
State aid and tax rulings

Prepared for Bruegel

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Overview of cases

'Ireland gave illegal tax benefits to **Apple** worth up to **€13 billion**'

'Therefore, the Commission has ordered Luxembourg and the Netherlands to recover the unpaid tax from **Fiat and Starbucks**, respectively [...].'

'Commission investigates transfer pricing arrangements on corporate taxation of **Amazon** in Luxembourg'

'Commission concludes Belgian "Excess Profit" tax scheme illegal; around **€700 million** to be recovered from **35 multinational companies**'

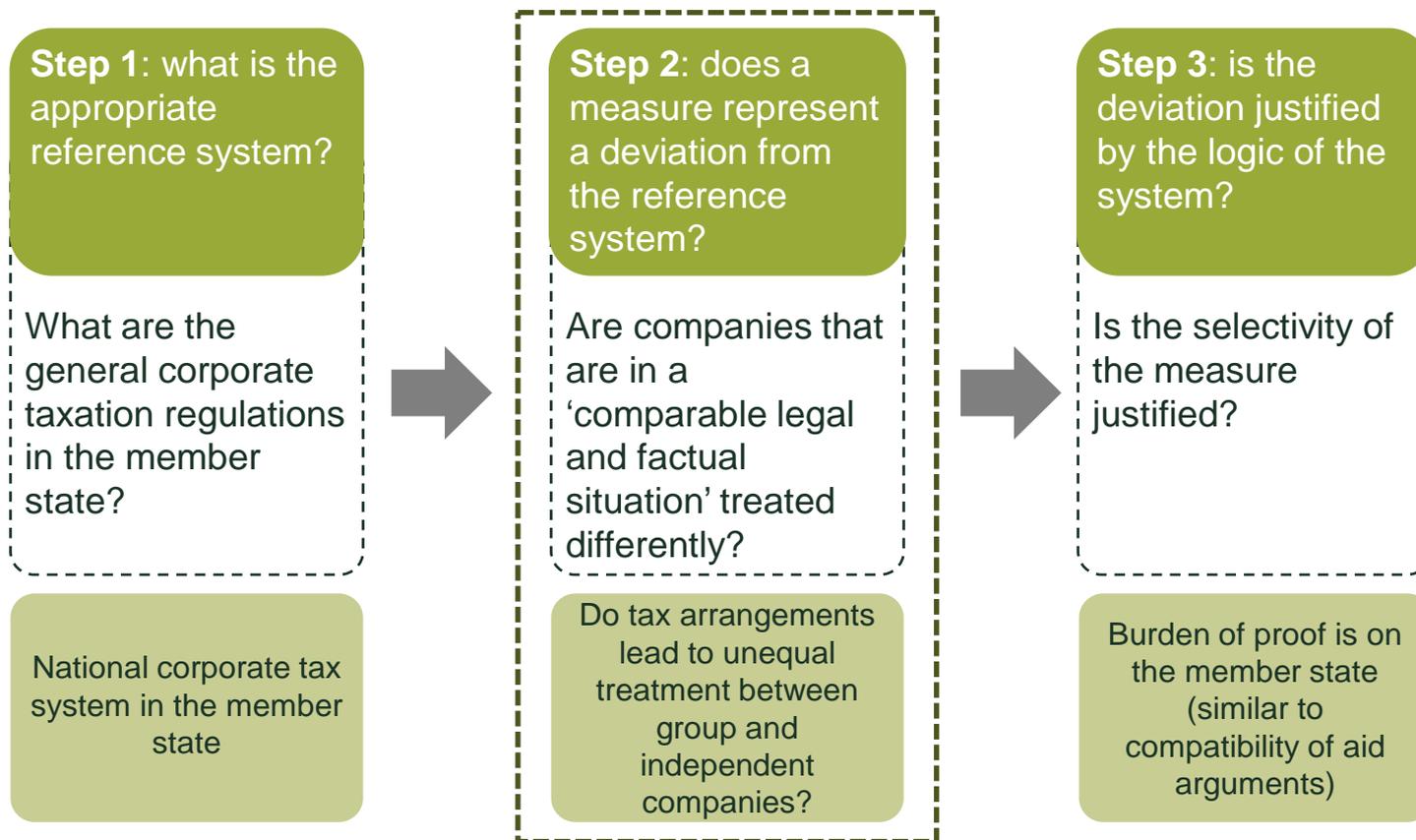
'Commission opens formal investigation into Luxembourg's tax treatment of **McDonald's**'

'Commission considers at this stage that the treatment endorsed in the tax rulings resulted in tax benefits in favour of **GDF Suez**'

Source: Various press releases on the European Commission's website.

State aid framework

Selectivity and economic advantage: two sides of the same coin?



Source: European Commission, Commission Decision of 21.10.2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks, C(2015) 7143, para. 230; Joined Cases C-78/08 to C-80/08 Paint Graphos, ECLI:EU:C:2009:417.

