

## Analysis

# Implications of the Starbucks and Fiat state aid decisions

## Speed read

The European Commission says that the Starbucks and Fiat tax rulings are unlawful state aid and that €20m to €30m should be repaid by these companies. Decisions in relation to Amazon and Apple are yet to come. Is it the role of the competition authorities to investigate detailed transfer pricing methodologies? Attention is likely to move onto others, with Luxembourg a particular focus. Groups with favourable rulings anywhere in the EU should review their position. Consider acting before an approach from the Commission to minimise adverse publicity. State aid needs to be considered in any future planning.



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The European Commission has decided that tax rulings granted by Luxembourg to Fiat Finance and Trade, and by the Netherlands to Starbucks, constitute 'selective tax advantages' contravening EU state aid rules. It did not come as a surprise that the Commission found against the companies involved in these 'flagship' tax cases, as the direction of travel was clear from documents published earlier in the year setting out the Commission's case. What is surprising is the level of technical tax detail that the competition authorities have considered in reaching their decisions.

The monetary amounts are not fundamental for the companies involved, with the Commission estimating that they will each be required to repay around €20m to €30m. In addition, both Luxembourg and the Netherlands have expressed disagreement with the decisions, as have the companies, so appeals are likely. The companies will probably have the expense and uncertainty of an ongoing dispute with the Commission.

### State aid: the basics

Under EU rules, it is unlawful for any EU country to give

financial help to selected companies in a way which would distort fair competition. The Treaty on the Functioning of the European Union says that '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, insofar as it affects trade between member states, be incompatible with the internal market.'

For state aid to exist:

- aid must be granted by the state or through state resources;
- it must be granted to a certain undertaking;
- thereby creating a selective advantage; and
- the transfer of resources must distort or have the potential to distort competition and trade between EU countries.

The key question for a tax relief or exemption or a favourable tax ruling is whether a selective advantage has been created.

Since June 2013, the Commission has been investigating the tax rulings of member states, starting out with selected states and then widening its scope to all states. Last year, it announced that it was beginning in-depth investigations into Starbucks and Fiat, as well as Apple in Ireland and, more recently, Amazon in Luxembourg. We are still waiting for the Apple and Amazon decisions, which may well be more significant in monetary terms than those involving Starbucks and Fiat.

For multinational groups, transfer pricing will always be a key issue and it is common for an advance pricing agreement (APA) to be sought in order to give certainty on the tax position. However, if the ruling contravenes market principles so as to confer a selective advantage, it could be considered to be state aid. The key question in the Starbucks and Fiat cases is where the line should be drawn between the proper exercise of discretion by tax authorities, and the right of the EU Commission to investigate potential state aid.

### The Starbucks decision

The Commission said that a tax ruling issued by the Netherlands tax authority in 2008 was not in line with the arm's length principle and gave a selective advantage to Starbucks Manufacturing, a Netherlands company, which had the effect of reducing its Netherlands tax liability by €20m to €30m. Starbucks Manufacturing bought coffee beans from a Swiss group company. It roasted and processed the beans, which it then sold to Starbucks coffee shop operations in Europe. It also paid a royalty to a UK limited partnership for coffee roasting know how. Overall, its profits were calculated on the basis that it was a low risk entity, akin to a contract manufacturer. It is important to note that the investigation was only into this specific entity, and not into the overall group position.

In its press release, the Commission said the ruling 'artificially lowered' the taxes paid by Starbucks Manufacturing, because it paid a 'very substantial' royalty to the UK-based entity in the Starbucks group for its coffee roasting know how and it paid an 'inflated price' for coffee beans to a Swiss group company.

Although the detailed decision has not yet been published, it appears, from the Commission's earlier letter setting out its concerns, that Starbucks had produced a full transfer pricing report and used a transfer pricing method accepted under the OECD Transfer Pricing Guidelines. However, the Commission said that the transactional net margin method (TNMM) used by Starbucks Manufacturing was not appropriate and it challenged the company's status as

a low risk manufacturer. It also took issue with adjustments made to the comparables used for benchmarking purposes. Effectively, the Commission is questioning the competence of the tax authorities in giving Starbucks an APA.

