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The EU General Court clarifies the burden of proof that has to be met by the Commission to demonstrate the existence of an advantage in the context of tax rulings *(Starbucks)*

STATE AID, NETHERLANDS, INTELLECTUAL PROPERTY, AGRICULTURE / FOOD PRODUCTS , STATE AID (NOTION), EUROPEAN UNION, STATE AID (TAX EXEMPTION), TRANSFER PRICING, TAXES, STATE AID (TAX RULING)

EU General Court, *Starbucks*, T-760/15 et T-636/16, 24 September 2019 (French)

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On 24 September 2019, the General Court ('GC') rendered its first two Judgments assessing under which circumstances EU State aid rules can curtail Member States' sovereignty to adopt individual tax rulings. [*1*] In the *Starbucks* Judgment discussed here, the GC ruled in favour of Starbucks since the European Commission ('Commission') failed to prove the existence of an *advantage* within the meaning of article 107(1) TFEU. The Judgment provides useful guidance in relation to the burden of proof the Commission has to meet to demonstrate if and when an advantage is conferred by an individual tax ruling.

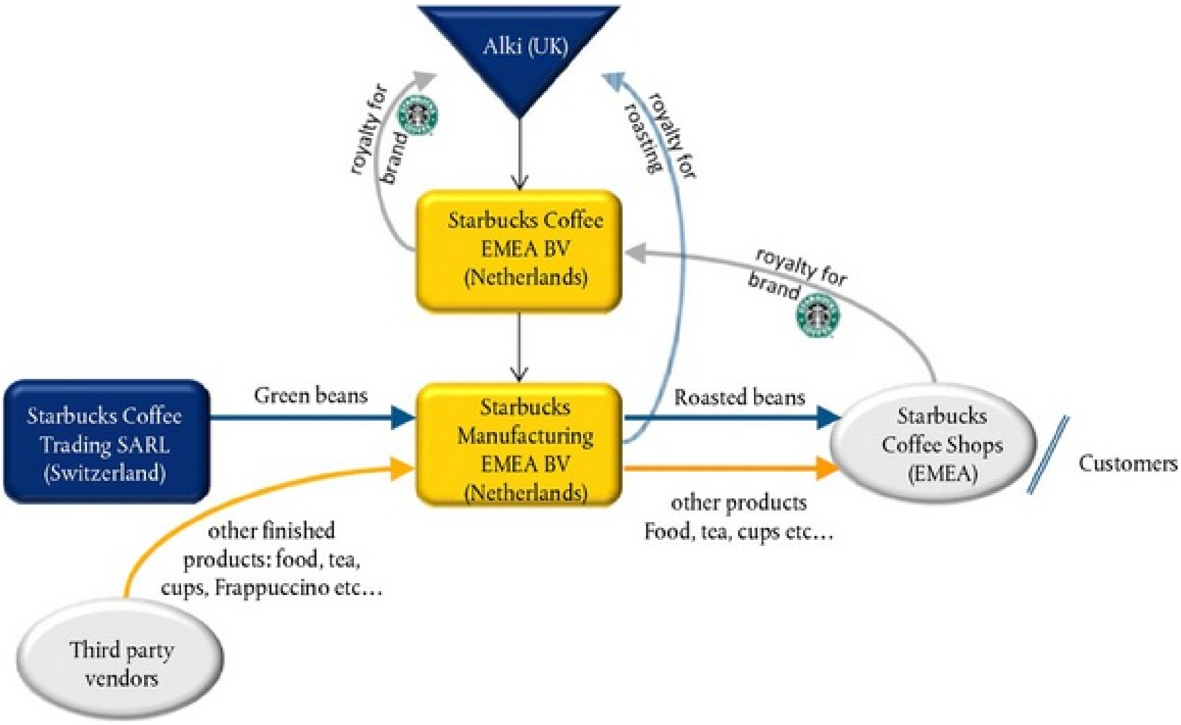
I. The parties

Starbucks Corp., headquartered in the United States, is the controlling entity of the Starbucks group.

