applies to domestic companies and foreign companies resident in Luxembourg, including Luxembourg branches of foreign companies. A company is deemed resident in Luxembourg if it has its corporate address or its central management in Luxembourg. Domestic companies and foreign companies resident in Luxembourg are liable to corporation tax on their worldwide profits, unless a tax treaty applies. Non-resident companies are only taxable on specific Luxembourg-sourced income[80]. Tax is payable on profits realised minus tax-deductible expenses and losses, which may be carried forward indefinitely.

(195) The Luxembourg corporate income tax consists of a corporate income tax on profits ("*impôt sur le revenue des collectivités*" or "*IRC*"), taxed at a rate of 21 %, and, for companies established in Luxembourg City, a municipal business tax on profits ("*impôt commercial communal*"), taxed at a rate of 6.75 %. In addition, there is a 5 % surcharge on the 21 % tax rate for an employment fund calculated on the IRC[81]. Since 1 January 2011, the total combined corporate income tax rate in Luxembourg is therefore 28.80 %.[82, 83]

(196) For the determination of the taxable profit for the purposes of Luxembourg corporate income tax, in principle, the commercial accounts of the taxpayer are followed, subject to adjustments imposed by Luxembourg tax law mainly relating to dividend/capital gains exemption, add-back expenses[84], corrections to the tax result

---

78 See Joined Cases C-78/08 to C-80/08 *Paint Graphos* ECLI:EU:C:2009:417, paragraph 65.

79 See also Joined Cases C-78/08 to C-80/08 *Paint Graphos* ECLI:EU:C:2009:417, paragraph 50.

80 This includes income attributable to a permanent establishment located in Luxembourg, income from professional services carried on in the country, dividends, interest from profit sharing loans and interest from bonds if the paying agent is the State or a resident individual or company, capital gains from the sale of shareholdings of 10 % or more in resident companies (except venture capital funds).

81 In 2012. The solidarity surcharge was increased from 5 % to 7 % with effect from tax year 2013.

82 With the changes introduced for tax year 2013, the aggregate income tax rate increases from 28.80 % to 29.22 % for Luxembourg City.

83 In addition, Luxembourg companies are subject to an annual net wealth tax, which is levied at a rate of 0.5 % on the company's worldwide net worth on 1 January of each year.

84 E.g. interest expenses on assets generating tax-exempt income or directors' fees, which are not for the day-to-day running of the company.

from transactions not executed at arm's length, and the application of different depreciation rules under tax and accounting rules.

(197) While the determination of taxable profits in the case of non-integrated/domestic standalone companies that transact on the market is rather straightforward, as it is based on the difference between income and costs in a competitive market, the determination of taxable profits in the case of integrated group companies like FFT, requires the use of proxies. Standalone, non-integrated companies can take their accounting profits as a starting point for determining the tax base to which corporate income tax applies, since those profits are dependent on prices dictated by the market for the inputs acquired and the products and services sold by the company. By contrast, an integrated company that transacts with companies of the same corporate group will have to estimate the prices applied to those intra-group transactions for determining their taxable profits for tax purposes, that estimate being determined by the same company controlling the group instead of being dictated by the market.

(198) However, this difference in determining the taxable profits of non-integrated companies, i.e. those not belonging to a corporate group and thus "standalone", and integrated companies, i.e. those belonging to a corporate group, has no bearing on the objective of the Luxembourg corporate income tax system, which aims to tax the profits of all companies resident in Luxembourg, whether non-integrated or integrated. Indeed, the IRC lists the entities in Luxembourg that are subject to corporate income tax and it includes "*toute entité économique pouvant être soumise directement à l'impôt sur le revenu des collectivités*". Neither the legal form of the undertaking, nor its structure (group of undertakings or not) constitute a determinant criterion for the imposition of corporate income tax in Luxembourg. Moreover, even if financing decisions could be expected to be taken in the best interest of a group as a whole, Luxembourg corporate income tax is levied on individual entities, not on groups, and the contested tax ruling relates only to the taxable profit of FFT, so that any reduced tax revenue is based individually on that company's results. While it is true that Luxembourg tax law contains certain special provisions applicable to groups (e.g. fiscal unity[85]), these are aimed at putting on equal footing non-integrated companies and economic entities structured in the form of groups, but not at treating groups more favourably[86].

(199) Accordingly, the different manner in which the taxable profit is necessarily arrived at for integrated and non-integrated companies has no relevance for determining the reference system for the selectivity analysis in the present case. Since under the Luxembourg corporate income tax system, the profits of all companies resident in Luxembourg are taxed in the same manner, without any distinction as to integrated

[85] Fiscal unity applies if a number of conditions are fulfilled: the parent company has held, directly or indirectly, a participation of 95 % or more in the share capital of a subsidiary, as from the beginning of the accounting period during which the application for the consolidation regime has been made; the subsidiary is a capital company resident in Luxembourg and fully subject to corporate income tax; the consolidating parent company is a capital company resident in Luxembourg and fully subject to corporate income tax, or a branch of a non-resident company which is subject in its jurisdiction of establishment to an income tax which is comparable to Luxembourg income tax; and the consolidation is requested for at least five accounting years.

[86] An integrated company can offset losses experienced in some of its plants against the profits realised in other plants. Tax consolidation assimilates a group of companies to a single taxpayer. It is a means to eliminate the disadvantages that groups of companies experience compared to integrated companies with respect to income taxation. Consolidation is not an aid measure if, once consolidated, a group of companies is not treated more favourably than an integrated company.

and non-integrated companies, both types of companies should be considered to be in a similar factual and legal situation in light of the intrinsic objective of that system[87]. Indeed, since the aim of the contested tax ruling is to determine FFT's taxable profit for the purpose of levying corporate income tax under the general Luxembourg corporate income tax system, it is that system that constitutes the reference system against which that ruling should examined to determine whether FFT has benefitted from a selective advantage.

(200) Finally, in response to the various arguments FFT advances to support its claim that group companies and stand-alone companies do not belong to the same reference system, the Commission notes the following.

(201) According to FFT, the reference system to assess the selectivity of the contested ruling should only include companies being subject to transfer pricing rules, i.e. dealing exclusively with related parties[88], so that the Commission, in order to establish selectivity, must demonstrate that FFT obtained a tax ruling under conditions which are different from those of other Luxembourg group entities engaged in financing activities[89]. According to FFT, this approach is confirmed by the Commission's decisions on *Groepsrentebox* and *Hungarian group interest tax regime*[90].

(202) At the outset, the Commission recalls that it is not bound by its decisional-practice. Each potential aid measure must be assessed on the basis of its own merits under the objective criteria of Article 107(1) of the TFEU, so that even if a contrary decisional practice were shown to exist, that could not affect the findings of the present decision[91].

(203) In any event, contrary to what FFT claims, neither decision confirms that where a tax measure is granted in favour of an integrated company, the reference system must necessarily be limited to those types of company. Moreover, the objective of the tax measure at the basis of both decisions is not comparable to the present case and therefore, the conclusions that can be drawn from those decisions are not applicable to the present case.

(204) The *Groepsrentebox* scheme was set up by the Dutch authorities to reduce the difference in tax treatment between the provision of equity capital and loan capital in a group context and, as such, to reduce arbitrage between these two forms of intra-group financing[92]. The Commission observed in the final decision that given the objective of the measure, which was to reduce the difference in tax treatment between the provision of equity capital and loan capital in a group context and, as such, to reduce arbitrage between these two form of intra-group financing, it is "*only group companies, [and not stand-alone companies,] that are confronted with arbitrage between equity capital and loan capital within their group*"[93]. It was in the light of that observation, as well as of the objective of the scheme which was "*to*

[87] In general, all undertakings having an income are considered to be in a similar legal and factual situation from the perspective of direct company taxation.

[88] Observations of FFT to the Opening Decision, paragraph 2.1.

[89] Observations of FFT to the Opening Decision, paragraph 2.1.3.

[90] See footnotes 69 and 70.

[91] See C-138/09 *Todaro Nunziatina & C.* ECLI:EU:C:2010:291, paragraph 21.

[92] The scheme provided that the positive balance between interest received on group loans and interest paid in the context of intra-group financing transactions was not taxed at the standard corporate tax rate of 25.5 % at the time but taxed in a "group interest box" at the rate of 5 %.

[93] *Groepsrentebox* decision, recital 85.

reduce incentives for arbitrage between financing through a capital injection and a loan, and ensuring tax neutrality in this regard"[94], that the Commission considered the reference system in that case to include only companies subject to corporation tax and engaged in intra-group financing transactions[95].

(205) By contrast, the objective of the contested tax ruling is to determine FFT's tax base to calculate the tax due for the purposes of levying the Luxembourg corporate income tax on that amount. First, while it could be argued that the objective underlying the *Groepsrentebox* decision is only valid in a group context (such as the fact that stand-alone companies are not faced with the issue of arbitrage between different forms of financing), the determination of the taxable base for the computation of the annual corporate income tax liability is equally relevant and applicable to entities that are part of a group as well as stand-alone companies.

(206) Second, FFT functions as a treasury company and only provides services to other companies of the Fiat group. However, the transaction it carries out could also be carried out outside a group context. The Circular compares this type of intra-group financing transactions with transactions carried out by independent financial institutions[96] and requires that the remuneration for these financial services should be based either on the loan amount or on the actual market value of the assets under management, just like it would be done by an independent financial institution. The Circular therefore recognises that the transactions, even though carried out in a group context, are directly comparable to normal market transactions.

(207) Those characteristics of the present case further confirm that the observation of the Commission in the *Groepsrentebox* decision – that with respect to debt financing activities, related companies are not in a legal and factual situation comparable to that of unrelated companies – cannot be generalised for situations where the objective of a tax ruling is to determine the tax base for the purposes of levying corporate income tax on that amount. The statement in the Circular on the comparability of the transactions mirrors the basic principles underlying the arm's length principle according to which commercial and financial relations between associated companies should not differ from relations which would be made between independent companies[97]. It is precisely the objective of transfer pricing rules that transactions between group/associated companies are compared to transactions between independent companies and any deviation needs to be corrected. On this basis, FFT's reliance on the *Groepsrentebox* decision is misplaced.

(208) The same conclusion holds for FFT's reliance to the *Hungarian group interest tax regime* decision. That decision concerned a scheme which had as its objective the reduction of arbitrage (in a domestic situation) through approximating the taxation of intra-group dividends and thus reinforcing the technical neutrality of the fiscal scheme.[98] The objective of reduction of arbitrage, which was considered at the time

94 *Groepsrentebox* decision, recital 101.

95 *Groepsrentebox* decision, recital 107.

96 The Circular states that "*[A]s regards intra-group financing companies, the functions they perform when they grant loans go group entities are, in substance, comparable to the functions performed by independent financial institutions, subject to the supervision of the 'Commission de Surveillance du Secteur Financier' (CSSF)*".

97 See Article 9 of the OECD Model Tax Convention.

98 In this case, the measure provided for the possibility to deduct from the tax base in Hungary 50 % of the amount of the net interest received from affiliated companies, which is the balance of interest received from affiliated companies less the interest paid to affiliated companies. Under the measure, half of the net interest received is taxed, while in the normal application of the tax system the whole amount would

by the Commission to arise primarily in a group context, is different from the objective underlying the present situation, which is to determine the taxable base of FFT in Luxembourg on which to apply corporate income tax. The latter objective does not differentiate between FFT being a group entity and any other (stand-alone) entity that turns to the Luxembourg tax authorities to have its tax base determined. Admittedly, in the case of FFT, the determination of the taxable base is more complicated, as it involves the application of transfer pricing rules and the arm's length principle, whereas in the case of a stand-alone company, the taxable income would in principle be equivalent to the accounting income, subject to possible adjustments based on tax law. However, the objective of the corporate income tax law as well as of the tax ruling is to tax all profits of companies subject to tax in Luxembourg, which applies irrespective of whether a corporate taxpayer is part of a group or not.

(209) The Commission therefore concludes that the reference system against which the contested ruling should be examined is the general Luxembourg corporate tax system in the form of the Luxembourg corporate income tax rules (IRC) as set out in recitals (193) to (208). In particular, that reference system is composed of a consistent set of rules that apply on the basis of objective criteria for the taxation of profits of stand-alone companies, where the determination of the taxable profit usually coincides with the accounting profit (subject to certain adjustments based on tax law) and group companies, which resort to transfer prices to allocate profits, alike. In light of the intrinsic objective of that system, both types of companies – non-integrated and integrated companies – should be considered to be in a similar factual and legal situation.

7.2.1.2. Article 164(3) L.I.R., the Circular and/or the relevant administrative practice do not constitute the appropriate reference system

(210) Luxembourg considers that the reference system should only comprise group companies that fall under Article 164(3) L.I.R.[99], whereas FFT seems to go further and considers that the reference system should be based on the Circular and only include group companies engaged in financing activities[100]. According to those views, the existence of selectivity would require evidence that FFT received a different treatment as compared to other group entities engaged in financing activities, which are in a similar factual and legal situation to FFT in light of the objectives of Article 164(3) L.I.R. and/or the Circular. The Commission should therefore have compared the contested tax ruling with the 21 other taxpayers whose advance pricing agreements were submitted to the Commission (see recital (8))[101]. Given that, according to Luxembourg and FFT, the treatment of FFT is in line with Article 164(3) L.I.R., the Circular and the relevant administrative practice, there is no selective advantage granted through the tax ruling.

(211) The Commission does not accept this line of reasoning.

---

be taxed. On the level of the affiliated company paying the net interest, 50 % of the amount of the net interest is added to the tax base, i.e. instead of a full deduction of the net interest paid under the normal tax system, companies only deduct half of this amount from their tax base. The scheme applied only to interest received from and paid to affiliated companies and it had as objective reducing the difference between equity and intra-group loan financing.

