EUROPEAN COMMISSION

Brussels, 11.06.2014

C(2014) 3627 final

In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, 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.

Subject: State aid SA. 38375 (2014/NN) (ex 2014/CP) – Luxembourg

Alleged aid to FFT

Sir,

The Commission wishes to inform Luxembourg that, having examined the information supplied by your authorities on the measure referred to above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union ("TFEU").

1. PROCEDURE

(1) By letter of 19 June 2013, the Commission sent to the Luxembourgish authorities an information request with detailed questions on the country's tax ruling practice.

(2) By letter of 17 July 2013, the Luxembourgish authorities answered in general terms to that letter and submitted part of the requested information.

Son Excellence
Monsieur Jean ASSELBORN
Ministre des Affaires étrangères
Hôtel Saint-Maximin
5, rue Notre-Dame
L-2240 Luxembourg

(3) By letter of 15 January 2014, the Luxembourgish authorities submitted 22 rulings relating to the period 2010-2013, but the taxpayers' names had been redacted from those documents. According to the Luxembourgish authorities, those 22 rulings – one of which related an Advance Pricing Arrangement ("APA") addressed to a company referred to as FFT (the "FFT APA") - were representative of the Luxembourg ruling practice.

(4) The FFT APA contained the following documents[1]:

(i) a letter by KMPG (hereinafter the "tax advisor") on behalf of its client FFT dated 14 March 2012, containing a request for an agreement on a transfer pricing arrangement;

(ii) a transfer pricing report by KPMG in support of FFT's APA request;

(iii) a letter by the Luxembourgish tax authorities dated 3 September 2012 by which those authorities agreed to the transfer pricing proposal of KMPG.

(5) By letter of 7 March 2014, the Commission asked the Luxembourgish authorities to confirm whether "Fiat Finance and Trade Ltd" was the taxpayer referred to as FFT. The Commission also indicated that, based on the submitted information, it could not exclude that the FFT APA represented State aid in favour of FFT incompatible with the internal market. The Commission requested the Luxembourgish authorities to provide additional information which would be relevant for the assessment of the FFT APA.

(6) Since the Luxembourgish authorities did not reply to that letter, the Commission sent a reminder on 7 April 2014 giving Luxembourg an additional 15 days to provide the requested information.

(7) On 24 April 2014, the Luxembourgish 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 Luxembourgish authorities referred to secrecy provisions under Luxembourgish law and argued that those provisions prohibited them from confirming the identity of the taxpayer.

(8) On 24 March 2014, the Commission issued an information injunction decision[2] to which the Luxembourgish authorities have not replied. Instead, the Luxembourg authorities informed the Commission on 24 April 2014 that they had appealed that information injunction.

(9) On 22 May 2014, the Commission issued a letter of formal notice based on Article 258 TFEU indicating that it would challenge the non-compliance with

[1] The Luxembourgish authorities had redacted selected information, in particular, the names of companies and subsidiaries.

[2] SA.37267, Pratiques en matière de ruling fiscal – Luxembourg, Not yet published. The Commission had sent detailed questions at an earlier stage, which the Luxembourg authorities did not answer

that information injunction before the Court of Justice of the European Union after giving Luxembourg a last opportunity for comments.

2. DESCRIPTION

2.1. Introduction to transfer pricing rulings

(10) This decision concerns tax rulings which validate transfer pricing arrangements, also known as APAs. APAs are arrangements that determine, in advance of intra-group transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time[3]. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations. APAs are intended to supplement the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues[4].

(11) Transfer pricing refers in this context to the prices charged for commercial transactions between various parts of the same corporate group, in particular prices set for goods sold or services provided by one subsidiary of a corporate group to another subsidiary of that same group. The prices set for those transactions and the resulting amounts calculated on the basis of those prices contribute to increase the profits of one subsidiary and decrease the profits of the other subsidiary for tax purposes, and therefore contribute to determine the taxable basis of both entities. Transfer pricing thus also concerns profit allocation between different parts of the same corporate group.

(12) Multinational corporations pay taxes in jurisdictions which have different tax rates. The after tax profit recorded at the corporate group level is the sum of the after-tax profits in each county in which it is subject to taxation. Therefore, rather than maximise the profit declared in each country, multinational corporations have a financial incentive when allocating profit to the different companies of the corporate group to allocate as much profit as possible to low tax jurisdictions and as little profit as possible to high tax jurisdictions. This could, for example, be achieved by exaggerating the price of goods sold by a subsidiary established in a low tax jurisdiction to a subsidiary established in a

---

[3] APAs differ in some ways from more traditional private rulings that some tax administrations issue to taxpayers. An APA generally deals with factual issues, whereas more traditional private rulings tend to be limited to addressing questions of a legal nature based on facts presented by a taxpayer. The facts underlying a private ruling request may not be questioned by the tax administration, whereas in an APA the facts are likely to be thoroughly analysed and investigated. In addition, an APA usually covers several transactions, several types of transactions on a continuing basis, or all of a taxpayer's international transactions for a given period of time. In contrast, a private ruling request usually is binding only for a particular transaction. See, OECD Guidelines, paragraph 4.132.

[4] OECD Guidelines, paragraph 4.123. Since APAs concern the remuneration for transactions that have not yet taken place, the reliability of any prediction used in an APA therefore depends both on the nature of the prediction and the critical assumptions on which that prediction is based. Those critical assumptions may include amongst others circumstances which may influence the remuneration for the transactions when they eventually take place.

high tax jurisdiction. In this manner, the higher taxed subsidiary would declare higher costs and therefore lower profits when compared to market conditions. This excess profit would be recorded in the lower tax jurisdiction and taxed at a lower rate than if the transaction had been priced at market conditions.

(13) Those transfer prices might therefore not be reliable for tax purposes and should not determine the taxable base for the corporate tax. If the (manipulated) price of the transaction between companies of the same corporate group were taken into account for the assessment of the taxable profits in each jurisdiction, it would entail an advantage for the firms which can artificially allocate profits between associate companies in different jurisdictions compared with other undertakings. So as to avoid this type of advantage, it is necessary to ensure that taxable income is determined in line with the taxable income a private operator would declare in a similar situation.

