



EU Commission arm's length principle

Speakers:

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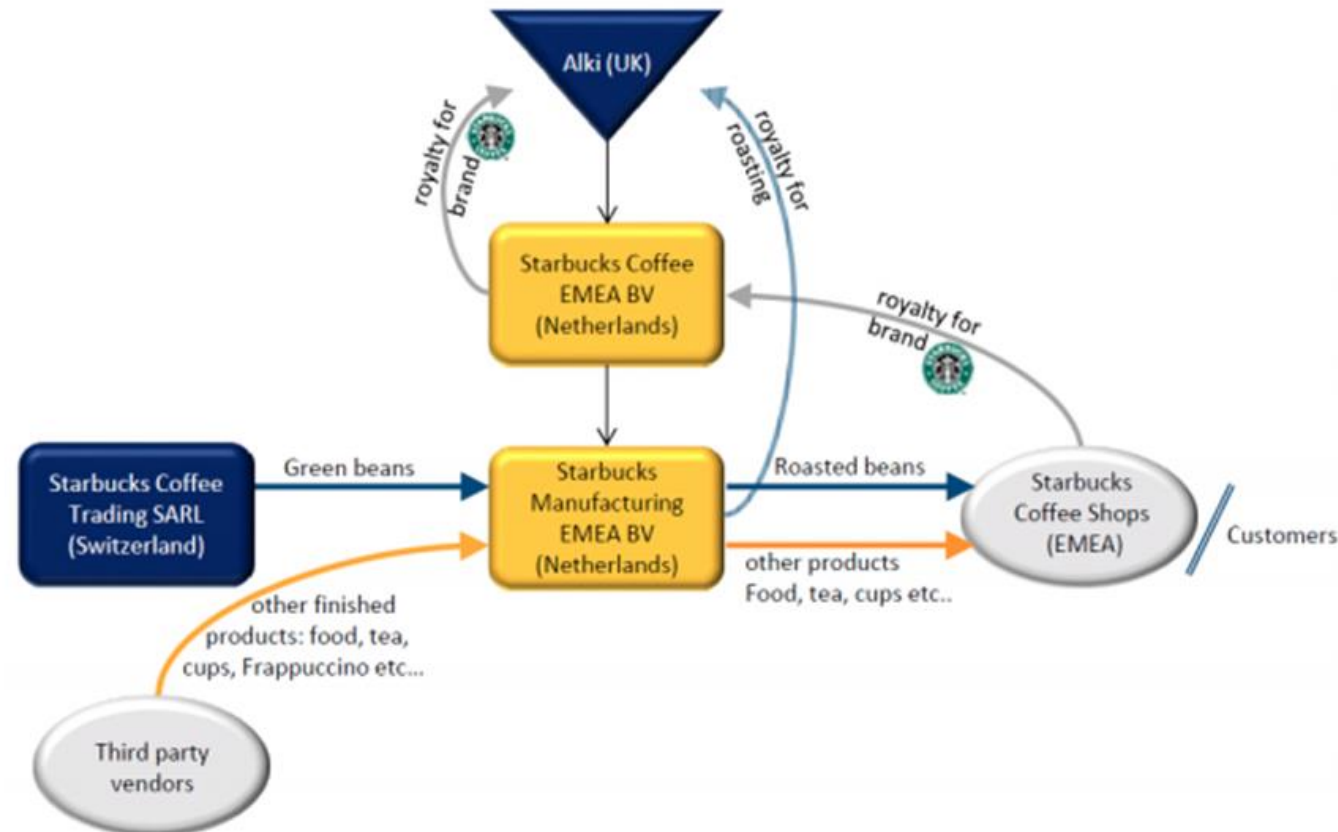
Raymund Gerardu

EU State Aid: Starbucks

-Structure

1. Starbucks Manufacturing EMEA BV ("SMBV") acts as a toller/performs roasting activities. Besides, SMBV operates as an intermediary distribution entity for a variety of non-coffee items.
2. SMBV also performs a reselling function, referred to as providing logistic and administrative services.