99 Luxembourg's observations to the Opening Decision, paragraph 73.

100 FFT's second set of comments, paragraphs 2.1.3. and 2.1.4.

101 FFT's first set of comments, paragraph 60.

(212) As explained in recital (198), the objective of the Luxembourg corporate income tax system is to tax the profits of all companies that fall under its tax jurisdiction, irrespective of whether those companies are integrated or non-integrated companies. As explained in recital (194), Luxembourg corporate income tax is levied on the worldwide profits of domestic companies and foreign companies resident in Luxembourg (unless a tax treaty applies), including Luxembourg branches of foreign companies, while non-resident companies are only taxed on specific Luxembourg-sourced income.

(213) By considering, as Luxembourg and FFT do, that the reference system only includes group companies, since only those companies need to revert to the arm's length pricing to determine their tax base, an artificial distinction is introduced between companies based on their company structure for the purposes of determining their taxable profits that the general Luxembourg corporate income tax system does not recognise when taxing the profits of companies falling within its tax jurisdicition.

(214) Similarly, FFT's distinction between groups and stand-alone companies based on the activities that the group entity carries out, by arguing that the reference system only includes those companies that apply the Circular, cannot be reconciled with the objective of the Luxembourg corporate income tax system. While it is true that FFT's activities relate almost exclusively to intra-group transactions[102], the financial transactions it carries out could equally be carried out outside a group context by independent financial institutions, as noted in the Circular. For the purposes of levying Luxembourg corporate income tax, FFT should therefore be compared to any other type of company, integrated or non-integrated, carrying out economic activities, since under Luxembourg corporate tax law the profits of independent financial institutions is subject to the same corporate income tax rules as the profits arising out of intra-group transactions, determined on the basis of the arm's length principle. The Commission therefore rejects FFT's argument that the reference system should only comprise group companies carrying out group-financing transactions.

(215) Accordingly, the Commission concludes that, in the present case, the reference system against which the contested tax ruling should be examined is the general Luxembourg corporate income tax system as set out in recitals (193) to (208), irrespective of whether corporate income tax is imposed on the profit of group or stand-alone companies and irrespective of the activities they carry out.

7.2.2. Selective advantage due to a derogation from the general Luxembourg corporate income tax system

(216) Having determined that the general Luxembourg corporate income tax system constitutes the reference system against which the contested ruling should be assessed, it is necessary to establish whether that ruling constitutes a derogation from that reference system, leading to unequal treatment between companies that are factually and legally in a similar situation.

(217) In relation to that second step of the selectivity analysis, whether a tax measure constitutes a derogation from the reference system will generally coincide with the identification of the advantage granted to the beneficiary under that measure. Indeed, where a tax measure results in an unjustified reduction of the tax liability of a beneficiary who would otherwise be subject to a higher level of tax under the

102 As noted at recital (206).

reference system, that reduction constitutes both the advantage granted by the tax measure and the derogation from the system of reference.

(218) According to the Court, in the case of an individual aid measure, as opposed to a scheme, "*the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective*"[103]. In the present case, the individual aid measure from which FFT benefits is the contested tax ruling, which endorses a methodology for determining its taxable profit in Luxembourg for the functions it performs within the Fiat group, which are subsequently taxed under the general Luxembourg corporate income tax system.

7.2.2.1. Selective advantage resulting from a deviation from the arm's length principle

(219) In principle, the function of a tax ruling is to establish in advance the application of the ordinary tax system to a particular case, given a set of facts and circumstances specific to that case, for a certain period of time and provided that there is no material change over the application of the ruling in that specific set of facts and circumstances. Where a tax ruling is based on a method of assessment that deviates from what would result from a normal application of the ordinary tax system without justification, that ruling will be considered to confer a selective advantage upon its beneficiary, in so far as that selective treatment results in the lowering of that beneficiary's tax liability in the Member State concerned as compared to companies in a similar legal and factual situation.

(220) An advantage pursuant to Article 107(1) of the TFEU is any economic benefit that an undertaking would not have obtained under normal market conditions, i.e. in the absence of the State intervention[104]. Thus, whenever the financial situation of an undertaking is improved as a result of a State intervention, an advantage is present.[105] Such improvement is shown by comparing the financial situation of the undertaking as a result of the contested measure with the financial situation of that undertaking had the measure not been granted[106]. An advantage can consist both in the granting of positive economic advantages as well as in the mitigation of charges normally included in the budget of an undertaking[107].

---

103 See Case C-15/14 P *Commission v MOL* ECLI:EU:C:2015:362, paragraph 60; see also, Case T-385/12 *Orange v Commission* ECLI:EU:T:2015:117.

104 Case C-39/94 *SFEI and Others* ECLI:EU:C:1996:285, paragraph 60; Case C-342/96 *Spain v Commission* ECLI:EU:C:1999:210, paragraph 41.

105 This advantage does not have to be "out of proportion" as FFT argues in its observations (paragraphs 1.7.1 and 1.7.2.) Any advantage is sufficient to constitute State aid, provided the other conditions of Article 107(1) of the Treaty are met. The *Umicore* decision (Commission decision of 26.5.2010 on State aid granted to Umicore S.A., C 76/2003 (ex NN 68/2003)) quoted by FFT is irrelevant to the present case given the fact that the Commission is not bound by its decisional practice (see recital (202)). In any event, the difference between the present case and the Umicore case does not allow parallels to be drawn between those two cases. The Umicore case concerned the application of VAT exemptions by Umicore in the context of certain sales of silver to undertakings established in other Member States. In December 2000, the Belgian tax authorities' Special Tax Inspectorate (*Inspection Spéciale des Impôts-ISI*) reached a settlement agreement with the company. This type of settlement was administrative practice by the Belgian tax authorities but only to the extent that the settlement related to the facts of the case and not to the level of taxation: "*Néanmoins, conformément à l'article 84, CTVA, de tells transactions ne sont possibles que dans la mesure où elles n'impliquent pas exemption ou moderation d'impôt. En application de ce principe, une transaction ne peut donc pas porter sur le montant de la taxe résultant de faits établis, mais bien sur des questions de fait*" (paragraph 154).

106 See Case 173/73 *Italy v Commission* ECLI:EU:C:1974:71, paragraph 13.

107 See, for instance, Case C-387/92 *Banco Exterior de Espana* ECLI:EU:C:1994:100.

(221) As explained in recitals (52) et seq., by the contested tax ruling, Luxembourg accepted a methodology for determining FFT's taxable profit in Luxembourg, as proposed by the latter's tax advisor in the transfer pricing report, which allows FFT to determine its corporate income tax liability in Luxembourg on a yearly basis for the period during which that ruling is valid. More specifically, the transfer pricing report endorsed by the contested tax ruling determines, in the absence of transactions dictated by the market as would exist for a non-integrated independent company, the profit to be allocated to that company of the Fiat group and which translates into the pricing of the transactions it concludes with the other group companies of the Fiat group.

(222) The Court of Justice has already held that a reduction in the taxable base that results from a tax measure that enables a taxpayer to employ transfer prices in intra-group transactions that do not resemble prices which would be charged in conditions of free competition between independent undertakings negotiating under comparable circumstances at arm's length confers a selective advantage on that taxpayer, by virtue of the fact that its tax liability under the ordinary tax system is reduced as compared to independent companies which rely on their accounting profits to determine their taxable base[108].

(223) In its judgment on the Belgian tax regime for coordination centres[109], the Court of Justice assessed a challenge to a Commission decision which concluded, *inter alia*, that the method for determining taxable income under that regime conferred a selective advantage on those centres[110]. Under that regime, taxable profits were set at a flat-rate amount which represented a percentage of the full amount of operating costs and expenses, from which staff costs and financial charges were excluded. According to the Court, "*in order to decide whether a method of assessment of taxable income such as that laid down under the regime for coordination centres confers an advantage on them, it is necessary, […], to compare that regime with the ordinary tax system, based on the difference between profits and outgoings of an undertaking carrying on its activities in conditions of free competition.*" The Court then held that "*the effect of the exclusion of [staff costs and the financial costs] from the expenditure which serves to determine the taxable income of the centres is that the transfer prices do not resemble those which would be charged in conditions of free competition*", which the Court found to "*[confer] an advantage on the coordination centres*"[111].

(224) The Court has thus accepted that a tax measure which results in a group company charging transfer prices that do not reflect those which would be charged in conditions of free competition, that is prices negotiated by independent undertakings negotiating under comparable circumstances at arm's length, confers an advantage on that group company, in so far as it results in a reduction of its taxable base and thus its tax liability under the ordinary corporate income tax system.

108 See Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 v. Commission ASBL* ECLI:EU:C:2006:416.

109 See Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 v. Commission ASBL* ECLI:EU:C:2006:416.

110 Commission Decision 2003/757/EC of 17 February 2003 on the aid scheme implemented by Belgium for coordination centres established in Belgium; OJ 2003 L 282, p. 25.

111 See Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 ASBL v. Commission*, ECLI:EU:C:2006:416, paragraphs 96 and 97.

(225) The principle that transactions between intra-group companies should be remunerated as if they were agreed to by independent companies negotiating under comparable circumstances at arm's length is generally referred to as the "arm's length principle". In the Belgian coordination centres judgment, the Court of Justice endorsed the arm's length principle as the benchmark for establishing whether a group company receives an advantage for the purposes of Article 107(1) of the TFEU as a result of a tax measure that determines its transfer pricing and thus its taxable base.

(226) The purpose of the arm's length principle is to ensure that transactions between group companies are treated for tax purposes by reference to the amount of profit that would have arisen if the same transactions had been executed by independent companies. Otherwise, group companies would benefit from a favourable treatment under the ordinary corporate income tax system when it comes to the determination of their taxable profits that is not available to independent companies, leading to unequal treatment between companies that are factually and legally in a similar situation in light of the objective of such a system, which is to tax the profits of all companies falling under its tax jurisdiction.

(227) The Commission's assessment of whether Luxembourg granted a selective advantage to FFT must therefore consist in verifying whether the methodology accepted by the Luxembourg tax administration by way of the contested ruling for the determination of FFT's taxable profits in Luxembourg departs from a methodology that leads to a reliable approximation of a market-based outcome and thus from the arm's length principle. In so far as the methodology Luxembourg accepted by the contested tax ruling results in a lowering of FFT's tax liability under the general Luxembourg corporate income tax system as compared to non-integrated companies whose taxable profit under that system is determined by the market, that ruling will be deemed to confer a selective advantage to FFT for the purposes of Article 107(1) of the TFEU.

(228) The arm's length principle therefore necessarily forms part of the Commission's assessment under Article 107(1) of the TFEU of tax measures granted to group companies, independently of whether a Member State has incorporated this principle into its national legal system. It is used to establish whether the taxable profits of a group company for corporate income tax purposes has been determined on the basis of a methodology that approximates market conditions, so that that company is not treated favourably under the general corporate income tax system as compared to non-integrated companies whose taxable profit is determined by the market. Thus, for any avoidance of doubt, the arm's length principle that the Commission applies in its State aid assessment is not that derived from Article 9 of the OECD Model Tax Convention, which is a non-binding instrument, but is a general principle of equal treatment in taxation falling within the application of Article 107(1) of the TFEU, which binds the Member States and from whose scope the national tax rules are not excluded[112].

(229) Consequently, in response to Luxemburg's argument that the Commission, in undertaking such an assessment, replaces the national tax authorities in the interpretation of Luxembourg law[113], the Commission recalls that is not examining

[112] See Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 v. Commission ASBL* ECLI:EU:C:2006:416, paragraph 81.

[113] Observations of Luxembourg to the Opening Decision, paragraphs 38 to 40.

whether the contested ruling complies with the arm's length principle as laid down in Article 164(3) L.I.R. or the Circular, but whether the Luxembourg tax administration conferred a selective advantage on FFT for the purposes of Article 107(1) of the TFEU by issuing a tax ruling that endorses a profit allocation that departs from the amount of profit that would have been taxed under the general Luxembourg corporate income tax system if the same transactions had been executed by independent companies negotiating under comparable circumstances at arm's length.

(230) Finally, in response to the argument of Luxembourg and FFT that, because transfer pricing is not an exact science, the assessment by the Commission of the transfer pricing arrangement agreed in the contested tax ruling should necessarily be limited, the Commission recalls that the approximation component of transfer pricing has to viewed in the light of its objective. While the OECD TP Guidelines do indeed acknowledge that transfer pricing is not an exact science in paragraph 1.13 thereof, that same point first explains that "*[i]t is important not to lose sight of the objective to find a reasonable estimate of an arm's length outcome based on reliable information*". The objective of the OECD TP Guidelines is to develop, for the benefit of tax administrations and multinational enterprises, the most appropriate methods for estimating arm's length prices of cross-border transactions between associated enterprises for taxation purposes. The pursuit of that objective would be impossible if the approximative nature of the transfer pricing exercise could be used to disregard the consensus on appropriate transfer pricing methodologies which those guidelines represent. The approximative nature of the arm's length principle can therefore not be invoked to justify a transfer pricing analysis that is either methodologically inconsistent or based on an inadequate comparables selection.

(231) In conclusion, if it can be shown that the methodology accepted by the Luxembourg tax administration by way of the contested ruling for the determination of FFT's taxable profits in Luxembourg departs from a methodology that leads to a reliable approximation of a market-based outcome and thus from the arm's length principle, that ruling will be found to confer a selective advantage on FFT for the purposes of Article 107(1) of the TFEU, in so far as it leads to a lowering of FFT's tax liability under the general Luxembourg corporate income tax system as compared to non-integrated companies whose tax base is determined by the profits they generate under market conditions.

7.2.2.2. Preliminary observation: doubt expressed on the existence of a fixed tax base

(232) The first doubt expressed by the Commission in the Opening Decision was that FFT's tax base as agreed to by the contested tax ruling appeared to constitute a fixed range. In addition, the documents submitted during the formal investigation show that FFT's tax base had been fixed at EUR 2 million annually before the contested tax ruling was issued. Although the Circular required FFT to renew its previous ruling request on the basis of a transfer pricing report, the transfer pricing report prepared for the contested tax ruling reached an outcome in terms of tax base, which is practically identical to the previously agreed lump sum amount.