(14) The internationally agreed standard for setting such commercial conditions between companies of the same corporate group or a branch thereof and its mother company and thereby for the allocation of profit is the "arm's length principle" as set in Article 9 of the OECD Model Tax Convention, according to which commercial and financial relations between associated enterprises should not differ from relations which would be made between independent companies. More precisely, using alternative methods for determining taxable income to prevent certain undertakings from hiding undue advantages or donations with the sole purpose of avoiding taxation must normally be to achieve taxation comparable to that which could have been arrived at between independent operators on the basis of the traditional method, whereby the taxable profit is calculated on the basis of the difference between the enterprise's income and charges.

(15) The OECD Transfer Pricing Guidelines[5] (hereinafter the "OECD Guidelines") provides five such 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 transactional net margin method (hereinafter "TNMM") and (v) the transactional profit split method. The OECD 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.

(16) Traditional transaction methods are regarded as the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are at arm's length[6]. All three traditional transaction methods approximate an arm's length pricing of a specific intra-group transaction, such as the price of a certain good sold or service provided to a related company. In particular, the CUP method consists in observing a

5 Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, OECD, 2010
6 OECD Guidelines, paragraph 2.3.

comparable transaction between two independent companies and applying the same price for a comparable transaction between group companies. The cost plus method consist in approximating the income from goods sold or services provided to a group company. The resale minus method consists in approximating the costs of goods acquired from or services provided by a group company. Other elements which enter into the profit calculation (such as personal costs or interest expenses) are calculated based on the price effectively paid to an independent company or are approximated using one of the three direct methods.

(17) The transactional profit methods, by contrast, do not approximate the arm's length price of a specific transaction, but are based on comparisons of net profit indicators (such as profits, margins, return on assets, operating income to sales, and possibly other measures of net profit) between independent and associated companies as a means to estimate the profits that one or each of the associated companies could have earned had they dealt solely with independent companies, and therefore the payment those companies would have demanded at arm's length to compensate them for using their resources in the intra-group transaction[7]. For this purpose, the TNMM relies on a net profit indicator which refers, in principle, to the ratio of profit weighted to an item of the profit and loss account or of the balance sheet, such as turnover, costs or equity. To this selected item, a margin is applied which is considered "arm's length" to approximate the amount of taxable profit. When the TNMM is used in combination with a net profit indicator based on costs, it is sometimes referred to as "cost plus" in exchanges between the taxpayer and the tax administration, but this should not be confused with the "cost plus method" described in the OECD Guidelines as described in the previous recital.

(18) The application of the arm's length principle is generally based on a comparison of the conditions in an intra-group transaction with the conditions in transactions between independent companies. For such comparisons to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences[8]. To establish the degree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof), it is necessary to compare attributes of the transactions or companies that would affect conditions in arm's length transactions. The OECD Guidelines list as attributes or "comparability factors" that may be important when determining comparability: the characteristics of the property or services transferred; the functions performed by the parties, taking into account assets used and risks assumed (functional analysis); the contractual terms; the economic circumstances of the parties; and the business strategies pursued by the parties[9].

[7] OECD Guidelines point 1.35.
[8] OECD Guidelines point 1.33.
[9] OECD Guidelines point 1.36.

2.2. The beneficiary: FFT

(19) The present decision concerns a tax ruling on transfer pricing granted to FFT in 2012. Based on the information provided by the Luxembourgish authorities[10], it is assumed that FFT is Fiat Finance and Trade Ltd., which is part of the Fiat Group.

(20) The Fiat Group is 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 as "Fiat"). Fiat carries out industrial and financial services activities in the automobile sector. It designs, engineers, manufactures, distributes and sells mass-market vehicles. Its brands include Fiat, Alfa Romeo, Lancia, Abarth, Ferrari, Maserati and also a number of Chrysler brands (such as Chrysler, Jeep, Dodge and Ram). In addition, Fiat is also active in the components sector (through Magneti Marelli and Teksid), the production systems sector (through Comau) and in after-sales services/products (under the Mopar brand name). Finally, to support its car activities, the group also provides retail and dealer finance, leasing and rental services (via subsidiaries, joint ventures and commercial agreements with specialised financing services providers). On 24 May 2011, Fiat acquired control of Chrysler[11] and from that date (for practical purposes as of 1 June 2011) Fiat consolidated Chrysler's financial results. Chrysler relies directly on capital markets funding for its operations. Fiat has locations in approximately 40 countries and commercial relationships in more than 140 countries. Fiat's car operations are run on a regional basis, for which Fiat uses the following geographical reporting segments: NAFTA (United States, Canada and Mexico), LATAM (South and Central America, excluding Mexico), APAC (Asia and Pacific countries) and EMEA (Europe, Russia, Middle East and Africa). Fiat reported revenues of EUR 86 816 million in 2013 and a net profit of EUR 1 951 million. In 2012, the corresponding figures were respectively EUR 83 957 million (revenues) and EUR 896 million (net profit).

(21) FFT is owned approximately 40% by Fiat S.p.A. and approximately 60% by Fiat Finance S.p.A., which in turn is a wholly-owned subsidiary of Fiat S.p.A.[12] FFT recorded pre-tax income of EUR 1 572 300 and of EUR 2 334 301 for the years 2012 and 2013 respectively[13]. 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 group companies based in the

[10] The transfer pricing report submitted by Luxembourg in support of the FFT APA contains financial information such as the fact that the revenues of the group amounted to EUR 59 559 million in 2011 (of which 15.5% were realised in Italy and 20.7% in the rest of Europe) and to EUR 35 880 million in 2010. This information as well as information about the number of employees of 197 021 in 2011 coincides with the figures in the 2011 Annual report of Fiat S.p.A. see Annual report of Fiat S.p.A. of 31 December 2011, pages 24, 25 and 30. Moreover, the Annual report indicates that Fiat S.p.A. has a consolidated subsidiary based in Luxembourg called Fiat Finance and Trade Ltd S.A. which issues bonds on the market (see page 249 of Annual report of Fiat S.p.A. of 31 December 2011).

[11] Following the acquisition of an incremental 16% stake in Chrysler, in addition to potential voting rights associated with options that became exercisable thereafter.

