

# 2023 IFA CANADA LECTURESHIP



## ***A NORTH AMERICAN VIEW OF STATE AID***

***Guest Lecturer: Ruth Mason***

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INTERNATIONAL FISCAL ASSOCIATION (CANADIAN BRANCH) | PRESENTED ON FEBRUARY 22, 2023

# Article 107(1) TFEU

- **Prohibition on State Aid**- TFEU art. 107(1): “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...shall, in so far as it affects trade between member states, be incompatible with the internal market”



# Elements of Illegal State Aid

- (1) an advantage
- (2) granted by a member state
- (3) to an undertaking
- (4) that is selective and
- (5) distorts trade or competition in internal market
  - Real issue is selectivity



# Determining Selectivity

- Commission determines selectivity using 3-step procedure: (1) identifies reference baseline, then (2) shows that state deviated from baseline in way that benefitted some enterprises while failing to benefit (3) other enterprises in a comparable factual and legal situation



# Apple in a Nutshell



United States



Apple, Inc.

Apple's tax plan shifts income from United States and rest of world to nowhere.

Irish-incorporated,  
nowhere resident



ASI

Rest of world



Apple Stores



Ireland



## Moorman (the American *Gibraltar*)

- Illinois had single-factor sales
- All other states equally weighed payroll, property, and sales
- TP sued Illinois
- SCOTUS said that the Constitution does not indicate what the apportionment formula should be. It only forbids discrimination against cross-border commerce.
  - Court could have required the dominant three-factor rule or it could have supplied its own idealized rule (ALS?), but it expressly stated that it lacked authority to pick the states' tax systems for them
  - So how can SCOTUS evaluate Illinois' facially neutral regime that, as applied, leads to double tax (and tax gaps)?

# U.S. SOLUTION IS THE “INTERNAL CONSISTENCY TEST”

Imagine all 50 states adopted the challenged state's rule. Would cross-border commerce face more tax than purely domestic commerce? If yes, state law is illegal. If not, it's generally permissible.

Alter for state aid: If all MSs had the rule, would cross-border commerce (or this sector, etc., pick your suspect class) face *less* tax than domestic commerce (other sectors)? If yes, aid must be justified. If no, it's generally permissible (as a mismatch).

## Mismatches “pass” internal consistency test

- McDonald’s
  - If everyone had Luxembourg’s concept of PE, business profits, and treaty interpretation approach, then the United States would have taxed the U.S. activities of the Lux Co. No double nontaxation
- Apple tax residence mismatch
  - If everyone had Ireland’s tax residence rule, the Apple subs would have been tax residents of the United States. No double nontaxation
- Gibraltar
  - If everyone had Gibraltar’s payroll and property tax, all offshore companies would be taxed on 100% of their income across all the taxing states. No double nontaxation
- In actual practice, internal consistency test does not mandate “single tax” because regimes can differ from each other (e.g., U.S. tax residence rule is just as internally consistent as the Irish)



## Advantages

- You don't need to know what's the main rule and what's the deviation
- Avoids tax-expenditure trap (what's included in the baseline?)
- Internal consistency test reliably identifies mismatches (different tax rates, Irish tax residence by management vs U.S. tax residence by incorporation), so Commission will not invade MS sovereignty by invalidating mere mismatches
  - Any tax advantage that disappears under the harmony assumption derives from a mismatch

## Advantages of Reference-Law Benchmarking

- These advantages apply to both the ordinary tax-expenditure approach and internal consistency test
- Commission never has to supply an external reference base
  - TFEU assigns the tax legislative power to the Council and Parliament, not the Commission
  - Commission has no democratic mandate or accountability; no special tax expertise
  - Not terribly offensive when Commission can rely on OECD standards, but Gibraltar!