(233) However, on the basis of a clarification provided by Luxembourg during the administrative procedure, explaining that the contested tax ruling agrees on a methodology and not on a fixed range[114], as well as data demonstrating that for 2012 and 2013 FFT's tax base was lower than the lower bound of the range that was

114 See recital (102).

allegedly agreed in that ruling[115], the Commission considers that doubt to have been adequately resolved.

7.2.2.3. Methodological choices, parameters and adjustments underlying the contested tax ruling

(234) The contested tax ruling accepts a methodology for determining a profit allocation to FFT, which is based on a transfer pricing analysis prepared by the latter's tax advisor that calculates a remuneration for the intra-group financing and treasury functions performed and the risk borne by FFT.

(235) Several methodological choices underlie that transfer pricing analysis: (i) the choice to use the TNMM to estimate FFT's taxable profit in Luxembourg; (ii) the choice of capital as profit level indicator in the application of the TNMM; (iii) the choice of the Basel II framework to calculate that capital and (iv) the choice of the CAPM based on equity prices to determine a required return on that capital.

(236) As explained in the following sections, in recitals (241) to (301), choice (i) is a choice between the five methods described and discussed in detail in the OECD Guidelines. The OECD Guidelines also discuss choice (ii) of a profit level indicator when using the TNMM. However, subsequent methodological choices (iii) and (iv) are not covered by the OECD Guidelines.

(237) FFT's tax advisor then proceeds to a selection of several parameters, i.e. actual figures, for use in estimating the amount of capital to be remunerated (in relation to choice (iii)) and the level of required return to be applied to that capital (in relation to choice (iv)). As regards the amount of capital to be remunerated, the tax advisor selects parameters for the risk weighting and the minimum capital requirement to estimate FFT's hypothetical regulatory capital. As regards the level of required return to be applied to that capital, the tax advisor selects parameters for a risk-free rate, a beta and a market premium that are required for using the CAPM[116].

(238) Finally, the tax advisor chooses to disregard FFT's total level of equity for the purposes of calculating an arm's length remuneration, by deducting from that equity FFT's participations in FFNA and FFC and calculating on that remaining amount a remuneration for the functions performed[117]. Those choices, however, do not seem to be a choice of parameters. Rather, they seem to introduce adjustments in the methodology for determining profit allocation to FFT which do not correspond to any commonly used methods.

(239) Based on these methodological choices, choices of parameters for their implementation and […] adjustments, the tax advisor arrives at a level of remuneration for FFT's intra-group financing and treasury activity that is accepted by the contested tax ruling as respecting the Circular and the arm's length principle.

(240) In the following sections, in recitals (241) to (301), the Commission will explain why it considers several of those methodological choices, choices of parameters and […] adjustments to result in a lowering of FFT's tax liability under the general Luxembourg corporate income tax system as compared to non-integrated companies whose taxable profits are determined by transactions concluded on market terms and, thus, that the contested tax ruling, by accepting those choices and adjustments,

115 See Table 7.
116 See recital (64).
117 See recital (70).

confers a selective advantage on FFT for the purposes of Article 107(1) of the TFEU by deviating from the arm's length principle.

7.2.2.4. The choice of the TNMM and the functional analysis in the transfer pricing report

(241) As regards choice (i), the remuneration accepted by the contested tax ruling for the functions performed and the risk borne by FFT is estimated by the tax advisor by using the TNMM[118]. That choice is a choice of one of the five methods described and discussed in detail in the OECD TP Guidelines. As a general matter, the OECD TP Guidelines require that the most appropriate method is aimed at when estimating an arm's length price in the context of transfer pricing[119].

(242) The use of a method further requires the use of one or more parameters, so that the method can result in an actual outcome. The choice of method and the choice of parameters cannot be an arbitrary choice. Leaving those choices to the sole discretion of the taxpayer would advantage integrated cross-border groups over companies that transact on the market, the former being given the choice of method and parameters for pricing intra-group transactions to determine their tax base, while the latter transact on market terms without any possibility to adjust their tax base. Those choices must therefore be guided by the objective of achieving an arm's length price for intra-group transactions.

(243) However, when estimating an arm's length price for transfer pricing purposes, the use of a second-best method does not automatically give rise to an advantage for integrated cross-border groups. For example, where such a method is chosen, but that method is used in combination with an overly conservative set of parameters, the remuneration arrived at might nevertheless result in an outcome which is in that specific case equal to a market-based outcome or it might result in an overestimated tax burden, in which case a tax ruling accepting that second-best method would not give rise to an advantage for the purposes of Article 107(1) of the TFEU.

(244) By contrast, even if the most appropriate method is chosen, when it is used in combination with overly favourable parameters the remuneration arrived at using that method might nevertheless underestimate the tax liability of the taxpayer and thus give rise to an advantage for the purposes of Article 107(1) of the TFEU.

(245) In the Opening Decision, the Commission expressed a doubt that the TNMM might not be the most appropriate method for determining an arm's length remuneration and thus the taxable profit of FFT. Compared to the other four methods described in the OECD TP Guidelines, the CUP method is more direct and would, if applicable, provide for a more reliable approximation of a market-based outcome.

(246) However, in light of the information submitted in the course of the formal investigation procedure, the Commission accepts FFT's argument that the CUP method might not be the most appropriate method in the case of FFT. That information shows that FFT concludes transactions with different counterparties of the Fiat group and that the applicable rates, the form and the maturity of the loans

---

118 For a description of the TNMM, see recital (91).

119 The Commission does not accept FFT's argument in recital (162) that the fact that the TNMM is relied upon with increasing frequency would justify its use. This argument is in contradiction with the reference made by FFT to paragraph 2.2 of the OECD Guidelines, as reported in recital (161), which states "*the selection of a transfer pricing method always aims at finding the most appropriate method for a particular case*." This objective of the OECD Guidelines is not compatible with the interpretation that the taxpayer would have a free choice of methods, notwithstanding the facts and circumstances of the case.

provided and the bonds issued by FFT vary, even if the seniority of the transactions does not seem to differ. Consequently, since using the CUP method for transfer pricing purposes would require finding comparable transactions for each individual loan FFT provides, the tax advisor's use of the TNMM to estimate an arm's length remuneration for the functions performed and the risk borne by FFT appears appropriate.

(247) Moreover, the Commission recognises that the transfer pricing analysis for FFT is based on a return on capital, which is an acceptable performance indicator for the financial industry, and that FFT's functions are comparable to financial institutions. Indeed, the complexity of FFT's asset and liability structure confirms that it ensures a maturity transformation function, as well as a financial intermediation function, since FFT calls upon external investors for the funding of the group financing needs[120]. Thus, the Commission considers the use of the TNMM for transfer pricing purposes in the case of FFT to be an appropriate choice.

7.2.2.5. The amount of capital to be remunerated

(248) While the Commission considers the tax advisor's use of the TNMM in the case of FFT to be appropriate, the Commission considers several of the methodological choices, choices of parameters and […] adjustments employed by the tax advisor in the application of that method inappropriate for calculating FFT's tax base in Luxembourg.

7.2.2.6. The use of FFT's hypothetical regulatory capital as profit level indicator

(249) First and foremost, the Commission does not consider the tax advisor's choice of regulatory capital as an appropriate profit level indicator in the application of the TNMM for estimating an arm's length remuneration for the functions performed by FFT. Instead, the Commission considers that the tax advisor's choice of the TNMM, in combination with its use of a return on equity estimated through the CAPM, necessitates that FFT's accounting equity is used as the profit level indicator against which a return on equity is applied to calculate that remuneration if the outcome is to result in a reliable approximation of a market-based outcome.

(250) More specifically, to ensure that FFT's tax base reflects a reliable approximation of a market-based outcome in line with the arm's length principle, the method used to arrive at an arm's length remuneration for the functions it performs should be methodologically consistent from an accounting perspective, which the choices made by the tax advisor are not.

(251) In the transfer pricing report, FFT's estimated tax base is said to consist of two components: a "risk remuneration" and a "functions remuneration"[121]. The tax advisor determines the first component, FFT's risk remuneration, by multiplying an estimated amount of capital to be remunerated, which the tax advisor estimates by calculating FFT's hypothetical regulatory capital using the Basel II framework by

120 This contrasts with the situation where, although engaging in intra-group loans, a company limits its functions to back-to-back transactions, for which a standalone company would not accept to remunerate a third party, because such transactions do not have any economic rationale in isolation of other functions and operations (i.e. back-to-back transactions can be used for hedging risks stemming from a different activity). Therefore, such transactions, as well as other functions which cannot be compared to the principal functions of a financial institution, might not be correctly priced based on capital, as in other industries different indicators, such as return on total assets or return on sales might be more appropriate.

121 See recital (70).

analogy[122], by an estimated required return on that capital, which the tax advisor estimates by using the CAPM.

(252) However, the CAPM estimates a theoretical required rate of return on equity investments and the beta used in that calculation is based on a variation of the return on companies' share price (or returns on equity)[123]. Therefore, the result of a CAPM calculation is by construction a return on equity, rather than a return on any other capital measure, such as a hypothetical regulatory determined through an application of the Basel II framework by analogy [124].

(253) A return on equity is a profitability ratio. Equity is remunerated through the net profits of a company, that is, income minus all charges incurred in the course of the business, but also all financial charges paid to debt holders. That net profit is thus the profit left to the company to remunerate equity holders: it constitutes a return on equity either through distribution or through increased value of the company. It is therefore a matter of consistency that return on equity is equal to the net profit in accounting terms left to shareholders after all other charges have been paid, divided by the value of the shares in accounting terms (i.e. equity) that that profit is remunerating.

(254) By contrast, it is inconsistent to consider the accounting net profit of the company to remunerate regulatory capital. Regulatory capital is the estimate of a regulator of a minimum capitalisation level to be maintained by a bank or other financial institution; it does not constitute, as such, a claim in that proportion to the profits of the regulated entity. Moreover, financial institutions must hold this level of capital at all times, so that, in practice, they generally hold more than the capital required as a buffer to avoid breaching minimum regulatory requirements in case of losses, which in turn reduces available capital. Any capital additional to the minimum required needs to be equally remunerated from the perspective of investors.

(255) Consequently, to ensure methodologically consistency from an accounting perspective, and thus a reliable approximation of a market-based outcome, FFT's tax advisor should have applied the return on equity it calculated using the CAPM to FFT's accounting equity. The green arrows in table below illustrate which approaches would be methodologically consistent; the diagonal arrow demonstrates the approach used by FFT's tax advisor:

Return measures	**Capital bases**
Return on Equity (RoE) = Profit / IFRS equity *Estimated by FFT using CAPM with β based on a sample of 66 companies*	IFRS equity *Available from FFT's balance sheet*
Return on regulatory capital = Profit / Regulatory capital *No estimates available*	Basel II regulatory capital *proxy of regulatory capital albeit incorrectly estimated was provided by FFT*

122 See recital (58) and (59).

123 See also recital (68) of the Opening Decision.

124 For further illustration of differences between different profit indicators based on capital see, for example, McKinsey Working Papers on Risk, Number 24, The use of economic capital in performance management for banks, January 2011, in particular Exhibit 10 on page 13.

(256) By applying an inconsistent methodology, consisting of applying a return on equity to FFT's hypothetical regulatory capital, FFT's tax advisor arrives at an estimated level of remuneration for the functions performed and the risks borne by FFT that does not constitute a reliable approximation of a market-based outcome. Indeed, the consequence of the tax advisor's mismatch has a significant impact on FFT's taxable remuneration in Luxembourg. In 2011, FFT's accounting equity was EUR 287.5 million, whereas the tax advisor uses FFT's hypothetical regulatory capital of EUR 28.5 million as profit level indicator in the application of the TNMM. Applying the estimated return on equity the tax advisor arrives at using the CAPM to FFT's hypothetical regulatory capital instead of its accounting equity results in a lowering of FFT's taxable remuneration in Luxembourg by a factor of ten[125]. In other words, the methodological choices made by the tax advisor result in a lowering of FFT's tax base in Luxembourg as compared to non-integrated companies whose taxable profits is determined by market conditions.

(257) Since FFT's equity level is observable and the CAPM provides for an estimate of return on equity, the tax advisor should have used FFT's accounting equity in the application of the TNMM, instead of a hypothetical level of its regulatory capital, to determine FFT's Luxembourg tax base in line with the arm's length principle.

(258) The Commission rejects FFT's argument in this respect that its actual level of equity should be disregarded for transfer pricing purposes because it results from historical decisions[126]. That argument implies that the level of FFT's accounting equity would be too high for historical reasons and need not be remunerated to that extent. That argument is, however, not in line with market requirements, as a suboptimal level of equity is not sustainable in a competitive market. In fact, equity is more expensive for companies to remunerate than debt and therefore if a company in conditions of free competition would be overcapitalised for historical reasons, such as claimed by FFT, that company would return the excess equity to its shareholders (for example through share buy-backs or distribution), because such funds could be deployed more efficiently in alternative investment opportunities. When calculating the tax base of companies in conditions of free competition, such companies are required to remunerate the entirety of their capital provided by shareholders at a level which can be considered in line with market requirements.

(259) The OECD TP Guidelines, for their part, indicate that return on capital may be an appropriate profit level indicator for the application of the TNMM in capital intensive financial activities[127]. The OECD TP Guidelines further refer to "capital employed" as a possible appropriate profit level indicator in the application of the TNMM[128]. Although "capital employed" is not more precisely defined in the OECD TP Guidelines, it does not appear to correspond to a regulatory capital denomination used in the Basel II or Basel III frameworks, or the respective transposing directives.

(260) The Circular also does not further define the capital to be used as a profit level indicator in the application of the TNMM[129]. The Circular specifies two possible

[125] In the transfer pricing report, the tax advisor arrives at a risk remuneration of EUR 1 726 000, whereas applying the return on equity calculated by the tax advisor of 6.05 % to FFT's accounting equity would result in a risk remuneration of EUR 17 392 000.

