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TAX RULINGS AND EU STATE AID LAW: LESSONS FOR CROATIA*

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ABSTRACT

Tax rulings and advance pricing agreements (APAs) are perceived by policymakers around the globe as important instruments for enhancing taxpayers' legal certainty. Croatian tax law saw the introduction of these schemes only fairly recently. Namely, advance tax rulings have been introduced in 2015, but hitherto there is limited practical experience with its usage. On the other hand, other EU member states which had rich experience with tax rulings and APAs are currently faced with new legal developments. Most importantly, administrative tax practices in a number of countries have been put under scrutiny from the perspective of EU state aid law. Against this background, aim of the present paper is to derive some lessons for Croatian policymakers and taxpayers when it comes to the usage of advance tax rulings and APAs in the future.

Keywords: *tax law, tax rulings, advance pricing agreements, state aid law*

1. INTRODUCTION

Tax certainty is an important topic on a global level for at least twofold reasons: first, because of the negative impact of tax uncertainty on the economic growth (Gale, Samwick 2014; Zangari et al. 2017) and second, because of the presumed positive correlation between tax uncertainty and tax avoidance schemes, linked with the complex legislative framework for taxation. Unfortunately, Croatian experience with the problem of tax uncertainty is well-documented. Deloitte's 2015 survey, conducted among tax professionals operating in 28 European countries, shows that only France and Italy fare worse than Croatia in terms of tax uncertainty (Deloitte, 2015). Furthermore, one recent survey conducted among certified tax advisors found that they recognise two biggest issues with the relationship between tax authorities and taxpayers in Croatia: (i) lack of legal certainty and (ii) tax authorities' prejudicial view of the taxpayers as tax evaders (Rogić Lugarić, 2016, p. 230).While there are many causes of legal uncertainty in the substantive sphere of Croatian tax system – e.g. frequent changes, complexity and even retrospective application of tax legislation – it is beyond doubt that the legal framework for tax procedure and tax administration did little to alleviate the problem. For example, a recent study issued by one business representative association pointed out that the excessive length of tax dispute procedures adds to legal uncertainty; other vexing problems are related to the unwillingness of the tax authorities to co-operate with taxpayers, as well as the practice of non-uniform application of tax laws by different organizational units within Croatian Tax Administration (Stojić et al., 2016, pp. 38-41). From a comparative perspective, new challenges for tax systems related to technological, economic and political developments led to the creation of new instruments dealing with complex tax issues. The difficulties related to the application and interpretation of tax law are especially noticeable in cross-border situations where taxpayers encounter the difficulties related to the compliance with more foreign tax

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systems. In this respect, important instruments for reducing tax uncertainty are advance tax rulings and advance pricing arrangements (APAs).

2. ADVANCE TAX RULINGS AND ADVANCE PRICING AGREEMENTS IN MODERN TAX SYSTEMS

Advance tax ruling can be defined as a statement of the revenue authority's interpretation and application of tax laws to an arrangement, which is binding on the revenue authority in terms of the future application of the tax laws (James, 1999, pp. 731-747). An increasing number of countries have introduced or formalized their rulings systems. The United States presents one of the most developed tax rulings system in the world with a wide variety of legal instruments of guidance to taxpayers (Romano, 2002). Policy reason underlying US rulings scheme is linked with the complexity and technicality of tax legislation, with the role of rulings as a tool alleviating these problems (Givati, 2009). Another well-structured and developed rulings system is found in the Netherlands. The Dutch rulings scheme is aimed at providing certainty to taxpayers, mainly foreign, investing in the Netherlands. Accordingly, advance rulings became an instrument for attracting foreign investment in the Netherlands (Romano, 2002). Other reasons for the introduction of advance rulings are related to the increased need for the simplification of tax system, since such schemes are sometimes seen as a vehicle for establishing some new forms of active taxpayers participation. The first forms of rulings introduced in Italy were limited to anti avoidance legislation. France developed the so-called protective tax rulings system, understood primarily as a new vision of legal norms and need for evolutionary relationship between tax taxpayers and tax authorities. Such rulings present norms aimed at improving relations between tax authorities and taxpayers with an overarching aim of promoting legal certainty. The rulings systems are emphasized as a standards that are recognized particularly in international law, that encourages states to develop mechanisms for better adaptation of taxpayers to tax coercion. Accordingly, tax rulings are linked with the "culture of negotiation", which is being developed in France through the system of *rescrit* and is one of the components of the "new fiscal management" (Rogić-Lugarić, Bogovac, 2012).