[12] Base Prospectus, Fiat S.p.A., 14 March 2014

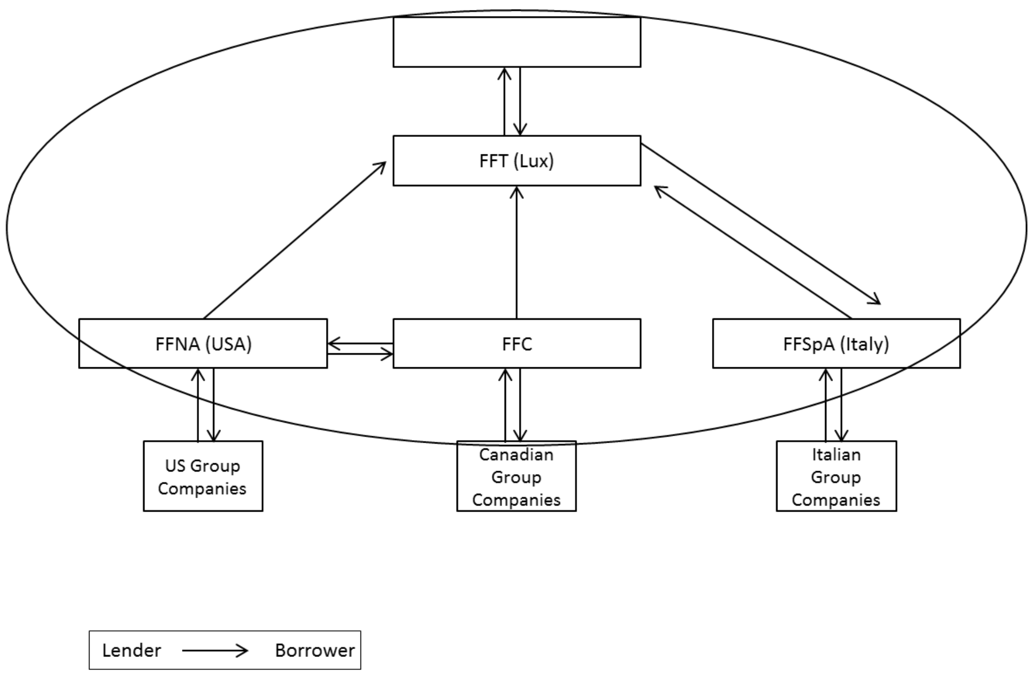
[13] Base Prospectus, Fiat S.p.A., 14 March 2014

[European country 1][*], [European country 2], [European country 3], the [European country 4], [European country 5], [European country 6], [European country 7] and [European country 8]. 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.

(22) The transfer pricing report provided by Luxembourg on 15 January 2014, contains the following information about FFT, which was, however, partially redacted[14]:

(23) 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.

Figure 1: FFT Intra-Sector transactions



(24) The treasury companies are organized as follows:

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

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

(i) FFSpA is the Italian-based treasury company in charge of the coordination of the financing operation for the group companies based in Italy;

(ii) FFT operates as treasury company for the group companies based in Europe (excluding Italy);

(iii) FFNA works for the US-based group companies;

(iv) FFC works for the Canada-based group companies;

(v) FFB performs treasury functions for the [non-European country]-based group companies.

FFT holds 100% of FFNA and of FFC.

(25) Based on the information in the transfer pricing report, it is assumed that FFNA is Fiat Finance North America, Inc. and FFC is Fiat Finance Canada Ltd.

(26) The cross-border intra-group transactions may be grouped in two main categories:

(i) <u>Transactions between treasury companies (Intra-Sector)</u>

§ T1 – intercompany loans from FFT to FFSpA: 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

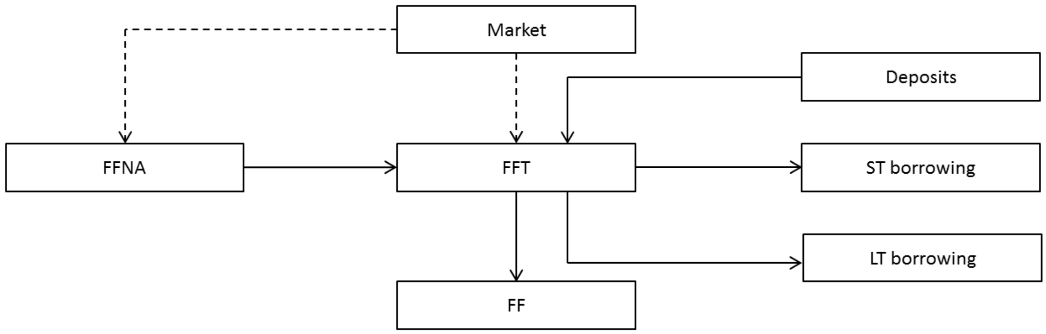
(ii) <u>Transactions between treasury companies and the group companies (Intra-group)</u>

§ T3 – transactions (loans/deposits) between FFT and the group companies located in other countries (mostly European);

§ T4 – guarantees provided 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).

Figure 2 illustrates the financing operations (from T1 to T3)

Figure 2: Main cross-border Intra-group transactions



(27) 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.

(28) 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. With regards 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, it would be mainly by using Interest Rate Swaps (“IRS”) and Forward Rate Agreements (“FRA”).

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

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

(31) 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 [European country 1] , [European country 2], [European country 3], the [European country 4], [European country 5], [European country 6],

[European country 7] and [European country 8]. On a daily basis, balances by country are centralized 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.

(32) The interest rate on intra-group loans is set as the sum of the group's weighted average cost of capital 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.

(33) 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.

(34) The main risks generally faced by the treasury companies are as follows:

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

(ii) Credit risk relative to bank deposits or other similar short term investments. 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 […][15]; over time, there have not been any insolvency cases within the group; group companies do not register allowances for doubtful accounts for group debt.

(iii) Counterparty risk relative to the derivative assets held with third parties (banks). This risk is mitigated since FFT deals only with major financial institutions and the derivative business is allocated among many

[15] The transfer pricing report does not contain a justification of this statement, which is reproduced here.

institutions. Group assets are not exposed to this risk for the reasons mentioned above.

(iv) Operational risk. FFT performs its financial operations in line with the guidelines. Financial activities are constantly monitored and subject to risk management control procedures to avoid any failure in the daily process.

(35) 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 the financial market performance.

2.3. The contested measure

2.3.1. The FFT APA

(36) By letter of 3 September 2012, the Luxembourgish tax authorities (*Administration des contributions directes*) confirmed that the transfer pricing analysis based on the transfer pricing report prepared by the tax advisor on behalf of FFT respects the arm's length principle. According to that letter, the decision by the tax authorities is binding for 5 years (i.e. from tax year 2012 to tax year 2016)[16]. The documents provided by Luxembourg as constituting all elements essential to support the FFT APA consist of two letters, one by the tax advisor of FFT and one from the tax administration, as well as a transfer pricing report.