[126] Recital (163).

[127] See paragraph 2.97 of the OECD Guidelines.

[128] See paragraph 2.86 of the OECD Guidelines.

[129] The Circular notes that service providers covered by the Circular would be in essence performing functions similar to functions performed by regulated institutions. The Circular also refers to possible

bases for remuneration of financing and treasury functions, which are the loan value and the amounts of assets under management[130]. However, by choosing the TNMM with a hypothetical regulatory capital as a base, FFT does not opt for a remuneration directly based on the value of loans, while assets under management refers to assets held in the name of third parties (for example by fund managers), which is a function that FFT does not in principle assume.

(261) In any event, while accounting equity is commonly used in the financial sector as a base for calculating a company's profitability, the Commission accepts that a different capital base could, in principle, be used for the application of the TNMM for transfer pricing purposes, so long as the methodology used to arrive at a remuneration for intra-group transactions is consistent. However, in the specific case of FFT, the Commission considers the tax advisor's choice of FFT's hypothetical regulatory capital for this purpose to be inappropriate for arriving at a reliable approximation of a market-based outcome for the following reasons.

(262) Firstly, FFT is not a regulated financial entity to which the Basel II framework applies, so that the application of that framework to estimate its hypothetical regulatory capital is difficult to verify when used only for tax purposes. Indeed, the Basel II framework defines required regulatory capital as a proportion of assets held by the institution weighted by the underlying risk of each such asset. Concretely, the risk-weighting of each asset for that regulatory purpose depends, in particular, on the credit rating of the counterparty, but also on other criteria assessed asset by asset. The burden of the administration for verifying individual asset risk weighting is removed from its prudential supervision context when used to calculate the tax base for transfer pricing purposes instead of minimum capital requirements. It is therefore unlikely that any outcome arrived at as a result of that exercise can be easily verified by the tax administration as constituting a reliable approximation of a market-based outcome in line with the arm's length principle.

(263) Secondly, as return on minimum regulatory capital is not a commonly used performance indicator in the financial sector, averages of return on minimum regulatory capital in the industry are not commonly analysed and available[131]. Therefore, any outcome arrived at using that capital base would be less likely to result in a reliable approximation of a market-based outcome than the use of accounting equity as a profit level indicator against which a return on equity in line with industry standards is applied.

(264) Thirdly, the 66 comparables selected by the tax advisor for estimating a return on equity using the CAPM are clearly inadequate for estimating average regulatory capital in the industry or the required return on that capital, since several of those

---

add-on to costs of credit relating to the obligation to respect solvency requirements. However the Circulaire does not limit capital to be remunerated to such solvency requirements.

130 See recital (81).

131 The use of return on regulatory capital is made more difficult in practice because of the different type of regulatory capital held by regulated institutions, such as Tier 1 and Tier 2 capital, whereas the only capital type that FFT has is equity. This complexity is increased under the Basel III framework. Regulated financial institutions do not typically report the amount of the minimum regulatory capital, although it can be indirectly recalculated. Rather, they report the actual level of regulatory capital they hold, which is always higher than the minimum required. Finally, risk-adjusted return on capital, which at an aggregate level could be seen as similar to a return on regulatory capital, is sometimes used by regulated institutions for internal pricing purposes. However, in that case, it is used asset by asset rather than as a profit indicator for the institution in aggregate and it is also therefore not disclosed in principle.

companies are not regulated entities falling under the Basel frameworks (such as stock exchanges), so that those companies might not in fact calculate an estimate of their regulatory capital requirement and it would be impossible to estimate minimum regulatory requirements for individual unregulated institutions on the basis of publically disclosed information alone.

(265) Moreover, using accounting equity as profit level indicator in the present case would have obviated the need for the tax advisor to calculate a separate "functions remuneration", the second component of FFT's estimated tax base in Luxembourg, which itself does not appear to be based on any sound methodology, as explained in recital (80) of the Opening Decision. Indeed, what FFT's tax advisor designates as the "Capital used to perform functions" in the transfer pricing report does not seem to correspond to any customary capital component used in the calculation of return requirements in market valuation. This concept is not defined in the transfer pricing report and there is no indication that such a risk based on the denomination used by the tax advisor would not be covered by either of the categories of regulatory capital, for example, capital to cover operational risk, and in particular risk related to process, if FFT's hypothetical regulatory capital would have been correctly estimated by the tax advisor, which is not the case. Further concerns regarding the separation of the capital into distinct components to which different levels of return, as low as zero, are applied is detailed below, in recitals (277) to (289).

(266) The Commission therefore concludes that the contested tax ruling, by accepting the tax advisor's use of FFT's hypothetical regulatory capital as a profit level indicator in the application of the TNMM, to which a return on equity estimated by using the CAPM has been applied to arrive at a component of FFT's taxable profits in Luxembourg, departs from a market-based outcome in line with the arm's length principle. Since that methodological choice results in a lowering of FFT's tax liability under the general Luxembourg corporate income tax system as compared to non-integrated companies which transact on market terms[132], the contested tax ruling should be considered to grant a selective advantage to FFT for the purposes of Article 107(1) of the TFEU.

7.2.2.7. The inconsistent application of the Basel II framework to calculate that capital

(267) In addition, and without prejudice to the Commission's objections to the use of FFT's hypothetical regulatory capital in the application of the TNMM, the Commission further considers that the inconsistent manner in which FFT's tax advisor applied the Basel II framework by analogy to arrive at that hypothetical level of regulatory capital confers a selective advantage on FFT for the purposes of Article 107(1) of the TFEU, since it also results in a lowering of FFT's tax liability under the general Luxembourg corporate income tax system as compared to non-integrated companies which transact on market terms.

(268) A proper application of the Basel II framework requires, first, an estimate of FFT's RWAs and, then, applying an appropriate regulatory capital ratio to that estimate. FFT's tax advisor underestimates both elements in the transfer pricing report.

(269) Firstly, FFT's hypothetical RWAs have been miscalculated, since the tax advisor allocates a zero risk weight for intra-group assets[133]. As is clear from recital (123), the intra-group loans representing most of FFT's assets are not without risk, contrary

[132] See recital (256).
[133] See Table 6.

to what Luxembourg and FFT claim, and there is no indication that those loans have a lower risk than loans provided by banks. In any event, considering Fiat's own Transfer Pricing Policy document qualifies FFT's credit and counterparty risk as "limited" rather than non-existent, a zero risk-weighting is clearly inappropriate. In addition, FFT's hypothetical RWAs have been miscalculated since the risk weighting of 20% for third party assets was never substantiated, either by Luxembourg or FFT.

(270) Applying the average European risk weighting over assets of banks of 36 % in 2010 as a relevant comparator[134] (which was available when the contested tax ruling was issued) to FFT's total assets of EUR 14 827 674 000, to illustrate what the correct level of FFT's hypothetical RWAs could have been, FFT's hypothetical RWAs would have been around EUR 5 338 000 000. If the 8 % capital requirement ratio under the Basel II framework had been retained as a minimum capitalisation level, FFT's hypothetical Basel II minimum level of regulatory capital would have been around EUR 427 million, rather than the minimum capital estimated by FFT's tax advisor in the transfer pricing report of EUR 28.5 million.

(271) Secondly, the tax advisor's calculation of FFT's credit and counterparty risk by analogy to the Basel II framework[135], on the basis of which banks are required to hold capital in proportion of their RWAs, is at variance with that framework. For the purposes of determining FFT's capital at risk in the transfer pricing analysis, FFT's tax advisor uses a 6 % capital ratio requirement in the calculation of those risks, whereas the correct ratio under that framework is 8 %.

(272) In response to the doubt expressed by the Commission on this point in the Opening Decision[136], FFT responded by justifying the use of 6 % in reference to the transposition in Italy of the requirement to non-bank financial institutions.[137] However, FFT provided no further reference to that transposition, nor has it clarified why a transposition by the Italian legislator would be applicable in Luxembourg or be used as a reference.

(273) Moreover, while under the Basel II framework half of the 8 % requirement could be provided in the form of Tier 2 capital, FFT does not seem to have any Tier 2 capital which could have been used for the regulatory requirement, had that requirement been applied. In the absence of other eligible forms of capital available, the 8 % would have had to be covered by equity.

(274) The Commission therefore maintains its view that the capital requirement ratio under the Basel II framework is 8 % and that the tax advisor's use of 6 % and its acceptance by the Luxembourg tax administration calls into question the conclusion reached in the contested ruling that the resulting profit allocation to FFT reflects a reliable approximation of a market-based outcome in line with the arm's length principle.

(275) Finally, as regards the tax advisor's calculation of the operating risk, while the Commission accepts the use of the figure of 15 % based on the clarifications provided by FFT[138] and Luxembourg[139], the base to which that 15 % margin is

---

[134] IMF WP/12/36, How Risky Are Banks' Risk Weighted Assets? Sonali Das and Amadou N.R. Sy, 2012, p. 6.

[135] Recitals (58) and (59).

[136] Opening Decision, recital (72).

[137] Recital (167).

[138] See recital (167).

[139] See recital (98).

applied does not seem to correspond to a correct estimation of the gross annual income of FFT. FFT's tax advisor applies that percentage to the net income stemming from bank deposits and loans only[140], which is not in line with the methodology put forward by Luxembourg[141], whereas all intra-group business is ignored for the purposes of calculating FFT's gross income. However, loans and deposits with banks represent only a small part of FFT's assets and liabilities.

(276) In sum, the Commission concludes that even if FFT's hypothetical minimum regulatory capital would have been acceptable as a profit level indicator for the application of the TNMM, the tax advisor underestimated that capital by using an arbitrary and low risk weighting on the assets (excluding most assets from the risk weighting), by applying a lower ratio than the minimum prescribed by the Basel II framework and by not including income from group assets and liabilities in FFT's gross income. The Commission therefore concludes that the contested tax ruling, by accepting those choices, departs from a market-based outcome in line with the arm's length principle. Since those choices lead to a reduction of FFT's tax liability under the general Luxembourg corporate income tax system as compared to non-integrated companies which transact on market terms, the contested tax ruling should be considered to grant a selective advantage to FFT for the purposes of Article 107(1) of the TFEU.

7.2.2.8. Inappropriate deductions from the capital to be remunerated

(277) In addition to underestimating FFT's hypothetical regulatory capital, the tax advisor engages in several deductions from FFT's remaining capital that depart from a market-based outcome. As follows from Table 2, to arrive at an amount the tax advisor designates as "Equity backing the functions performed", FFT's remaining equity, less its underestimated hypothetical regulatory capital, is reduced by what the tax advisor designates as FFT's "Equity supporting the financial investments in FFNA and FFC". However, had FFT's hypothetical regulatory capital been correctly estimated, it is likely that no capital in excess of regulatory capital would have been found[142]. Therefore, neither of those two estimated equity components would have been applicable.

(278) Notwithstanding this observation, the Commission further considers that the tax advisor's decision to isolate the equity component designated as "Equity supporting the financial investments in FFNA and FFC" and to accord it a zero remuneration for the purpose of estimating FFT's tax base is inappropriate[143], since it leads to a reduction of FFT's tax liability under the general Luxembourg corporate income tax system as compared to non-integrated companies which transact on market terms.

(279) As a preliminary observation, it is not clear whether the tax advisor choice to separate the two equity components is an alleged application of the Basel II framework or whether the tax advisor's deduction of FFT's participation interests in FFNA and FFC was an ad hoc adjustment, which the tax advisor would also have deducted from FFT's equity for the purpose of calculating FFT's tax base if it had properly chosen FFT's accounting equity as profit level indicator for the application

---

140 See recital (58).

141 See recital (98).

142 In absence of sufficient data for calculating a correct estimate of FFT's regulatory minimum capital, the industry average would have resulted in a minimum regulatory capital of EUR 427 million, see recital (270), which is above FFT's total equity of EUR 287 million.

143 See recital (69) and Table 1.

of the TNMM. That is because, as explained at recital (238), the tax advisor does not seem to rely on any commonly used methodology when separating FFT's equity into three components[144].

(280) In any event, for the reasons given in recitals (281) to (290), the tax advisor's choice to accord that portion of FFT's equity designated as the "Equity supporting the financial investments in FFNA and FFC" a zero remuneration is inappropriate. Since that choice effectively leads to an unjustified deduction from the capital to be remunerated, and thus from FFT's tax base for taxation purposes, any transfer pricing methodology based on that choice cannot be considered to result in a reliable approximation of a market-based outcome in line with the arm's length principle.

(281) Firstly, Luxembourg's arguments regarding the deductibility of the participations in other credit institutions under the Basel II framework are not applicable to the case of FFT[145]. That is not only because, as noted in recital (262), FFT is not a regulated institution, but also because the paragraphs from that framework, referred to by Luxembourg and FFT, apply to non-consolidated entities, whereas, in the present case, FFNA and FFC are consolidated entities. Indeed, as explained in recital (112), FFT provides consolidated accounts to Luxembourg. In principle, consolidated equity would be higher than the equity in FFT's unconsolidated accounts before any deductions for participations would be made. Consequently, if Luxembourg and Fiat had properly and systematically applied regulatory deductions, the capital estimate to which the return on equity would have been applicable would have been higher and, therefore, FFT's resulting tax base in Luxembourg would have been higher.

(282) Secondly, and more generally regarding deductions to equity in the context of the Basel II framework and in the context of assessing FFT's accounting equity, Luxembourg's argument that FFT's acquisition of the participations was financed entirely through own funds[146], a mode of financing which would automatically mean that those funds are no longer available to cover other risks borne by FFT, cannot be accepted by the Commission. Sources of funding, be it equity or debt on the liabilities side of the balance sheet, are not attributed or dedicated to an identifiable asset, unless specific legal provisions bind the liability to a specific asset or pool of assets (this is for example the case of covered bonds). If no specific claims are attached to the liabilities of the company, equity and liabilities contribute jointly to the funding of the assets of a company. In a case of insolvency, those funds would be available to absorb losses stemming from the assets of FFT, contrary to Luxembourg's argument above. The fact that the amount deducted from FFT's equity in the transfer pricing report corresponds to the purchase price of FFNA and FFC[147], does not have any bearing on the fact that funding sources cannot, in principle, be allocated to specific assets, which would be true for any amount of participation. FFT's equity is fully available to support the solvency of FFT and should be remunerated in full according to the risks of FFT's assets.