It is necessary to distinguish advance tax rulings from other forms of guidance provided by the tax administration to taxpayers in order to help them fulfil their tax obligations (Arbutina, 2009). There are some basic common features found in every ruling scheme: binding nature, formality, treatment of costs etc. Differences in advance rulings regimes are consequence of historical practice and the result of sovereign choices exercised in different states (Sawyer, 2004). Ideally, efforts could be made for development of uniform rulings schemes applicable across national borders. For example, different domestic rules governing advance tax rulings systems in EU Member States (hereinafter: MS) constitute an obstacle to the cross border investments and jeopardise the EU internal market. Accordingly, there have been proposals in the literature for the harmonization of advance tax rulings at the EU level. Romano (2002) proposed a two-tier rulings procedure, in which a national competent authority would be the body of first instance and a central EU authority would be second instance body. Such a central body could function as an supervisor with respect to rulings policy, collection of certain types of rulings requests and as a distribution centre of these requests amongst the competent offices (Žunić Kovačević, 2013). There are certainly some advantages of potential harmonization of advance tax rulings systems on the EU level (Romano, 2002): (1) obtaining a higher degree of certainty in the interpretation and application of tax law provisions; (2) greater consistency and uniformity in the application and interpretation of the law; (3) enhancing the transparency of the decision-making process of the tax authorities in such a way as to improve the perception of the fairness of the tax obligations by taxpayers and thus tax compliance; (4) fostering compliance with tax law and administrative practice; (5) improving the functioning of the self-assessment and self-reporting systems and reducing tax litigation. It is also useful to have in

mind that a similar harmonized system with regard to administrative practices in different MS is found in the field of customs law.

2.1. Advance pricing agreements (APAs)

According to the OECD (2017, p. 214), an advance pricing arrangement (APA) is "an arrangement that determines, in advance of controlled 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." The arrangement usually covers a certain number of years upon the its adoption. In essence, APA is a mechanism aimed at preventing future disputes between tax authorities and taxpayers in the specific field of transfer pricing, which is extremely important for multinational companies (MNCs). While APAs may, to some extent be considered as a sub-type of advance tax ruling, there are some important differences. Most importantly, APAs normally entail very detailed analysis of pertinent factual issues, whereas traditional tax rulings tend to be limited to addressing legal questions based on facts presented by a taxpayer (OECD, 2017, p. 216). There are other key differences between APAs and advance tax rulings (Romano, 2002, p. 486). While APAs may be bilateral or even multilateral, advance tax rulings are unilateral and generally do not cover foreign jurisdictions. Advance rulings and APAs also differ in their legal nature since APAs are regarded as agreements whereas advance rulings are considered as one-sided statements of the tax administrations. APA may not be implemented without the approval of the taxpayer, whereas advance rulings are valid without considering the consent of the taxpayer as applicant. The participation of the taxpayer in an advance rulings procedure is limited only to the initial level of the process.

As a consequence of different legal natures, APAs should be differed from advance rulings on the basis of their effect since APAs are binding for the tax authorities, sometimes for taxpayers whereas advance rulings may have binding effects on tax authorities and almost never for taxpayers. Irrespective of the differences between advance rulings and APAs, there is a significant degree of similarity that justifies their joint consideration (Sawyer, 2004). A growing number of states has introduced provisions on APAs in their tax systems, mainly in accordance with OECD's suggestions. For example, in the United Kingdom (UK) a taxpayer may propose a methodology for transfer pricing and supply documentation that confirms or shows that the result of such treatment is fair and neutral. If the tax authorities accept the proposed methodology (proposed by the taxpayer), after checking all the "accompanying" documents and materials, the parties conclude an APA. UK tax law also allows for bilateral and multilateral APAs, which entail participation of tax authorities of other states (Sawyer, 2004). UK rules give taxpayers a choice, before applying for an APA, to opt for some kind of discussion or meeting "pre-filing conference". This may help taxpayers in assessing whether an agreement is appropriate vehicle for resolving pertinent tax issues. The same pre-filing stage as part of APA is known in US procedure (Boidman, 1992). The Italian tax authorities published in 2010 the first report on the successful adoption of APAs. These practices refer to the period of the first five years after the entry into force of APA rules. The report reveals that during a specified five-year period, 52 requests were submitted and 19 agreements were concluded. The average time needed for the procedure was 20 months (Žunić Kovačević, 2010). The above mentioned bilateral and multilateral APAs, where two or more countries are involved, are more efficient in providing legal certainty. In the cases of a bilateral or multilateral advance pricing agreement there is always a second agreement that is concluded between the competent authorities of countries which are affected by the covered transaction, based on the mutual agreement provision of tax treaties.

