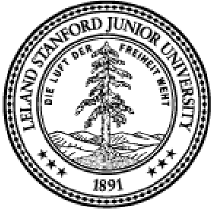

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Representation Without Taxation – Multinational Enterprises and Tax Avoidance in the European Union

Elian van Zyl

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Editors: Siegfried Fina and Roland Vogl

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Abstract

American multinational enterprises have long been under fire for their aggressive and intricate tax avoidance schemes. In recent years, these seemingly clandestine schemes have become more and more visible to the public, exposing the extent to which large international corporations skirt taxes around the world. In 2014, the European Commission announced that it would start investigating corporate tax abuse in the EU using State aid provisions by scrutinising advance tax agreements granted by Member States to multinational enterprises. State aid rules can be applied retroactively, meaning this approach has the potential to claw back large sums in foregone taxes even for past transgressions. To date however, the European Commission has suffered several well-publicised defeats in its bid to combat tax avoidance using this method.

The thesis critiques the Commission's novel use of EU State aid law as being ineffective, largely to the extent that it faces a near impossible burden of proof in demonstrating that a suspect advance tax agreement necessarily leads to an unfair tax advantage. The immense burden of proof correlates to the vast leeway that corporations are afforded when setting appropriate transfer prices for the use of their unique and valuable intellectual property. State aid provisions are also incapable of counteracting regulatory mismatches that permit profit shifting between jurisdictions. While ineffective in directly combating tax avoidance, State aid provisions have been an effective and powerful tool for investigating and exposing harmful tax practices, notwithstanding the de facto legality of such schemes. This has accelerated an overhaul of global corporate tax rules with the introduction of a global minimum tax rate, one of many forward-looking measures specifically designed to address regulatory mismatches and the cause of legal tax avoidance.

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Abbreviations

ALP	Arm's Length Principle
AOE	Apple Operations Europe
APA	Advance Pricing Agreement
AS CV	All Star C.V.
ASI	Apple Sales International
ATAD	Anti-Tax Avoidance Directive
BEPS	Base Erosion and Profit Shifting
CFC	Controlled Foreign Corporation
CN BV	Converse Netherlands B.V.
CRS	Common Reporting Standard
CUP	Comparable Uncontrolled Price
DAC	Directive on Administrative Co-operation
DTT	Double Taxation Treaty
EC	European Commission
EU	European Union
FATCA	Foreign Account Tax Compliance Act
GC	General Court
IP	Intellectual Property
IRS	Internal Revenue Service
LP	Limited Partnership
LuxOpCo	Amazon EU Société à Responsabilité Limitée
LuxSCS	Amazon Europe Holding Technologies SCS
McD Europe	McD Europe Franchising, S.à.r.l.
MNE	Multinational Enterprise
NEH	Nike Europe Holding B.V.
NEON	Nike European Operations Netherlands B.V.
NI CV	Nike International C.V.
NIL	Nike International Limited
OECD	Organisation for Economic Co-operation and Development
SMBV	Starbucks Manufacturing EMEA BV
TFEU	Treaty on the Functioning of the European Union
TNMM	Transactional Net Margin Method
TRIPs	Trade-Related Aspects of Intellectual Property Rights
UK	United Kingdom
UN	United Nations
US	United States
US$	United States Dollar

Introduction

"For every €1 million in profit, it paid just €500 in taxes". The extent to which Apple had avoided paying tax in Ireland was laid bare by Margrethe Vestager during a press conference in August 2016[1]. The European Commissioner for Competition explained that for the 2011 tax year, Apple had paid only €50 million in taxes on profit in excess of €10 billion, an effective tax rate of around 0.05%. In 2014, Apple's effective tax rate in Ireland dropped by a factor of 10 to as low as 0.005%[2]. Ms Vestager was speaking on the same day that the European Commission ("EC") ordered Ireland to recoup an eye-popping €13 billion from Apple, an amount related to tax benefits that the American tech giant had ostensibly received between 1991 and 2014. In July 2020 however, the European General Court annulled this Decision. Apple had been spectacularly successful in avoiding European taxes for more than two decades.

Apple is not the only multinational enterprise ("MNE") that has enjoyed widespread representation in the EU without having to suffer the burden of taxation. Several other MNEs, that is, large corporations that operate on an international scale, have come under fire for their tax practices in the common market. In recent years, household names such as Apple and Amazon have had to endure increasingly negative press coverage and souring public sentiment related to the relative size of their tax bills[3]. The harshest criticism seems to have been reserved for those giant American MNEs with unparalleled global brand recognition. Sports- and leisurewear behemoth Nike could reportedly have shirked EU taxes in the billions

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[1] Margrethe Vestager, 'EU says Apple must repay 13 bn euros over 'illegal' Irish tax deal' (European Commission, 30 August 2016) <https://www.youtube.com/watch?v=y2gTeRdiKtQ> accessed 27 September 2022.

[2] European Commission Press Release IP/16/2923, 'State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to E13 billion' (30 August 2016), <http://europa.eu/rapid/press-release_IP-16-2923_en.htm>

[3] Nick Sommerlad, 'Six firms including Google and Facebook made £14BILLION last year but paid just 0.3% UK tax' (Sunday Mirror, 31 January 2015) <https://www.mirror.co.uk/news/business/six-firms-including-google-facebook-5081824> accessed 28 September 2022.

of Euros stretching back to 2006[4]. How could some of the world's most profitable and recognisable companies have been so successful in avoiding tax in one of the world's largest economies? How has the EC tried to combat aggressive tax avoidance in the common market, and how successful has it been in doing so?

This thesis examines these questions in the context of five such large American MNEs with undeniable brand value: Apple, Amazon, Starbucks, McDonald's, and Nike. Chapter 1 details the essential elements of successful tax avoidance, and discusses several sophisticated methods that companies might employ in order to achieve this goal. Chapter 2 examines how intellectual property licensing can be an invaluable mechanism for shifting corporate profits between tax jurisdictions. The chapter further discusses how Member States sanction this through advance tax agreements, and how the EC has employed State aid rules in order to combat harmful tax practises. Chapter 3 critically discusses the corporate structures employed by the five MNEs in the European Union and details how profits were shifted away from the EU tax net, before summarising the EC's novel approach to policing these tax avoidance schemes. Chapter 4 analyses the success of this approach with reference to judgments handed down by the European General Court, while chapter 5 contemplates how the EC's use of State aid provisions has influenced a push towards global tax reform. Chapter 6 concludes.

[4] Simon Bowers, 'Nike Could Owe Billions In Back Tax If New EU Probe Finds Against It' (International Consortium of Investigative Journalists, 10 January 2019) <https://www.icij.org/investigations/paradise-papers/nike-could-owe-billions-in-back-tax-if-new-eu-probe-finds-against-it/> accessed 28 September 2022.

Chapter 1: The Anatomy of Tax Avoidance

The goal of the tax-optimising MNE is to recognise as much corporate profit in a non- or low tax jurisdiction as is legally possible. In so doing, an astute MNE can avoid paying taxes on those profits that would otherwise have been due, had the profit been recognised in what could generally be considered a "normal" tax jurisdiction. Two elements are essential in order to achieve effective tax avoidance within the EU: the use of one or more corporate vehicles that are not subject to tax laws in any Member State, and a mechanism for shifting corporate profits to those entities. The former is discussed below, while the latter is discussed in Chapter 2.

MNEs employ many different types of corporate vehicles across their global structures in order to achieve their business goals. The choice of corporate vehicle depends on considerations such as the specific goal, the jurisdiction in which the vehicle operates, and local laws. A common thread running through many effective tax avoidance schemes is the exploitation of laws which allow for the use of a vehicle or entity that is incorporated in the EU, but not subject to the tax laws of any Member State. This is typically achieved where the members of such an entity, be they partners in a partnership or shareholders of a limited liability company, are not themselves resident in the EU. Large MNEs structure their European operations in such a way so that the lion's share of business profits is shifted to these entities that have no obligation to pay taxes within the common market. The resulting situation is one where a company can have ubiquitous representation across all Member States while only having to pay corporate taxes on a fraction of its profits.

MNEs employ various structuring methods to accomplish this seemingly impossible feat. One such tax avoidance tactic is the use of the Limited Partnership ("LP"), a type of hybrid corporate entity that enjoys benefits of both a partnership and an incorporated company. An LP differs from a normal partnership in one major respect: while members of a partnership are

liable for all debts of that partnership, certain members of an LP enjoy the privilege of limited liability and would therefore only be liable to the extent of their individual contributions[5]. The members of an LP (called "limited partners") enjoy limited liability protection in the same way that members (shareholders) of a capital company limited by shares would. The trade-off for these limited partners is that they hold only restricted management rights with regards to the LP as a whole[6].

A partnership, which may generally be defined as the relationship that exists between persons carrying on a business in common with a view of generating profit[7], is typically regarded as being transparent for tax purposes[8]. This means that it is the members of the partnership who are liable for taxation and not the partnership itself. This notion of tax transparency holds true for an LP as well, and it is the combination of limited liability protection and tax transparency that affords a certain flexibility which can be a valuable tool for MNEs when designing their corporate structures.

Of specific value for the tax-optimising MNE is the potential for regulatory mismatch, a curious situation that may arise where an LP that is registered in one State (the source State) has partners that are resident in a different State (the resident State). Regulatory mismatch may occur where the one State considers the LP to be tax transparent, while the other State does not[9], which under certain circumstances could lead to a situation where the corporate profits of the LP are not subject to tax laws in either State. Herein lies an exploitable loophole of effective double non-taxation, the holy grail of corporate tax optimisation.

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[5] AFM Dorresteijn and others, *European Corporate Law* (3rd ed, Wolters Kluwer 2017) 24.
[6] Ibid 25. The management function of an LP is performed by one or more general partners (GP) who do not enjoy the same limited liability protection as LPs.
[7] Ibid 4.
[8] Ibid 25.
[9] Peter Essers and Gerard TK Meussen, 'Taxation of Partnerships/Hybrid Entities' (Oxford University Press 2004) 416.

The concept of the LP exists in different forms in the respective sets of corporate law in the various Member States and are similar in nature, for example a *Société en Commandite Simple* in Luxembourg)[10], *Gesloten Commanditaire Vennootschappen* in the Netherlands)[11], and simply a *Limited Partnership* in the UK[12]. All three these examples confer similar rights: tax transparency for the partnership (meaning it is the individual partners who are liable to tax, not the LP itself) and limited liability protection for the partners. As will be seen further below, this combination has made for an effective tax avoidance vehicle used by several well-known MNEs.

Another well-documented corporate vehicle used to avoid paying taxes in the EU is the Irish limited liability company, used in a scheme referred to as the "Double Irish" arrangement. The Irish tax code had allowed for a company duly incorporated within Ireland, to move its tax residence away from Ireland to where the company's management and control function was performed[13]. At the time, Ireland was one of the few EU Member States that allowed this practise.

The Irish company would not be subject to taxes in Ireland if the management and control function was situated elsewhere, i.e., if the board of Directors or central administration office was relocated to a different jurisdiction. One such commonly used jurisdiction is the infamously low-tax jurisdiction of Bermuda, which imposes no taxes on profits, income, dividends, or capital gains, has no limit on the accumulation of profit, and has no requirement

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[10] Bertrand Mariaux, 'Qu'est-ce qu'une société en commandite simple (SCS) ?' (Bertrand Mariaux Avocats, 18 June 2020) < https://mariauxavocats.com/vademecum/39799zt2fdd73lkp7gnb2pll25kb5b > accessed 1 June 2022.

[11] 'Open CV wordt transparant' (VWG) <https://vwg.nl/nieuws/open-cv-wordt-transparant/> accessed 1 June 2022.

[12] 'Limited partnership: a tax and liability shelter' (Net Lawman, December 2020) <https://www.netlawman.co.uk/ia/limited-partnership> accessed 1 June 2022.

[13] Within the EU, this mobility of companies and the ability to move the place of central administration is made possible by the right of establishment provisions enshrined in Article 49 TFEU and more specifically Article 54 TFEU. The famous ECJ cases such as *Daily Mail*, 81/87 (ECJ 1988), *Centros*, C-212/97 (ECJ 1999), *Überseering* , C-208/00 (ECJ 2002), and *Inspire Art,* C-167/01 (ECJ 2003) further developed the notion of the right of establishment and the mobility of companies.

to distribute dividends[14]. Further, by incorporating a second Irish company (hence the second leg of the so-called "Double Irish" arrangement) US MNEs could circumvent controlled foreign corporation ("CFC") provisions in the US tax code which are meant to combat the use of offshore entities in low tax jurisdictions. This meant that no US corporate taxes would be paid on any profits kept outside of the US. The US Internal Revenue Service would deem the profitable company to be Irish, as it is there incorporated, while the Irish tax authorities would deem the same company to be Bermudan due to the location of its management and control function[15]. Neither the US nor Ireland nor Bermuda would levy taxes on the profits of the company.

Many large MNEs have been accused of using the *Double Irish* arrangement and variations thereof, in order to avoid paying taxes in the EU. Household names such as Google (Alphabet), Coca-Cola, and Facebook[16], have all come under fire in recent years. Some estimates put a staggering value of US$ 1 trillion on profits that have been funnelled by US MNEs to Caribbean tax havens using the *Double Irish* arrangement[17]. The successful *Double Irish* tool highlights the ideological difference between two overarching legal theories as regards the recognition of foreign legal persons: the incorporation theory (or the doctrine of incorporation) as applied by the US, and the real seat theory (real seat doctrine) applied by Ireland. It is a prominent example of how such a regulatory mismatch can be exploited. This

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[14] Scott D. Slater, 'Bermuda Corporate - Taxes on corporate income' (pwc, 10 January 2022) <https://taxsummaries.pwc.com/bermuda/corporate/taxes-on-corporate-income> accessed 8 June 2022.