(283) In any event, FFT's annual reports do not seem to confirm Luxembourg's claim that those acquisitions were financed through own funds, if this assertion means that the group provided additional own funds to FFT to acquire FFNA and FFC. Indeed, FFT's equity level (i.e. capital and reserves) in 2010, that is, before the acquisition,

144 See recital (61).
145 See recital (97).
146 See recital (96).
147 As noted by Luxembourg in recital (154).

was EUR 286 million and that level remained at EUR 287 million in 2011 after the acquisition took place.

(284) Luxembourg further argues that since charges from holdings are not tax deductible in Luxembourg and that therefore dividends are also not taxed[148] and because the participations in FFNA and FFC would be remunerated through dividends they should not be taxed and should not be taken into account in the functions performed and risks assumed[149], should equally be rejected, as should FFT's claim that since the participations are remunerated through dividends they should therefore not be taxed[150]. The Commission observes in this respect that FFNA and FFC did not pay any dividends over the period of the application of the contested tax ruling. However, had either of the companies paid dividends, that fact should not alter the calculation of FFT's taxable remuneration, since that remuneration was established by the tax advisor using the TNMM applied to capital. The TNMM is a transactional profit method applied to the level of capital for the treasury functions ensured by FFT. Had FFT's tax advisor instead used the CUP method for transfer pricing purposes, individual transactions or remuneration streams such as individual loans or, in FFT's case, dividends would have been relevant for calculating FFT's taxable remuneration. That is because the CUP method consists in pricing individual transactions, whereas the TNMM consists in estimating the profitability of a function. However, for the reasons given in recital (161), FFT's tax advisor considered the TNMM a more appropriate method in the case of FFT. Thus, by invoking the relevance of certain types of remuneration paid on some assets of FFT (dividends), Luxembourg and FFT attempt to combine the CUP and TNMM methods for the calculation of FFT's taxable remuneration, without any justification for that hybrid method in the transfer pricing report. Considering the tax advisor justified the use of the TNMM in that report, the use of that combination without any additional justification would not result in a reliable approximation of a market-based outcome.

(285) Thirdly, in the application of the TNMM based on capital, any estimate of such capital should ensure that FFT is properly capitalised in line with industry standards. This also follows from the approach advocated in the Circular, which considers the functions performed by intra-group financing companies, in substance, comparable to the functions performed by independent financial institutions.

(286) At the end of 2011, which is the reference date in the transfer pricing report, the average leverage ratio defined as Tier 1 capital to total exposure[151] was, according to the European Banking Authority, 2.9 % for the monitored group 1 of EU larger banks and 3.3 % for the monitored group 2 of smaller EU banks. Applying a leverage ratio (the ratio of equity to total assets) in line with industry standards (and the new Basel III framework) shows that the IFRS equity of FFT was not in excess of the market. Indeed, based on that calculation, FFT's leverage ratio stood at [2-3%][152], […]. In other words, FFT's […] level of equity does not leave room for any deductions, be it of estimated excess capital or of any participations, since such deductions would bring FFT's level of equity […].

148 See recital (154).
149 See recital (95).
150 See recital (165).
151 Leverage is the proportion of assets financed by equity. Since the remainder of the assets is financed by debt, leverage is a measure of indebtedness and inversely of capitalisation of a company.
152 In the case of FFT, Tier 1 capital is equal to equity, as FFT does not have other Tier 1 instruments in issue.

(287) Consequently, FFT's level of capitalisation did not leave any room for reductions of either equity or hypothetical regulatory capital for tax purposes[153], […]. The doubts expressed in recital (80) of the Opening Decision concerning the level of the reduced remuneration rate for excess capital are, in view of this conclusion, without object, as there is no room for a differentiated remuneration.

(288) Fourthly, the inconsistency of deducting FFT's participations in FFNA and FFC from FFT's equity to calculate an estimate of capital to be remunerated as part of the transfer pricing analysis is apparent when applying the same methodology to the accounts of FF. According to Fiat's internal Transfer Pricing Policy document[154], the remuneration of FFT and FF for the pricing of loans is determined through the same method, but that document only describes the application of that method for the purposes of estimating FFT's tax base in detail. However, if FF's equity to be remunerated were estimated through the same method as FFT's in the transfer pricing report, the result of that estimate in 2010, when FF was holding the participations in FFNA and FFC, would be that FF would have had a negative estimated equity[155]. Indeed, at the end of 2010, FF's equity amounted to EUR 271 million, while the total value of participations which would have to be deducted from that equity, if the same method was adopted as approved by the contested tax ruling, would amount to EUR 358 million. FF's equity to be remunerated would therefore have been negative in the amount of EUR 87 million. As the value of participations was higher than FF's total equity, estimating the capital to be remunerated by the same method as the method applied for determining FFT's Luxembourg tax base in the transfer pricing report, would have resulted in a negative capital, as is the case for insolvent companies. However, as FF was not insolvent at that point in time, this fact alone indicates that the deduction of participations from FFT's equity does not seem appropriate to calculate an estimate of capital to be remunerated for determining FFT's tax base in Luxembourg.

(289) Moreover, that inconsistent result would equally arise in the case FFT acquires new participations during the lifetime of the contested tax ruling. By validating a methodologically flawed deduction for participations, the contested tax ruling could result in FFT effectively being taxed nothing in Luxembourg, provided the value of the subsequent participations acquired results in reducing FFT's capital to be remunerated to nil or even a negative amount. In that case, the intra-group financing functions performed by FFT could remain identical, but the taxation would be much lower or even nil when applying the method validated by the contested tax ruling.

(290) If FFT's tax advisor had properly applied the Basel II framework for transfer pricing purposes, those deductions would not have been possible with FFT's current level of capitalisation. However, since FFT is not a regulated entity, information is absent on what would have been the level of FFT's RWAs that would have been acceptable to a financial institutions regulator. That hypothetical level of regulatory capital would also not allow FFT to hold any participations if their value is to be deducted from that capital[156].

(291) In light of these observations, the Commission concludes that the contested tax ruling, by accepting the tax advisor's application of a return estimated through the

153 See recital (268).

154 Described in recitals (121) to (126).

155 Based on the accounting figures of FF presented in the table in recital (114).

156 That hypothetical regulatory capital of EUR 427 million would also be higher than FFT's equity of EUR 286 million held at the moment of the acquisitions of FFNA and FFC.

CAPM to a hypothetical regulatory capital, where that hypothetical regulatory capital was underestimated as a result of a misapplication of the Basel II framework and inappropriate deductions, departs from the arm's length principle. Since that departure results in a lowering of FFT's tax base under the general Luxembourg corporate income tax system as compared to non-integrated companies which transact on market terms, the contested tax ruling should be considered to grants a selective advantage to FFT for the purposes of Article 107(1) of the TFEU.

7.2.2.9. The level of required return applied to the capital to be remunerated

(292) In addition to the Commission's conclusion on the inconsistent manner in which FFT's tax advisor arrives at the estimated amount of capital to be remunerated for the application of the TNMM, the Commission considers that the manner in which FFT's tax advisor arrives at the estimated level of required return to be applied to that capital base does not result in a reliable approximation of a market-based outcome and therefore is not in line with the arm's length principle for the reasons presented in recitals (293) to (300).

(293) Firstly, the beta of 0.29 retained by the tax advisor for use in the CAPM seems at odds with the beta of the financial sector companies considered to be the relevant comparables in the transfer pricing analysis and retained as a reference for the estimated level of required return. The level of the beta of those companies tends to be very high (see Table 3), often many times higher than the market average beta which is 1. The Commission refers, for instance, to the beta of the Stoxx 50 Bank subindex, which amounted to 1.36 for the period 31 December 2009 to 31 December 2011[157], and to the fact that almost all banks participating in that subindex had a beta above 1.

(294) Secondly, the list of 66 companies in Table 3 contains companies which are active in very different business segments than FFT and even contains two central banks: the Banque Nationale de Belgique and the Schweizerische Nationalbank. Many companies present in the sample engage in specialised financial activities, such as leasing and factoring, or are stock exchanges rather than banks[158], whereas many European banks which in principle would engage in wholesale financing activities are not included in the sample. The comparables selected by the tax advisor for the calculation of the beta are therefore not appropriate for that exercise to result in a reliable approximation of a market-based outcome.

(295) Thirdly, and notwithstanding the appropriateness of the comparables in the sample retained by FFT's tax advisor, the transfer pricing analysis does not use the median for the calculation of the beta, but rather the 25th percentile, without any further justification. By doing so, FFT retains a relatively low beta of 0.29, whereas the median of the sample would have resulted in a beta of 0.64[159]. However, according to paragraph 3.57 of the OECD TP Guidelines, the more comparability concerns, the more the arm's length range should adopt the central tendency of the sample.

(296) The Commission notes, in this regard, that the beta represents the non-diversifiable risk of a capital return. Against this background, loan portfolios of banks would, in principle, be more diversified than FFT's portfolio, the exposure of which is concentrated on car companies of the Fiat Group. For this very reason it could be

157 The transfer pricing report is dated 2011; therefore, this reference period is retained. By comparison, over the period 12 May 2012 to 12 May 2014 the beta of the index was 1.3.

158 See Table 6 of the Opening Decision.

159 See Table 4.

argued that a higher point in the range of comparables should have been selected by FFT's tax advisor for the determination of the beta, arguably higher than the median, rather than the 25th percentile.

(297) Indeed, the Circular itself specifically points to the counterparty risk and more specifically the sector risk, which is amplified here by FFT's concentration on only one sector, when setting an appropriate remuneration. Although the indications of the Circular are not specific in terms of how those risks are to be factored in an actual remuneration calculation, the method chosen by FFT's tax advisor, where risks of intra-group loans (as opposed to third party receivable) do not have any risk-weight and therefore also do not result in any capital requirement or any remuneration, is not in line with the Circular. Therefore, considerations regarding the reduced risk of FFT's activities cannot be accepted.

(298) In addition, Fiat's internal Transfer Pricing Policy document points to an important function not presented in the transfer pricing report. As indicated in recital (123), FFT, in addition to the functions presented in that report, also provides guarantees in favour of the Fiat group companies. In 2013, for instance, those guarantees amounted to EUR 10 million[160]. Moreover, in the Transfer Pricing Policy document it is also acknowledged, contrary to what is presented in the transfer pricing report, that the intra-group loans present a certain counterparty and credit risk[161]. […]

(299) As regards guarantees provided by Fiat S.p.A. to FFT, invoked in the comments by Luxembourg[162], those guarantees cover FFT's liabilities, not its assets. They therefore benefit the holders of the guaranteed notes issued, but do not reduce the risk of FFT's assets. The benefit in terms of costs of funding from the guarantee of the notes and bonds issued by Fiat S.p.A. is passed to the group companies through the pricing mechanism described in recital (124). In fact, the pricing of the company loans is calculated by applying a margin of the funding costs of the treasury companies, where the benefit of the guarantee by the mother company, if any, is reflected.

(300) In light of these observations, the Commission considers that neither the implicit nor the explicit guarantees materially decrease the risk borne by FFT when performing its functions. This risk is higher than has been presented in the transfer pricing report because of the existence of guarantees provided to group companies leading to a significant off-balance sheet exposure, so that a beta higher than the 25th percentile should have been chosen.

(301) In conclusion, the Commission considers that the contested tax ruling, by endorsing the tax advisor's choice of a beta of 0.29 in the application of the CAPM for determining the return on capital to be applied to FFT's hypothetical regulatory capital, results in a profit allocation to FFT that departs from market conditions in line with the arm's length principle. Since that departure results in a lowering of FFT's tax liability under the general Luxembourg corporate income tax system as compared to non-integrated companies which transact on market terms, the contested tax ruling should be considered to grant a selective advantage to FFT for the purposes of Article 107(1) of the TFEU.

160 See recital (114).
161 As indicated in recital (123).
162 See recital (155).

7.2.2.10. Conclusion on the amount of capital to be remunerated and level of required return on that capital

(302) Given the tax advisor's choice of the TNMM in the transfer pricing analysis and in light of the observations above, the Commission is of the opinion that, to ensure an appropriate market-based level of remuneration to FFT for the financing and treasury functions it performs within the Fiat group in line with the arm's length principle, that remuneration should be established on the basis of FFT's accounting equity on the basis of its specific facts and circumstances.

(303) The Commission accepts 2012 as reference year for the assessment of FFT's tax base in Luxembourg. The Commission also does not object to the use of comparables database search to estimate arm's length returns, but maintains its objections regarding the appropriate choice of comparables expressed in recital (294).

(304) Indeed, the analysis in section 7.2.2.9 indicates that the risks borne by FFT to be considered for the calculation of an arm's length remuneration are higher than the risks presented in the transfer pricing report and that, therefore, the pre-tax return on equity of 6.05 % (and the corresponding 4.3 % post-tax) accepted by the contested tax ruling, calculated by FFT's tax advisor using the CAPM, falls well below the required returns on capital in the financial sector, which has consistently remained at and above 10 %, confirming the Commission's conclusion that the tax advisor's choice of comparables was not appropriate.

