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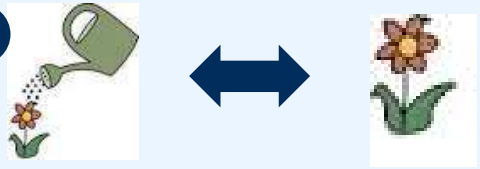
EU COMMISSION INITIATIVE AGAINST "AGGRESSIVE" TAX PLANNING AS IT AFFECTS THE MEMBER STATES

Andreas von Bonin, 24 June 2016

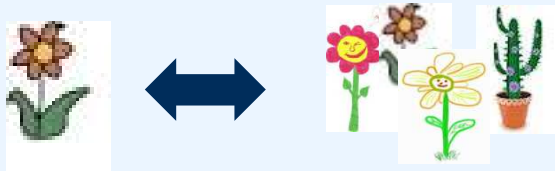
A few questions

1. Is the Commission taking a shortcut to the “selective advantage”?
2. What is the “reference system”?
3. What is the meaning and the role of the CLFS criterion?
4. What is the EU ALP?
5. Where does it come from?
6. Are all mis-applications of the EU ALP (or national law) caught?

Is the Commission taking a shortcut to the "selective advantage"?

1 

[…] advantage is based on an analysis of the financial situation of an undertaking with and without the particular measure. (***NoA***, 72)

2 

[…] whether a [...] measure […] differentiates between economic operators who […] are in a comparable legal and factual situation. (***NoA***, 128)

- "advantage" and "selectivity" require two very different comparisons

(217) […] whether a tax measure constitutes a derogation from the reference system will generally coincide with the identification of the advantage granted to the beneficiary under that measure. Indeed, where a tax measure results in an unjustified reduction of the tax liability of a beneficiary who would otherwise be subject to a higher level of tax under the reference system, that reduction constitutes both the advantage granted by the tax measure and the derogation from the system of reference. ***(FFT = EPR,*** 131***)***

- Selectivity => advantage?

(218) According to the Court, in the case of an individual aid measure, […], "*the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective*". ***(FFT)***

- Advantage => selectivity?

- ***MOL*** (59) confirms that selectivity "*must be clearly distinguished*" from advantage. ***MOL*** (60) is *obiter dictum*, and seems overbroad (e.g. disregarding the possibility of justification).

What is the "reference system"?

(133) The reference system is composed of a consistent set of rules that generally apply - on the basis of objective criteria - to all undertakings falling within its scope as defined by its objective. […]
(134) In the case of taxes, the reference system is based on such elements as the tax base, the taxable persons, the taxable event and the tax rates. (***NoA***)

- Who defines "consistent", "generally", "scope" and "objective"?

(194) […] the Commission considers the reference system to be the general […] corporate income tax system, which has as its objective the taxation of profits of all companies subject to tax in […].
(196) For the determination of the taxable profit […], in principle, the commercial accounts of the taxpayer are followed, subject to adjustments imposed by […] tax law […]. (***FFT***)

- Reference system comprised of *a set of rules*

- Different tax base for resident and non-resident taxpayers part of the reference system (***FFT***, 194; ***EPR***, 121).
  - So, e.g. a ruling confirming a non-resident status would not be a derogation.
- DTTs belong to the reference system (***McDo***, 72).
  - So, e.g. a ruling confirming the content of a DTT would not be a derogation.
- However, a Member States' implementation of ALP does not constitute (***FFT***, 210 et seq.) or belong to (***EPR***, 123 et seq.) the reference system.

- Adjustments to the basic rules are part of the reference framework (***Sanierungsklausel***, 114)

What is the meaning and role of the CLFS criterion?

(135) […] it is necessary to determine whether the measure is liable to favour certain undertakings or the production of certain goods as compared with other undertakings which are in a similar factual and legal situation, in the light of the intrinsic objective of the system of reference. (***NoA***)

(49 - EN) – „ in light of the objective assigned to the tax system of the Member State concerned" (***PG)***
(49 - DE) – „im Hinblick auf das mit der Steuerregelung dieses Mitgliedstaats verfolgte Ziel"(***PG)***

(41) […] The only question to be determined is whether […] a State measure is such as to favour 'certain undertakings or the production of certain goods' […] in comparison with other undertakings which are in a legal and factual situation that is comparable in the light of the objectives pursued by the measure in question". (***Adria Wien Pipeline = Azores***, 54)

- CLFS needs to exist with respect to the objective of the *contested measure*

- Commission wrongly concludes on CLFS from the alleged "*intrinsic objective of the system*" (***FFT***, 199) that all taxpayers are in a CLFS: "*In general, all undertakings having an income are considered to be in a similar legal and factual situation from the perspective of direct company taxation.*" (***FFT***, FN 87)
- Case law demands a "non-discrimination" assessment between taxpayers in scope of the contested measure – if the measure differentiates between taxpayers who are in a CLFS, it is discriminatory, i.e. selective.
- In relation to a measure, which seeks to align the taxation of a group company to that of a stand-alone company, group and stand-alone companies *cannot* be in a CLFS, because otherwise the measure would not be required in the first place.