(37) The arm's length remuneration of FFT, as established in the transfer pricing report and accepted by the FFT APA, 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.*" (sic). On this remuneration, the standard tax rate of 28.80% is applied. Moreover, the remuneration is considered arm's length and will not lead to any adjustment over a 5 year period

(38) In the FFT APA, that remuneration is calculated using the TNMM; in the application of the TNMM, the profit allocation is determined by using the Capital Asset Pricing Model (hereinafter the "CAPM"). As explained at recital (15), the TNMM consists in applying an arm's length margin to a net profit indicator. In the FFT APA, equity was chosen as the net profit indicator, in which context an approximated arm's length margin on equity was estimated through the CAPM financial model.

(39) The CAPM is used to estimate a theoretical required rate of return on assets, more specifically on equity. This return is estimated based on the variations of the price of shares, which is used to measure risk. The basis axiom of financial

[16] However, the APA 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 APA agreement is no longer compliant with national or international law.

models is that the required return for an asset is higher when the risk of that asset is higher. The CAPM model is based on separating the overall risk of an asset into diversifiable risk and non-diversifiable risk. A rational investor, according to financial theory, diversifies its risk by investing in several securities (a portfolio) instead of investing in only one security. Because the share prices of different securities are not perfectly correlated, that is, they do not all fall in price at the same time, the risk of a portfolio is lower than adding the risk of the securities comprising the portfolio.

(40) As a rational investor would therefore invest in a diversified portfolio rather than in only one security, the CAPM model considers that an efficient market would only remunerate the non-diversifiable risk component for each asset[17]. This non diversifying risk is measured as the correlation of the asset price movements with the price movements of the diversified portfolio (the diversified portfolio is usually considered to be the entire market and approximated by a wide market index). This correlation is multiplied by the standard deviation of the asset and divided by the standard deviation of the diversified portfolio to calculate the beta; dividing by the standard deviation of the diversified portfolio ensures that the value of the beta of the diversified portfolio, that is the beta of the market, is equal to one.

(41) In the CAPM model, the beta is the main parameter determining the required remuneration of the equity. To arrive at the figure of the hypothetical required remuneration of equity, the beta is multiplied by the risk premium, which is defined as the difference of the market return and the risk-free return. This product is added to the risk-free rate. The calculation of the hypothetical required return on the basis of the beta is done as follows:

$$\textit{Expected Return of asset} = \textit{Risk Free Rate} + \beta \textit{ of asset} \times \textit{Risk Premium}$$

(42) To illustrate the effect of the beta on the hypothetical required return, it could be expected, for example, that when the overall market increases by 1% point, an asset with a beta equal to 2 would increase in price by about 2% points.

2.3.2. The transfer pricing report

(43) According to the transfer pricing report submitted by FFT to the Luxembourg tax authorities, the method considered as most appropriate to determine the taxable profit of FFT is the TNMM. According to the tax advisor, TNMM would be particularly adequate when, within the transaction, there is one party not making valuable and unique contributions. Since FFT performs only financial services, this method would be considered the most appropriate to determine arm’s length pricing in line with the OECD Guidelines.

(44) The TNMM can be applied by making an internal or an external comparison. FFT performs its functions to the Fiat group companies only, which do not receive any similar type of services by third parties. For this reason, an internal comparison would not be possible. Instead, the tax advisor considers an external

[17] The diversifiable risk is not remunerated because it can be removed through diversification.

comparison more appropriate by identifying the net margins that would have been earned in comparable transaction enterprises.

(45) According to the tax advisor and in reference to the OECD Guidelines[18], when applying the TNMM, it is necessary to choose the party to the transaction for which a financial indicator is tested (the "tested party"). As a general rule, the tested party is the least complex of the enterprises involved in the controlled transaction and does not own valuable intangible property or unique assets. FFT is the less complex entity - tested party – of the case.

(46) The transfer pricing report refers to the OECD Guidelines for the choice of the most appropriate net profit indicator for the application of the TNMM. As regards the numerator reference is made to paragraph 2.83 of those guidelines which states: "*for financial activities where the making and receiving of advances constitutes the ordinary business of the taxpayer, it will generally be appropriate to consider the effect of the interest and the amounts in the nature of interest when determining the net profit indicator*". As regards the denominator, reference is made to the "*return on assets (or on capital)*" in paragraph 2.97 of those guidelines where assets are a better indicator of the value added by the taxpayer in capital intensive financial activities.

(47) The remuneration due to FFT was established by reference to the capital needed by FFT to perform its functions and to bear its risks, with respect to the assets in use.

(48) The estimate of the arm's length remuneration for FFT includes the following steps: 1) estimate of the capital at risk (in application of the Basel II criteria); 2) identification of the capital used to perform the functions and to support the financial investments; 3) estimate of the expected return of capital by using the CAPM to remunerate the capital at risk and identification of the return to reward the capital used to perform the functions; and 4) estimate of the overall profitability to be left to FFT to remunerate the functions performed and the risks borne by FFT.

(49) The equity comprises the capital needed to support the functions undertaken, the assets used and the risks assumed by FFT. Equity has been analysed by applying the Basel II criteria, distinguishing the minimum capital requirement to cover the following risks: operations, exchange rate, credit and counterparty risk. Based on the functional analysis, FFT bears operational, credit and counterparty risks while the exchange rate risk is nil. Based on the Basel II criteria, the estimation of the risks is as follows:

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

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

[18] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, OECD, 2010.

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

The results of the application of the Basel II criteria are summarized in Table 1:

Table 1

Minimum capital requirement	**2011**
Operational risk	938
Counterpart risk	2.603
Exchange rate risk	0
Credit risk	24.982
Minimum capital required by Basel II	28.523

(50) The capital used to perform the functions is estimated by deducting the portion of capital at risk and the capital used to support the financial investments. FFT equity amounts as of end of 2011 to EUR 287.5 million of which:

(i) EUR 28.5 million are the minimum capital, estimated by using the Basel II criteria, to bear the risks;

(ii) EUR [100-200] million are used to offset the participation interests in FFNA and FFC[19];

(iii) EUR [75-150] million are the capital used to perform the functions.