Starbucks Manufacturing Emea BV ('**SMBV**'), founded in 2001 and established in the Netherlands, is a subsidiary of the Starbucks group. SMBV's activities include amongst others the roasting of coffee and the sale of coffee-derived and non-coffee products. SMBV provides these roasted coffee beans and related products to Starbucks shops in Europe, the Middle East and Africa.

Alki LP ('**Alki**'), established in the United Kingdom, is also a subsidiary of the Starbucks group and indirectly controls SMBV. Alki and SMBV concluded a roasting agreement, which provides *inter alia* that SMBV has to pay Alki a royalty for the use of Alki's IP rights, including roasting methods and other roasting know-how ('roasting IP').

Starbucks Coffee Trading SARL ('**SCTC**'), established in Switzerland, is another subsidiary of the Starbucks group and supplies green coffee beans to SMBV.



Source: GC Judgment

II. The facts

On 28 April 2008, the Dutch tax authorities concluded an advance pricing arrangement ('APA') with SMBV. Using the transactional net margin method ('TNMM'), a method included in the OECD Transfer Pricing Guidelines ('OECD Guidelines'), [*2*] the APA's goal was to determine SMBV's remuneration within the Starbucks group in conformity with transfer pricing principles. [*3*] The resulting remuneration could then be used to determine SMBV's annual taxable profit.

In addition, the APA endorsed the amount of the royalty paid by SMBV to Alki for the use of its roasting IP. The amount of royalties paid to Alki corresponded to the difference between the realised operating profit and SMBV's remuneration as set in accordance with the APA (*i.e.*, all profits generated by SMBV in excess of the percentage of operating costs considered as SMBV's remuneration).

On 21 October 2015, the Commission decided that the Netherlands granted unauthorized State aid to Starbucks. [*4*] According to the Commission, the APA conferred an advantage as it led to a reduction in the corporate income tax paid by SMBV compared to a stand-alone company whose taxable profits were determined under market conditions. The Commission came to this conclusion as it found that the APA was not in conformity with the arm's length principle ('ALP') due to the following reasons:

- The *choice for the TNMM was erroneous* as (i) the ruling failed to assess the intra-group transfer for which the APA had actually been requested and granted (namely, the royalty SMBV paid to Alki for the licence to use the roasting IP), (ii) the TNMM was not the appropriate method and if the right method – the Commission refers to the comparable uncontrolled price method ('CUP method') – [*5*] was applied to the right intra-group transaction the royalty should have been zero, and (iii) unjustified high prices were paid to SCTC for green beans. ('principal position')

- The *TNMM was applied incorrectly* as (i) it wrongly identified SMBV as least complex entity, (ii) SMBV's functions were incorrectly analysed and the operating costs were not the right profit level indicator; and (iii) the adjustments to the mark-up were inappropriate. ('subsidiary position') Following this Decision, the Commission ordered the Netherlands to recover approximately 30 million euros from Starbucks.

III. The Judgment

As indicated above, the GC ruled in favour of Starbucks since the Commission failed to prove the existence of an *advantage* within the meaning of article 107(1) TFEU.

State aid and transfer price rulings – principles

Before digging into the reasons why the Commission's assessment *in casu* was erroneous, the GC sets out the principles to determine whether a transfer pricing ruling confers a selective advantage under EU state aid rules.

Direct taxation competence of MSs within limits EU law

The GC confirms that, in line with settled case-law, *direct taxation* falls within the competence of the Member States ('MSs'). However, when exercising their competence, MSs must do so in accordance with EU law, including State aid provisions. [*6*] Consequently, the Commission has the ability to check whether transfer price rulings are compliant with State aid rules. [*7*]

ALP recognized as a 'tool' to assess whether an advantage is granted

To assess whether an individual tax ruling confers an advantage on an undertaking, the Commission can use the ALP as a tool or benchmark enabling it to check whether intra-group transactions are remunerated as though they had been negotiated between independent companies. In this regard, the GC further clarifies that, although formally not binding, the OECD Guidelines "*have a certain practical significance in the interpretation of issues relating to transfer pricing*"

State aid and transfer pricing – advantage not proven in casu

After setting out these principles, the GC assesses in more detail the various grounds demonstrating that the Commission failed to prove that the APA conferred an advantage on Starbucks. The key teachings found in the Commission's assessment are set-out below.