(305) Moreover, a comparison of the declared profitability of FF and FFT, Fiat's euro–area treasury companies, indicates that the difference in profits between FF and FFT, despite the similarities in the structure of assets, functions and income appears to be due to the intention to lower the level of profitability declared in Luxembourg. Based on the structure of assets and liabilities and the profit and loss account of FF and FFT[163], the two companies have a very similar balance sheet size and structure of assets. Their interest income and expense are also of comparable amounts. FF is the most important counterparty of FFT, which sources funding on the market and passes part of the funding to FF, which in turn lends it on to the Italian companies of the Fiat group. […]

(306) Fiat's internal Transfer Pricing Policy document seems to aim at remunerating both companies with similar returns[164]. However, the actual returns of equity recorded and subject to taxation at the level of the two companies are much higher for FF compared to FFT. Based on the figures in the tables in recitals (113) and (114), the tables below present the realised return on equity (RoE) calculated for FF and FFT.

FF	2010	2011	2012	2013
Net profit in EUR thousand	17,292	25,290	24,450	10,514
Shareholders' equity in EUR thousand	271,047	268,610	268,837	256,053
RoE	6.4%	9.4%	9.1%	4.1%

FFT	2010	2011	2012	2013
Net profit in EUR thousand	1,737	1,851	1,217	1,146
Shareholders' equity in EUR	285,625	287,477	288,693	289,839

163 As presented in recital (113) and (114).
164 See table in recital (125).

thousand				
RoE	0.6%	0.6%	0.4%	0.4%

(307) As follows from the tables above, presented in recital (306), for the period 2010-2013, the average return on equity was 7.2 % for FF and 0.5 % for FFT, which again confirms that the tax advisor's choice of comparables in the transfer pricing report and the resulting return on capital were not appropriate.

(308) To determine an appropriate return on equity to apply to FFT's accounting equity, the aggregate statistics for the banking sector seem more adequate than the set of 66 financial companies, which seem in large part to engage in specific financial activities, as the former would in any case better approximate a central tendency.

(309) As mentioned in recital (304), the currently required return on equity for European banks is around 10 %, a level which has been maintained even during the financial crisis. In fact, information from the time of the contested tax ruling confirms that level of required return on equity. For example, according to the Bank of International Settlements' publication of 2011 "*Over a longer time horizon, financial firms have tended to achieve ROEs of 11–12%*"[165]. In addition, a study by the ECB of 2011 found that "*at the average equity ratio in the sample [of 54 international banks], the required return on equity is about (…) 10.3%.*"[166] Equity research from 2011 equally confirms that level; for example, according to Deutsche Bank "*[Deutsche Bank] have a [share price target], reflecting low-teens sustainable RoEs and a cost of equity that [Deutsche Bank] expect to stay above 10% in the current cycle*"[167], while an equity research report by Morgan Stanley and Oliver Wyman of 19 March 2015 set target returns at 10-12 %.

(310) The Commission further observes that an arm's length remuneration must not be lower than the difference between the income and the charges of the company. Therefore, if the remuneration of loans provided or deposits received by FFT were to be adjusted and the resulting remuneration of FFT would be higher than a remuneration calculated through transfer pricing, the entire recorded profit must be taxed, because a third party would not accept to reduce its remuneration if none of its counterparties would make justified claims to receive a higher remuneration on their deposits or justified claims to pay a lower remuneration on their loans received.

(311) The Commission is therefore of the opinion that, if the TNMM is used for transfer pricing purposes to calculate an appropriate remuneration due to FFT for the functions it performs with the Fiat group, the correct estimate of FFT's taxable base in Luxembourg corresponds to at least 10 % post-tax applied to the full amount of its accounting equity, which is considered to be broadly in line with the leverage corresponding to the industry average. A taxable base calculated on that basis would result in a profit allocation reflecting market conditions in line with the arm's length principle, since it is a level of profit standalone financial institutions could expect on the market, so that any tax ruling accepting that base for determining FFT's tax liability under the general Luxembourg corporate tax system would not give rise to a selective advantage for the purposes of Article 107(1) of the TFEU.

165 Bank for International Settlements, 81th annual report, 1 April 2010-31 March 2011, 26 June 2011, p.81

166 ECB, Financial Stability Review, December 2011, page 130.

167 Deutsche Bank, European Banks : Running the Numbers: Spring edition, 5 April 2011; in a Deutsche Bank report of 20 March 2015 the implied cost of equity for European banks is estimated at 10 %.

7.2.3. "Group advantage"

(312) In its comments on the Opening Decision, FFT raises the argument that the Commission should consider the "group effect" of the measure, namely that no advantage exists for the Fiat group because any increase of the taxable base in Luxembourg would be offset in full by an increased tax deduction in other Member States[168]. According to FFT, that effect has already been recognised in a number of Commission decisions[169].

(313) The Commission recalls, as a preliminary matter, that it is not bound by its decisional practice and that each measure must be assessed on the basis of its own merits under Article 107(1) of the TFEU[170]. In any event, the reference by FFT to the *Hungarian group interest tax regime* decision, where the Commission would have recognised such a "group effect", is based on an incorrect reading of that decision. In that decision, the Commission rejected Hungary's argument to assess the existence of an advantage at group level and concluded that the advantage had to be assessed at the individual entity level.

(314) The present decision examines whether Luxembourg, by issuing the contested tax ruling, conferred a selective advantage on FFT by lowering its tax liability in that Member State. Therefore, the assessment of whether that ruling gives rise to an advantage should be made at the treatment of the individual company by the Member State in question, namely FFT and Luxembourg, and should not take into account a possible neutral impact of the measure at the level of other Fiat group companies as a result of their treatment by other Member States[171]. In any event, according to the case-law[172], the mere fact that a specific exemption measure is offset by an increase in a specific charge which is different from and unconnected with the former measure does not save that measure from a categorisation as State aid. In other words, an advantage at the level of one company received from a Member States cannot be compensated with the disadvantage at the level of another company, even if those companies are part of the same corporate group.

7.2.4. Subsidiary line of reasoning: Selective advantage due to a derogation from Article 164 L.I.R. and/or the Circular

(315) Luxembourg and FFT raised the argument that Article 164 L.I.R. or the Circular constitute the reference system against which the existence of a selective advantage resulting from the contested tax ruling must be determined. Luxembourg also raised the argument that the Luxembourg tax administration merely interpreted the rules and that there is no indication that in FFT's case the Luxembourg authorities have deviated from the generally applicable tax rules had they been examined by the Commission[173].

(316) As noted at recitals (210) to (215), the Commission does not agree with the arguments of Luxembourg and FFT concerning the applicable reference system.

---

168 FFT's first set of comments, paragraph 64; FFT's second set of comments, paragraphs 1.8.1. et seq., paragraph 3.1.8.

169 Notably *Hungarin group interest tax regime* Decision.

170 See recital (202).

171 See also the *Groepsrentebox* decision, paragraphs 80 to 82; *Hungarian group interest tax regime* decision, paragraphs 131 and 132.

172 See Case C-81/10 P *France Télécom v Commission* ECLI:EU:C:2011:811, paragraph 43, Case C-66/02 *Italy v Commission* ECLI:EU:C:2005:768, paragraph 34 ; See also Joined Cases T-427/04 and T-17/05 *France and France Télécom v Commission* ECLI:EU:T:2009:474, paragraph 207 and paragraph 215

173 Observations of Luxembourg to the Opening Decision, paragraph 28.

However, as a subsidiary line of reasoning, the Commission concludes that the contested tax ruling also grants FFT a selective advantage in the context of the more limited reference system composed of group companies applying transfer pricing to which Article 164(3) L.I.R. and the Circular apply. Article 164(3) L.I.R. and the Circular are considered to establish the "arm's length principle" under Luxembourg tax law, according to which transactions between intra-group companies should be remunerated as if they were agreed to by independent companies negotiating under comparable circumstances at arm's length. Section 2 of the Circular, in particular, contains a description of the arm's length principle as set out in the OECD TP Guidelines and transposed into domestic law[174].

(317) Considering that the Commission has already demonstrated in Section 7.2.2 that the contested tax ruling endorses certain methodological choices, choices of parameters for their implementation and *ad hoc* adjustments made by FFT's tax advisor for transfer pricing purposes that cannot be considered to result in a reliable approximation of a market-based outcome resulting in a reduction in FFT's Luxembourg tax base, the Commission can similarly conclude that that ruling also gives rise to a selective advantage under the more limited reference system of Article 164(3) L.I.R. or the Circular, since it results in a lowering of FFT's tax liability as compared to the situation where the arm's length principle laid down in that provision had been properly applied.

7.2.5. The Commission has not identified any consistent tax ruling practice under the Circular that could constitute an appropriate reference system

(318) FFT also argued that to prove a selective treatment benefitting FFT as a result of the contested tax ruling, the Commission should compare that ruling to the administrative practice of the Luxembourg tax administration under the Circular and, in particular, the rulings granted to other financing and treasury companies that Luxembourg submitted to the Commission as part of a representative sample of its ruling practice[175].

(319) The Commission disagrees with this line of reasoning, as it would mean that the system of reference against which the contested tax ruling would have to be examined is Luxembourg's tax ruling practice under the Circular in relation to other financing and treasury companies. The Commission has already demonstrated why the general Luxembourg corporate tax system constitutes the appropriate reference framework for selectivity analysis[176].

(320) Nevertheless, in a further subsidiary line of reasoning, the Commission will demonstrate why Luxembourg's tax ruling practice under the Circular constitutes an appropriate reference system for determining whether the contested tax ruling grants FFT a selective advantage. That is because, first, the Circular is drafted in an overly broad manner, so that it does not allow for the identification of objective criteria applicable to all financing and treasury companies that request a tax ruling for transfer pricing purposes. Second, the Commission's examination of the rulings submitted to it by Luxembourg further evidence that there is no consistent set of rules that generally apply on the basis of objective criteria against which the contested tax ruling could be examined for determining whether FFT received a selective advantage as a result of that ruling.

174 See recital (77).
175 FFT's first set of comments, paragraph 60; FFT's second set of comments, paragraph 1.4.
176 Section 0.

7.2.5.1. The Circular is drafted too broadly to constitute an appropriate reference system

(321) As explained in recital (193), a reference system is composed of a consistent set of rules that generally apply on the basis of objective criteria to all undertakings falling within its scope as defined by its objective. The Commission considers that the Circular, as regards group financing and treasury companies that make a ruling request, cannot constitute such a system, due to the lack of objective criteria that allow a consistent application of the arm's length principle to intra-group financing transactions.

(322) The Circular is phrased in very broad terms and the factors to be taken into account by the tax administration for the application of the arm's length principle to intra-group financing companies are explained in a succinct manner. Those factors include that companies should perform a risk analysis and determine the additional expenses relating to granting loans that translate into additional charges to be applied to the cost base which, in turn, requires a credit risk analysis. The Circular further explains that "*a group financing company must have sufficient equity in order to assume the risks connected*" and that "*based on the facts and circumstances of each individual case, it should be assessed what are the risks assumed and whether the group financing company has the appropriate level of equity to assume these risks*"[177].

(323) The Circular does not, however, contain any information as to how to estimate the expected return of capital, whether the use of the CAPM is acceptable and, if so, how the relevant components of the CAPM should be determined. The Circular also does not contain much information as to the equity to be considered except that it must be "*sufficient in order to assume the risks*".

(324) In its observations on the Opening Decision, Luxembourg indicates that the "*tax ruling is based on limited discretion*" afforded by Article 164(3) L.I.R. which lays down the arm's length principle in Luxembourg tax law[178], but it also indicates that the "*rules for taxation […] should be interpreted in the light of the facts of each case, which by definition requires consideration of the characteristics of the activities actually carried on by the taxpayer and of the context in which they are carried on*"[179]. Luxembourg thus admits, on the one hand, that the rules need to be interpreted in the light of the facts of each case, but does not explain, on the other, how the broad criteria laid down in the Circular translate into a concrete assessment of FFT's tax situation or how a consistent treatment of all taxpayers is ensured when applying the Circular. It is therefore unsurprising that, with the exception of a reference to the Circular at the beginning, FFT's transfer pricing report does not include any further references to the criteria of the Circular nor does it explain how the transfer pricing report applies the Circular to the specific case of FFT.

(325) Therefore, by concluding that the transfer pricing analysis "*has been realised in accordance with the Circular 164/2 of the 28 January 2011 and respects the arm's length principle*", the Luxembourg tax administration did not rely on any objective criteria laid down in the Circular, since that document does not include any precise and objective criteria that could be used to allow a consistent application of the arm's length principle to intra-group financing transactions.

177 The Circulaire, pp. 3 and 4.
178 Observations of Luxembourg to the Opening Decision, paragraph 34.
179 Observations of Luxembourg to the Opening Decision, paragraph 36.

7.2.5.2. Luxembourg's tax ruling practice is too inconsistent to constitute an appropriate reference system

(326) In addition to the broad wording of the Circular, the Commission has examined the tax rulings submitted to it by Luxembourg and found that its tax ruling practice in relation to group financing and treasury companies further evidences that there is no consistent set of rules that generally apply to all similarly situated taxpayers on the basis of objective criteria.

(327) Out of the 21 rulings initially submitted, only two concern financing activities which were approved on the basis of the Circular and are accompanied by a transfer pricing report:

– A ruling of […] 2013 (No. 2)[180] concerns the application of the Circular to intermediary financing activities […]

– A ruling of […] 2013 (No. 4) also deals with the analysis of the arm's length principle under the Circular to intra-group financing activities. […]

(328) A cursory reading of those two rulings and a comparison with the contested tax ruling reveals that there is no consistent treatment of treasury companies under the Circular and Luxembourg tax administration's assessment of the taxable profit. Without assessing whether the two rulings properly apply the CUP, the two rulings in question expressly acknowledge that for intermediary financing transactions, the CUP method is in any event the most appropriate method based on the functional analysis and the availability of comparables, which include, among others, banks. This is also in line with the Circular, which considers the functions performed by intra-group financing companies, in substance, comparable to the functions performed by independent financial institutions. Contrary, to those two rulings, the CUP method was not applied in the contested tax ruling because FFT's tax advisor considered the TNMM as most appropriate method based on the fact that the "*TNMM looks adequate*"[181].