Table 2 provides for the breakdown of the equity

Table 2

FFT Equity breakdown	**Equity 2011**
Minimum Equity at risk	28.523
Equity supporting the financial investments in FFNA and FFC	[100.000-200.000]
Equity backing the functions performed	[75.000-150.000]
Total Equity	287.477

(51) The minimum capital is remunerated with the expected return on equity, estimated by using the CAPM, whereby:

Expected Return Pre-Tax = (Risk Free Rate + β*×Equity Risk Premium)/(1-tax rate)*

The expected return on equity has been computed by using the following variables:

(i) Beta of 0.29 estimated[20] on the basis of 66 comparable set of companies performing financial services, provided by the Damoradan website[21];

[19] The equity has been reduced by the value of the participations in FFNA and FFC, the latter being remunerated with dividends.

(ii) Risk free rate of 2.85% (10 years German Government Bond “Bund”, 2011 year average);

(iii) Luxembourg tax rate of 28.80%;

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

As a result, the expected return on equity investors would expect to receive for the risks taken amounts to 6.05%.

The portion of equity used to perform the functions has been remunerated by using the market interest rate applied to short term deposits[22].

[20] The 25th percentile of betas has been employed as it is considered that FFT bears limited risks

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

[22] 2011 year average Eonia (Euro OverNight Index Average)

Computation recap of the minimum capital requirement and impact on the result before taxes of FFT

Table 3

Minimum Capital Requirement	FFT 2011	
(amounts in Euro/000)		
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	[100.000-200.000]	x
Excess Capital	[75.000-150.000]	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	[1.000-2.000]	k=h*e
Functions remuneration	[500-1.000]	j=i*f
Total EBT	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

Main financial and economic data (Source: 2009, 2010 and 2011 statutory financial statement of FFT)

Table 4

Statutory Financial Statement			
(€/000)	2009	2010	2011
EBIT	-3.457	-3.419	-3.655
Financial Revenues	526.900	685.852	727.552
Financial Changes	-520.749	-679.948	-721.270
EBT	2.694	2.485	2.627
Net Result	1.874	1.737	1.851
EBT/Equity	0.90%	0.90%	0.90%
Equity	293.888	285.625	287.477
Debt with Group companies	2.723.099	4.355.518	2.275.578
Debts with third parties	11.377.877	10.186.531	8.192.745
Liabilities	14.394.864	14.827.674	10.755.800
Fixed Assets	306	155	165.433
Receivables with Group Companies	10.456.794	11.954.726	7.387.279
Receivable with third parties	199.364	167.171	174.832
Cash and banks	3.738.400	2.705.622	3.028.256
Assets	14.394.864	14.827.674	10.755.800

Arm’s length range of betas of comparable companies

Table 5

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

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

Table 6

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
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

3. ASSESSMENT

3.1. Existence of aid

(52) According to Article 107(1) 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.

(53) The qualification of a measure as aid within the meaning of Article 107(1) therefore requires the following cumulative conditions to be met: (i) the measure must be imputable to the State and financed through State resources; (ii) it must confer an advantage on its recipient; (iii) that advantage must be selective; and (iv) the measure must distort or threaten to distort competition and have the potential to affect trade between Member States.

(54) The main question in the present case is whether the APA confers a selective advantage upon FFT in so far as it results in a lowering of its tax liability in Luxembourg. If the existence of a selective advantage can be shown, the presence of the other two conditions for a finding of State aid under Article 107(1) TFEU is relatively straightforward.

(55) As regards the imputability of the measure, the contested APA was issued by the Luxembourgish tax authorities, which is part of the Luxembourgish State. In the present case, this APA was used by FFT to calculate its corporate income tax basis in Luxembourg. The Luxembourgish tax authorities has accepted those calculations and on that basis set the tax due.

(56) As regards the measure's financing through State resources, provided it can be shown that the contested APA resulted in a lowering of FFT's tax liability in Luxembourg, it can also be concluded that this APA gives rise to a loss of State resources. That is because any reduction of tax for FFT results in a loss of tax revenue that otherwise would have been available to Luxembourg[23].

(57) As regards the fourth condition for a finding of aid, Fiat is a globally active firm, operating in various Member States, so that any aid in its favour distorts or threatens to distort competition and has the potential to affects intra-Union trade.

(58) Finally, as regards the presence of a selective advantage, it follows from the case-law that the notion of aid encompasses not only positive benefits, but also measures which in various forms mitigate the charges which are normally included in the budget of an undertaking[24]. At the same token, treating taxpayers on a discretionary basis may mean that the individual application of a general measure takes on the features of a selective measure, particularly, where the

---

[23] Joined Cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and United Kingdom* [2011] ECR I-11113, paragraph 72.

[24] Case C-143/99 *Adria-Wien Pipeline* [2001]ECR,I-8365, paragraph 38.

exercise of the discretionary power goes beyond the simple management of tax revenue by reference to objective criteria.[25]

(59) Accordingly, APAs should not have the effect of granting the undertakings concerned lower taxation than other undertakings in a similar legal and factual situation. Tax authorities, by accepting that multinational companies depart from market conditions in setting the commercial conditions of intra-group transactions through a discretionary practice of tax rulings, may renounce taxable revenues in their jurisdiction and thereby forego State resources, in particular when accepting commercial conditions which depart from conditions prevailing between independent economic operators[26].

(60) In order to determine whether a method of assessment of the taxable income of an undertaking gives rise to an advantage, it is necessary to compare that method to the ordinary tax system, based on the difference between profits and losses of an undertaking carrying on its activities under normal market conditions. Thus, where an APA concerns transfer pricing arrangements between related companies within a corporate group, that arrangement should not depart from the arrangement or remuneration that a prudent independent operator acting under normal market conditions would have accepted[27].

(61) In this context, market conditions can be arrived at through transfer pricing established at arm's length. The Court of Justice has confirmed that if the method of taxation for intra-group transfers does not comply with the arm's length principle[28], and leads to a taxable base inferior to the one which would result from a correct implementation of that principle, it provides a selective advantage to the company concerned.[29]

(62) The OECD Guidelines are a reference document recommending methods for approximating an arm's length pricing outcome and have been retained as

[25] Case C-241/94 *France v Commission (Kimberly Clark Sopalin)* [1996] ECR I-4551, paragraphs 23 and 24.

[26] If, instead of issuing a ruling, the tax administration simply accepted a method of taxation based on prices which depart from conditions prevailing between independent economic operators, there would also be State aid. The main problem is not the ruling as such, but the acceptance of a method of taxation which does not reflect market principles.

[27] Commission Decision 2003/757/EC of 17 February 2003, Belgian Coordination centres, OJ L 282, 30.10.2003, p. 25, recital 95.