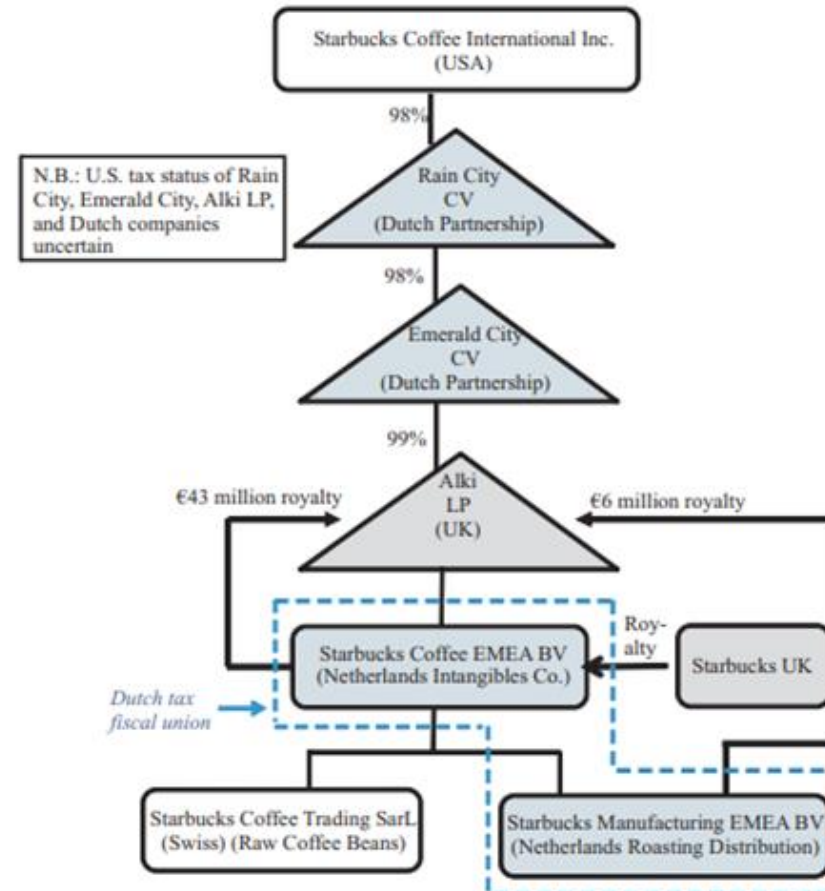
APA – SMBV compared with 20 independent but similar coffee roasters who all realise a net profit margin similar to the remuneration agreed in the ruling.



Source: EU Commission

Starbucks legal structure


Simplified Starbucks Netherlands Structure
(Ignores 1 percent equity holders; all companies 100 percent indirectly owned by Starbucks Corp.)