Existence inaccuracies or mere non-compliance with methodological requirements is not sufficient to prove an advantage

When applying the ALP tool, the Commission must take into account its approximate nature. Consequently, when the Commission identifies inaccuracies inherent to the application of a method or a mere non-compliance with methodological requirements, this does not suffice to conclude to the existence of an advantage. Inaccuracies or non-compliance with methodological requirements do not necessarily lead to a reduction of the tax burden.

The GC emphasizes that the Commission should provide actual proof that the used methodology did not result in a reliable approximation of a market-based outcome and fell outside an arm's length range before it can conclude that it leads to an advantage.

MSs can in general apply transfer price method they consider most appropriate

The GC starts by recalling that choosing the transfer pricing method is not an end in itself. The goal of the various methods for setting transfer prices is the same: "*attain profit levels reflecting AL transfer prices*". Consequently, the Commission cannot conclude that, as a rule, a certain method does not allow a reliable approximation of an AL outcome.

In this regard, the GC notes that the mere application of the TNMM instead of the CUP method does not confer an advantage to SMBV. Again, the Commission should have proven that the choice of the TNMM did not lead to a reliable approximation of a market-based outcome and fell outside an arm's length range before it could conclude that it leads to an advantage.

Only information known at moment of the adoption of the ruling should be taken into account

The GC rules that the Commission cannot retroactively rely on facts that are subsequent to the conclusion of the tax ruling. The GC indicates in this regard that the Commission cannot criticise MSs to not have taken into consideration information that was not known or reasonably foreseeable at the time of the adoption of the agreement. The Commission needs to examine the existence of an advantage in view of the context of the time at which the agreement was concluded. The implication of that finding is that the Commission is required to "*refrain from assessments based on a situation subsequent to the adoption*" of a ruling.

Royalty payment is defendable when not devoid of all economic rationality

When an IP is necessary for exercising an economic activity – *in casu* the production of roasted coffee according to Starbucks' specifications –, it follows that the undertaking using the IP derives added value from the use of the IP – *in casu* SMBV could not resell the roasted coffee to Starbucks stores without the roasting IP. [*8*] In such circumstances, the Commission cannot claim that the "*value of the roasting IP is exploited only where the products are sold to final consumers*". [*9*]

IV. Comment

Context. Since June 2013, fiscal State aid through tax rulings became one of the Commission's main focus areas. In addition, to the two Judgments rendered today, various enforcement actions of the Commission are pending at different stages. In Luxembourg, an appeal lodged by Ireland against a Commission Decision ordering Ireland to recover EUR 13 billion from Apple is pending. [*10*] Additional appeals are pending against Commission Decisions concerning aid granted to Amazon and Engie by Luxembourg; and to various multinational companies by Gibraltar. [*11*] The Commission itself has ongoing investigations pending with regard to the tax treatment of Ikea and Nike by the Netherlands; and Huhtamäki by Luxembourg. [*12*] In addition, the Commission re-opened investigations into various companies that benefitted from Belgian excess profit rulings. [*13*] The re-opening is the result of a GC Judgment annulling the initial Commission Decision on procedural ground as the Commission should have dealt with each individual ruling separately instead of with the scheme as a whole. Finally, recently reappointed Commissioner Vestager stated that fair taxation will continue to be a focus area of EU State aid enforcement. [*14*]

Notwithstanding this continued scrutiny, tax rulings will remain omnipresent as a result of a demand for legal certainty. Traditionally, they entail a letter of comfort on how certain companies' corporate tax liability will be calculated. Generally speaking, these rulings are legal and do not confer an advantage *per se*. Nevertheless, as confirmed by today's Judgments, they can violate State aid rules if the methodologies used to establish transfer prices are not economically justified.