## Disadvantages

- Permits tax competition
- Allows the Gibraltar payroll-and-property tax and the old Irish tax-residence rule. States will surely take advantage
- Maybe that's good, or at least tolerable

## Conclusions

- EU courts should continue to reject the Commission's *sui-generis* arm's-length standard in favor of the Member States' own domestic-law income allocation rules, as tested by internal consistency
- Gibraltar was wrongly decided
- One-sided TP methods may confer state aid, but still may be justified

# THANK YOU!

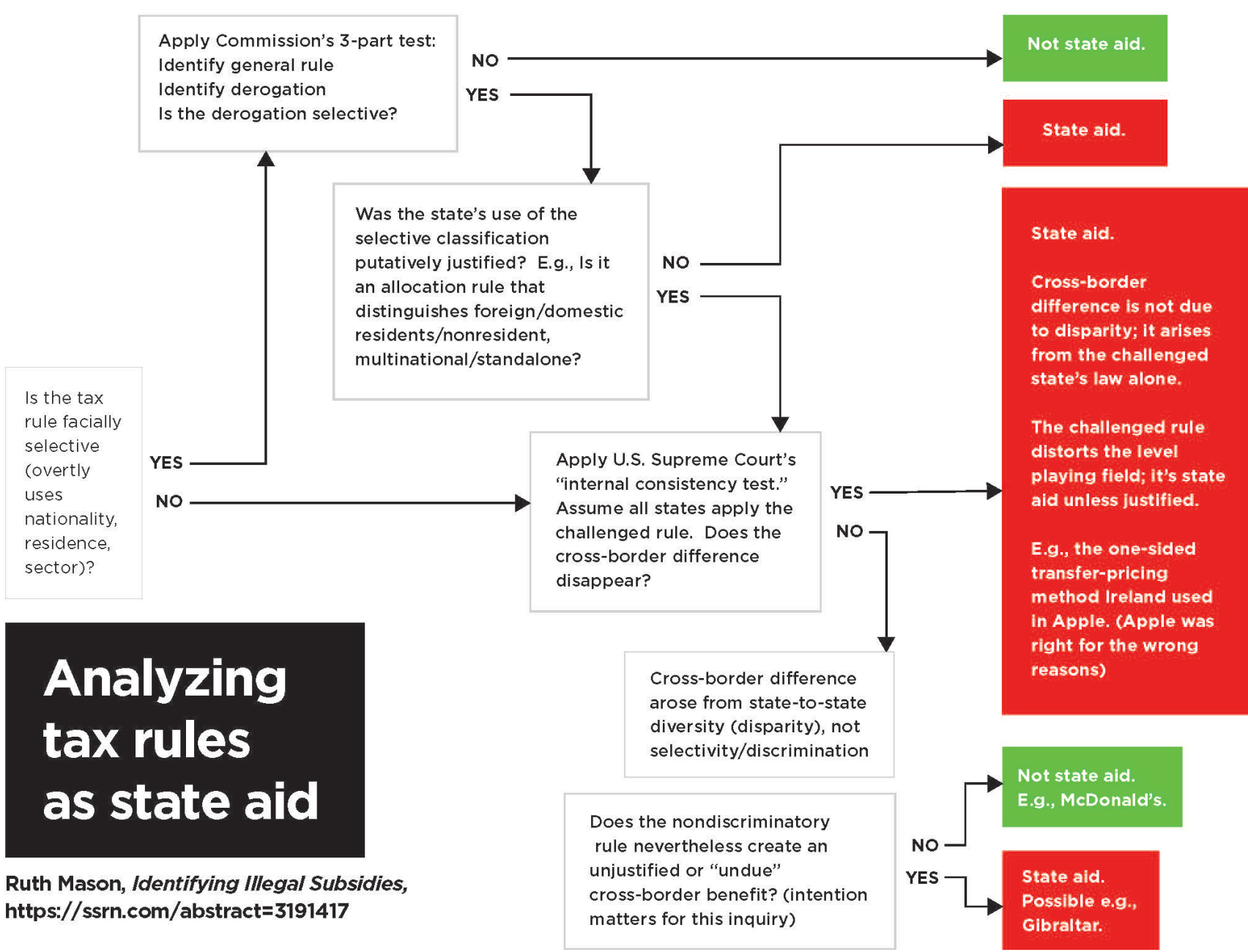


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# Analyzing tax rules as state aid

Ruth Mason, *Identifying Illegal Subsidies*, <https://ssrn.com/abstract=3191417>