What is the EU ALP?

(171) […] transfer prices in intra-group transactions that […] result in a reliable approximation of a market-based outcome […]" (***NoA***)

(171) This arm's length principle necessarily forms part of the Commission's assessment of tax measures granted to group companies under Article 107(1) of the Treaty, independently of whether a Member State has incorporated this principle into its national legal system and in what form. (***NoA***)
(172) […] This principle binds the Member States and the national tax rules are not excluded from its scope. (***NoA***)

(228) […] 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 […] (***FFT***)

- No *advantage* if EU ALP is complied with – but who decides that?

- "*The notion of advantage is based on an analysis of the financial situation of an undertaking in its own legal and factual context with and without the particular measure.*" (***NoA***, 72; ***FFT***, 220)
- The counterfactual for the assessment of the advantage is the ordinary national (tax) law: "*The advantage must be assessed, within the framework of the State aid investigation, purely at national level*" (***Dutch Intl. Financing Activities***, 82). **Paint Graphos**: "*it is necessary to begin by identifying and examining the common or 'normal' regime applicable in the Member State concerned*" (49).
  - Difference to the MEOP.
- Commission replaces the "national law counterfactual" by its own "EU counterfactual" to determine the advantage.
  - **McDo**, 86, goes one step further: Commission replaces the Member State's interpretation of the "national law counterfactual" by its own interpretation of national law.

Where does it come from?

(96) In that regard, the staff costs and the financial costs incurred in cash-flow management and financing are factors which make a major contribution to enabling the coordination centres to earn revenue, inasmuch as those centres provide services, particularly of a financial nature. Accordingly, the effect of the exclusion of those 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. (***Forum 187***, 22 June 2006)

- A general principle of EU law since 1956?

- Any explicit mentioning in the case law before or after Forum 187?
- Any mentioning in a Commission notice or guidance document before the NoA of May 2016?
  - In the draft NoA of 2014?
- Anything in the judgment that would suggest that the Court made a point of such a far reaching general nature, as opposed to assessing very specific factual circumstances (and very specific types of cost being disregarded for the determination of the tax base of coordination centres)?

Are all misapplications of EU-ALP (or national law) caught?

(171) […] transfer prices in intra-group transactions that […] result in a reliable approximation of a market-based outcome […]" (***NoA***)

(174) […] tax rulings confer a selective advantage where a) the ruling misapplies national tax law and this results in a lower amount of tax; c) […] the ruling allows its addressee to use alternative, more indirect methods for calculating taxable profits, for example the use of fixed margins for a cost-plus or resale-minus method for determining an appropriate transfer pricing, while more direct ones are available (***NoA***)

(FN 105) […] Any advantage is sufficient to constitute State aid, provided the other conditions of Article 107(1) of the Treaty are met. […] (***FFT***)

(23) […] DG Competition's focus is on cases where there is a **manifest breach** of the arm's length principle. (***Working Paper***)

Yes. Working paper contradicts decisions and NoA.

- Member State's choice of methodology cannot determine advantage, because State aid is effects-based and objective.
- Commission replaces internationally accepted system of taxation by State aid regime that
  - is entirely subject to its (and the EU Courts') interpretation;
  - harmonises Member States' tax laws through State aid enforcement, for which the Commission has no mandate under the Treaties;
  - creates considerable legal uncertainty.

Effect on Member States

- Expansive interpretation of Art. 107 TFEU into an area which is in the sole competence of Member States
- EU ALP concept “replacing” well established concept to deal with TP issues
- Imposing Commission interpretation of national tax law as binding
- What is next?

Backup

1. What is the contested measure?
2. Does this measure grant an advantage to its beneficiary?
   - A: What are the taxable profits with the ruling?
   - B: What are the taxable profits without the ruling?
   - Is A < B?
3. Is the measure selective?
   - What is the reference framework?
   - Does the measure constitute a derogation from it?
   - Does the measure lead to a different treatment of taxpayers that are – in light of the objective of the measure – in a CLFS?
   - Is there a justification?
4. All other conditions of Art. 107 (1)

Thank you

Andreas von Bonin

T +32 2 504 7179
E andreas.vonbonin@freshfields.com

About

Andreas is a competition law partner based in Brussels, who specialises in state aid investigations.

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