[15] Roger Royse, 'Double Irish Tax Sandwich' (Royse Law Firm, 1 November 2013) <https://rroyselaw.com/tax-law/article/double-irish-tax-sandwich/> accessed 7 June 2022 .

[16] Edward Helmore, 'Google says it will no longer use 'Double Irish, Dutch sandwich' tax loophole' (The Guardian, 1 January 2020) < https://www.theguardian.com/technology/2020/jan/01/google-says-it-will-no-longer-use-double-irish-dutch-sandwich-tax-loophole > accessed 8 June 2022.

[17] Eoin Burke-Kennedy, 'Explainer: Google and its double Irish tax scheme' (Irish Times, 3 January 2020) < https://www.irishtimes.com/business/economy/explainer-google-and-its-double-irish-tax-scheme-1.4128929 > accessed 8 June 2022.

method of tax avoidance was effectively used in the EU for many years up until 2015 when Ireland amended its tax laws following pressure from the European Commission[18].

[18] Suzanne Lynch, 'Controversy over 'double Irish' raises issue of EU's power over tax regimes' (Irish Times, 17 October 2014) <https://www.irishtimes.com/business/economy/controversy-over-double-irish-raises-issue-of-eu-s-power-over-tax-regimes-1.1966394> accessed 7 June 2022.

Chapter 2: Shifting Profit

The second element needed for effective tax avoidance is a mechanism by which an MNE can shift corporate profits around its group structure. Shifting profits away from corporate entities situated in higher-tax jurisdictions will erode the tax base on which that entity is taxable. The smaller the tax base, the lower the tax liability. Several different profit shifting techniques exist, such as hybrid financial instruments, the use of debt between related companies, and tax inversions. This chapter however focuses on profit shifting techniques related to intellectual property ("IP") licensing.

2.1: BEPS

The Organisation for Economic Cooperation and Development (OECD) defines base erosion and profit shifting ("BEPS") as:

> *BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid*[19].

Consider an MNE with representation in the EU by way of a German company, GER1. GER1 manufactures a product for €5 and sells it to a German end-customer for €100, thereby making a profit of €95. Under normal circumstances, GER1 would be liable to corporate taxes in Germany on the €95 profit, its tax base. Assuming a corporate tax rate of 30%, GER1 would be liable to taxes of €28.50 (€95 x 30% = €28.50).

In order to minimise its global tax liability, the MNE would seek to shift as much of the €95 profit away from Germany as possible. Consider now the existence of another company

[19] 'What is BEPS?' (OECD) <https://www.oecd.org/tax/beps/faq/> accessed 8 June 2022.

within the MNE group, BER1, which is situated in Bermuda where the corporate tax rate is zero[20]. Our MNE needs to engineer a legitimate reason which will enable GER1 to incur and pay certain expenses to BER1. Such an intra-group transaction would decrease the taxable profit in Germany while increasing the (non-) taxable profit in Bermuda, i.e., shifting profit from a high- to a low-tax jurisdiction. If BER1 were the legal owner of the MNE's intellectual property, it could grant GER1 a license to use those assets in exchange for a royalty fee. GER1 would then have a legally enforceable obligation to pay BER1, thereby incurring an additional expense and lowering its taxable profit in Germany.

The potential for misuse of this mechanism to artificially lower taxable income is clear to see. Ideally, from the perspective of the MNE, the royalty paid by GER1 to BER1 for use of the IP would be set at €95 to reduce GER1's taxable income to zero[21]. Considering this, many countries have adopted transfer pricing rules which govern what prices MNEs are allowed to apply to such intra-group transactions.

2.2: Transfer Pricing and the Arm's Length Principle

Transfer pricing is the practice of setting the price for goods and services that are sold between related companies, or companies within the same corporate group. Transactions between unrelated or independent companies would typically be set at prices determined by external market forces, that is, in a competitive free market economy. This would not be the case for related companies. Transfer pricing policies aim to set a price for transactions between related enterprises in the absence of external market forces[22]. While it cannot be said that MNEs use transfer pricing solely for the manipulation of profit, the practise has long been

[20] Scott D. Slater, 'Bermuda Corporate - Taxes on corporate income' (pwc, 10 January 2022) <https://taxsummaries.pwc.com/bermuda/corporate/taxes-on-corporate-income> accessed 8 June 2022.
[21] Even more beneficial for the global tax position of the MNE would be for GER1 to pay more than €95 thereby creating a tax loss, which in certain circumstances could be used to reduce future taxable income.
[22] OECD (2010), 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010' (OECD Publishing, Paris) <https://doi.org/10.1787/tpg-2010-en> accessed 16 June 2022.

associated with misuse[23] which has been described by the United Nations as transfer "mis-pricing".

The foreword to the UN Practical Manual on Transfer Pricing states:

> *"There is a risk, without an effective response to transfer pricing issues, that profits might appear to be earned in low- or no-tax jurisdictions (thereby serving to reduce tax rates on taxable profits/incomes and associated tax obligations), and losses might appear to be incurred in high-tax jurisdictions (thereby increasing allowable deductions for tax purposes). This may have the net effect of minimizing taxes and, in so doing, may impact on the legitimate tax revenues of countries where economic activity of the MNE takes place, and therefore the ability of such countries to finance development."*[24]

The Organisation for Economic Co-operation and Development (OECD) recognised the importance of robust transfer pricing guidelines as early as 1979. The problem is framed in a report on transfer pricing and MNEs prepared for and adopted by the Council of the OECD:

> *"…The prices charged for such* [intra-group] *transfers do not necessarily represent a result of the free play of market forces, but may, for a number of reasons and because the MNE is in a position to adopt whatever principle is convenient to it as a group, diverge considerably from the prices which would have been agreed upon between*

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[23] 'Managing IP's guide to transfer pricing and IP' (Managing Intellectual Property, November 2012) <https://uaccess.univie.ac.at/login?url=https://www.proquest.com/trade-journals/managing-ips-guide-transfer-pricing-ip/docview/1220438522/se-2?accountid=14682> accessed 17 June 2022.

[24] United Nations, Secretariat, Department of Economic & Social Affairs, 'Practical Manual on Transfer Pricing for Developing Countries 2021' (May 2021, Third Edition, ST/ESA/377). <https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2021-10/Transfer%20Pricing%20with%20new%20cover.pdf> accessed 17 June 2022.

unrelated parties in the same or similar transactions under the same or similar conditions in the open market (hereafter referred to as "arm's length prices")."[25]

The same report defines the problem from the perspective of tax authorities:

"Multinational enterprises may adopt transfer prices which are not arm's length prices in order to minimise tax (for example, by selling goods to a subsidiary in a tax haven country at less than arm's length prices) or they may adopt them for other reasons but, whatever the reason, whenever intra-group transfers are not carried out at arm's length prices, the result is likely to be that profits are shifted from one company to another company in the group and the tax liability of the relevant companies distorted in consequence"[26].

The OECD issued its first set of Transfer Pricing Guidelines in 1995[27]. These guidelines have been revised and extended regularly since then, with the latest version being published in January 2022[28]. The arm's length principle ("ALP") was included in the OECD's transfer pricing guidelines to help eliminate the special conditions in which MNE group companies operate, that is, the ability to set a price for their intra-group transactions without being subject to competitive free market forces. The ALP therefore attempts to create parity between the tax treatment of MNEs and that of independent companies. Even though OECD guidelines are voluntary for member nations, its transfer pricing guidelines have been widely accepted as they also form an integral part of the OECD Model Tax Convention, which in

[25] OECD (1979), 'Transfer Pricing and Multinational Enterprises, Report of the OECD Committee on Fiscal Affairs' (OECD Publishing, Paris) < https://read.oecd-ilibrary.org/finance-and-investment/transfer-pricing-and-multinational-enterprises_9789264167773-en#page9> accessed 22 June 2022.

[26] OECD (1979), 'Transfer Pricing and Multinational Enterprises, Report of the OECD Committee on Fiscal Affairs' (OECD Publishing, Paris) < https://read.oecd-ilibrary.org/finance-and-investment/transfer-pricing-and-multinational-enterprises_9789264167773-en#page9> accessed 22 June 2022.

[27] OECD (1995), 'Transfer Pricing and Multinational Enterprises, Report of the OECD Committee on Fiscal Affairs' (OECD Publishing, Paris) <https://tpguidelines.com/oecd-transfer-pricing-guidelines-1995/?tx_category=tpg1995-chapter-i-the-arms-length-principle> accessed 21 June 2022.

[28] OECD (2022), 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022' (OECD Publishing, Paris) <https://doi.org/10.1787/0e655865-en> accessed 22 June 2022.

turn forms the basis of bilateral tax treaties between OECD members. This again helps to serve the OECD's stated goal of minimizing conflict between tax administrations and promoting international trade and investment[29].

The ALP aims to approximate the workings of the free market. The practical application of the ALP depends on a comparison between the conditions in a "controlled transaction" with those prevalent in comparable transactions between independent enterprises. A "controlled transaction" is defined as a transaction between related entities, i.e., between entities within the same group structure of an MNE. An "uncontrolled transaction" is defined as a transaction between unrelated, independent third parties. For controlled and uncontrolled transactions to be considered comparable, three key elements need to be considered, namely the functions performed, the assets used, and the risks borne by the various enterprises. If these elements are sufficiently similar, then the prices charged and/or profits realised in the uncontrolled transaction can be used as a reliable measure of an arm's length comparison for the controlled transaction[30].

The OECD Transfer Pricing Guidelines differentiate between several different methods of arriving at an arm's length price. These are broadly split into the two groups of traditional transaction methods and transactional profit methods:

a) Traditional transaction methods:
    - Comparable uncontrolled price ("CUP") method,
    - Resale price method,
    - Cost plus method.

b) Transactional profit methods:

[29] Ibid.
[30] Wagdy M Abdallah and Athar Murtuza, 'Transfer Pricing Strategies of Intangible Assets, E-Commerce and International Taxation of Multinationals' (The International Tax Journal, Vol. 32, Iss. 2, 2006) p5-16, p45-46.

- Comparable profit method,
- Transactional net margin method ("TNMM"),
- Transactional profit split method.

Traditional transaction methods aim to compare prices charged in controlled transactions (between related enterprises) with prices charged in comparable, uncontrolled transactions (between independent enterprises). The CUP method is particularly reliable where there exists a perfectly comparable transaction, i.e., where the controlled and uncontrolled transactions are identical. For example, where both the controlled and uncontrolled transactions entail the purchase of unbranded Colombian coffee beans of a similar type, quality, quantity, under similar conditions, then the price charged in the controlled transaction can be easily compared to the price charged in the uncontrolled transaction. This comparison then determines if the uncontrolled transaction resembles an arm's length price. Where the transactions are not perfectly comparable, for example the controlled transaction relates to Brazilian instead of Colombian coffee beans, then certain adjustments will need to be made before the prices can be compared[31].

Transactional profit methods for approximating arm's length conditions are used when traditional transaction methods cannot be reliably applied. This might occur where there are no relevant data available, or the available data are not of sufficient quality to rely solely or at all on the traditional transaction methods. A transactional profit method, as the name suggests, examines the profits that arise from a controlled transaction with the profits arising from comparable uncontrolled transactions. While profits can be a relevant indicator of whether a controlled transaction complies with the ALP, it is a less direct method than comparing prices. Profit methods are inherently more volatile due to the number of factors that can influence

[31] OECD (1995), 'Transfer Pricing and Multinational Enterprises, Report of the OECD Committee on Fiscal Affairs' (OECD Publishing, Paris) para. 2 <https://tpguidelines.com/oecd-transfer-pricing-guidelines-1995/?tx_category=tpg1995-chapter-i-the-arms-length-principle> accessed 21 June 2022.

profitability. This volatility increases the potential risk of inaccuracies when applying the method, leading to an arm's length range rather than a specific arm's length price for any given controlled transaction. Consequently, transactional profit methods grant a certain flexibility to what transfer prices will be considered acceptable. The 1995 OECD Transfer Pricing Guidelines therefore recommend the use of transactional profit methods only as a last resort[32]. For a detailed review of the various transfer pricing methods, refer the International Tax Journal article from 2006 written by Wagdy M Abdallah and Athar Murtuza[33].

The choice of an appropriate transfer pricing methodology for an MNE is critical. While a traditional transaction method such as the CUP method is straightforward and might provide the most reliable arm's length benchmark, it is only suitable where the controlled transaction is relatively simple, easily reproduced, and where comprehensive comparable market data are readily available. However, when transfer pricing relates to complex and specialised intra-group transactions with little or no comparison on the free market, transaction methods become unsuitable. Less accurate profit-based methods of approximating arm's length prices are necessitated. A controlled transaction that is perfectly *incomparable* to free market conditions would allow the greatest arm's length range for what constitutes an acceptable transfer price, affording maximum pricing leeway and rendering the ALP almost meaningless. The unique nature of intellectual property might offer the tax-optimising MNE just such an opportunity.

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[32] Ibid.

[33] Wagdy M Abdallah and Athar Murtuza, 'Transfer Pricing Strategies of Intangible Assets, E-Commerce and International Taxation of Multinationals' (2006), Vol. 32, Iss. 2, The International Tax Journal, 5-16,45-46.

2.3: Intellectual Property and Brand Value

Intellectual property has long been an effective tool used by MNEs to design intra-group transactions for global strategic tax planning[34]. IP assets are intangible in nature and therefore highly moveable. Transferring the ownership of IP assets between group companies is a relatively simply process, compared to transferring ownership of tangible assets such as fixed equipment, or even bank deposits which can have any number of regulatory restrictions. Valuable IP, placed in the correct group entity, can be a compelling justification for intra-group transactions. IP spans a vast range of intangible assets such as copyrights, trademarks, patents, industrial designs, and trade secrets, which are all granted a certain minimum standard of protection by members of the World Trade Organisation (WTO) since the conclusion of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) in 1994. IP assets therefore enjoy protection and enforcement on a global scale.