(329) Three other rulings submitted by Luxembourg equally concern intra-group financing activities applying the Circular, but without any accompanying transfer pricing report to justify the request:

– A ruling of […] 2012 (No. 1) concerns a financing activity […].

– A ruling of […] 2012 (No. 5) concerns, among others, a tracking loan […].

– A ruling of […] 2013 (No. 22) concerns, among others, a financing activity […].

(330) As regards a comparison between rulings No. 1, 5 and 22 with the contested tax ruling, the obvious difference in treatment by the Luxembourg tax administration is that, contrary to the contested tax ruling, the requests for rulings No. 1, 5 and 22 were not accompanied by a transfer pricing report, although this is expressly required under the Circular[182].

(331) Two further rulings submitted by Luxembourg to the Commission concern financing activities, but do not refer to the Circular:

180 The numbering refers to the numbering of the rulings as submitted by Luxembourg to the Commission.
181 Page 34 of the FFT transfer pricing report.
182 See recital (83).

– A ruling of […] 2012 (No. 6) concerns a company restructuring. It contains, among others, a tracking loan […].

– A ruling of […] 2012 (No. 21) concerns the acquisition of […].

(332) Finally, the Commission examined the two tax rulings provided by Luxembourg as part of the 13 rulings covering a treasury function identified in the list of 5 323 rulings provided by Luxembourg on 22 December 2014[183]. Both of those rulings are based on the Circular.

– A ruling on treasury functions of Company E consists of meeting notes produced by Company E's tax advisor and signed on […] by representatives of the Luxembourg tax administration. […]

– A ruling on treasury functions of Company G dates from […], approving a request of the same day by company G. […]

(333) The Commission observes that, contrary to the contested tax ruling, neither of those two rulings applies the TNMM or the CAPM, and neither ruling seems to determine the taxable profit of the company as a return on a hypothetical regulatory capital. Moreover, although the ruling request of Company G refers to a transfer pricing report to be provided at a later stage, such a report does not seem to have ever been provided to the Luxembourg tax administration[184]. Finally, although the ruling of Company G does not clearly indicate the level of the margin nor to what the margin applies, it is distinct from the contested tax ruling because the margin would be, according to the ruling request, based on assets and additional to a return on equity. In short, the tax treatment of those two companies for treasury functions does not seem to follow any coherent method or approach when compared to the contested tax ruling.

(334) Luxembourg argues that FFT cannot be compared to other treasury companies, since FFT raises funds on the market whereas other financing companies usually obtain financing intra-group. Luxembourg also argues FFT cannot be compared to any other taxable company in Luxembourg: "*la situation de chaque contribuable est suffisamment spécifique, pour empêcher toute comparaison pertinente avec des dossiers d'autres contribuables*."[185]

(335) While the Commission does not agree with those arguments, it submits that the lack of a consistent set of rules that generally apply to financing and treasury companies making a ruling request on the basis of objective criteria is best demonstrated by the existence of an alternative tax ruling in favour of [company F]. The [company F] ruling, issued on the same day and covering the same functions as the contested tax ruling (with [company F] covering the industrial segment […] in an alternative structure of group treasury companies), arrives at a substantially different conclusion as regards the companies' respective tax bases, without any apparent justification for that difference in treatment. Indeed, the contested tax ruling agrees on a tax base of around EUR 2.5 million, whereas the tax ruling in favour of [company F] agrees to a remuneration of similar financing and treasury activities resulting in a tax base of EUR […]. This difference in treatment of practically identical companies without

183 Thereof, two rulings concerned FFT and [company F] requests, see recital (28) and (29).

184 The request of the Commission of 23 June 2015 requests any transfer pricing reports provided by the company and the submission by Luxembourg of 25 June 2015 does not contain any such subsequent report.

185 Letter of Luxembourg dated 24 March 2015, reply to question 6.

any apparent justification further demonstrates that Luxembourg's tax ruling practice, based on the broad wording of the Circular, does not constitute an appropriate reference system for the purposes of the selectivity analysis.

(336) In sum, an examination of the tax ruling practice of the Luxembourg tax administration does not allow for the identification of a consistent set of rules that generally apply on the basis of objective criteria to all undertakings falling within its scope as defined by its objective. That practice can therefore not constitute the framework against which the contested tax ruling is examined to determine whether FFT obtained a selective advantage for the purposes of Article 107(1) of the TFEU.

7.2.6. Justification by the nature or general scheme of the tax system

(337) Neither Luxembourg nor FFT have advanced any possible justification for the selective treatment of FFT as a result of the contested tax ruling. The Commission recalls that the burden of establishing such a justification lies with the Member State.

(338) In any event, the Commission has not been able to identify any possible ground for justifying the preferential treatment from which FFT benefits as a result of the contested tax ruling that could be said to derive directly from the intrinsic, basic or guiding principles of the reference system or that is the result of inherent mechanisms necessary for the functioning and effectiveness of the system,[186], whether that reference system is the general Luxembourg corporate income tax system, as established by the Commission, or Article 164 L.I.R. and the Circular, as advocated by Luxembourg and Fiat.

7.2.7. Conclusion on the existence of a selective advantage

(339) The Commission concludes that the contested tax ruling, by endorsing a method for arriving at a profit allocation to FFT within the Fiat group that departs from a market-based outcome in line with the arm's length principle resulting in a lowering of FFT's tax liability under the general Luxembourg corporate income tax system as compared to non-integrated companies taxable in Luxembourg that transact on market terms, confers a selective advantage on FFT for the purposes of Article 107(1) of the TFEU.

(340) By a subsidiary line of reasoning, the Commission concludes that the contested ruling, by endorsing a method for arriving at a profit allocation to FFT within the Fiat group that departs from a market-based outcome in line with the arm's length principle resulting in a lowering of FFT's tax liability under Article 164(3) L.I.R. and the Circular as compared to other group companies taxable in Luxembourg, confers a selective advantage on FFT for the purposes of Article 107(1) of the TFEU.

7.3. Beneficiary of the contested measure

(341) The Commission considers the contested tax ruling to grant a selective advantage to FFT within the meaning of Article 107(1) of the TFEU, since it leads to a lowering of that entity's taxable profit in Luxembourg as compared to non-integrated companies whose taxable profits are determined by transactions concluded on market terms. However, the Commission notes that FFT forms part of a multi-national corporate group, i.e. the Fiat Chrysler Automobiles (hereinafter "FCA") group, and that FFT's role within that group is the provision of financing and treasury functions to other Fiat group companies, the remuneration of that role being the subject-matter of the contested tax ruling.

186 Joined Cases C-78/08 to C-80/08 *Paint Graphos and others* ECLI:EU:C:2009:417, paragraph 69.

(342) Separate legal entities may be considered to form one economic unit for the purpose of the application of State aid rules. That economic unit is then considered to be the relevant undertaking benefitting from the aid measure. As the Court of Justice has previously held, "*[i]n competition law, the term 'undertaking' must be understood as designating an economic unit […] even if in law that economic unit consists of several persons, natural or legal.*"[187] To determine whether several entities form an economic unit, the Court of Justice looks at the existence of a controlling share or functional, economic or organic links[188]. In the present case, FFT is owned by Fiat S.p.A. (now Fiat Chrysler Automobiles, NV) and by FF, which, in turn, is wholly owned by Fiat, S.p.A.[189] FFT is thus fully controlled by Fiat S.p.A which in turn controls the Fiat group[190].

(343) Moreover, it is the Fiat group which took the decision to establish FFT in Luxembourg and thus the Fiat group which benefits from the contested tax ruling as that ruling, as indicated in recital (52), establishes the profit that should be allocated to FFT within that corporate group for the financing and treasury functions it provides to the companies of that group. The contested tax ruling is, after all, a ruling that accepts a transfer pricing methodology for transactions within the Fiat group, so that any favourable tax treatment afforded to FFT by the Luxembourg tax administration, benefits the Fiat group as a whole by providing additional resources not only to FFT, but to the entire the group. In other words, as discussed in recital (221), where transfer pricing is required to set prices for products and services within various legal entities of one and the same group, the effects of setting a transfer price affects by its very nature more than one group company (a price increase in one company reduces the profit of the other).

(344) Accordingly, notwithstanding the fact that the group is organised in different legal personalities, in the context of a transfer pricing arrangement those companies must be considered as a single group benefitting from the contested aid measure[191].

(345) Finally, in the present case the amount of taxes paid by FFT to Luxembourg influence the pricing conditions of the inter-group loans granted by it to the Fiat group companies, since they are based on the WACC and a margin[192], so that reductions of FFT's tax liability necessarily reduce the pricing conditions of its inter-group loans. A reduction of FFT's tax liability in Luxembourg therefore not only benefits FFT but all the group companies receiving financing from FFT and therefore the Fiat group.

---

187 Case C-170/83 *Hydrotherm* ECLI:EU:C:1984:271, paragraph 11. See also Case T-137/02 *Pollmeier Malchow v Commission* ECLI:EU:T:2004:304, paragraph 50.

188 Case C-480/09 P *Acea Electrabel Produzione SpA v Commission* ECLI:EU:C:2010:787 paragraphs 47 to 55; Case C-222/04 *Cassa di Risparmio di Firenze SpA and Others* ECLI:EU:C:2006:8, paragraph 112

189 See recital (110).

190 See recital (34).

191 See, by analogy, Case 323/82 *Intermills* ECLI:EU:C:1984:345: paragraph 11 "*It is clear from the information supplied by the applicants themselves that following the restructuring both SA Intermills and the three manufacturing companies are controlled by the Walloon regional executive and that , following the transfer of the plant to the three newly constituted companies, SA Intermills continues to have an interest in those companies . It must therefore be accepted that, in spite of the fact that the three manufacturing companies each has a legal personality separate from the former SA Intermills, all those undertakings together form a single group , at least as far as the aid granted by the Belgian authorities is concerned […]*".

192 See recital (48).

7.4. Conclusion on the existence of aid

(346) In light of the foregoing, the Commission concludes that the contested tax ruling granted by Luxembourg in favour of FFT grants FFT and the Fiat group a selective advantage that is imputable to Luxembourg and financed through State resources and which distorts or threatens to distort competition and is liable to affect intra-EU trade. The contested tax ruling therefore constitutes State aid within the meaning of Article 107(1) of the TFEU.

(347) Since the contested tax ruling gives rise to a reduction of charges that should normally be borne by FFT in the course of its business operations, the contested tax ruling should be considered as granting operating aid to FFT and the Fiat group.

8. COMPATIBILITY OF THE AID

(348) State aid shall be deemed compatible with the internal market if it falls within any of the categories listed in Article 107(2) of the TFEU[193] and it may be deemed compatible with the international market if it found by the Commission to fall within any of the categories listed in Article 107(3) of the TFEU. However, it is the Member State granting the aid which bears the burden of proving that State aid granted by it is compatible with the internal market pursuant to Articles 107(2) or 107(3) of the TFEU.

(349) Luxembourg has not invoked any of the grounds for a finding of compatibility in either of those provisions for the State aid it has granted to FFT and the Fiat group by way of the contested tax ruling.

(350) Moreover, as explained in recital (347), the contested tax ruling should be considered as granting operating aid to FFT and the Fiat group. As a general rule, such aid can normally not be considered compatible with the internal market under Article 107(3)(c) of the TFEU in that it does not facilitate the development of certain activities or of certain economic areas, nor are the tax incentives in question limited in time, digressive or proportionate to what is necessary to remedy to a specific economic handicap of the areas concerned.

(351) Consequently, the State aid granted to FFT and the Fiat group by Luxembourg through the contested tax ruling is incompatible with the internal market.

9. UNLAWFULNESS OF THE AID

(352) According to Article 108(3) of the TFEU, Member States are obliged to inform the Commission of any plan to grant aid (notification obligation) and they may not put into effect any proposed aid measures until the Commission has taken a final position decision on the aid in question (standstill obligation).

(353) The Commission notes that Luxembourg did not notify the Commission of any plan to grant to contested tax ruling, nor did it respect the standstill obligation laid down in Article 108(3) of the TFEU. Therefore, in accordance with Article 1(f) of

[193] The exceptions provided for in Article 107(2) of the TFEU concern aid of a social character granted to individual consumers, aid to make good the damage caused by natural disasters or exceptional occurrences and aid granted to certain areas of the Federal Republic of Germany, none of which apply in the present case.

Regulation (EU) No. 2015/1589 [194], the contested tax ruling constitutes unlawful aid, put into effect in contravention of Article 108(3) of the TFEU.

10. RECOVERY

(354) Article 16(1) of Regulation No. 2015/1589 establishes an obligation on the Commission to order recovery of unlawful and incompatible aid. That provision also provides that the Member State concerned shall take all necessary measures to recover unlawful aid that is found to be incompatible. Article 16(2) of Regulation No. 2015/1589 establishes that the aid is to be recovered, including interest from the date on which the unlawful aid was at the disposal of the beneficiary until the date of its effective recovery. Commission Regulation (EC) No 794/2004 elaborates the methods to be used for the calculation of recovery interest[195]. Finally, Article 16(3) of Regulation No. 2015/1589 states, that "*recovery shall be effected without delay and in accordance with the procedures under the national law of the Member State concerned, provided that they allow for the immediate an effective execution of the Commission decision*".

10.1. Legitimate expectations and legal certainty

(355) Article 16(1) of Regulation No. 2015/1589 also provides that the Commission shall not require recovery of the aid if this would be contrary to a general principle of law.

(356) Luxembourg argues, first, that the principle of legitimate expectations mandates that the effects of any decision finding the existence of aid should not take effect until the end of the relevant tax ruling period, i.e. until the end of tax year 2016. According to Luxembourg, both the Code of Conduct Group and the OECD Forum on Harmful Tax Practices assured Luxembourg that its tax ruling practice based on the Circular is consistent with the OECD Code of Conduct and Guidelines. Luxembourg therefore submits that it was explicitly confirmed at the Council meeting of 27 May 2011 that, in view of the adoption of the Circular, Luxembourg's tax ruling practice should not be evaluated according to the Code of Conduct[196].