3. CROATIAN LEGISLATIVE FRAMEWORK

3.1. Advance rulings

Croatian academic literature considers advance tax rulings as an affirmation and implementation of the tax procedural principle of good faith. The principle of good faith and fair dealing was for the first time introduced in Croatian tax law by the General Tax Act (hereinafter: GTA) of 2001, but did not contain provisions which would define the content of notion or criteria to apply rulings or APA's. The enactment of the new GTA in 2008 indicated that certain alterations would be made with the aim to more precisely and more clearly regulate the principle of good faith, but legislator again failed to recognize the role of tax rulings. It was only in 2015, by way of amendments to the GTA, when advance rulings became part of Croatian tax system, apparently under the influence of developments of EU framework on information exchange (Žunić Kovačević, 2016, p. 282). According to Art. 10 GTA, tax authorities may issue an advance ruling upon the explicit request of the taxpayer with regard to a limited number of tax-related issues. Namely, the objective scope of the rulings is limited to the following: (i) apportionment of the input VAT; (ii) application of tax laws related to investment projects carried on in Croatia and value of which exceeds EUR 2.66 million; (iii) assessment of the corporate tax base related to corporate restructurings; (iv) application of tax treaty provisions; and (v) tax treatment of business activities which are deemed "unusual". Further elucidation on the advance ruling scheme, particularly as to procedural aspects, is provided in the relevant by-law. It is certainly too early to assess the efficiency of Croatian advance rulings system. On the one hand, it certainly represents a step forward with regard to modernization of tax procedure law. On the other hand, doubts remain regarding limited objective scope of the scheme. Namely, until late 2016 tax authorities have dismissed over 50 ruling requests for rulings on the grounds of their inadmissibility under pertinent law.

3.2. APAs

Turning our attention to APAs, it first has to be noted that the arm's length standard (ALS) was first introduced in Croatian domestic law in 2004.[1] Over the last decade or so, tax authorities have gained more specialized expertise in transfer pricing enforcement, both in tax treaty context and in circumstances where only relevant domestic provisions apply. Consequently, the focus on transfer pricing has intensified in recent years. This may be evidenced by a marked increase in the number of tax audits specifically related to transfer pricing (PwC, 2016, p. 61). While in the past, the tax authorities tended to focus on intra-group services – sometimes even without necessary substantiation – in recent years a higher degree of sophistication pervades transfer pricing audits. It is important to note how domestic transfer pricing legislation has been clearly developed under the influence of international standards, embodied primarily in Art. 9 OECD Model Convention and in OECD's Transfer Pricing Guidelines. Even if direct reference to OECD Guidelines is not found anywhere in domestic law, Croatian tax authorities heavily rely on its recommendations in transfer pricing enforcement. Unfortunately, official guidance on the proper application of transfer pricing rules is extremely limited. In contrast to the practice of many other countries, Croatian tax authorities have hitherto not issued a comprehensive, publicly available soft-law instrument comprising more detailed explanations and practical examples. Moreover, domestic case law on application of transfer pricing rules is still rather scarce and did not involve sophisticated substantive issues, e.g. intangibles, intra-group allocation of risk etc. However, Croatian tax authorities have on two separate occasions – first in 2009, then in 2014 – commissioned the printing of a special "Manual on transfer pricing audit", i.e. with the aim to serve as a general guidebook for tax inspectors engaged in transfer pricing enforcement. The latest edition of this internal manual is generally based on the OECD

[1] Current version of Art. 13 Profit Tax Act, codifying the ALS, is for the most part identical to the original one, adopted in 2004.