[28] In particular, rulings allowing taxpayers to use improper transfer pricing methods for calculating taxable profits, e.g. the use of fixed margins for a cost-plus or resale-minus method for determining an appropriate transfer pricing may involve State aid- See Commission Decision 2003/438/EC of 16 October 2002 on State aid C 50/2001, Luxembourg Finance Companies, OJ L 153, 20.6.2003, p. 40, recitals 43 and 44; Commission Decision 2003/501/EC of 16 October 2002 on State aid C 49/2001, Luxembourg Coordination centres, OJ L 170, 9.7.2003, p. 20, recitals 46-47 and 50; Commission Decision 2003/755/EC of 17 February 2003, Belgian Coordination centres, OJ L 282, 30.10.2003, p. 25, recitals 89 to 95 and the related Joined Cases C- 182/03 and C-217/03 Belgium and Forum 187 v. Commission [2006] ECR I-5479, paragraphs 96 and 97; Commission Decision 2004/76/EC of 13 May 2003, French Headquarters and Logistic Centres, OJ L 23, 28.1.2004, p. 1, recitals 50 and 53

[29] See Joined Cases C- 182/03 and C-217/03 *Belgium and Forum 187 v. Commission* [2006] ECR I-5479, paragraph 95.

appropriate guidance for this purpose in previous Commission decisions[30]. The different methods explained in the OECD Guidelines can result in a wide range of outcomes as regards the amount of the taxable basis. Moreover, depending on the facts and circumstances of the taxpayer, not all methods approximate a market outcome in a correct way. When accepting a calculation method of the taxable basis proposed by the taxpayer, the tax authorities should compare that method to the prudent behaviour of a hypothetical market operator, which would require a market conform remuneration of a subsidiary or a branch, which reflect normal conditions of competition. For example, a market operator would not accept that its revenues are based on a method which achieves the lowest possible outcome if the facts and circumstances of the case could justify the use of other, more appropriate methods.

(63) It is in the light of these general observations that the Commission will examine whether the FFT APA complies with the arm's length principle or whether they give rise to a selective advantage conferred by the Luxembourgish tax authorities upon that undertaking. At this stage, the Commission has the following doubts as regards compliance with that principle:

(64) In the first place, the Commission observes that the transfer pricing report seems to aim at a fixed tax base of EUR 2.542 million (+/- 10%), as described in recital (37), which would translate into a fixed range for the taxable basis of EUR 2.288 to 2.796 million. It is not clear from the FFT APA whether the authorities agree to that fixed range or to the calculation method proposed. However, by agreeing to a taxable basis which can vary only marginally, the Luxembourgish tax authorities disregard any significant increase or decrease in the activities of FFT. Such an approach – i.e. a virtually fixed tax base – could only reflect economic reality if it was very likely that the underlying business would remain stable throughout the duration of the APA's validity. The information submitted by the Luxembourgish authorities does not, however, contain any guarantees or predictions which indicate that FFT will maintain a stable business in the period covered by the APA. Moreover, it does not follow from that APA that FFT's tax base would be modified if it doubled its underlying activities.

(65) In the second place, the Commission has doubts that the calculation of the taxable basis of FFT reflects an appropriate arm's length remuneration. The Commission observes that FFT's tax advisor used the TNMM method to estimate the arm's length profit level (see recital (43)). The TNMM method is one of two indirect methods for estimating the profit level according to the OECD Guidelines. However, according to the case law[31], as well as those guidelines[32], the use of direct methods for setting an appropriate level of profits is preferred. In particular, it is acknowledged that, whenever possible, the CUP

[30] Cf. Commission Decision 2003/755/EC of 17 February 2003, Belgian Coordination centres, OJ L 282, 30.10.2003, p. 55, recitals 89 to 95 and decision of 5 September 2002 in case C 47/01 German Coordination Centres, OJ 2003 L 177/17, para 27 and 28.

[31] See Joined Cases C- 182/03 and C-217/03 *Belgium and Forum 187 v. Commission* [2006] ECR I-5479, paragraph 95.

[32] Paragraph 2.3

method is best at approximating conditions prevailing between prudent independent operators. FFT could have attempted to value a number of the profit and loss items using the CUP method, for example, the fact that Chrysler, the US company of the group, issues bonds itself (see recital (20)) could provide for a point of reference for the pricing of intra-group loans.

(66) Nevertheless, the selection of the net profit indicator in FFT APA, which was capital employed, does not as such seem to contradict the OECD Guidelines[33]. For the FFT APA, the arm's length remuneration for the functions and risks performed by FFT is calculated on the basis of the CAPM, which is a commonly used methodology to estimate required equity returns. However, in the calculation of the taxable basis of FFT, the Commission considers at this stage that both components which determine the estimated arm's length remuneration on the basis of the CAPM are set at too low a level: (i) the amount of capital remunerated and (ii) the level of remuneration applied to this capital amount.

(67) On the one hand, as regards the amount of capital remunerated, the FFT APA accepts, in accordance with the transfer pricing report, that a number of elements are subtracted from the capital basis and the required equity remuneration is applied only to a small proportion of the capital of FFT (see recital (50) above). Table 2 and Table 3 illustrate that only 9.9%[34] of equity is referred to as "equity at risk" of FFT and remunerated accordingly with the required rate of return on equity. The Commission has the following doubts on the method employed:

(68) Firstly, the CAPM estimates the required return on equity and not the required return on regulatory capital or on "equity at risk". This is because the beta is based on a variation of the return on the share price and not on minimum regulatory capital. If minimum regulatory capital were used for the calculation of the beta, the results would be different. The Commission therefore has doubts whether the CAPM method can be transposed to a lower capital base than total equity.

(69) In particular, the Commission observes that the equity which is injected into FFNA and FFC is deducted from the equity to be remunerated and that the transfer pricing report justified this deduction by the fact that the investments in FFNA and FFC would be remunerated with dividends[35]. There is no explanation, however, why this equity should be deducted from the capital to be remunerated, nor does there seem to be a financial logic in this deduction. The Commission notes that no tax logic is invoked in the report.

---

33 In particular, according to paragraph 2.97 "*returns on assets (or on capital) can be an appropriate base in cases where assets […] are a better indicator of the value added by the tested party, e.g. in certain manufacturing or other asset-intensive activities and in capital-intensive financial activities.*" Paragraph 2.86 of the OECD Guidelines also indicates that for capital intensive industries which involve significant investment risk the capital employed might be an appropriate profit line indicator.