Main takeaways. With its Starbucks Judgment, the GC confirms the approach taken by the Commission to assess the conformity of tax rulings with EU State aid rules. Key in this regard is the GC's acceptance that the ALP can be used as a tool or benchmark and that, although not legally binding, the OECD Guidelines "*have a certain practical significance in the interpretation of issues relating to transfer pricing*."

At the same time, the GC's annulment sends a clear message to the Commission. To prove that a certain ruling confers an advantage on an undertaking it will not be sufficient to demonstrate issues with the selection or implementation of a certain method. The Commission will have to prove that the choice for or the implementation of a certain method did not result in a reliable approximation of a market-based outcome and fell outside an arm's length range before it can conclude that it leads to an advantage.

Next steps regarding Starbucks. The Commission already flagged that it will not appeal the Judgment. [*15*] However, it remains to be seen whether the Commission will reopen its investigation in a second attempt to recover the alleged State aid.

[*1*] In addition to the Starbucks Judgment, the GC also rendered a Judgment in relation to a tax ruling struck between Luxembourg and Fiat Chrysler that dealt with the same issue but lead to the opposite outcome. *See* Joint cases T-755/15 and T-759/15, *Fiat Chrysler,* 24 September 2019.

[*2*] The purpose of the OECD Guidelines is to make sure that transactions between intra-group companies are remunerated in line with transactions that take place between independent companies.

[*3*] The APA stated that SMBV's remuneration had to be determined on the basis of the cost plus method – the chosen profit level indicator for application of the TNMM thus being operating costs –, and that it was at arm's length if the 'operating margin' reached a certain percentage of the relevant cost base. In accordance with the OECD Guidelines, when applying the TNMM account should be taken of net margins being received in comparable transactions by non-affiliated companies. With the conclusion of the APA, the Netherlands confirmed that the use of the TNMM *in casu* was in accordance with the arm's length principle.

[*4*] Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374, implemented by the Netherlands to Starbucks (OJ 2017 L 83. p. 38).

[*5*] The CUP method is a traditional transaction method which compares the price charged for the transfer of property or services in a transaction between two associated undertakings with the price charged for the transfer of property or services in a comparable transaction carried out in comparable circumstances between two independent undertakings.

[*6*] *See* for example C-269/09, *Commission v Spain*, 12 July 2012, paragraph 47 and the case-law cited.

[*7*] *See* for example C-182/03 and C-217/03, *Forum 187*, 22 June 2006, paragraph 81.

[*8*] In this regard, the GC further states that "*The question of who ultimately bears the costs corresponding to the compensation of the value of the IP used for coffee production is clearly separate from the question of whether the roasting IP was necessary to allow SMBV to produce roasted coffee according to the criteria stipulated by Starbucks stores, to which it sells, on its own behalf, the coffee.*"

[*9*] In this regard, the GC also further clarifies that "*The question of who ultimately bears the costs corresponding to the compensation of the value of the IP used for coffee production is clearly separate from the question of whether the roasting IP was necessary to allow SMBV to produce roasted coffee according to the criteria stipulated by Starbucks stores, to which it sells, on its own behalf, the coffee.*"

[*10*] T-778/16, *Ireland v Commission*, pending.

[*11*] SA.44888 – Aid to Engie; SA.38944 – Aid to Amazon – Luxembourg; SA.34914 – UK-Gibraltar Corporate Tax Regime.

[*12*] Case SA.46470 – potential aid to IKEA – NL; Case SA.51284 – alleged aid to Nike; Case SA.50400 – Huhtamäki.

[*13*] *See* the Commission's press release regarding the opening of 39 separate investigation into the companies benefiting from an excess profit ruling in Belgium, available at: *https://europa.eu/rapid/press-release_IP-19-5578_en.htm* ↗. Note that the Commission appealed the Judgment of the GC in parallel.

[*14*] Statement by Commissioner Margrethe Vestager of 24 September 2019, available at: *https://europa.eu/rapid/press-release_STATEMENT-19-5831_en.htm* ↗

[*15*] Mlex report '*Starbucks' EU court victory on tax bill to go unchallenged, Vestager says*', 27 November 2019, *Mlex*.