It is not surprising that MNEs played a pivotal role in securing the TRIPs Agreement[35]. The push to include legal protection for IP rights in multinational agreements started in the late 1970s, in an attempt by developed economies to combat the then-prevalent phenomenon of piracy and counterfeiting in foreign markets. Little progress was made on this front during the Tokyo Round of multilateral trade negotiations that concluded in 1979[36]. By 1984 however, the US Congress had been pressured by American companies to act against "unjustifiable and unreasonable" trade practices, seeking greater protection for intellectual property considering sustained losses suffered by US businesses. The Trade Act of 1984 was passed, granting the US significant powers to protect its IP rights in the global economy. Intense lobbying from US businesses including Pfizer and IBM helped push the notion that international infringement of IP was unacceptable. US bilateral trade negotiations became inexorably

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[34] Wagdy M Abdallah and Athar Murtuza, 'Transfer Pricing Strategies of Intangible Assets, E-Commerce and International Taxation of Multinationals' (2006), Vol. 32, Iss. 2, The International Tax Journal, 5-16,45-46.

[35] Duncan Matthews, 'Globalising Intellectual Property Rights : The TRIPS Agreement' (Routledge 2002) 4.

[36] At that time, multilateral trade negotiations took place between the nation-states that were parties to the General Agreement on Tariffs and Trade (GATT).

linked with IP considerations. Ultimately, IP was included on the agenda of the Uruguay Round GATT negotiations leading to the conclusion of the TRIPs Agreement in 1994[37].

Commentators have argued that the conclusion of the TRIPs Agreement disproportionately favoured developed countries. Large US-based MNEs saw a significant increase in revenue as a result of the Agreement[38]. Intangible assets had become a major determinant of enterprise value. Brand value had become inextricably linked with IP protection. With IP rights now protected and enforced on the international stage, the use by MNEs of their valuable IP as a tool in global tax planning grew in popularity[39]. A study based on European MNEs between 1995 to 2005 shows that a lower corporate tax rate of a subsidiary (relative to other affiliates of an MNE) correlates to a higher level of intangible assets at that location. The study therefore provides empirical evidence that the location of IP assets held by MNEs are distorted towards low-tax jurisdictions[40]. This provides a conduit through which the MNE can transfer profits from via group companies from high- to low tax jurisdictions.

Consider Apple Inc. ("Apple") an American MNE with a range of ubiquitous consumer electronics, software, and online services. In May 2010, Apple applied to the United States Patent and Trademark Office (USPTO) for the design and layout of its physical flagship Apple stores to be granted trademark protection. After some initial pushback from the USPTO, the design that Apple submitted was granted trademark protection in April 2012[41]. Subsequently, Apple attempted to extend the trademark internationally under the Madrid

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[37] Duncan Matthews, 'Globalising Intellectual Property Rights : The TRIPS Agreement' (Routledge 2002) 8 - 29.
[38] J. Michael Finger, Julio J. Nogues, 'The Unbalanced Uruguay Round Outcome : The New Areas in Future WTO Negotiations' (Volume 25, Issue 3, The World Economy, March 2002) 321-340 <https://openknowledge.worldbank.org/handle/10986/19413> accessed 13 June 2022.
[39] 'Managing IP's guide to transfer pricing and IP' (Managing Intellectual Property, November 2012) https://uaccess.univie.ac.at/login?url=https://www.proquest.com/trade-journals/managing-ips-guide-transfer-pricing-ip/docview/1220438522/se-2?accountid=14682 accessed 14 June 2022.
[40] Matthias Dischinger & Nadine Riedel, 'Corporate taxes and the location of intangible assets within multinational firms' (Journal of public economics, 2011, Vol.95 (7)) p.691-707.
[41] Trevor Mogg, 'Apple trademarks its distinctive store design' (Digital Trends, 30 January 2013) <https://www.digitaltrends.com/news/apple-trademarks-its-distinctive-store-design/#!bhQEFy> accessed 28 June 2022.

Agreement concerning the International Registration of Marks of 14 April 1891, as revised and amended. In early 2013 however, the German Patent and Trademark Office (*Deutsches Patent- und Markenamt*) refused the extension on the basis that the Apple store layout and design was merely a presentation of an essential aspect of Apple's business. The case was appealed, ultimately leading to a review by the European Court of Justice. The Court essentially sided with Apple, finding that the presentation of an establishment in which a service is provided can indeed be registered as a trademark under certain circumstances[42].

An obvious consequence of Apple's victory is their legal right to enforce trademark protection, which in the above case might take the form of Apple prohibiting any competitor from using similar store designs or layouts. This is undoubtedly a valuable outcome for Apple. A less obvious but arguably more valuable consequence is the potential that such IP protection holds for Apple in terms of transfer pricing. If, for example, the registered trademark of the Apple store design is owned by an Apple group-company situated in a low-tax jurisdiction, then said company could charge a royalty fee to Apple stores in high-tax jurisdictions for the right to use the trademarked store design. The design and layout of an Apple store is what gives it the distinctive feel and familiarity that consumers have come to identify with the brand, and is undoubtedly of great value to Apple. Allocating a specific monetary value to this is however likely impossible. The pricing of such a licensing agreement would not be subject to free market forces. The unique nature of the trademark is itself an indication that no comparable uncontrolled transactions are available against which to apply the arm's length principle. This fact might therefore lead to a wide range of prices for what might be deemed an acceptable royalty fee, granting the MNE significant leeway in how much profit can be shifted between group companies. The value of the IP is underpinned by its uniqueness. Thus, the creation of an internationally protected intangible asset might well be an invaluable tax optimisation instrument for the tax-conscious MNE.

[42] Case C-421/13, 'Apple Inc. v Deutsches Patent- und Markenamt' (10 July 2014, ECLI:EU:C:2014:2070).

2.4: Advance Pricing Agreements, Fiscal Autonomy, and State Aid

Many countries have a practice of issuing advance rulings regarding the application local tax laws to a taxpayer's particular facts[43]. Advance pricing arrangements ("APAs") are those agreements concluded with tax authorities where an MNE agrees pricing methodologies for certain types of transactions in advance. APAs confirm the arm's length result for controlled transactions by agreement between taxpayer and tax authority. They define agreed outcomes on certain sets of criteria (for example transfer pricing methods, comparables, and appropriate comparability adjustments). APAs provide the taxpayer with greater certainty on the taxation of cross-border and other non-standard transactions. This provides the taxpayer with the safest way of adhering to local tax laws[44]. MNEs often rely on APAs in the various jurisdictions in which they operate, due to the size and complexity of their transactions. Tax authorities might also benefit from concluding APAs with MNEs, as concluding such an arrangement in advance is typically less costly and time-consuming than examinations and litigation after the fact. Tax authorities can also thereby develop a deeper understanding of business operations in their jurisdictions. A successfully concluded APA therefore represents an endorsement made by the tax authority that an MNE's corporate structure and transfer pricing methods adhere to local tax laws.

APAs have been in use in the US since 1991[45] and have been widely adopted by the OECD and its members[46]. At best, APAs serve to avoid disputes, prevent double taxation, promote legal certainty, and consequently encourage investment. By their very nature however, APAs are individually tailored to each company. It follows that APAs granted by the same tax

[43] United Nations, Secretariat, Department of Economic & Social Affairs, 'Practical Manual on Transfer Pricing for Developing Countries 2021' (May 2021, Third Edition, ST/ESA/377) p514.
[44] Ibid p518.
[45] Ibid.
[46] Sandra Marco Colino, 'The Long Arm of State Aid Law: Crushing Corporate Tax Avoidance' (Fordham International Law Journal, 44:2, 2020) p421.

authority might not be consistently concluded or applied, negating any advantage of legal certainty. This uncertainty and the individualistic nature of APAs, according to the European Commission, opens the doors for misuse and harmful tax competition.

Since June 2013, the EC has been investigating APAs granted by several Member States, including Ireland, Luxembourg, and the Netherlands. The investigation scrutinised several advance tax rulings in the light of EU State aid rules, which at the time represented a novel approach by the EC in combating tax avoidance in the single market. By December 2014, the EC had widened the scope of its inquiry, asking Member States to provide details of all tax rulings in place between 2010 and 2013. The EC also requested several Member States to provide certain information about their intellectual property taxation regimes. In December 2014, Margrethe Vestager, the Commissioner in charge of competition policy, said:

> *"We need a full picture of the tax rulings practices in the EU to identify if and where competition in the Single Market is being distorted through selective tax advantages. We will use the information received in today's enquiry as well as the knowledge gained from our ongoing investigations to combat tax avoidance and fight for fair tax competition."*[47]

Member States in the EU enjoy fiscal sovereignty, meaning each Member State retains exclusive competency concerning direct taxation. National governments are therefore free to establish their own tax laws, subject to certain international rules and any bilateral treaties that may be in effect, such as double tax treaties[48]. MNEs, with their international scope and vast resources, have a certain freedom to "shop around" for tax laws which best fit their business[49],

[47] European Commission Press Release IP/14/2742, 'State aid: Commission extends information enquiry on tax rulings practice to all Member States' (17 Dec 2014, IP/14/2742).
[48] Sandra Marco Colino, 'The Long Arm of State Aid Law: Crushing Corporate Tax Avoidance' (Fordham International Law Journal, 44:2, 2020) p433.
[49] Ibid p423.

a phenomenon known as regulatory arbitrage[50]. Member States vying for direct investment into their territories might actively engage in competitive law-making in order to attract MNEs. In the US, this practice has been termed the *Delaware Effect*, referring to the historically business-friendly laws of that state which led to a disproportionately large number of US corporations being there incorporated. Delaware's corporate laws, low tax rate, and robust judiciary have made it the leading incorporation state in the US since the 1920s[51]. This fact has not however been without criticism; detractors have argued that social, labour, and environmental standards might systematically be eroded as competitive law-making takes hold and corporate tax rates are lowered, resulting in a "race to the bottom"[52]. This is the unhealthy tax competition between Member States that Ms Vestager was alluding to.

Despite several attempts over the years to harmonise company laws across the EU, Member States have enjoyed significant autonomy in crafting their own corporate- and tax laws[53]. This meant that the risk of a similar race to the bottom also existed within the EU. To a certain extent, the prolific use by MNEs and Member States of APAs in corporate structuring and tax planning represent an exploitation of that risk. In State aid provisions, the EC had however found a seemingly useful tool with which to fight back. Even though Member States retain fiscal autonomy with regards to direct taxation, that competence must nevertheless be exercised consistently with EU law. Therefore, as settled case law shows, matters such as direct taxation that have not been harmonised between Member States are not excluded from the scope of State aid rules, which is an exclusive competence of the EU[54]. The EC's use of

[50] McCahery, J. A., & Vermeulen, E. P. M., 'Does the European company prevent the 'Delaware-effect'?' (TILEC Discussion Paper Series; Vol. 2005, No. 010) p5.
[51] Ibid p7.
[52] Rüdiger Hahn, 'Multinationale Unternehmen und die 'Base of the Pyramid' - Neue Perspektiven von Corporate Citizenship und Nachhaltiger Entwicklung' (Gabler, Wiesbaden 2009) p118–126.
[53] McCahery, J. A., & Vermeulen, E. P. M., 'Does the European company prevent the 'Delaware-effect'?' (TILEC Discussion Paper Series; Vol. 2005, No. 010) p12.
[54] For example, Case C-269/09 *Commission v Spain* [2009] ECLI:EU:C:2012:439 para 47; Case C-155/09 Commission v Greece [2011] ECLI:EU:C:2011:22, paragraph 39; Case C-10/10 Commission v Austria [2011] ECR I-5389, paragraph 23; Case C-250/08 Commission v Belgium [2011] ECR I-12341, paragraph 33; and Case C-253/09 Commission v Hungary [2011] ECR I-12391, paragraph 42).

State aid provisions is an ingenious attempt to investigate and combat suspected tax avoidance, sanctioned through APAs, using a single piece of EU legislation to address differing Member State tax laws.

State aid provisions are contained in Articles 107 through 109 TFEU. Consequently, it grants the EC broad enforcement powers that do not require the consent of the Member States. Article 107(1) TFEU is far-reaching in its scope:

> *Save as otherwise provided in the Treaties, 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.*

The above demands a blanket prohibition of State aid favouring specific companies, unless one or more of the exceptions in Articles 107(2) and (3) apply. Article 108 compels the EC together with the Member States to "*keep under constant review all systems of aid existing in those States*". An extensive body of secondary legislation, soft law, and case law, has since accompanied these rules[55]. In the *Altmark* case from 2000[56], the European Court of Justice stipulated four requirements for a measure to be considered State aid for the purposes of Article 107:

> *First, there must be an intervention by the State or through State resources. Second, the intervention must be liable to affect trade between Member States. Third, it must confer an advantage on the recipient. Fourth, it must distort or threaten to distort competition.*[57]

[55] Sandra Marco Colino, 'The Long Arm of State Aid Law: Crushing Corporate Tax Avoidance' (Fordham International Law Journal, 44:2, 2020) p411.
[56] Case C-280/00, *Altmark Trans GmbH v. Regierungsprasidium Magdeburg*, 2003 E.C.R. I-7810.
[57] Ibid I-7836.

