

# **EU STATE AID CONTROL AND CORPORATION TAX**

**Recent European Commission decisions, including  
Belgian Excess Profits, Apple, Fiat  
Starbucks, McDonalds, Amazon  
Spanish Goodwill, CFC Group Financing Exemption**

**CONOR QUIGLEY QC**

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# State aid control in the EU

- State aid (subsidies) prohibited
  - Prima facie prohibition on State measures that grant aid
  - Aid may be permitted by the European Commission (EC)
    - e.g. R&D&I, environmental protection, regional investment
    - operating aid (aid not linked to investment) generally prohibited
  - Requirement to seek advance approval from EC
- Aid that is implemented without approval is illegal
  - Investigation by EC
    - Investigation against Member State
    - Recipient of aid, competitors, interested parties make representations
  - Member State required to recover illegal aid from the recipient
    - e.g. Apple decision - €13 billion plus interest
  - Compare with WTO anti-subsidies rules

# State aid control in the EU Treaty (TFEU)

- Article 107(1) TFEU:

“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”

# State aid as defined by European Court of Justice (CJEU)

## ■ CJEU definition:

- Intervention by the State
- Measure results in an economic advantage to beneficiary
- Selective advantage granted to certain undertakings
- Potential distortion of competition
- Potential effect on trade between Member States

# Criteria for grant of State aid

## ■ Intervention

- Departure from the norm
- Measure adopted imputable to the State
- Burden on State resources

## ■ Economic advantage to recipient/beneficiary

- Advantage by comparison to situation before the intervention
- Recipient is better off as a result of the measure

## ■ Advantage must be selective, favouring certain undertakings

- Advantage for recipient as compared to other undertakings in comparable legal and factual position

## ■ Beneficiary is an undertaking

- Undertaking is a provider of goods or services
- Distinguish between undertaking and taxpayer

# Taxation and State aid

## ■ Tax sovereignty

- Democratic control
- Burden choices
- Policy objectives

## ■ State aid

- Defined by reference to effects
- Policy objectives do not prevent measures from being State aid

## ■ Fiscal State aid

- Aid granted through tax system
- Same principles as grant of direct financial aid
- Deductions, exemptions, exclusions, administrative benefits

# Intervention implies an existing norm

## ■ CJEU case law:

- “interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking”: Case 30/59, *Steenkolenmijnen*, p.19.
- “innovation with regard to the previous legal position”: Case 173/73, *Italy v Commission*, para 6

## ■ Pre-existing normative liability

- General tax legislation

## ■ Departure from the norm, thereby creating advantage

- Derogating legislation, exemption

## ■ Administrative action

- Discretionary power of administrative authority to determine tax liability

# Tax rulings and intervention

## ■ Belgian Excess Profits Exemption Scheme

- Reduction in corporate tax base by 50-90% based on legislation
- Tax ruling required to obtain application of the exemption

## ■ McDonalds (final decision pending)

- Luxembourg-US double taxation treaty: US treated the profits as non-taxable
- Tax ruling of Lux administration to determine McDonald's p.e. status
- Mistake of law

## ■ Fiat/Apple/Starbucks

- Tax ruling integral to the tax assessment
- Advance determination of appropriate pricing/attribution criteria
- Mistake of fact

## ■ Amazon

- Any assessment adopted by tax authority is an intervention

# Economic advantage

- CJEU case law relied on by EC:
  - “economic benefit that an undertaking would not have obtained under normal market conditions”: Case C-39/94, *SFEI*, para 60
  - Test applicable to market transactions, e.g. sale of property
  - Query whether right test for fiscal State aid
  - Relief from taxation regulatory in nature
- Economic benefit that the recipient would not have obtained but for the intervention measure
  - Tax ruling or assessment sets the amount of tax due
  - Mistake in tax ruling or tax assessment resulting in less tax payable
  - Any mistake, deliberate mistake, manifest error of assessment?
- Economic advantage distinguished from selective advantage
  - Constant confusion by EC (and sometimes CJEU)

# Economic advantage and arm's length principle

- EC's arm's length principle:
  - A reduction in the taxable base that results from a tax measure that enables a taxpayer to employ transfer prices in intra-group transactions that do not resemble prices which would be charged in conditions of free competition between independent undertakings negotiating under comparable circumstances at arm's length confers a selective advantage on that taxpayer for the purposes of Article 107(1) TFEU. This is because that taxpayer's tax liability, determined under the ordinary rules of taxation of corporate profit, is reduced as compared to independent undertakings whose taxable profit reflects prices determined on the market negotiated at arm's length.