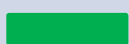


EU State Aid: Starbucks

- F/A/R analysis and main arguments of the Commission

OECD Arm's length principle approach – based on OECD/BEPS standard	EU Commission arguments on arm's length principle
<p>F/A/R – Starbucks Manufacturing EMEA BV (“SMBV”) acts as a toller/performs roasting activities.</p> <p>Choice of method – TNMM, based on “risk stripped” operations by SMBV.</p> <p>Level of I/C compensation – MOTC of [9-12]% based on transitional benchmark performed</p>	<p>Para 252. “(...)the general Dutch corporate income tax system constitutes the reference system against which the SMBV APA should be assessed.”</p> <p>Para 263 “(...) the Netherlands accepted by the SMBV APA results in a lowering of SMBV’s tax liability under the general Dutch corporate income tax system as compared to non-integrated companies whose taxable profit under that system is determined by the market, that APA will be deemed to confer a selective advantage to SMBV for the purposes of Article 107(1) of the Treaty.”</p> <p>Para 264 “(...) Thus, for any avoidance of doubt, the arm’s length principle that the Commission applies in its State aid assessment is not that derived from Article 9 of the OECD Model Tax Convention, (...), but is a general principle of equal treatment in taxation falling within the application of Article 107(1) of the Treaty, (...)”.</p> <p>Para 265 “ the Commission recalls that is not examining whether the SMBV APA complies with the arm’s length principle as laid down in Article 8b(1) of the CIT or the Decree, but whether the Dutch tax administration conferred a selective advantage on SMBV for the purposes of Article 107(1) of the Treaty (...)”.</p> <p>Para 381 “(...)the Commission considers that the tax advisor incorrectly designated SMBV as a low-risk manufacturer. More specifically, information provided on SMBV’s revenues demonstrates that roasting is not the main source of income of SMBV. (...) income from the sales of roasted coffee (...) represents only [15-20] % of the revenues of SMBV in 2013 and 2014. In 2007, that is, at the time that the SMBV APA was concluded, that proportion was substantively at the same level at [15- 20] %”</p> <p>Para 382 “Instead, SMBV derives most of its profits recorded in the Netherlands from an activity different from roasting. Indeed, SMBV’s reselling function, referred to as providing logistic and administrative services by the Netherlands and Starbucks, appears more important than its roasting activity and accounted for [80-85] % of SMBV’s revenues in 2013 and 2014.”</p> <p>Para 383 “(...) SMBV’s reselling function not only represents the main source of SMBV’s income, but also represents the only source of SMBV’s profit since 2010, considering SMBV’s roasting activity has been loss making since that year, without prejudice to the question whether those losses on the roasting activities were caused by incorrect pricing of the green coffee beans”</p> <p>Para 446 “the Netherlands should take SMBV’s accounting profits, with no deduction of the royalty payment from SMBV to Alki LP from those profits for the licensing of the roasting IP, as the starting point from which SMBV’s tax liability in the Netherlands is determined to properly ensure that the aid granted by the SMBV APA is eliminated through recovery.”</p> <p>Para 450 “In conclusion, the Commission finds that the Netherlands has unlawfully granted State aid to SMBV and the Starbucks group by concluding the SMBV APA in breach of Article 108(3) of the Treaty”</p>

 Upheld by the General Court

 Rejected by the General Court



1. **The EU Commission's difficulty with the tax rulings cases**
 - The rulings conformed with national law / the OECD Guidelines.
 - National laws do not all contain the arm's length principle.

2. **The invention of "Commission ALP"**
 - Invention during the course of the Commission investigations – no earlier appearance.
 - The doubtful basis in Forum 187 – Belgian law on transfer pricing.
 - The use of Commission ALP as a tool to assess whether a selective advantage has been granted to integrated companies (i.e. members of a multinational group).

3. **The central issue for Commission ALP** – comparison with a stand-alone enterprise which transacts on the market.

EU Commission vs. OECD: Arm's length Principle



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OECD Transfer pricing guidelines	Commission ALP
<ul style="list-style-type: none">• Highly formalised and developed system based on guidelines• Has moved away from anti-avoidance in favour of an agreed allocation of taxing rights between states• Takes into account the existence of a group relationship – e.g. group synergies• Is based on domestic law rules and tax treaties	<ul style="list-style-type: none">• Novel invention – no details available at all• Looks to compare a member of a group with a stand-alone enterprise: cannot take account of group relationship• Conformity with the OECD TPG does not necessarily ensure that there is no state aid• Operates independently of national law – has existed in principle since 1957• Exists as a tool to determine if an integrated company has received a selective advantage

- The Belgian coordination centres judgment

In its judgment on the Belgian tax regime for coordination centres, the Court of Justice assessed a challenge to a Commission decision which concluded that the method for determining taxable income under that regime conferred a selective advantage on those centres.

According to the Court, “in order to decide whether a method of assessment of taxable income such as that laid down under the regime for coordination centres confers an advantage on them, it is necessary, [...], to compare that regime with the ordinary tax system, based on the difference between profits and outgoings of an undertaking carrying on its activities in conditions of free competition.” The Court then held that “the effect of the exclusion of [staff costs and the financial costs] from the expenditure which serves to determine the taxable income of the centres is that the transfer prices do not resemble those which would be charged in conditions of free competition”, which the Court found to “[confer] an advantage on the coordination centres”.

Question:

Is *Belgium and Forum 187 v. Commission* a suitable legal source for an EU "Arm's Length Principle"?

- What is the difference between a tool of state aid analysis and a rule of law?
- Will transfer pricing reports for EU Member States need to include a section on “the equivalent outcome for a stand-alone enterprise”?
- How do you demonstrate the equivalent outcome for a stand-alone enterprise?
- What about group synergies?
- Is this the end of the OECD ALP as we know it?

Q&A



Head for the main session for a few closing remarks