For Article 107 TFEU to be applicable to an APA, and for that APA to be considered incompatible with the internal market, all four the abovementioned criteria must apply:

i) Intervention by the State or through State resources

APAs are typically initiated when an MNE petitions a tax authority for approval of a proposed method of calculating and filing tax returns. An APA is an agreement between taxpayer and tax authority on how taxes will be calculated. While the conclusion of an APA thus constitutes intervention by the State (via its tax authority), it cannot be said that any State resources will be directly transferred to the MNE as a consequence of the APA. Settled case-law however makes it clear that any measure which is likely to favour a corporation, directly or indirectly, that was not obtained under normal market conditions, is to be regarded as State aid. A measure by which the tax authority grants favourable tax treatment which places the taxpayer in a more favourable financial situation than that of other taxpayers, constitutes State aid for the purposes of Article 107(1) TFEU [58].

ii) Liable to affect trade between Member States; distort or threaten to distort competition

Much like the EU's competition law provisions, State aid rules will apply if a measure affects trade between Member States. Where an APA strengthens the

[58] Judgment of 15 July 2020, Ireland aid to Apple (Cases T-778/16 & T-892/16, ECLI:EU:T:2020:338) paras. 107 & 108. See also judgments in case C-399/08 P, Commission v Deutsche Post (2 September 2010, EU:C:2010:481) para 40, and case C-387/92, Banco Exterior de España (15 March 1994, EU:C:1994:100) para. 14.

position of one MNE with regards to its competitors in a different Member State, the APA might do just that[59].

iii) Confer a (selective) advantage on the recipient

The third requirement has proven to be the most hotly contested element. The criterion must be analysed in two parts: firstly, has the APA in question granted an *advantage* to the MNE, and secondly, is that advantage *selective* in nature rather than being generally available[60]. The determinant of an advantage lies in assessing whether the APA derogates from the *usual* or *normal* tax treatment given similar taxpayers in similar situations. The EC therefore looks at whether "the [MNE] receives an economic advantage which it would not have obtained under normal market conditions."[61] Here, the arm's length principle comes to the fore as a tool with which to determine if the APA has placed the MNE in a position it would not have achieved, had it been subject to competition in the free market[62].

For an assessment of selectivity, the *actual* treatment that Member States grant other taxpayers in similar situations is analysed. Selectivity of an APA denotes differentiated treatment. The decisive issue here is if the APA favours "certain [MNEs] … in comparison with other undertakings which are in a legal and factual situation which is comparable…". The Court of Justice has developed a selectivity analysis with three steps:

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[59] Sandra Marco Colino, 'The Long Arm of State Aid Law: Crushing Corporate Tax Avoidance' (Fordham International Law Journal, 44:2, 2020) p416.
[60] Ibid.
[61] Case C-39-94, SFEI v. La Poste (11 July 1996) E.C.R., 1-3577, 1-3596.
[62] Sandra Marco Colino, 'The Long Arm of State Aid Law: Crushing Corporate Tax Avoidance' (Fordham International Law Journal, 44:2, 2020) p417.

a. identify a framework of reference, which would typically be the tax code of the Member State in question;

b. determine whether the APA endorses a derogation from that framework; and

c. analyse whether the APA might be justified by the general scheme of the reference system (in which case it would be lawful)[63]

In the words of the Court of Justice:

> "*…the requirement as to selectivity under Article 107(1) TFEU must be clearly distinguished from the concomitant detection of an economic advantage, in that, where the Commission has identified an advantage, understood in a broad sense, as arising directly or indirectly from a particular measure, it is also required to establish that that advantage specifically benefits one or more undertakings. It falls to the Commission to show that the measure, in particular, creates differences between undertakings which, with regard to the objective of the measure, are in a comparable situation. It is necessary therefore that the advantage be granted selectively and that it be liable to place certain undertakings in a more favourable situation than that of others.*"[64].

It is therefore quite possible for an APA to fall within the ambit of Article 107 TFEU, and for that measure to flout the rules on State aid. However, the second half of the above passage hints at the burden of proof the EC faces in demonstrating, to the requisite legal standard, the

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[63] Ibid p417 – p419.

[64] Case C-15/14, Commission v. MOL Magyar Olaj- és Gázipari Nyrt (22 January 2015, ECLI:EU:C:2015:32) para. 59.

existence of a selective advantage within the meaning of Article 107(1) TFEU. As will be discussed below, the EC has faced an uphill battle on this front.

Chapter 3: Case Studies

This chapter analyses the tax optimisation strategies employed by five large MNEs in the EU: Apple, Starbucks, Amazon, McDonald's, and Nike. The European Commission's investigations into the compatibility of these strategies with State aid provisions are then examined and summarised. Each MNE is discussed in three parts:

1) Corporate structure and profit shifting mechanisms,
2) Advance pricing agreements,
3) The EC's investigations into the APAs through the lens of State aid provisions.

3.1: Apple Inc.

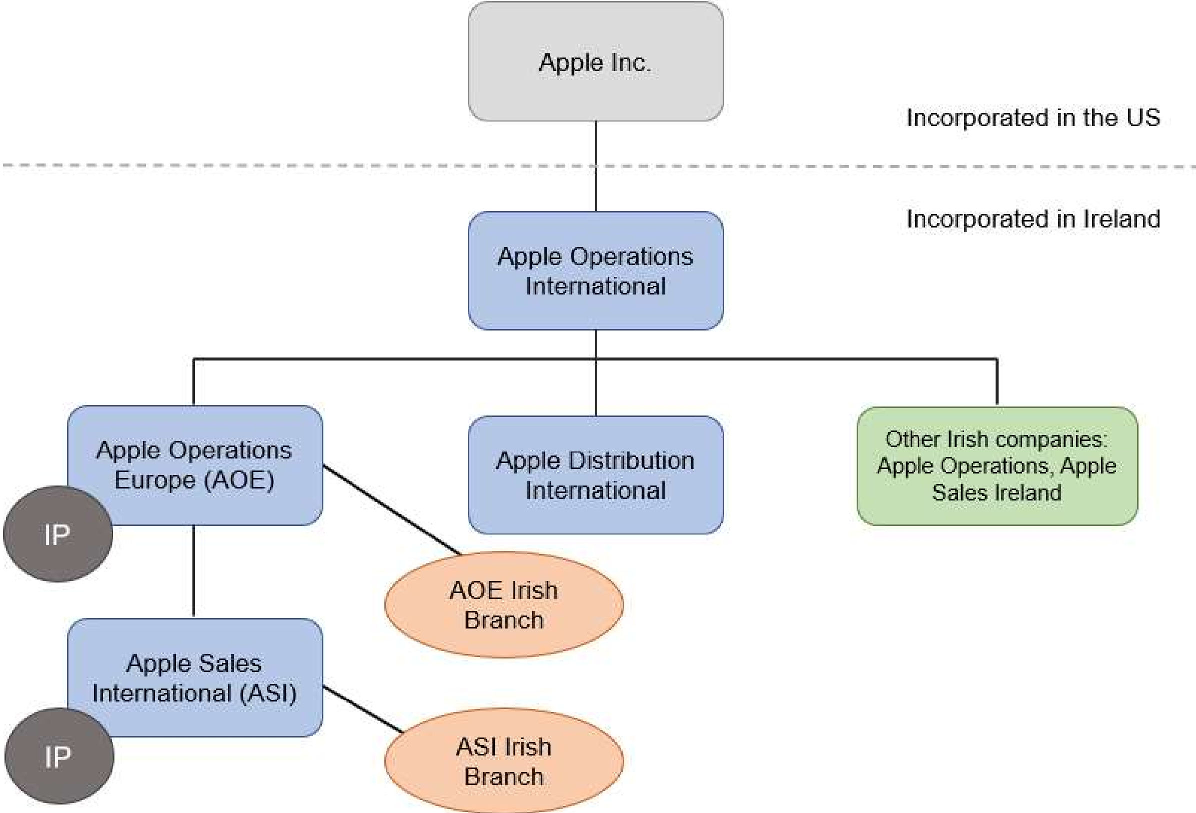
3.1.1: Corporate Structure

The Apple Group is composed of Apple Inc., which is headquartered in California in the United States, and all companies controlled by Apple Inc.[65] From 1991 until 2014, Apple's presence in Europe was spearheaded through several Irish companies. Of particular interest were two entities within the Apple Group, Apple Sales International ("ASI") and Apple Operations Europe ("AOE"), both of which were incorporated in the Republic of Ireland but neither of which had any physical presence nor any employees. ASI was a wholly owned subsidiary (i.e., 100% ownership) of AOE. Both companies were ultimately owned by Apple Inc. The boards of directors of both ASI and AOE comprised Apple Inc. employees located in the US. Strategic business decisions were made in the US, which meant that the companies' management and control functions were not performed in Ireland[66]. Under Irish tax law at the

[65] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/5.
[66] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/25.

time[67], this meant that neither ASI nor AOE were considered tax resident in Ireland. While both companies were de facto headquartered in California due to the location of their directors, neither had a taxable presence in the US because they both lacked physical US presence and direct employees[68]. In effect, ASI and AOE were stateless from a taxation perspective. Both companies, while incorporated in Ireland but not there tax resident, were then able to set up branches in Ireland in order to carry out their operational activities. These two Irish branches did have physical presence and employees in Ireland, and would be taxed in Ireland only on profits generated from an Irish source – this curious structure being a variant of the *Double Irish* scheme.

An excerpt from the EC's 2016 Decision shows a simplified corporate structure[69]:



[67] Section 23A of the Taxes Consolidation Act 1997.
[68] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/7.
[69] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/6.

The two Irish branches were responsible for operational functions such as procurement, sales and distribution, logistics, after-sales customer support, inventory, warranty, and credit limit risks, process engineering, production and operations, quality assurance and quality control, and refurbishing operations[70].

Irish-source profits of a branch are determined by reference to the activities performed by that branch[71]. From the above list of functions, it might appear that the two Irish branches were responsible for most of Apple's profits, however this was ostensibly not the case. ASI and AOE were granted royalty-free licences to use Apple intellectual property after concluding certain agreements[72]. Important to note is that the ASI and AOE headquarters, and not their respective Irish branches, were granted these Apple IP licences. Apple Inc. retained legal ownership of the IP. The agreements related to a vast range of intangible assets including IP related to marketing:

> *'all technologies, procedures, processes, designs and design rights, inventions, discoveries, know-how, patents (including patent applications, etc.), copyrights (and other rights of authorship), trade secrets, computer programmes (in source code and object code form), flow charts, formulae, enhancements, updates, translations, adaptations, information, specifications, process technology, manufacturing requirements, quality control standards, marketing intangibles, and any other similar intangible property as defined under Treas. Reg. §1.482-4(b) developed pursuant to the Development Programme'.*[73]

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[70] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/7 and 8.

[71] Ibid L187/7.

[72] These agreements had been in place in some form since December 1980 and were amended several times since then.

[73] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/32 and 33.

Apple's IP permeates all its products, services, and brand recognition power. The immense value that it holds for Apple is self-evident. The Apple IP licences were not allocated to the respective Irish branches of ASI and AOE, meaning profits generated from use of the assets were not deemed to be from an Irish source. The valuable IP assets were therefore effectively owned by the ASI and AOE "headquarters" and were not subject to taxes in either Ireland or the US. Through the strategic ownership and licensing of its IP assets, Apple had succeeded in creating a mechanism which enabled the transfer of profits from a high- to a low-tax jurisdiction. For the 12 years from 2003 to 2014, ASI alone recorded total revenue of around $315 billion, profit before tax in excess of $133 billion, while paying only $542 million in taxes, an effective tax rate of only 0.4%[74].

3.1.2: Advance Pricing Agreements

Apple, represented by ASI and AOE, concluded two APAs with the Irish tax authority: the first in January 1991, and a revised version in May 2007. Both APAs endorsed methods for determining the net profit attributable to the respective Irish branches of ASI and AOE. Profit attributable to the two branches would be taxable in Ireland, while the remaining profit would by default be attributable to the two companies' headquarters, and consequently not taxable anywhere. Both APAs endorsed attribution of profits to the Irish branches based on a fixed percentage of those branches' operating costs. For example, the 2007 APA endorsed a method for determining the net profit attributable to ASI's Irish branch calculated as between 10% and 15% of branch operating costs[75].

The percentages referenced in the two APAs were not based on any profit allocation study or transfer pricing report, nor was there any supporting explanation for the figures or how they

[74] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/19.
[75] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/9.

were arrived at. The profit levels endorsed by the APAs were rather loosely based on general profit levels within the computer industry, and seemed to have been agreed between Apple and the Irish tax authority after negotiations[76].

3.1.3: EC Investigation and Decision

In June 2014, the EC initiated a formal investigation procedure after coming to the preliminary conclusion that the two APAs constituted State aid within the meaning of Article 107(1) TFEU. The EC expressed doubt that the profit allocation methods endorsed by the APAs reflected normal market conditions, and were therefore not consistent with the arm's length principle[77].

Most of the EC's Decision focused on determining if the APAs had conferred a selective advantage onto ASI and AOE. The EC followed the three-step analysis developed by the Court of Justice in determining selectivity. To this end, the EC followed three separate lines of reasoning: the first (primary) line being that the Irish tax authority should not have accepted Apple's assertion that the valuable Apple IP was fully allocated outside of the Irish branches. The EC argued that ASI's and AOE's headquarters, having no employees and no physical offices, existed on paper only and therefore could not have performed the functions associated with the Apple IP. Consequently, those IP assets should necessarily have been allocated to the two Irish branches[78]. The two headquarters should therefore not have been allocated, in an arm's length context, the profits derived from the use of those licences. All profits should rather have been allocated to the two Irish branches where Irish corporate taxes

[76] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/10 & 11.
[77] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/38.
[78] Ibid L187/68.

would have applied[79]. According to the EC, this amounted to a selective advantage because it reduced ASI's and AOE's tax liabilities in Ireland as compared with similar entities whose chargeable profits reflected prices negotiated at arm's length on the free market[80].