(357) According to established case-law, a Member State whose authorities have granted aid in breach of the procedural rules laid down in Article 108(3) of the TFEU may not plead the legitimate expectations of a recipient to justify a failure to comply with the obligation to take the steps necessary to implement a Commission decision instructing it to recover the aid. If it were allowed to do so, Articles 107 and 108 of the TFEU would be deprived of all practical force, since national authorities would

---

194 Regulation (EU) No. 2015/1589 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (OJ L 248, 24.9.2015, p. 9.)

195 Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty (OJ L 140, 30.4.2004, p. 1).

196 Luxembourg's observations to the Opening Decision, paragraphs 104 et seq. Luxembourg quotes paragraph 19 of the report of the Code of Conduct Group (Business Taxation) to the Council (ECOFIN) which reads: "*With respect to the Luxembourg tax measure concerning companies engaged in intra-group financing activities the Group discussed the agreed description at the meeting on 17 February 2011. Luxembourg informed the Group that Circular No 164/2 dated 28 January 2011 determines the conditions for providing advance pricing agreements confirming the remuneration of the transactions. At the meeting on 11 April 2011, Luxembourg informed that Group that Circular No 164/2 bis dated 8 April 2011 ensured that advance confirmations granted prior to the entry into force of Circular No 164/2 would cease to be valid by 31 December 2011. With the benefit of this information, the Group agreed that there was no need for this measure to be assessed against the criteria of the Code of Conduct.*"

thus be able to rely on their own unlawful conduct to render decisions taken by the Commission under those provisions of the TFEU ineffective[197]. Thus, it is not for the Member State concerned, but for the recipient undertaking, to invoke the existence of exceptional circumstances on the basis of which it had entertained legitimate expectations, leading it to decline to repay the unlawful aid[198]. Since FFT did not submit any argument to that effect in any of its observations submitted to the Commission, the Commission considers Luxembourg's reliance on legitimate expectations inadmissible for the purposes of the present Decision.

(358) In any event, for a claim of legitimate expectations to succeed, the expectation must arise from prior Commission action in the form of precise assurances[199]. Luxembourg argues that an agreement in a Code of Conduct Group meeting that "*there [is] no need for the [Luxembourg tax measure on companies engaged in intra-group financing activities] to be assessed against the criteria of the Code of Conduct*" constitutes such a precise assurance giving rise to legitimate expectations. The Commission recalls that the Code of Conduct, adopted by the ECOFIN Council[200], is a non-legally binding instrument which aims at providing a forum of discussion for Member States on measures which have, or may have, a significant impact on the location of business within the Union. The Code of Conduct and the State aid rules pursue different objectives: while the Code of Conduct aims at tackling harmful tax competition between Member States, the State aid rules seeks to address distortions of between competitors that result from favourable treatment, also in the form of tax reductions, by Member States to certain undertakings. Moreover, while the Code of Conduct group enjoys a certain margin of appreciation, the Commission has no discretion in determining whether a measure falls within the notion of State aid, since that notion is an objective one. Thus, an agreement in the Code of Conduct Group meeting can neither bind nor restrict the Commission's actions in exercising its powers which are conferred on it by the TFEU in the field of State aid[201].

(359) The same is true for agreements reached in the OECD Forum on Harmful Tax Practices. At its meeting on 6 December 2011, the OECD Forum "*agreed that the following 10 regimes did not need to be examined further […] Luxembourg – Advance tax analysis for intra-group financing*". The OECD is not a Union institution, nor is the Union a member of that organisation[202]. Its conclusions, which

---

197 See Case C-5/89 *Commission v Germany*, ECLI:EU:C:1990:320, paragraph 17, and Case C-310/99 *Italy* v *Commission* ECLI:EU:C:2002:143, paragraph 104.

198 See Case T-67/94 *Ladbroke Racing v Commission* ECLI:EU:T:1998:7, paragraph 183; See also Joined Cases T-116/01 and T-118/01, *P&O European Ferries (Vizcaya) SA and Diputacion Floral de Vizcaya v Commission* ECLI:EU:T:2003:217, paragraph 203.

199 See Case T-290/97, *Mehibas Dordtselaan v Commission* ECLI:EU:T:2000:8, paragraph 59 and judgement in cases C-182/03 and C-217/03, *Belgium and Forum 187 ASBL v Commission* ECLI:EU:C:2006:416, para 147.

200 Council conclusions of the ECOFIN Council meeting of 1 December 1997 concerning taxation policy, OJ C 2, 06.01.1998, p. 1. See also documents at the following link: http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/#code_conduct

201 See, to that effect, Advocate General Léger's opinion in Case C-217/03, *Belgium and Forum 187 ASBL v Commission* ECLI:EU:C:2006:89, paragraph 376.

202 In the Supplementary Protocol No. 1 to the Convention on the OECD of 14 December 1960, the signatories to the Convention agreed that the European Commission shall take part in the work of the OECD. European Commission representatives participate alongside Members in discussions on the OECD's work programme, and are involved in the work of the entire Organisation and its different bodies. However, while the European Commission's participation goes well beyond that of an observer,

are non-binding, cannot bind the Union institutions. Moreover, far from giving a precise assurance, the OECD Forum refrained from further examining the Luxembourg tax analysis for intra-group financing. It is therefore impossible to draw any kind of conclusions or inferences from this statement as regards the application of the State aid rules to the contested tax ruling.

(360) Second, Luxembourg argues that the Commission infringed the principle of legal certainty. It refers to previous decision-making practice where the Commission accepted to limit recovery based on that principle.

(361) However, there is no previous decision-making practice that might have created uncertainty about the fact that tax rulings could lead to the granting of State aid. Indeed, in the decision referred to by Luxembourg, the Commission limited recovery because of uncertainty created by a previous Commission decision. In the present case, to the contrary, the Notice on Direct Business Taxation makes express reference to tax rulings and the circumstances according to which they could be considered to lead to the granting of State aid.

(362) As regards the argument of Luxembourg that the aid amount cannot be quantified with precision, due amongst others to the novelty of the approach, and recovery should therefore be excluded, the Commission notes that it has applied the arm's length principle in its past decision-making practice, in particular with respect to measures adopted by Luxembourg, and it concluded that a violation thereof could constitute State aid[203]. That conclusion has further been confirmed by the Court of Justice[204]. There is therefore nothing novel in the Commission's approach to the contested tax ruling. Member States should be aware that an agreement between a tax authority and a company that leads to a favourable treatment for the company in terms of artificially lowering its tax base, because the transfer prices it employs do not give a reliable approximation of a market-based outcome, lead to a violation of the State aid rules and should, in case of doubt, be notified to the Commission.

(363) Finally, as regards the allegedly difficulty to quantify the aid amount and therefore not order recovery, the Court has previously held[205] that the Commission is not required to state the exact amount of the aid to be recovered. Union law merely requires recovery of unlawful aid to restore the position to the status quo ante and that repayment be made in accordance with the rules of national law[206]. Accordingly, the Commission may confine itself to declaring that there is an obligation to repay the aid at issue and leave it to the national authorities to calculate the exact amount of aid to be repaid[207].

(364) It can therefore be concluded that the arguments of legitimate expectations and legal certainty invoked by Luxembourg are without merit for the purposes of recovery of the aid unlawfully granted to FFT by way of the contested tax ruling.

---

it does not have the right to vote and does not officially take part in the adoption of legal instruments submitted to the Council for adoption.

[203] Commission Decision of 11 July 2001 in Case C 47/2001 (ex NN 42/2000) – Germany: Control and coordination centres of foreign companies, OJ 201 C 304, p. 2. Commission Decision 2003/501 of 16 October 2002 on the State aid scheme C 49/2001 (ex NN 46/2000) – Coordination Centres – implemented by Luxembourg, OJ 2003 L 170, p. 20.

[204] Joined Cases C-182/03 and C-217/03 *Belgium and Forum 187 ASBL v. Commission* ECLI:EU:C:2006:416.

[205] Albeit in the context of "impossibility to recover" and not "difficulty to quantify the aid amount".

[206] Joined Cases T-427/04 and T-17/05 *France v Commission* ECLI:EU:T:2009:474, paragraph 297.

[207] Joined Cases T-427/04 and T-17/05 *France v Commission* ECLI:EU:T:2009:474, paragraph 299.

10.2. Methodology for recovery

(365) In accordance with the TFEU and the Court of Justice's established case-law, the Commission is competent to decide that the Member State concerned must abolish or alter aid when it has found that it is incompatible with the internal market. The Court has also consistently held that the obligation on a State to abolish aid regarded by the Commission as being incompatible with the internal market is designed to re-establish the previously existing situation. In this context, the Court has stated that that objective is attained once the recipient has repaid the amounts granted by way of unlawful aid, thus forfeiting the advantage which it had enjoyed over its competitors on the market, and the situation prior to the payment of the aid is restored.

(366) In relation to unlawful State aid in the form of tax measures, the Notice on business taxation[208] provides in point 35 thereof that the amount to be recovered should be calculated on the basis of a comparison between the tax actually paid and the amount which should have been paid if the generally applicable rule had been applied. In order to arrive at an amount of tax which should have been paid if the generally applicable rules would have been complied with, that is, if arm's length principle had been properly applied for the determination of FFT's tax base in Luxembourg, the Luxembourg tax administration must change the annual calculation method employed by FFT in the context the TNMM method on the basis of the CAPM, i.e. (i) the amount of capital remunerated and (ii) the level of remuneration applied to this capital amount need, in line with the above assessment, presented in recital (311).

(367) No provision of Union law requires the Commission, when ordering the recovery of aid declared incompatible with the internal market, to quantify the exact amount of the aid to be recovered. Rather, it is sufficient for the Commission's decision to include information enabling the addressee of the decision to work out that amount itself without overmuch difficulty[209].

(368) The Commission has proposed one possible methodology in section 7.2.2.10 and, in particular, in recital (311) for eliminating the selective advantage granted to FFT by the contested tax ruling[210], if Luxembourg retains the TNMM to determine FFT's tax base. However, the Commission appreciates that other transfer pricing methods may also result in a reliable approximation of a market-based outcome in line with the arm's length principle. Thus, should Luxembourg propose a method for recovery within the deadline for the implementation of this decision using an alternative transfer pricing method, the Commission would be ready to accept that method provided it results in a reliable approximation of a market-based outcome and provided that whatever method is chosen it does not replicate the choices and adjustments made by FFT's tax advisor in the transfer pricing report that the Commission considers constitute a deviation from an arm's length principle.

(369) In particular, the Commission sees no reason why any adjustments should be made to FFT's accounting capital for the calculation of the amount of capital to be remunerated. Moreover, regarding the estimated arm's length remuneration on that capital, while the use of the CAPM methodology seems unnecessary cumbersome, there appears to be no reason why it could not be used for transfer pricing purposes,

---

208 Commission notice on the application of the State aid rules to measures relating to direct business taxation (OJ No C 384, 10.12.98, p. 3).

209 See Case C-441/06 *Commission v France* ECLI:EU:C:2007:616, paragraph 29 and the case-law cited.

210 See, in particular, recital (308) to (311).

unless it is employed to clearly deviate from a market-based outcome, which is reflected in an observable return on equity for peers.

10.3. Entity from which the aid is to be recovered

(370) In light of the observations in recitals (341) to (345), the Commission considers that Luxembourg should, in the first place, recover the unlawful and incompatible aid granted by the contested tax ruling from FFT. Should FFT not be in a position to repay the full amount of the aid received as a result of the contested tax ruling, Luxembourg should recover the remaining amount of that aid from Fiat Chrysler Automobiles N.V., the successor of Fiat S.p.A., since it is that entity which controls the Fiat group, so as to ensure that the previously existing competitive situation on the market is restored through recovery.

11. CONCLUSION

(371) In conclusion, the Commission finds that Luxembourg, by way of the contested tax ruling, has unlawfully granted State aid to FFT and the Fiat group, in breach of Article 108(3) of the TFEU, which Luxembourg is required to recovery by virtue of Article 16 of Regulation No 2015/1589 from FFT and, if the latter fails to repay the full amount of the aid, from Fiat Chrysler Automobiles N.V. for the amount of aid outstanding,

HAS ADOPTED THIS DECISION:

Article 1

The tax ruling issued by Luxembourg on 3 September 2012 in favour of Fiat Finance and Trade Ltd., which enables the latter to determine its tax liability in Luxembourg on a yearly basis for a period of five years, constitutes aid within the meaning of Article 107(1) of the TFEU that is incompatible with the internal market and that was unlawfully put into effect by Luxembourg in breach of Article 108(3) of the TFEU.

Article 2

(a) Luxembourg shall recover the incompatible and unlawful aid referred to in Article 1 from Fiat Finance and Trade Ltd.

(b) Any sums that remain unrecoverable from Fiat Finance and Trade Ltd., following the recovery described in the paragraph 1, shall be recovered from Fiat Chrysler Automobiles N.V.

(c) The sums to be recovered shall bear interest from the date on which they were put at the disposal of the beneficiaries until their actual recovery.

(d) The interest shall be calculated on a compound basis in accordance with Chapter V of Regulation (EC) No 794/2004.

Article 3

(a) Recovery of the aid granted referred to in Article 1 shall be immediate and effective.

(b) Luxembourg shall ensure that this Decision is implemented within four months following the date of notification of this Decision.

Article 4

(a) Within two months following notification of this decision, Luxembourg shall submit to the Commission information regarding the methodology used to calculate the exact amount of aid.

(b) Luxembourg shall keep the Commission informed of the progress of the national measures taken to implement this Decision until recovery of the aid granted referred to in Article 1 has been completed. It shall immediately submit, on simple request by the Commission, information on the measures already taken and planned to comply with this Decision.

Article 5

This Decision is addressed to Luxembourg.

Done at Brussels, 21.10.2015

For the Commission

Margrethe VESTAGER
Member of the Commission