Guidelines and it even includes an unofficial translation of the Guidelines in Croatian (Tucaković et al., 2014). While the 2016 amendments to the Profit Tax Act (hereinafter: PTA)[2] introduced the concept of APAs, full usage of this instrument was not possible until the amendments were made to the relevant by-law in 2017. [3] APA is defined in first paragraph of 14a PTA as an arrangement between the taxpayer and Ministry of Finance, Tax Administration, and tax bodies from other countries in which associated parties are residents or perform business activities through a business unit, through which, for transactions between associated parties, before their commencement, an appropriate set of criteria is determined, such as methods, comparative criteria, appropriate harmonisation, or key suppositions related to future events, in order to determine transfer pricing for these transactions during a given time period. It is prescribed as obligatory for the taxpayer and for the tax authorities for the time in which it is concluded. Costs for concluding the APA are borne entirely by the taxpayer. The APA procedure starts with a request of the taxpayer and it ends with an agreement between the taxpayer and the tax authority. Such an agreement is binding for the tax period in which the agreement has been entered and for the four subsequent periods, unless changes occur in the relevant factual or legal circumstances. The issues regarding detailed procedure for the conclusion of an APA, its contents, validity deadlines and costs of concluding APAs are prescribed by the Minister of Finance in a special by-law.

4. EU STATE AID LAW ASPECTS OF TAX RULINGS

While the usage of tax rulings and APAs is not without its drawbacks from a tax policy perspective (amplius supra), the designers of EU member states' tax systems have to be particularly wary of the potential conflict between these instruments and EU state aid law. Namely, recent years, beginning with 2013, witnessed an unprecedented wave of investigations into the legality of EU member states' (hereinafter: MS) tax ruling practices, from the state aid law perspective. The investigations were carried out by the European Commission (EC) as a body competent for state aid enforcement within the EU. According to the information provided by high-level EC officials, more than 1000 tax rulings issued by the tax authorities in a number of MS were put under scrutiny (Fort, 2017, p. 381). While the investigations in some cases are still on-going, EC has already issued several so-called negative decisions, i.e. decisions declaring the pertinent measure as incompatible with the EU internal market, which entail the obligation of a MS in question to fully recover the aid from its beneficiary (Luja, 2003, p. 96-97). These EC decisions have made global headlines, since the beneficiaries of the aid declared illegal included some of the biggest multinational companies in the world, like *Amazon*, *Apple*, *McDonalds* and *Starbucks*. Moreover, the amount of recovery provided by the EC in its decision regarding *Apple* reaches a quite staggering number of 16 billion EUR, which the Republic of Ireland is supposed to recuperate from the US-based tech giant. Important legal caveat applying in this and other similar cases (e.g. Fiat, Starbucks) is that the legality of EC decisions will be tested before the European Court of Justice (ECJ), since interested parties have brought an action for the annulment of respective decisions (Fort, 2017, p. 381). It is important to underline that EC investigations in "tax rulings cases" have become much more extensive after the so-called *LuxLeaks* affair broke out, bringing attention to the wider public of blatant tax avoidance schemes utilized by large MNCs and sanctioned by tax authorities of some EU MS (Wattel, 2016, p. 791). Accordingly, this new activism of the EC may be linked with other important developments on the EU and global level aimed at curbing international tax avoidance, such as the OECD/G20 project against "base erosion and profit shifting (BEPS), launched in 2013, or the adoption of a new EU directive against tax avoidance in 2016 (Fort, 2017, p. 370).

[2] Profit tax Act, Official Gazette, nos. 177/04, 90/05, 57/06, 146/08, 80/10, 22/12, 148/13, 143/14, 50/16, 115/16.
[3] Ordinance on the procedure for adopting advance pricing agreements, Official Gazette, No. 42/2017.