The EC's second (subsidiary) line of reasoning for a conclusion of selective advantage focused on the profit allocation method endorsed by the two APAs. The EC argued that the chosen method (the TNMM) contained three methodological errors which led to an undervaluation of branch profits, and thereby produced an outcome which did not represent a reliable approximation of a market-based outcome in line with the arm's length principle. One of these methodological errors relates to the EC's view that the Irish branches of ASI and AOE performed more complex functions than their respective headquarters. This contrasts with Ireland's and Apple's assertions that the Irish branches performed merely routine functions. Methodological errors such as this, argued the EC, led to a lower percentage of profits being allocated to the Irish branches[81].

The third (alternative) line of reasoning relates in part to the arm's length principle. The EC held that, even though the arm's length principle was not explicitly laid down in Irish tax legislation until 2011, the Irish tax authority had used the principle as early as the 1990s as the basis for determining a non-resident integrated company's taxable profit. The EC therefore argued that the ALP was inherently a part of Irish tax law, and that the derogation of the ALP (as per the EC's findings in their subsidiary line of reasoning) necessarily meant that the APAs endorsed a derogation of the normal Irish tax rules and thereby granted a selective advantage[82].

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[79] Ibid L187/77.

[80] Judgment of 15 July 2020, Ireland aid to Apple (Cases T-778/16 & T-892/16, ECLI:EU:T:2020:338) para. 40.

[81] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/81.

[82] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/93.

In their 2016 Decision, the EC stated unequivocally that the purpose of their assessment was not to determine an arm's length remuneration for those functions performed by ASI's and AOE's Irish branches. Rather, the purpose of the assessment was merely to show that the APAs contained methodological errors, and thereby that the profit allocation method did not produce an outcome that was a reliable approximation of market-related prices[83]. The EC clearly felt it would be sufficient to show Apple that did not have suitable methods for calculating transfer prices between ASI's and AOE's headquarters and their branches. Indeed, correspondence from 1991 shows that no transfer pricing report was ever produced and that the percentage of profits allocated between headquarters and branch was based on little more than educated guesswork. Apple therefore seemingly lacked evidentiary proof that their APAs were in line with the arm's length principle. This fact undoubtedly spurred the EC in concluding that Ireland had granted unlawful State aid to Apple[84]. In August 2016, Ireland was ordered to recover up to €13 billion from Apple's two Irish companies, ASI and AOE[85].

3.2: Starbucks Corporation

3.2.1: Corporate Structure

Starbucks is a chain of coffeehouses and roastery services headquartered in Seattle in the United States. Starbucks is omnipresent in major cities across the globe, selling hot and cold coffee drinks, teas, juices, confectionaries, and related products. The Starbucks group is composed of the Starbucks Corporation and all the companies controlled by that corporation. Of particular interest for Starbucks' presence in the EU are two related entities: Starbucks Manufacturing EMEA BV ("SMBV"), and Alki LP ("Alki"). SMBV is a company

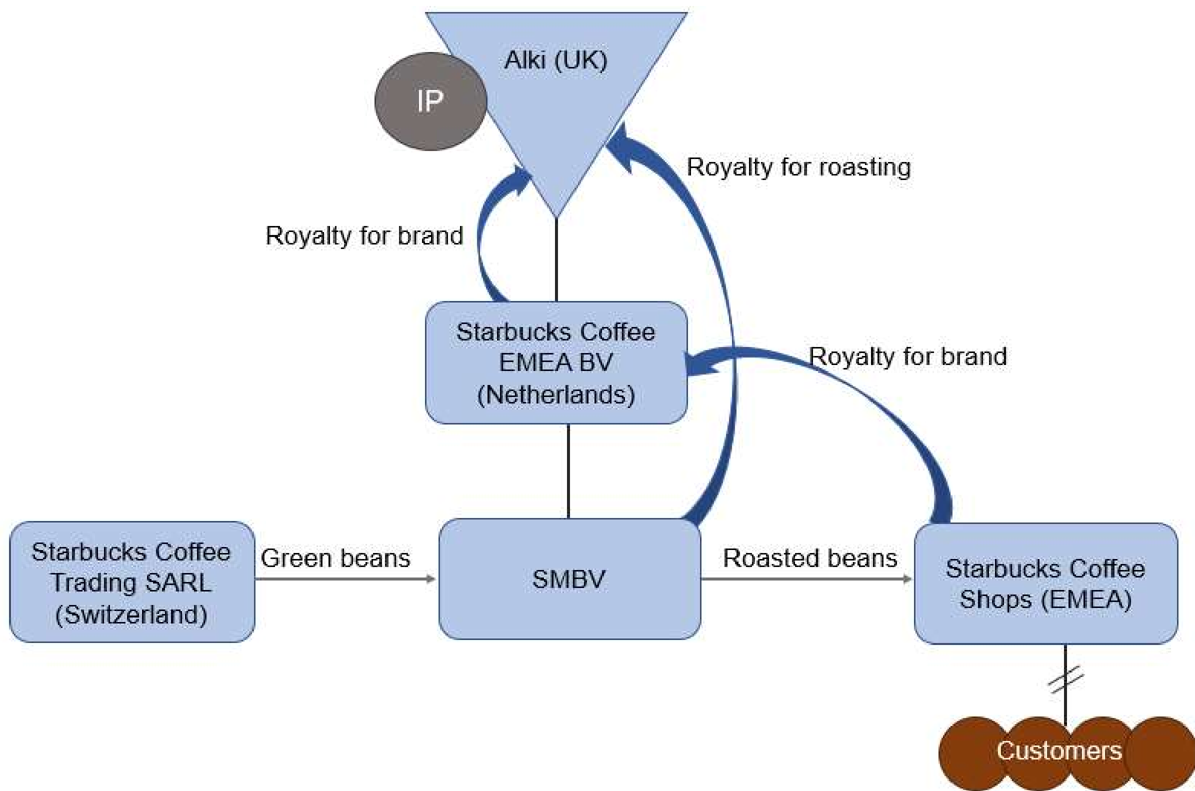
[83] Ibid L187/86.
[84] Ibid L187/109.
[85] European Commission Press Release IP/16/2923, 'State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to E13 billion' (30 August 2016), <http://europa.eu/rapid/press-release_IP-16-2923_en.htm>

incorporated in the Netherlands and subject to Dutch corporate tax law, while Alki is a limited partnership registered in the UK.

Alki, being a limited partnership, was a transparent entity for both UK and Dutch tax purposes, meaning Alki itself is not subject to either UK or Dutch tax laws, but rather Alki's partners. In the wider Starbucks group, Alki was in turn indirectly owned by Starbucks Corp. in the US through several layers of Dutch limited partnerships (*gesloten commanditaire vennootschappen*, or "closed CVs"). These closed CVs were also transparent for Dutch tax purposes, meaning any royalty payments from SMBV to Alki was considered from a Dutch tax perspective to be a direct payment to Starbucks US[86]. Any royalty income received by Alki however, would not be integrated in the income of the partners of Alki under US tax law[87]. Effectively this meant that royalty payments received by Alki were not subject to taxes in the Netherlands, the UK, or the US.

An excerpt from the EC's 2015 Decision shows a simplified corporate structure for Starbucks in the EU[88]:

[86] *Netherlands Alleged aid to Starbucks* (State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2014/3626 [2014] OJ C3626/9 and 10.
[87] *Netherlands State aid to Starbucks* (State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/502 [2015] OJ L83/56.
[88] Ibid L83/44.



Alki acquired certain rights to Starbucks Corp. IP in August 2006. These rights included the ability for Alki to license and sublicense to third parties the right to operate Starbucks stores[89]. Starbucks IP consisted broadly of trademark rights, system rights, and coffee-related rights, which included the coffee roasting 'brand curves' and the formula for the coffee mixes[90]. Alki earned royalty fees from the licensing of the Starbucks IP rights.

SMBV is a coffee-roasting house in operation since 2002. Its Amsterdam-based roasting facility is the only such facility located outside the US. SMBV is supplied with green coffee beans which it buys from a different Starbucks entity based in Switzerland. The beans for the EMEA market are roasted and packaged in the Netherlands. The roasting curves and know-how that SMBV uses to roast and process the beans is licensed from Alki, for which SMBV

[89] Ibid L83/65.
[90] Ibid L83/56.

pays a royalty fee. The roasted coffee is then sold to both affiliated and non-affiliated Starbucks branches and coffee shops[91].

As in the Apple case above, Starbucks had succeeded in creating a group entity (Alki) that is effectively not subject to any tax laws within the EU, and an effective mechanism for shifting profits to that entity. For the 11 years from 2003 to 2014, SMBV shifted in excess of €95 million to Alki, reducing its taxable income in the Netherlands by this amount[92].

3.2.2: Advance Pricing Agreements

The Starbucks APA was concluded in 2008 between the Netherlands tax authority and SMBV. The APA was binding for 10 years up to December 2017. Starbucks had relied on a transfer pricing report, prepared by their tax advisors, as justification of the proposed tax treatment of SMBV defined in the APA. The transfer pricing report included inter alia a company overview, a profit comparability study, and an explanation for choosing the transfer pricing method, which in this case was the transactional net margin method (TNMM). The report also included a functional analysis, which is an analysis of the specific functions performed, assets used, and risks assumed by SMBV. The report's stated objective was to support the proposed profit allocation to SMBV within the Starbucks group as being based on an arm's length pricing of intra-group transactions[93]. SMBV was categorised as a toll manufacturer in the transfer pricing report, that is, a company which processes raw materials or semi-finished goods under arrangement on behalf of another company[94].

[91] *Netherlands Alleged aid to Starbucks* (State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2014/3626 [2014] OJ C3626/7.
[92] *Netherlands State aid to Starbucks* (State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/502 [2015] OJ L83/54.
[93] Ibid L83/42.
[94] Ibid L83/44.

The APA endorsed the level of remuneration allocated to SMBV, as well as the level of royalty fees paid by SMBV to Alki for the use of Alki's intellectual property[95]. SMBV's remuneration was calculated as a percentage between 9% and 12% of certain costs incurred, while the royalty fees payable by SMBV was determined as the difference between its realised operating profit and remuneration[96]. The applied percentage represented the median of profitability figures earned by a selection of comparable companies, as detailed in the comparability study included in the transfer pricing report. This meant that the Dutch tax authorities accepted that SMBV's taxable profit in the Netherlands would be calculated as a fixed percentage of costs, and that the vast majority of remaining profits would be paid to Alki in the form of royalties where it would not be subject to tax.

3.2.3: EC Investigation and Decision

In contrast with Apple, Starbucks had commissioned a comprehensive transfer pricing report to support their assertion that the APA endorsed measures that were in line with the arm's length principle. Nevertheless, the EC expressed several doubts whether that was indeed the case, questioning several aspects of the transfer pricing report. These doubts included the correct analysis of the functions performed and risks assumed by SMBV, as well as the appropriateness of the TNMM as the chosen transfer pricing method. In June 2014, the EC initiated a formal investigation procedure laid down in Article 108(2) TFEU under a preliminary conclusion that the APA constituted the granting of State aid within the meaning of Article 107(1) TFEU by the Netherlands to SMBV[97]. As in Apple's case above, the EC's investigation focused on whether the APA in question constituted a selective advantage as the

[95] This IP being the know-how related to the roasting of green coffee beans, specifically the roasting curves which dictate the temperature and length of time required to complete the roasting process.
[96] *Netherlands State aid to Starbucks* (State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/502 [2015] OJ L83/42.
[97] *Netherlands State aid to Starbucks* (State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/502 [2015] OJ L83/69.

remaining criteria for meeting the definition of State aid were easily met. Again, the EC followed the three-step analysis for determining selectivity[98], and put forth several lines of reasoning in concluding that the APA granted such a selective advantage.

The first line of reasoning concerns the choice of transfer pricing method endorsed by the APA. The EC relied on the 1995 and 2010 OECD Transfer Pricing Guidelines which favour traditional transactional methods (such as the CUP method) over transactional profit methods (such as the TNMM) as a means of establishing whether a transfer price is at arm's length[99]. The EC held that the TNMM is a method of last resort, and should not have been selected as the transfer pricing method ahead of the more direct and reliable CUP method, since several comparable uncontrolled transactions could be found in the market against which SMBV's controlled transactions could be measured. Consequently, the EC held that by using the TNMM method as endorsed by the APA, the Netherlands had conferred a selective advantage as that method would not have produced a reliable approximation of a market-based outcome[100]. The EC stopped short of performing their own analysis to show what the result would have been, had the CUP method been applied. This also reflects the EC's position in *Apple*, where it stated that the purpose of the investigation was not to determine an arm's length remuneration for the functions performed by the relevant entities.

The EC's second line of reasoning concerns the royalty payments made by SMBV to Alki for the use of the latter's coffee roasting IP. The EC held that the variable nature of the royalty payments (being calculated as the difference between SMBV's remuneration and operating profit) showed that it bore no relation to the value of the IP for which payment was being made. The EC argued that SMBV performed more complex functions than a mere toll manufacturer as stated in the transfer pricing report, and in fact acted more like a vendor

[98] Ibid L83/79.
[99] Ibid L83/87.
[100] Ibid L83/88.

taking on various risks such as those related to inventory, supply, and manufacturing capacity[101]. Furthermore, the EC held that SMBV did not directly exploit the IP licensed from Alki on the open market, arguing that none of SMBV's finished goods are sold to final customers. According to the EC, it would be irrational for such a coffee roaster to pay a royalty for the use of IP when it does not market the finished product directly. Lastly, the EC analysed several manufacturing agreements between Starbucks and third parties, as well as similar agreements concluded between Starbucks' competitors and third-party roasters, i.e., comparable uncontrolled transactions, finding that these agreements did not provide for any royalty payments for the use of roasting know-how and IP. The EC therefore concluded that, in stark contrast to what was endorsed by the APA, no royalty fees should have been paid by SMBV to Alki whatsoever.