34 EUR 28 523 thousand over EUR 287 477 thousand.

35 See footnote 19.

(70) Secondly, the Commission considers that the way in which the "equity at risk" is calculated might result in a too low taxable basis. The equity at risk is calculated by analogy to the Basel II framework in the context of which banks are required to hold capital in proportion of their "risk weighted assets". The assets are weighted based on the Basel II regulation depending on their rating or based on internal risk models. Some assets could be considered risk-free and would not generate capital needs. However, the Basel II framework is in principle limited to sovereign bonds with a rating of AAA to AA-[36].

(71) Against this background, the Commission notes that in approximating the regulatory capital need in analogy to the Basel II framework, the FFT APA disregards all assets other than third party assets (see recital (49)). This means that the FFT APA considers that these assets, like high-quality government bonds, would not generate any capital needs. This treatment of not allocating any capital needs to the intra-group assets would be based on the assumption that there is no risk of default for the group because "*the group has interest to financially support all the group companies*" and because no defaults are observed (see recital (34)).

(72) The Commission has doubts as to the validity of this justification. Although the creditworthiness of a parent company can impact the calculation of the creditworthiness of its subsidiary, banks do not exclude assets from risk weighting on that basis. This is even more so in the present case, considering that the creditworthiness of the Fiat Group is much lower than the creditworthiness of a highly-rated sovereign[37].

(73) The Commission therefore questions the assumption that there is no credit/counterparty risk on operations with group companies and considers that this assumption might not be in line with the arm's length principle. Indeed, it is difficult to accept that an independent market operator in a competitive market would not set aside capital for loans granted to group companies, especially considering that in the present case those group companies are active in the car industry and related industries which are characterised by strong competition and which historically have been cyclical and volatile. The hypothesis to not provide capital for intra-group loans is all the more surprising as the transfer pricing report makes reference to "*significant amount of financial assets, which are mainly related to intercompany loans*" when describing the "*assets used*" by FFT[38]. As reflected in Table 4, intra-group exposure represents 69% of the total assets in 2011[39], so that this exclusion decreases the estimated minimum regulatory capital proportionately.

---

36 This would be the case under the so called "standardised approach", which is the Basel II approach that does not use internal models because such models have not been developed or approved by the regulator. The transfer pricing report does not indicate that FFT would have such models. The rating used to compute the risk-weight is under the standardised approach the rating provided by an external credit assessment institution. One or more rating agencies can be retained by each bank as a reference for providing credit ratings used as input in the risk weighting calculation.

37 Fiat currently has a non-investment grade credit rating.

38 See recital (35).

39 See Table 4.

(74) Thirdly, the report does not explain why a relatively low risk weight factor of 20% would be justified, nor does the report nor the FFT APA contain a provision which describes what will happen if the regulatory framework (i.e. Basel II) will change in a meaningful manner. Moreover, the Commission also observes that the transfer pricing report does not contain any justification for the parameters used to calculate the minimum required capital as described in recital (49). Indeed, the report does not explain why the "*difference between creditor interests accrued on bank deposits and debtor interests accrued on bank loans*" is a good indication of operational risk and it does not explain why that risk has to be weighted at 15%. In any event, the Commission believes that a prudent independent operator would ensure that it has a certain prudential margin on top of the minimum capital requirements, so that it is not immediately faced with a capital shortfall if a problem arises.

(75) Finally, the transfer pricing report as endorsed by the Luxembourg tax authorities seems to contain a mistake as regards the minimum capital requirements under Basel II. In fact, to arrive at the "minimum capital required by Basel II" in Table 1 the counterparty risk is multiplied by 6% (see recital (49)). However, the minimum capital requirement for counterparty risk under Basel II is 8% of risk weighted assets, not 6%. In fact, according to the Basel II framework "*[t]he total capital ratio must be no lower than 8%*"[40]. In light of this error, the Commission considers, at this stage, that the counterparty risk component of the equity at risk is undervalued at least by one fourth and the taxable basis is too low.

(76) On the other hand, as regards the level of remuneration, the Commission has the following doubts at this stage.

(77) Firstly, the Commission observes that the Luxembourgish tax authorities accepted the comparables selected by the tax advisor for the determination of an appropriate beta in the transfer pricing report without making any effort to filter out names which might not be appropriate peers. Indeed, the list of 66 companies 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. However, the functions and risks of central banks are very different from any commercial bank or a treasury company like FFT.

(78) The beta of companies performing financial services (considered to be the relevant comparables in the transfer pricing report, see recital (51)) tends to be relatively high, in fact, 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[41]. Furthermore, almost all banks participating in the index had a beta above 1. Therefore, the beta of 0.29 retained for F&T seems at odds

---

40 International Convergence of Capital Measurement and Capital Standards, Bank for International Settlement, June 2006, page 12, http://www.bis.org/publ/bcbs128.pdf

41 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.

with the beta of the financial sector retained as a reference for the remuneration of that company.

(79) Secondly and notwithstanding the appropriateness of the comparables in the sample retained by the tax advisor, the Commission observes that the transfer pricing report does not use the median for the calculation of the beta, but the 25% 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[42]. The Commission notes in this regard that the beta represents the non-diversifiable risk of a capital return. Against this background, it is observed that, in principle, the loan portfolio of banks would be more diversified than the portfolio of FFT, the exposure of which is concentrated on car companies of the Fiat Group. Therefore, it could be argued that a higher point in the range of comparables should have been selected for the determination of the beta, arguably higher than the median, rather than the 25% percentile.

(80) Thirdly, as regards the expected return on the equity backing the functions performed by FFT, the Commission observes that the transfer pricing report uses a very low rate of 0.87%, which is the 2011 year average EONIA[43]. The transfer pricing report does not include any justification for the use of this rate and the Commission can only observe that it is, for instance, different from the risk free rate of 2.85% which was used in the CAPM calculations to calculate the expected return on the capital required under Basel II.

(81) On the basis of these observations, the Commission is of the opinion that the FFT APA does not comply with the arm's length principle. Accordingly, the Commission is of the opinion that through the FFT APA the Luxembourgish authorities confer an advantage on FFT. That advantage is obtained every year and on-going, when the annual tax liability is agreed upon by the tax authorities in view of that APA.

(82) That advantage is also granted in a selective manner. While APAs that merely contain an interpretation of the relevant tax provisions without deviating from administrative practice do not give rise to a presumption of a selective advantage, rulings that deviate from that practice have the effect of lowering the tax burden of the undertakings concerned as compared to undertakings in a similar legal and factual situation. To the extent the Luxembourgish authorities have deviated from the arm's length principle as regards the FFT APA, the measure should also be considered selective.