4.1. On the interaction between EU state aid law and member states' tax systems

Before we delve deeper into the analysis of state aid implications for tax ruling schemes in EU MS, it seems worthwhile to briefly address the fundamentals of EU state aid control and particularly its influence for tax policy of individual MS. The foundations of EU state aid law are set in primary EU law, more precisely in Art. 107(1) of the Treaty on the Functioning of the EU (TFEU), which reads: "Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market." According to the settled case-law of the ECJ, there are four cumulative conditions embedded in the notion of state aid under Art. 107(1) TFEU (Kronthaler, Tzubery, 2013, p. 94-95): (1) a measure has to be granted by a MS or financed through state resources; (2) an economic advantage has to be conferred on the recipient, relieving him from the burden normally borne; (3) the advantage conferred is "selective or specific", i.e. it favours only certain undertakings or the production of certain goods; (4) the measure in question has an effect on competition and trade between EU MS. Only if each of these cumulative conditions is met, there is a state aid incompatible with the internal market (Fort, 2017, p. 375). The rationale of state aid control within the EU is related to the overarching goal of ensuring level playing field in the internal market (Kronthaler, Tzubery, 2013, p. 94). Hence, state aid law may be perceived as a subpart of a much wider area of the EU competition law. Against the background of a wide notion of state aid, prescribed in the TFEU, it seems self-evident that elements of MS tax systems may also bring about state aid concerns. This holds in particular as regards to the so-called "tax expenditures", i.e. instruments by virtue of which a state fails to collect a part of tax revenue it is normally entitled to (Luja, 2003, p. 8-10). In other words, whenever a special domestic rule results in the non-taxation of a part of taxpayer's economic faculty, which would be taxed in the absence of such rule, there is a looming shadow of state aid scrutiny. In 1998 EC issued a notice addressing the interaction between MS direct tax systems and state aid law (European Commission, 1998). In essence, this document laid down the analytical framework for assessing compatibility of domestic direct tax measures with EU state aid law. First, it was explained that there are three main ways how a tax measure leads to economic advantage for undertakings: (1) reduction in the tax base (e.g. special deductions, special or accelerated depreciation arrangements or the entering of reserves on the balance sheet); (2) total or partial reduction in the amount of tax (such as exemption or a tax credit); (3) deferment, cancellation or even special rescheduling of tax debt (European Commission, 1998, para. 9). Second, the EC clarified that any loss of tax revenue, including that resulting from the administrative practice of tax authorities, is equal to consumption of State resources. Third, it has been made clear that the criterion of "effect on EU competition and trade" would be satisfied very easily, since it suffices that the beneficiary of a tax advantage exercises an economic activity. Finally, regarding the criterion of selectivity, the EC explained that selective tax measure may derive from an exception to the tax provisions of a legislative, regulatory or administrative nature or from a discretionary practice on the part of the tax authorities. However, such measures may be justified by "the nature or general scheme of the system" (European Commission, 1998, para. 12). As has been hinted already in the 1998 Notice by the EC, the subsequent ECJ jurisprudence confirmed that the crux of applying state aid rules to domestic tax measures lies at the analysis of selectivity.[4] The EC and the ECJ use a three-step derogation test in evaluating whether pertinent tax measure is selective (Micheau, 2011, pp. 201-204). In the first step, one has to identify the system of reference, i.e. the collection of tax rules that are generally applicable to the undertakings in question. In the second step, one should determine whether a given measure

[4] See especially Case *European Commission (C-106/09 P) and Kingdom of Spain (C-107/09 P) v Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland,* EU:C:2011:732.

constitutes derogation from the system of reference insofar as it differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation (European Commission, 2016, para. 128). If the deviation from the reference framework, i.e. prima faciae selectivity, is established, then, in the third and final step, one needs to address whether such derogation is justified by the nature or the general scheme of the (reference) system, thus falling outside the scope of Art. 107(1) TFEU. In essence, this selectivity test amount to an analysis from the standpoint of equality between economic operators (Lang, 2016, p. 36). If the measure in question results in unequal tax treatment of legally and factually comparable undertakings, then the selectivity criterion is prima faciae fulfilled (Micheau, 2011, p. 202). It is also apparent that the final conclusion on selectivity largely depends on the selection of the system of reference. Put simply, the wider the chosen reference system, more likely it is that the given measure constitutes a derogation (Micheau, 2011, p. 204). It is therefore vital to draw attention to EC's view that the reference system may be, in most cases, equated with the general system of imposing an individual type of tax (European Commission, 2016, para. 134). According to this view, a tax advantage conferred to corporate taxpayers should be assessed against the backdrop of the general system of corporate income tax employed in a given country. Furthermore, for the purposes of this paper, it is important to underline that, in assessing compatibility of APAs with EU internal market, EC shares the view that the arm's length principle (hereinafter: ALS) forms part of reference system applicable to MNCs (European Commission, 2016, para. 172).