The EC also followed a further subsidiary line of reasoning concerning a selective advantage, that of an incorrect application of the chosen transfer pricing method. The EC contends that SMBV performed functions more complex than what was described in the transfer pricing report. In addition to the routine roasting function, the EC argued that SMBV also undertook market research, held other IP, concluded contracts with other toll manufacturers, and negotiated sales prices for its finished goods. The EC argued that Alki was the least complex entity, stemming partially from the fact that Alki had no employees and therefore extremely limited operating capacity[102]. For this reason, the EC held that since the methodology for determining SMBV's tax base was premised on flawed assumptions, that methodology did not result in a reliable approximation of a market-based outcome in line with the arm's-length principle. Since the APA's endorsement of that methodology led to a lowering of SMBV's tax liability under the general Dutch corporate income tax system as compared to non-integrated companies whose taxable profit under that system is determined by the market, that APA

[101] Ibid L83/94.
[102] *Netherlands State aid to Starbucks* (State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/502 [2015] OJ L83/102.

derogated from the normal tax rules and therefore confers a selective advantage to SMBV for the purposes of Article 107(1) TFEU[103].

Consequently, in its Decision of 21 October 2015, the EC found that the Netherlands had granted State aid to SMBV and the Starbucks Group within the meaning of Article 107(1) TFEU through the conclusion of the SMBV APA, said State aid being unlawfully put into effect by the Netherlands in breach of Article 108(3) TFEU[104]. The Netherlands was ordered to recover up to €30 million from SMBV[105]. Although this was not altogether the same eyewatering sum as in the Apple case, it still represented a victory for the EC in their novel approach to tackling tax avoidance.

3.3: Amazon.com, Inc.

3.3.1: Corporate Structure

Amazon.com, Inc. is an American MNE headquartered in the city of Seattle in Washington State. Amazon started as an online marketplace for books, but quickly expanded into the corporate behemoth it is today, with a focus on e-commerce, cloud computing, digital streaming, and artificial intelligence. Amazon has been the market leader in many of these fields, consistently vying for the title of the world's largest online retailer[106] and cloud

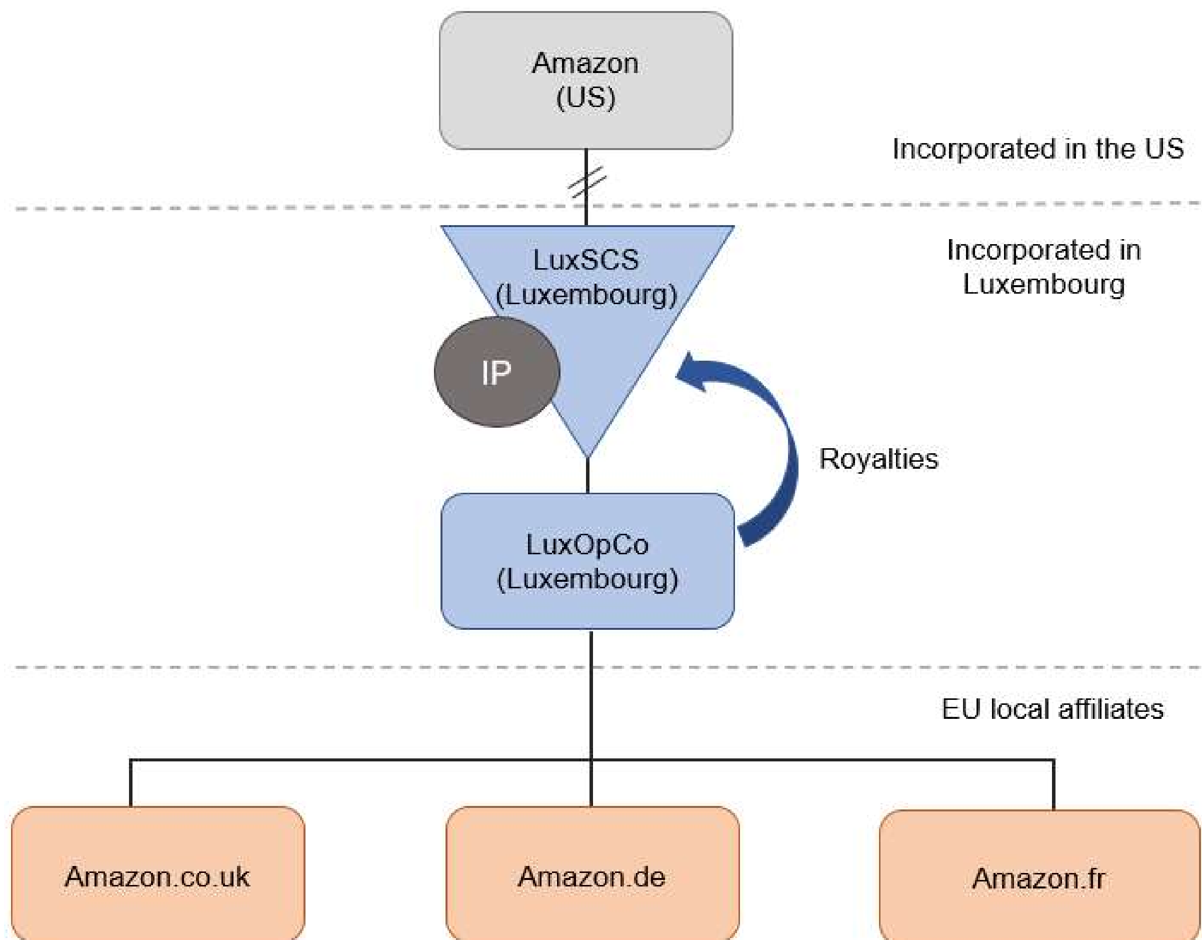
[103] Ibid L83/103.
[104] Ibid L83/114.
[105] European Commission Press Release IP/15/5880, 'Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules' (21 October 2015), https://ec.europa.eu/commission/presscorner/detail/en/IP_15_5880.
[106] Lukas Peters, 'Top online stores worldwide in 2020, by e-commerce net sales' (Statista.com, 2022) <https://www.statista.com/forecasts/860716/top-online-stores-global-ecommercedb#:~:text=Amazon.com%20is%20leading%20the,revenue%20of%20US%24%2041%2C114%20million.> accessed 6 July 2022.

computing service provider[107]. Amazon offers its products and services via several branded websites.

Between May 2006 and June 2014, Amazon's European operations were structured around two limited partnerships registered in Luxembourg: an operating company called Amazon EU Société à responsabilité limitée ("LuxOpCo"), and a holding company called Amazon Europe Holding Technologies SCS ("LuxSCS"). While LuxOpCo was a wholly-owned subsidiary of LuxSCS, the partners of the latter were all US-resident companies which included Amazon.com, Inc.[108] This meant that LuxOpCo was liable to taxes in Luxembourg, but LuxSCS was not[109].

An excerpt from the EC's 2017 Decision sets out a simplified view of Amazon's European holding structure[110]:

[107] Edward Jones, 'Cloud Market Share – a Look at the Cloud Ecosystem in 2022' (Kinsta, 8 June 2022) <https://kinsta.com/blog/cloud-market-share/> accessed 6 July 2022.
[108] *Luxembourg aid to Amazon* (State aid SA.38944 (2014/C) (ex 2014/NN)) Commission Decision 2018/859 [4 October 2017] OJ L153/10.
[109] Ibid L153/23.
[110] Ibid L153/10.



During the relevant period between 2006 and 2014, LuxOpCo functioned as principal for both the retail and service businesses on Amazon's European websites (at that time www.amazon.de, www.amazon.co.uk, and www.amazon.fr)[111] and employed several hundred employees. LuxOpCo would also further develop and improve the software-based business model underlying Amazon's European retail and service business, and functioned as the headquarters of the Amazon group in Europe. It managed the strategic decision-making related to the retail and services businesses carried out through the EU websites, along with the management of key physical components of the retail business. It was expected to set the strategies and guidelines regarding which products would be featured and sold on the

[111] *Luxembourg aid to Amazon* (State aid SA.38944 (2014/C) (ex 2014/NN)) Commission Decision 2018/859 [4 October 2017] OJ L153/9.

websites, the pricing and merchandising strategies for the products sold or service offerings, and certain website promotions and advertising programmes offered. It was responsible for strategic decisions relating to the selection of third-party merchants and product categories and for marketing towards third parties. LuxOpCo managed all aspects of the order fulfilment business and was the seller of record[112] of Amazon inventory on its websites, held title to the inventory, and bore the risk of any loss in that respect[113]. One might reasonably conclude form this extensive list of functions performed by LuxOpCo, that it was the main revenue driver for Amazon in the EU. However, like *Apple* above, this was ostensibly not the case.

Much of Amazon's success and competitive advantage lies in its investment in technology. Technology allows Amazon to provide dynamic and competitive prices, personalise shopping recommendations, process payments, manage inventory and ship products to customers. Technology is also necessary to support the scale of the business, since Amazon's business strategy relies on constant expansion[114]. Amazon therefore considers its technological investment and constant innovation a unique and valuable contributor that has enabled it to be competitive in a highly competitive environment that is characterised by narrow margins. Technology is at the heart of Amazon's business model[115] and comprises both software and hardware. Software consists of inter alia, software code used to operate Amazon websites as well as the appearance of the websites, search and navigations, logistics software and order processing. During the relevant period, LuxSCS functioned solely as a holding company for intangible assets intended for use in Amazon's European operations. Even though the company had no physical offices nor any employees[116], it received the rights to a ream of intangible assets through a series of agreements with other Amazon group companies, both in

[112] The seller of record is the entity which owns and offers the goods for sale and which is responsible for collection and payment of value added taxes where applicable.
[113] *Luxembourg aid to Amazon* (State aid SA.38944 (2014/C) (ex 2014/NN)) Commission Decision 2018/859 [4 October 2017] OJ L153/12.
[114] Ibid L153/28.
[115] Judgment of 12 May 2021, Luxembourg aid to Amazon (Cases T-816/17 & T-318/18, ECLI:EU:T:2021:252).
[116] *Luxembourg aid to Amazon* (State aid SA.38944 (2014/C) (ex 2014/NN)) Commission Decision 2018/859 [4 October 2017] OJ L153/10, 11.

the US and Europe. The intangible assets comprised Amazon IP such as the rights to the European websites, technology[117], customer data[118], and trademarks[119]. LuxSCS then licensed this valuable IP to LuxOpCo, which in turn used the assets to facilitate Amazon's European operations. LuxSCS therefore received passive income in the form of royalties from LuxOpCo.

As the partners of LuxSCS were all US-resident companies, it was deemed a fiscally transparent entity for Luxembourg tax purposes. Any royalty payments therefore received by LuxSCS were not considered taxable in Luxembourg, but rather taxable in the hands of its US-resident partners. By contrast, the US did not consider LuxSCS as fiscally transparent, but as a separate corporate entity resident in Luxembourg. This meant that the taxation of LuxSCS' partners could be deferred indefinitely so long as no profits were repatriated to them in the US. The different tax treatment of LuxSCS in Luxembourg and the US is another example of regulatory mismatch[120]. Amazon had successfully exploited this difference to create a European corporate entity that was not subject to taxes anywhere within the common market.

Between 2006 and 2012, LuxSCS received IP licencing royalties in excess of €2,76 billion. This meant that LuxOpCo paid around 92% of its net operating profit to LuxSCS[121], leaving only a small fraction of operating profits to be taxed in Luxembourg.

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[117] This includes the technology for Amazon's software platform, appearance of the EU websites, catalogues, search and navigation functions, logistics process, order processing, customer service and personalisation functions.
[118] This is a collection of data on products and customers. It includes customer reviews, publisher reviews, product data, customer names, purchase histories and other data.
[119] These include the trade mark, trade name, style, logos, presentation of Amazon and associated intangible assets.
[120] *Luxembourg aid to Amazon* (State aid SA.38944 (2014/C) (ex 2014/NN)) Commission Decision 2018/859 [4 October 2017] OJ L153/23.
[121] Ibid.

3.3.2: Advance Pricing Agreements

Amazon petitioned the Luxembourg tax authority by way of two letters in October 2003. The company sought advance rulings concerning inter alia the tax treatment of LuxOpCo, LuxSCS, and the US-based partners. The first letter details Amazon's proposed business structure in Europe and included a functional analysis of both LuxSCS and LuxOpCo. The letter was accompanied by an "economic analysis" in the form of a transfer pricing report, which set out the functions and risks that the companies were expected to undertake. The report also covered the nature and extent of intangible assets that were subject to an IP licensing agreement between the entities. Amazon asserted that its transfer pricing report followed the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations prepared by the OECD. Based on that report, a transfer pricing arrangement was proposed under which LuxOpCo would pay royalties to LuxSCS for the use of the IP. The report specifically included a calculation of an arm's length range for the royalty fee based on a search performed for comparable transactions. The transactions identified were not considered sufficiently comparable and were therefore rejected for the purpose of using a traditional transaction method in determining the appropriate transfer pricing method to use. Consequently, the analysis recommended the less accurate residual profit split method[122]. The letter further sought confirmation that the transfer pricing arrangement resulted in "an appropriate and acceptable profit" for LuxOpCo with respect to Luxembourg income tax law, including specifically transfer pricing provisions[123]. It is therefore clear that Amazon was aware of the importance of setting the royalty fee at an acceptable level, not only for the purposes of local tax law, but also for internationally accepted transfer pricing conventions.

In the second letter of October 2003, Amazon set out its reasons for concluding that LuxSCS was not taxable in Luxembourg; as it did not have fixed offices or employees, it could not be

[122] *Luxembourg aid to Amazon* (State aid SA.38944 (2014/C) (ex 2014/NN)) Commission Decision 2018/859 [4 October 2017] OJ L153/19.
[123] Ibid L153/16, 17, 18.

deemed carry out a commercial activity or to have a permanent establishment in Luxembourg. Consequently, LuxSCS did not have a separate tax personality from that of its US-based partners and as such, it was not subject to corporate income tax in Luxembourg[124].