State aid framework

Economic advantage: OECD guidelines on transfer pricing

Key test is compliance with arm's-length principle

Are the terms and conditions of intra-group transactions in line with comparable transactions between independent companies?



Do tax rulings lead to a taxable base that is lower than the level that would result from the application of the arm's-length principle?

Traditional methods

- **comparable uncontrolled price (CUP) method**—comparison of prices charged in intra-group transactions with those charged in similar transactions between independent companies
- **cost plus method**—comparison based on costs incurred by suppliers in intra-group transactions, plus a profit mark-up
- **resale price method**—comparison based on prices at which products/services that have been purchased from an associated enterprise are resold to an independent enterprise, net of selling costs

Transaction profit methods

- **transactional net margin method (TNMM)**—comparison based on a specific profit indicator
- **transaction profit split method**—benchmarks the division of profits that independent enterprises would have expected from engaging in economic transactions

the preferred approach

Source: OECD (2010), 'Review of Comparability and of Profit Methods: Revision of Chapters I-III of the Transfer Pricing Guidelines', 22 July.

Apple's tax arrangements in Ireland

Overview of the Commission's Decision



- licenses for Apple's intellectual property held by ASI and AOE were allocated outside Ireland
- ASI's and AOE's 'head offices' had no employees, were not based in any country, and were not subject to tax in any country



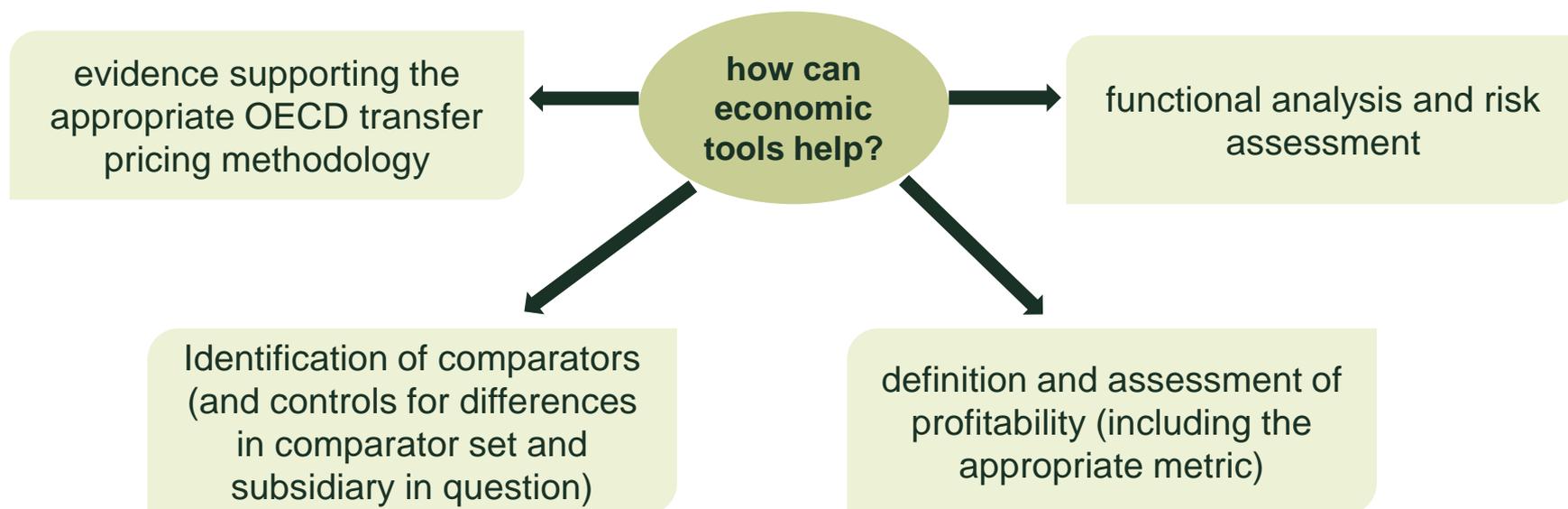
- ASI's and AOE's taxable profit in Ireland was further under-estimated due to the misapplication of the transactional net margin method
 - the selected profit indicator (operating expenses) does not result in a market-based outcome
 - the required level of profitability was too low
 - no contemporaneous explanations justifying the choice of the profit margins in the 1991 and 2007 tax rulings
 - ASI's and AOE's Irish branches may not perform the "least complex function" compared to their head offices

Source: European Commission, Commission Decision of 30.08.2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple, C(2016) 5605.

Conclusions

Mitigating state aid risk through economic and financial analysis

- the scope of the tax state aid investigations is increasing (e.g. McDonald's)
- state aid risk can be significantly mitigated through a transfer pricing report, prior to the start of the tax ruling, based on robust financial and economic analysis



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