4.2. Tax rulings and APAs as incompatible state aids: the example of Apple case

Already in its 1998 Notice, the EC has issued a telling warning on how discretionary practices of MS' tax authorities may constitute state aid under Art. 107(1) TFEU. Of particular interest is how the EC drew attention to the lack of transparency of tax rulings schemes, which amounts to one of their biggest disadvantages from a general tax policy perspective (Lang, 2015, pp. 394-395). However, it wasn't until the recent wave of EC investigations into MS' rulings schemes (see supra) that their potential conflict with EU state aid law drew serious attention. As explicitly described in the 2016 EC Notice on the notion of state aid: "(W)here a tax ruling endorses a result that does not reflect in a reliable manner what would result from a normal application of the ordinary tax system, that ruling may confer a selective advantage upon the addressee, in so far as that selective treatment results in a lowering of that addressee's tax liability in the Member State as compared to companies in a similar factual and legal situation" (European Commission, 2016, para. 170). Moreover, the EC listed three categories of cases where a tax ruling confers selective advantage: (1) the ruling endorses a misapplication of domestic tax law, leading to lower tax burden; (2) availability of ruling scheme is limited to only some taxpayers; (3) the ruling endorses a tax treatment for an undertaking which is more favourable than in respect of taxpayers who are legally and factually comparable (European Commission, 2016, para. 174). Recent activism of the EC regarding administrative tax practices in MS has been particularly focused on APAs. In this respect, EU state aid provisions have played a role in curbing international tax avoidance by largest MNCs. The reasoning of the EC in the (in)famous Apple case, decided in 2016,[5] will be used in this section to illustrate how transfer pricing outcomes enshrined in APAs may be put to scrutiny from the EU level. In its negative decision with recovery, the EC held that the two tax rulings issued by the Irish tax authorities – first one in 1991, second one in 2007 – in favour of two Irish-incorporated companies within the Apple group constituted illegal state aid. Factual substratum of the case involved a rather simple international tax planning scheme employed by Apple group in order

[5] Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple (notified under document C(2017) 5605 (hereinafter: EC Apple decision).

to minimize its overall tax burden from the operations in the EMEIA area (Europe, Middle East, Africa and India). Without going into too much detail, the sales of Apple products to EMEIA customers were attributed for legal, accounting and tax purposes to an Irish-incorporated entity (Apple Sales International; hereinafter: ASI). However, ASI is a classical example of a double non-resident, i.e. a company that, due to a perfect mismatch between relevant rules of Irish and US domestic tax law (Wattel, 2016, p. 798), is not considered to be a tax resident in any country. Therefore, ASI had to pay taxes only with regard to profits that may be attributed to its Irish branch, on the basis of source principle. Accordingly, this is a classical transfer pricing case involving attribution of profits to permanent establishments (PEs). In the first tax ruling issued in 1991, Irish tax authorities, upon negotiation with the representatives of Apple, agreed on a specific method for attributing profits to Irish branches of ASI and its immediate parent company Apple Operations Europe (hereinafter: AOE). Put simply, profits that would be taxable in Ireland were calculated on the basis of operating expenses incurred by the branches, which is very similar to the transactional net margin method (TNNM) provided in the OECD Transfer Pricing Guidelines. With some deviations, similar method of calculating profits of Irish branches was endorsed in the 2007 tax ruling.[6] The effect of applying such methodology in calculating taxable base of Irish branches is that the vast majority of profits derived from the sales of Apple products in the EMEIA market was taxed nowhere. This is mainly a consequence of the fact that Irish tax authorities shared the view that Irish PEs of ASI and AOE were performing only routine functions and economic ownership over valuable intangibles may not be attributed to them.[7] The material effect of such profit attribution is that effective tax burden of ASI amounted to less than 1% on a yearly basis. Against this factual background, the EC held that the Irish tax rulings conferred an economic advantage to Apple, in that corporate tax liability of ASI and AOE was lowered in comparison to what was prescribed by the "ordinary" rules of Irish corporate income tax.[8] Moreover, such economic advantage is selective, since it entails an unjustified derogation from the relevant system of reference, which is formed by the general rules for taxation of corporate income in Ireland. Accordingly, all companies subject to tax in Ireland – including resident and non-resident companies – are in a comparable legal and factual situation. The fact that Irish subsidiaries of Apple group are not standalone companies but rather part of an integrated group does not change this basic assumption, according to the EC.[9] Main argument in favour of finding a selective tax advantage revolved around the misapplication of the arm's length standard (ALS) by the Irish tax authorities. Most remarkably, the EC shares the view that ALS is derived directly from Art. 107(1) TFEU, since its goal is to ensure neutrality between economic operators (European Commission, 2016, para. 172). Thus, even if Ireland did not have domestic transfer pricing rules in place at the time of the issuance of the first ruling, revenue bodies should have pursued an ALS outcome in profit allocation.[10] This inevitably leads to the conclusion that the ALS has a new function: not only is it used to allocate profits within MNCs, but it is also a part of competition law, aimed at preserving level playing field in the EU internal market (Wattel, 2016, p. 792). While a more detailed analysis of transfer pricing aspects of this case lies outside the scope of the present paper, we may highlight two main reasons why the EC held that contested tax rulings departed from the ALS: (1) Irish revenue bodies' assumption that royalties related to Apple intangible property may not be allocated to Irish PEs is uncorroborated; (2) on a subsidiary line of reasoning, Irish revenue bodies used inappropriate methodology for attributing profits to Irish PEs of ASI and AOE.