### The Fiat decision

In the Fiat case, the Commission said a tax ruling issued by the Luxembourg authorities in 2012 gave a selective advantage to Fiat Finance and Trade, a Luxembourg company providing financial services to other group companies. It said that Fiat's activities were comparable to those of a bank and so its taxable profits should be calculated as a return on capital deployed by the company for its financing activities. However, the Commission found that due to 'a number of economically unjustifiable assumptions and downward adjustments', the capital base of the company used in the tax ruling was much lower than the company's actual capital. It also found that the return made by the company on its activities was lower than the market rate.

Again, it appears that Fiat submitted a full transfer pricing report and was using OECD approved transfer pricing methodologies. As with Starbucks, the Commission's initial letter setting out its concerns showed that it was considering the application of transfer pricing methodologies in considerable detail.

### Role of the Commission

Although tax rulings can impact on a company's competitiveness, is it really the role of the competition authorities to be looking over the shoulder of the tax authorities in this way?

It is surprising that the Commission has chosen to comment so explicitly on national governments' tax methodologies, particularly where the rulings were stated to be in accordance with OECD principles. Although EU law (and therefore the state aid rules) takes precedence over national rules, such a detailed consideration of the work of the tax authorities appears to be in danger of encroaching on member states' sovereign rights over direct taxation matters.

### Next steps

The Commission has said that it will require the Netherlands and Luxembourg to recover the benefits of the state aid from the companies concerned. The amount to be recovered will be the economic benefits over a ten year period, although repayments can be required in respect of a longer period because there are a number of actions that can interrupt the 'ten year clock'.

For a US company, an EU ruling which was found to amount to state aid could be extremely expensive. Amounts repaid are repayments of aid and so will not automatically be considered to be 'tax' for the purposes of double tax relief. Even if they do qualify for credit, the group's overall foreign tax credit position may limit the relief available.

The Amazon and Apple decisions are yet to come. From what we have already heard about the Commission's investigations, it looks to be on much stronger ground in relation to Apple. In its initial letter setting out the case against Apple, the Commission relied less on detailed technical points on the transfer pricing methodology and more on suggestions that this ruling was 'reverse engineered' to give the desired tax outcome, in an attempt by the Irish government to attract Apple's investment in Ireland and the resulting creation of employment. The ruling also lasted 16 years – an unusually long time.

Arguably, this is the kind of case that should fall within the remit of the Commission, rather than those situations where, because transfer pricing is not an exact art, there is no clear right or wrong answer. Apple has already disclosed, in its form 10-K filings with the Securities and Exchange Commission, that the amount may be material.

The Amazon decision is probably the one that will have the greatest impact for others, because so many multinationals have similar rulings in Luxembourg. Once the team at the Commission has cleared its desks by issuing these outstanding decisions, we can expect it to move on to looking at other specific rulings. The Commission has been criticised by the US for its apparent focus in its investigations on US owned multinationals, so it would not be surprising if European owned groups were to feature more prominently in the future.

The Commission has received information (by the truckload, apparently) in relation to its enquiry into rulings given by member states. However, Luxembourg looks likely to remain a particular focus of the Commission's investigations, as it already has the papers published as part of the 'Lux Leaks' disclosures and for many years Luxembourg was the destination of choice within the EU for tax efficient structuring.

The EU is introducing automatic exchange of information on tax rulings between tax authorities every six months, with a start date of 1 January 2017. However, it appears that some parts of the Parliament, such as the Economic and Monetary Affairs Committee and the TAXE Committee (which is specifically charged with looking at rulings), fear that the proposals have been watered down too far.

### What should others do?

Any group with a favourable ruling in an EU member state should be considering its position and should be carrying out a state aid 'health check' on past structures. Even if a full transfer pricing report was prepared, the Starbucks decision shows that the ruling may not now be safe.

Taking action now, before an approach by the Commission, could minimise a company's liability and significantly reduce the risk of adverse publicity.

There are also concerns that even if the Commission does not investigate, if another person, such as a competitor, thinks that that a ruling obtained by a company could amount to unlawful aid, they can try to obtain an order from the national court requiring the authorities to recover the tax advantage.

It is often said that the only certainties in life are death and taxes. What now seems clear is that, for companies operating in Europe, there is no longer any certainty to be had on tax. ■

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