In a brief letter on 6 November 2003, the Luxembourg tax authority accepted Amazon's proposals set out in their two letters, thereby concluding the APA. This APA therefore endorsed the proposed tax treatment of LuxSCS and LuxOpCo, the transfer pricing arrangement between the two, and the method for calculating the IP royalty payments. Pursuant to that IP licensing agreement, LuxSCS would be entitled to a royalty fee from LuxOpCo based on a fixed percentage of the latter's annual revenue in connection with the operation of Amazon's EU websites. The agreement included floor- and ceiling limits for the royalty fee.

3.3.3: EC Investigation and Decision

In October 2014, the EC initiated preliminary procedures to investigate Amazon and Luxembourg under Article 108(2) TFEU, citing several doubts that the APA was compatible with the internal market. The EC specifically held that the royalty fee between LuxOpCo and LuxSCS was not an arm's length approximation. The EC alleged that the royalty fee deviated from OECD Transfer Pricing guidelines, and criticised the functional analysis performed by Amazon arguing that LuxOpCo, and not LuxSCS, was the more complex of the two entities. The EC questioned the floor- and ceiling limits of the royalty fee, as well as the choice of transfer pricing method[125].

As with the cases discussed above, the EC had no trouble with the three less contentious requirements of the *Altmark* case in finding that the APA fell within the ambit of Article 107

[124] Ibid L153/16.
[125] Ibid L153/61, 62.

TFEU: intervention by the State, liable to affect trade between Member States, and distortion of competition. The EC's investigation again focused on the requirement of selective advantage. Two different lines of reasoning were put forward to determine that the APA had derogated from normal Luxembourg tax rules, giving Amazon an economic advantage which it would not have obtained under free market conditions.

The first and primary line of reasoning focused on the respective functions performed and risks assumed by LuxSCS and LuxOpCo, as well as the choice of transfer pricing method in determining an arm's length level for the royalty fees. The EC disagreed with Amazon's transfer pricing report insofar as the functional analysis included therein classified LuxSCS as performing more complex functions than LuxOpCo. In contrast, the EC considered LuxSCS as only performing routine functions, and should not have been deemed to perform "unique and valuable" functions in relation to the IP assets for which it merely held legal title. The EC rather considered that LuxSCS did not have the capacity to perform any active and critical functions in relation to the development, enhancement, management, and exploitation of the IP which would justify attributing to it almost all the profit generated by LuxOpCo[126]. This fact led the EC to conclude that the transfer pricing report, as endorsed by the APA, did not convey a level of royalty fees that resembled arm's length conditions. The EC then proposed an appropriate remuneration for LuxSCS based on a broad report citing merely "low-added intra-group services". Notably, as in the previous two cases, the EC did not perform their own detailed comparability analysis with which to gauge such an appropriate royalty fee[127].

The EC's second and subsidiary line of reasoning focused on three methodological errors which it argued had not produced an outcome that reliably approximated arm's length principles. First, the EC disagreed with Amazon's assertion that LuxOpCo performed solely

[126] *Luxembourg aid to Amazon* (State aid SA.38944 (2014/C) (ex 2014/NN)) Commission Decision 2018/859 [4 October 2017] OJ L153/84.
[127] Ibid L153/124.

"routine" management functions and indeed performed a range of unique and valuable functions, finding therefore that the choice of transfer pricing method was inappropriate[128]. Second, the EC pointed out that Amazon had misapplied their own transfer pricing report, insofar as the report recommended *total costs* as the profit level indicator for determining LuxOpCo's remuneration, while the APA actually endorsed *operating expenses* as the profit level indicator. Third, the EC found that by including a ceiling level for LuxOpCo's remuneration, the APA departed from a reliable approximation of a market-based outcome[129]. Notable once again is the fact that the EC did not attempt to determine a precise arm's length remuneration for LuxOpCo that it felt would have been appropriate. The EC merely highlighted errors in Amazon's transfer pricing arrangement, arguing that they resulted in lowering LuxOpCo's taxable income as compared to companies whose taxable profit reflects prices negotiated at arm's length on the free market[130].

On 4th October 2017, the EC found that Luxembourg had unlawfully granted State aid to the Amazon group in contravention of Articles 107(1) and 108(3) TFEU. The EC ordered Luxembourg to recover around €250 million from LuxOpCo. Commissioner Margrethe Vestager was quoted as saying:

> "*Luxembourg gave illegal tax benefits to Amazon. As a result, almost three quarters of Amazon's profits were not taxed. In other words, Amazon was allowed to pay four times less tax than other local companies subject to the same national tax rules. This is illegal under EU State aid rules. Member States cannot give selective tax benefits to multinational groups that are not available to others.*"[131]

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[128] Ibid L153/125.
[129] Ibid L153/127.
[130] Ibid L153/125.
[131] European Commission Press Release IP/17/3701, 'State aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million' (4 October 2017), https://ec.europa.eu/commission/presscorner/detail/en/IP_17_3701.

3.4 McDonald's Corporation

3.4.1: Corporate Structure

McDonald's Corporation has its principal office in Chicago, Illinois, United States, and is a publicly traded company listed on the New York Stock Exchange. McDonald's Corporation operates and franchises McDonald's fast-food restaurants, boasting over 38,000 locations at the end of 2019 in more than 100 countries across the globe[132]. Roughly 80% of McDonald's restaurants are owned and operated by franchisees. The company is therefore primarily a franchisor[133]. Outside of the US, McDonald's Corporation licenses the rights to develop and operate McDonald's restaurants on a market-by-market basis[134].

As of December 2013, McDonald's' European structure was concentrated in Luxembourg, with the McDonald's Corporation controlling at least five companies in the jurisdiction[135]. Of particular interest was McD Europe Franchising, S.à.r.l. ("McD Europe"), a Luxembourg limited liability company which operated two branches outside of the common market: one branch operating in the US ("US Franchise Branch") and the other operating in Switzerland ("Swiss Service Branch"). The US Franchise Branch did not have any employees, but was represented by a branch manager who was an employee of the McDonald's Corporation. Through a series of agreements with the McDonald's Corporation in 2009, McD Europe acquired beneficial ownership of valuable IP in the form of certain franchise rights[136]. These assets were subsequently allocated to McD Europe's US Franchise Branch with its head office

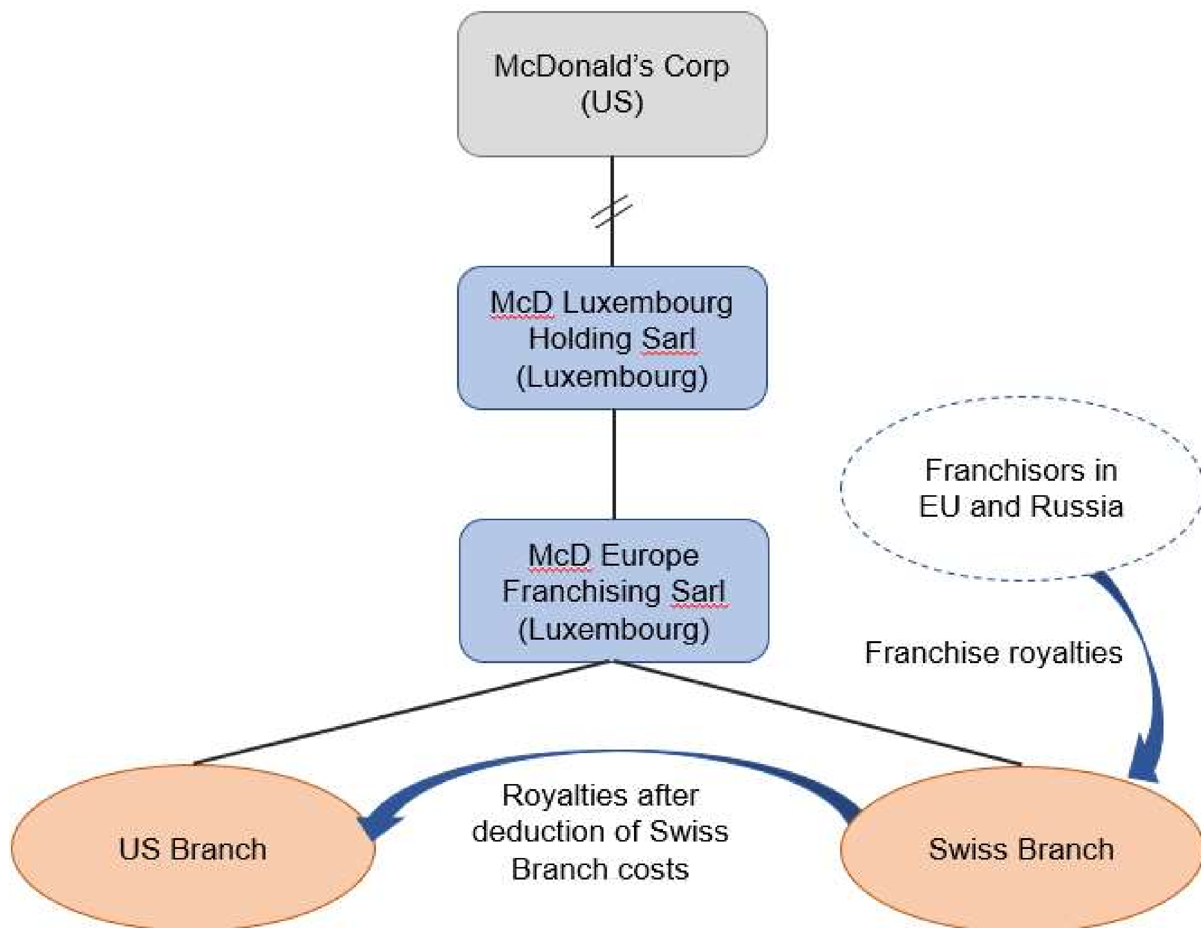
[132] McDonald's. "2020 Notice of Annual Shareholders' Meeting and Proxy Statement," Page 21.
[133] *Luxembourg aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN) (ex 2014/CP)) Commission Decision 2019/1252 [19 September 2018] OJ L195/21.
[134] *Luxembourg alleged aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN) European Commission [15 July 2016] OJ C258/33.
[135] Ibid C258/33.
[136] These franchise rights included inter alia: brand development, advertising, marketing, restaurant design and specifications, food and menu development, supply chain, operating platform and systems (including training intangibles), franchising administration, business analysis, quality assurance, human resources, legal.

in the US. This meant that all royalties previously received directly by McDonald's Corporation in the US, would now be received by the Luxembourg entity, McD Europe, through its US Franchise Branch[137].

For the company's European operations, the Swiss Service Branch was used. That branch, with its head office in Geneva, Switzerland, sublicensed the franchise rights (those rights owned by McD Europe in Luxembourg and allocated to the US Franchise Branch in the US) to franchisors based in Europe, and further provided management, support, development, and similar services related to those franchise rights. Royalties so received by the Swiss Service Branch from European franchisors were then paid to the US Franchise Branch after deduction of costs incurred by the Swiss Service Branch, including a profit markup[138]. McDonald's had therefore managed to structure their corporate affairs so that all royalty income received from franchisors were paid to McD Europe via the Swiss Service Branch, or the US Franchise Branch, or both.

An extract of the McDonald's corporate structure[139]:

[137] *Luxembourg alleged aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN) European Commission [15 July 2016] OJ C258/35.
[138] *Luxembourg alleged aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN) European Commission [15 July 2016] OJ C258/36.
[139] Ibid C258/37.



McD Europe was tax resident in Luxembourg under Article 159(1) of the Luxembourg Income Tax Law 1967. Both the US Franchise Branch and the Swiss Service Branch were part of the same corporate entity, which meant that McD Europe's financial statements and tax filings incorporated both branches. McD Europe could also benefit from any applicable double taxation treaties ("DTT"). DTTs are bilateral treaties concerned with relieving cross-border double taxation, the phenomenon that can occur when the same item of income or property is subject to taxes in two countries for the same taxpayer over the same period. The provisions of DTTs between countries often follow a template Model Tax Convention drafted by the OECD, which represents a push by the international community to harmonise cross-border taxation issues. From a Luxembourg point of view, by virtue of the Luxembourg – Swiss DTT in place since January 1993, the activities of the Swiss Service were considered to

be performed in Switzerland, meaning the branch was considered a permanent establishment in that country. Profits from that branch were therefore taxable only in Switzerland and exempt from tax in Luxembourg, thereby preventing the same profits from being taxed in both Switzerland and Luxembourg (i.e., double taxation). Similarly, under the Luxembourg – US DTT, in place since April 1996, the activities of the US Franchise Branch were considered to be performed in the US. The Luxembourg tax authorities considered the branch to be a permanent establishment in the US. Again, this meant that any profits realised in the US Franchise Branch were exempt from tax in Luxembourg[140], ostensibly a sign that the respective double taxation treaties were functioning as intended.

The catch however was that the US Franchise Branch was not considered a permanent establishment in the US under US tax law. Notwithstanding the fact that the branch had a fixed place of business in the US from which the branch manager conducted certain activities, it was insufficient from a US tax law point of view to be considered an active trade or business within the US[141]. Therefore, any profit realised by the US Franchise Branch of McD Europe was not taxable in the US, and yet still exempt from tax in Luxembourg. McDonald's had exploited this regulatory mismatch and succeeded in creating a European corporate entity which was not subject to taxes anywhere. Even though Luxembourg and the US share the same double taxation treaty, the interpretation of that same treaty differed due to the different national tax laws. In 2015 alone, McD Europe had recorded pre-tax profit of $536 million while paying only $3,8 million in tax, an effective rate of 0.7%[142].