[6] See paras. 59-62 of the EC Apple decision.
[7] See para. 195 of the EC Apple decision.
[8] See para. 223 of the EC Apple decision.
[9] See para. 228-229 of the EC Apple decision.
[10] See para. 255 of the EC Apple decision.

Which conclusions may be drawn from the EC reasoning in Apple case and other cases involving tax rulings and APAs? First, the EC has hitherto focused only on the outliers, i.e. on the cases that constitute radical departures from international standards, such as those embodied in the OECD Transfer Pricing Guidelines. The EC seems to acknowledge the reality of transfer pricing: it is more an art than exact science and various ALS outcomes may be appropriate in a given set of facts (Kardachaki, Van Hulten, 2017, p. 285). Second, APAs are not selective *per se*: if tax authorities abide to the international standards in allocating profits to MNEs, there is minimal risk of incompatibility with EU state aid provisions. Third, transfer pricing documentation plays a significant role in proving that tax authorities gave serious thought to all facts-and-circumstances in approximating final tax outcome.

5. CONCLUDING REMARKS

The usage of advance tax rulings and APAs seems to be a necessity in modern tax systems. In the light of complex and often extremely technical tax legislation, coupled with the factual intricacies related to cross-border trade and investment, these instruments provide a way to avoid disputes between tax authorities and taxpayers even before they may arise. Accordingly, the main rationale behind such administrative practices is found in the promotion of legal certainty. Moreover, tax rulings and APAs are conceptually based on the new understanding of the tax relationship, commonly branded as "enhanced relationship" or "co-operative compliance". While Croatian experience in this field has hitherto been severely limited, in times ahead greater usage of rulings schemes should be expected. Namely, advance rulings became part of Croatian tax system only in 2015, and APAs may be obtained only as of January 1st 2017. One may expect a rather cautious approach of the tax authorities in granting tax benefits to specific taxpayers via advance rulings or APAs (Bogovac, 2016, pp. 279-282). However, in the present paper we tried to emphasize the need for taxpayers and tax authorities to keep track of the important developments at the EU level, i.e. new wave of EC investigations into ruling practices in a number of states. Against this background, there are some lessons to be drawn especially for Croatian tax authorities. First, in granting a tax ruling or an APA special consideration has to be made to the analytical framework followed by the EC and ECJ in assessing the compatibility of a ruling with EU state aid law. In other words, tax authorities need to precisely identify the benefits they are potentially giving to the taxpayer, in light of the reference system composed of general rules for a specific type of tax. If there is a derogation from this reference system, the only way to escape conflict with state aid law is to provide a reasonable justification. Second, the most pragmatic way to avoid potential state aid concerns, particularly when it comes to APAs, is that all stakeholders in Croatia abide the international standards, such as transfer pricing soft-law rules enshrined in OECD Transfer Pricing Guidelines. In this respect, there is some optimism, since Croatian tax authorities have traditionally followed the OECD's approach in transfer pricing enforcement. Undoubtedly, the focus in the future will be on reliable transfer pricing documentation proving that the chosen methodology is appropriate for a given case. This will help to avoid state aid scrutiny, since the alignment between EU internal market and arm's length principle is a new mantra pursued by the European Commission.

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