# Cases C-182/03 & C-217/03, *Belgium and Forum 187 v Commission* (1)

## ■ Facts:

- Belgian corporation tax was on the basis of stated accounts.
- Specific legislation was adopted dealing with the taxation of coordination centres of multinational groups which derogated from the ordinary tax regime in a number of respects.
- Taxable income was determined at a standard rate according to the cost plus method, representing a percentage of total operating expenses and costs, from which staff costs, financial charges and corporation tax were excluded.
- The Commission held that this regime constituted a system of State aid for the centres and ordered its abolition.

# Cases C-182/03 & C-217/03, *Belgium and Forum 187 v Commission* (2)

## ■ CJEU judgment:

“95. 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.

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 these costs from the expenditure which serves to determine the taxable income of the centres is that the transfer prices do not resemble those that would be charged in conditions of free competition.

97. It follows that such an exclusion confers an economic advantage on the centres.”

# Cases C-182/03 & C-217/03, *Belgium and Forum 187 v Commission* (3)

## ■ Advocate General's Opinion:

“241. The tax scheme applicable to the coordination centres is not to be based on the difference between the income and the charges of an undertaking, as is the case under the ordinary tax law in Belgium. It is set at a flat-rate amount which represents a percentage of the full amount of operating costs and expenses, from which staff costs and financial charges are excluded.

247. The Commission ... considers that ... the taxable amount to which the normal corporation tax rate falls to be applied is not calculated in such a way that services provided by the coordination centre are to be taxed as if they were supplied by another company, in a context of free competition, pursuant to the principle underlying the OECD's 'cost-plus' method.”

# Commission's arm's length principle is dubious

- Corporate taxation is normally based on stated accounts
- Adjustment to stated profits only as provided for by legislation
- No adjustment to profits generally to reflect market outcome
- Special rules applicable to associated companies, e.g. transfer pricing rules, based on legislation
- No basis in Article 107(1) TFEU for alternative method of calculating tax liability
- No additional liability arises directly on the basis of Article 107(1) TFEU

# Selectivity and fiscal State aid

- Identification of the relevant reference framework
  - e.g. corporation tax
- For Article 107(1) TFEU to apply, it must be determined that the State measure is such as to favour certain undertakings or the production of certain goods compared to others which, in the light of the objective pursued by the system in question, are in a comparable legal and factual situation:  
Case C-143/99, *Adria Wien Pipeline*, para 41
- Derogation justified by the nature of the general system
  - Case C-78/08, *Paint Graphos*: justification must be intrinsic
  - e.g. tax avoidance

# Selectivity and discrimination

- Objective pursued by the system in question
  - Objective of corporation tax is to raise money by taxing profits
- EC 2016 Notice on Notion of Aid, para 172
  - Arm's length principle prohibits unequal treatment in taxation
- Differential treatment and discrimination
  - Comparable legal and factual situation
  - Cases C-20/15P and C-21/15P, *World Duty Free Group/Santander*, para 54: discrimination entails others suffering different treatment
  - No requirement that category of undertakings be identified
- Tax codes contain many examples of differential treatment
  - UK CFC Group Financing Exemption investigation

# Undertakings v taxpayers

## ■ State aid must favour undertakings

- Undertakings carry on economic activity, i.e. provision of goods or services on market
- Pure holding companies not undertakings
- Conflation of taxpayers and undertakings

## ■ Direct and indirect aid

- Case C-156/98, *Germany v Commission* – tax deduction for investment by taxpayer in East German companies – indirect aid to target company – not aid to taxpayer
- Cases C-20/15P and C-21/15P, *World Duty Free Group and Banco Santander* - tax relief for acquisition by Spanish companies of shares in non-Spanish companies – aid to taxpayer investors

# Issues arising from the recent decisions

- Scope of discrimination giving rise to State aid
- Exercise of discretionary power by tax authorities
- Misapplication of national rules in tax assessments
- Subsidiarity/competence relating to tax administration
- Judicial review of EC decisions v national tax appeals
- Legal certainty and proportionality of recovery orders
- Misuse of powers by EC

# UK CFC Group Financing Exemption

## ■ UK CFC rules

- Finance Act 2012
- Part 9A, TIOPA 2010
- Chapter 9 – Group Finance Exemption
- Commission Opening Decision 26/10/2017
- Published in OJEU, 24<sup>th</sup> November 2017
  - OJ 2017 C400/10
  - Comments from interested parties within 30 days
- Final decision likely end 2018
  - Suspensory effect of investigation

**For further reference:**

**EUROPEAN STATE AID  
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# Thank you for your attention

CONOR QUIGLEY QC

SERLE COURT

6 NEW SQUARE

LINCOLN'S INN

LONDON WC2A 3QS

[CQUIGLEY@SERLECOURT.CO.UK](mailto:CQUIGLEY@SERLECOURT.CO.UK)

serle court