3.2. Compatibility of aid

(83) As the measure appears to constitute State aid, it is necessary to examine whether that aid could be considered compatible with the internal market. State

[42] See Table 5.

[43] Euro Over Night Index Average is an effective overnight interest rate computed as a weighted average of all overnight unsecured lending transactions in the interbank market in Euros.

aid measures can be considered compatible with the internal market on the basis of the exceptions listed in Article 107(2) and 107(3) TFEU.

(84) At this stage, the Commission has no indication that the contested measure can be considered compatible with the internal market. The Luxembourgish authorities did not present any argument to indicate that any of the exceptions provided for in Article 107(2) and 107(3) TFEU apply in the present case.

(85) The exceptions provided for in Article 107(2) TFEU, which 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, do not seem to apply in this case.

(86) Nor does the exception provided for in Article 107(3)(a) TFEU seem to apply, which allows aid to promote the economic development of areas where the standard of living is abnormally low or where there is a serious unemployment, and for the regions referred to in Article 349 TFEU, in view of their structural, economic and social situation. Such areas are defined by the Luxembourgish regional aid map. This provision does not seem to apply in this case.

(87) As regards the exceptions laid down in Article 107(3)(b) and (d) TFEU, the aid in question does not appear to be intended to promote the execution of an important project of common European interest nor to remedy to a serious disturbance in the economy of Luxembourg, nor is it intended to promote culture or heritage conservation.

(88) Finally, according to Article 107(3)(c) TFEU, aid granted in order to facilitate the development of certain economic activities or of certain economic areas could be considered compatible where it does not adversely affect trading conditions to an extent contrary to the common interest. The Commission has no elements at this stage to assess whether the tax advantages granted by the contested measure are related to specific investments eligible to receive aid under the State aid rules and guidelines, to job creation or to specific projects.

(89) At this stage, the Commission considers that the FFT APA appears to result in a reduction of charges that should normally be borne by the entity concerned in the course of its business, and should therefore be considered as operating aid. According to the Commission practice, such aid cannot be considered compatible with the internal market in that it does not facilitate the development of certain activities or of certain economic areas, nor are the incentives in question limited in time, digressive or proportionate to what is necessary to remedy to a specific economic handicap of the areas concerned.

3.3. Information injunction

(90) According to Article 10(3) of Regulation No 659/99, the Commission shall issue an information injunction where despite a reminder pursuant to Article 5(2) of that regulation, the Member State concerned does not provide the information requested by the Commission.

(91) By letter of 7 March 2014, the Commission requested information from Luxembourg, *inter alia*, to confirm the identity of the beneficiary of the FFT APA within 10 working days. By letter of 7 April 2014, the Commission sent a reminder to provide that information. This reminder is in line with Article 5(2) of Regulation No 659/99 as it sets an appropriate deadline of 15 workings days. Luxembourg has not reacted to the reminder.

(92) The information regarding the confirmation of the identity of the beneficiary is necessary to properly address the beneficiary and its group in a final decision. Since Luxembourg has not supplied information in line with Article 10 of Regulation No 659/99, an information injunction is mandated pursuant to Article 10(3) of Regulation No 659/99.

(93) Considering the lack of information provided by the Luxembourgish authorities during the preliminary investigation, the Commission might be in need of additional information from other sources, which it can request pursuant to Article 6a of Regulation (EC) No 659/1999, unless this concerns the beneficiary, and Luxembourg disagrees on the basis of Article 6a (2) b) of Council Regulation (EC) No 659/1999.

4. DECISION

In the light of the foregoing considerations, the Commission's preliminary view is that the tax ruling by Luxembourg in favour of FFT constitutes State aid within the meaning of Article 107(1) TFEU and has doubts as to its compatibility with the internal market. The Commission has therefore decided to initiate the procedure laid down in Article 108(2) TFEU with respect to the measures in question.

In the light of the foregoing considerations, the Commission further enjoins Luxembourg, within one month of receipt of this letter, to provide all documents, information and data needed for assessment of the existence and compatibility of the aid measure. In particular, the Commission requires Luxembourg to confirm the identity of the beneficiary.

In the light of the lack of information provided by the Luxembourgish authorities during the preliminary investigation, the Commission might be in need of additional information from other sources.

Therefore, in the event that Luxembourg will not fully respond to the above information within one month from receipt of this letter, the Commission, pursuant to Art. 6a of Council Regulation (EC) No 659/1999, will consider requesting the beneficiary i.e. Fiat Finance and Trade Ltd to provide the information requested from Luxembourg above. In that case, Luxembourg will be invited to agree with this request on the basis of Article 6a (2) b) of Council Regulation (EC) No 659/1999[44].

[44] OJ L 83 of 27.3.1999, p. 1, last amended by Regulation 734/2013 of 22 July 2013 OJ L 204 of 31.7.2013, p.15

The Commission further requests Luxembourg to submit its comments and to provide all such information as may help to assess the aid/measure, within one month of the date of receipt of this letter. In particular:

- to explain why the capital of subsidiaries is not remunerated and subtracted
- to explain the parameters in the calculation of the operation risk
- to provide all information in order to recalculate the risk weighted assets including the exposure towards the group.
- to provide quantitative information on the setting of prices for intragroup loans and deposits, as well as to provide the average level of the interest rate charged on intra-group loans provided by FFT and deposits received by FFT in 2012 and 2013 for each company of the group.
- to provide information on which functions are performed by FFT and which functions are performed by other entities of the group.
- to provide information on risk limits set by other entities of the group, specifying the entity of the group which sets these limits.

The Commission requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

The Commission wishes to remind Luxembourg that Article 108(3) of the Treaty on the Functioning of the European Union has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999[45], which provides that all unlawful aid may be recovered from the recipient.

The Commission warns Luxembourg that it will inform interested parties by publishing this letter and a meaningful summary of it in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the *Official Journal of the European Union* and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

[45] OJ L 83 of 27.3.1999, p. 1, last amended by Regulation 734/2013 of 22 July 2013 OJ L 204 of 31.7.2013, p.15

European Commission
Directorate-General for Competition
Directorate H
State aid registry
1049 Brussels
Belgium
Fax : +322 296 12 42

Yours faithfully,

For the Commission

Joaquín ALMUNIA
Vice-President