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[140] *Luxembourg alleged aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN) European Commission [15 July 2016] OJ C258/38, 39.

[141] Ibid C258/39.

[142] Simon Bowers, 'McDonald's to scrap Luxembourg tax structure' (The Guardian, 8 December 2016) <https://www.theguardian.com/business/2016/dec/08/mcdonalds-to-scrap-luxembourg-tax-structure> accessed 13 July 2022.

3.4.2: Advance Pricing Agreements

The McDonald's advance pricing arrangement is unique in that it does not seek endorsement of a transfer pricing agreement with regards to IP licensing between related entities. Unlike the APAs in favour of Apple, Starbucks, Amazon, and Nike, the APA in favour of McDonald's did not seek confirmation that any licensing- or royalty fee was set at an appropriate arm's length level. The APA sought merely to confirm how the relevant tax laws would be applied.

McD Europe twice approached the Luxembourg tax authorities in 2009 requesting rulings which concerned its taxable status in Luxembourg. The first request included details of McDonald's' group structure in Europe, as well as an overview of the franchising rights owned by McD Europe and allocated to its US Franchise Branch and Swiss Service Branch, respectively[143]. Citing the relevant double tax treaties, McDonald's' appointed tax advisor explained that any profits generated by the two branches would be taxable in those respective countries and exempt from tax in Luxembourg. In a letter of 30 March 2009, the Luxembourg tax authority confirmed the tax advisor's interpretation of the law. The US Franchise Branch and Swiss Service Branch constituted "permanent establishments" under Luxembourg tax laws. The Luxembourg tax authority therefore accepted that profits of McD Europe that were imputable to the two branches were subject to tax in their respective countries and tax exempt in Luxembourg[144].

The second request included a review of US tax laws applicable to the case. Notwithstanding the fact that the US Franchise Branch of McD Europe was considered a "permanent establishment" in the US under Luxembourg tax law, it was not so considered under US domestic law. Essentially this meant that while the US Franchise Branch was not considered

[143] *Luxembourg alleged aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN) European Commission [15 July 2016] OJ C258/35.
[144] *Luxembourg alleged aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN) European Commission [15 July 2016] OJ C258/38, 39.

taxable in the US under US law, it was considered taxable in the US under Luxembourg tax law. The tax advisor concluded that the tax exemption in Luxembourg per the Luxembourg-US double tax treaty was still applicable, due to the specific wording of the treaty:

> Article 25(2)(a) of the DTT provides that Luxembourg will exempt from tax income that "*may be* taxed in the United States". According to the tax advisor, "there is however no requirement that the other contracting state (US) *effectively taxes* this income".[145]

The added emphases in the above passage highlight how a subtle difference in interpretation by two parties subject to the same double tax treaty can significantly affect the outcome. The tax advisor's analysis concluded with a request to the Luxembourg tax authority to confirm its agreement with the advisor's interpretation of how Luxembourg tax law would be applied. Such confirmation was issued by the Luxembourg tax authority by letter of 17 September 2009, constituting an APA[146].

3.4.3: EC Investigation and Decision

In December 2015, the EC notified Luxembourg that it would start preliminary investigations under Article 108(2) TFEU after taking the view that the APA constituted State aid within the meaning of Article 107(1) TFEU. The EC contested that the APA's interpretation of the Luxembourg-US double tax treaty, and Luxembourg's subsequent endorsement thereof, granted a selective advantage to McD Europe and was therefore incompatible with the internal market. In its investigation, the EC's focus was once again centred around the Court of Justice's three-step analysis for determining if a measure is selective in nature. As a first

[145] Ibid C258/39, 40.
[146] Ibid C258/40.

step, the EC defined the reference framework as the general Luxembourg corporate income tax system which also included the double taxation treaties to which Luxembourg is a party. As a second step in its investigation, the EC considered whether the APA was a derogation of that reference framework leading to an advantage for McD Europe as compared to similar companies. If that was found to be the case, and if no justification existed for that derogation, then the APA would constitute a selective advantage.

The EC's initial position was that Luxembourg should not have endorsed the APA and exempted the profits of McD Europe's US Franchise Branch, because they were aware that the US Franchise Branch would not constitute a permanent establishment for US tax purposes. The EC argued that Luxembourg was therefore fully aware that the branch's income *may not* be taxable in the US in accordance with the Luxembourg-US double tax treaty. Consequently, in its opening decision, the EC argued that Luxembourg had misapplied the treaty's provisions which represented a derogation from normal Luxembourg tax rules, granting an economic advantage to McD Europe.[147]

During the EC's investigation, McD Europe put forward several arguments that the EC's interpretation of the Luxembourg-US double tax treaty was flawed. McD Europe argued, inter alia, that Article 3 of the treaty confirmed that it is up to the contracting State that applies the double tax treaty to interpret it by reference to its own legal system. Hence, in this case, it was for the Luxembourg tax administration to interpret the double tax treaty by reference to its own legal system, and to consider that the US Franchise Branch constituted a permanent establishment for the purposes of the double taxation treaty[148]. Contrary therefore to what the EC asserted in its initial decision, it recognised that whether or not the Luxembourg tax

[147] *Luxembourg aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN)) Commission Decision 2019/1252 [19 September 2018] OJ L195/29.
[148] Ibid L195/32.

authority knew about the non-taxation of the US Franchise Branch in the US, was irrelevant to how the double tax treaty would be interpreted with regards to Luxembourg tax law[149].

Addressing the subject of selectivity and the question of derogation from "normal" Luxembourg tax rules, McD Europe argued that many undertakings had already benefited from the same treatment. This claim was made with reference to publicly available information from the so-called "LuxLeaks" scandal[150]. McD Europe argued that the Luxembourg authorities had followed a consistent interpretation of the Luxembourg-US double tax treaty, which was equally applicable to all taxpayers in a comparable situation within the same reference framework. Luxembourg's interpretation of the treaty was perfectly in line with the application of Luxembourg law[151].

In an ironic twist, the so-called LuxLeaks exposé showed that Luxembourg had in fact consistently applied its tax laws and interpretation of the Luxembourg-US double tax treaty to many other MNEs. Therefore, as it could not be found that the McDonald's APA was selective in nature, Luxembourg could not be found to have granted State aid to McDonald's. Hampered no doubt by the lack of transfer pricing arrangements to attack (unlike in *Apple*, *Starbucks*, and *Amazon*), the EC was forced to adopt a positive decision in this case. In September 2018, the EC found that the APA did not constitute State aid within the meaning of Article 107(1), representing a significant win for both McDonald's and Luxembourg[152].

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[149] Ibid L195/36.

[150] *LuxLeaks* or *Luxembourg Leaks* is a collaborative investigation from 2014 centred around almost 28,000 leaked confidential documents concerning advance tax rulings granted by Luxembourg to several MNEs. The International Consortium of Investigative Journalists (5 November 2014) <https://www.icij.org/investigations/luxembourg-leaks/about-project-luxembourg-leaks/> accessed 23 August 2022.

[151] *Luxembourg aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN)) Commission Decision 2019/1252 [19 September 2018] OJ L195/38.

[152] *Luxembourg aid to McDonald's* (State aid SA.38945 (2015/C) (ex 2015/NN)) Commission Decision 2019/1252 [19 September 2018] OJ L195/38.

3.5: Nike, Inc.

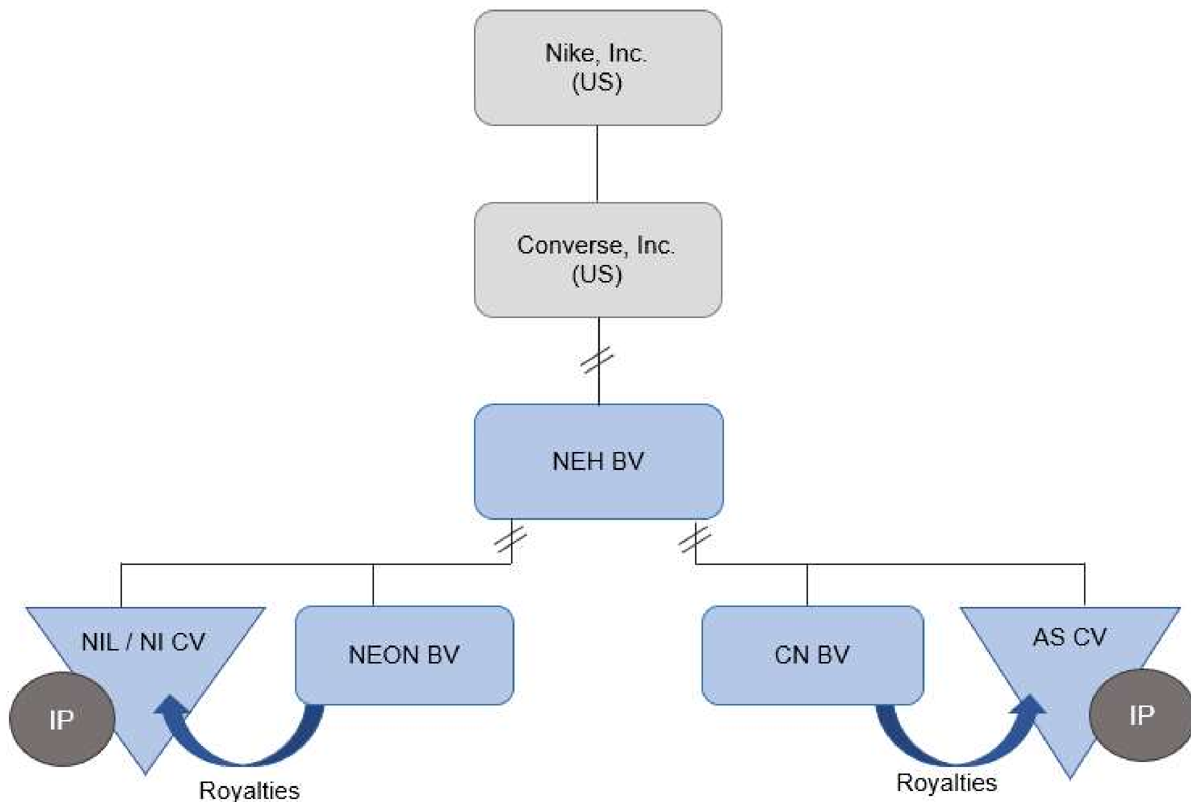
3.5.1: Corporate Structure

Nike, Inc. was incorporated in 1967 and is headquartered in Beaverton, Oregon, USA. The Nike Group is active in the design, development, manufacturing, and worldwide marketing and sales of footwear, apparel, equipment, and accessories. Nike is another world-renowned and instantly recognisable brand, inextricably linked to sports stars and athletic achievement around the globe. The company owns several famous trademarks, such as "Just Do It" and the Swoosh logo, the latter of which was registered with the US Patent and Trademark Office as far back as January 1974[153]. At the end of their 2021 financial year, Nike boasted consolidated revenues of $44.5 billion as well as approximately 73,300 worldwide employees[154]. In 2003, Nike acquired the Converse group, a rival US footwear and apparel company based in Boston, Massachusetts[155].

Between 2006 and 2015, the Nike Group's European structure was centred around several Dutch corporate entities including Nike Europe Holding B.V. ("NEH"), Nike European Operations Netherlands B.V. ("NEON"), Converse Netherlands B.V. ("CN BV"), and All Star C.V. ("AS CV"). Nike International Limited ("NIL") was a limited liability company resident in Bermuda and the owner of the Nike IP consisting of trademarks, trade names, and patents for non-US markets. Of particular importance for Nike's European operations was NEON and NIL concerning the Nike brand, and CN BV and AS CV concerning the Converse brand[156].

[153] Cait Murphy, 'A History of American Sports in 100 Objects' (Basic Books, New York 2016) p. 1973.
[154] Nike, Inc. From 10-K <https://investors.nike.com/investors/news-events-and-reports/default.aspx> accessed 13 July 2022.
[155] *Possible State aid in favour or Nike* (State aid SA.51284 (2018/NN) European Commission [5 July 2019] OJ C226/33.
[156] Ibid C226/33 – 37.

A simplified group structure chart illustrates the above relationships[157]:



Concerning the Nike brand: In 2005, NEON obtained an exclusive licence to use Nike intellectual property from NIL which allowed it to distribute Nike products in the EMEA region. Consequently, NEON paid royalty fees to NIL. NEON also performed various functions such as product design, sales management, pricing policies, inventory management, customer services, marketing management and research, advertising and promotion, sales forecasting, ordering, warehousing, treasury, and finance. Additionally, NEON negotiated and concluded sponsorship endorsements with prospective sports clubs and individual athletes[158].

NIL was established in 1980. Its management board consisted of either Bermuda- or US-resident persons. All management decisions were made outside of the Netherlands. Even

[157] Ibid C226/34.
[158] *Possible State aid in favour or Nike* (State aid SA.51284 (2018/NN) European Commission [5 July 2019] OJ C226/35.

though it was the owner of certain Nike IP, the company had no direct employees. Several Nike, Inc. headquarter employees were appointed as authorised managers to run the day-to-day business. The IP licensing agreement between NIL and NEON commenced in June 2005, and was amended in June 2008. In 2015, NIL transferred all IP assets to a new Dutch LP, Nike International C.V. ("NI CV") which essentially took over NIL's role. NI CV was considered transparent for Dutch tax purposes and therefore not subject to Dutch corporate income tax[159].

As a consequence of the IP licensing agreement, NEON's net profit was effectively fixed at a level between 2% and 5% of its revenue. Between 2007 and 2017, this meant that on average, around 75% of NEON's operating profits were paid to NIL / NI CV as royalties for use of the Nike IP, thereby reducing its taxable income in the Netherlands by this amount[160].

Concerning the Converse brand: Converse, Inc. was bought by Nike, Inc. in 2003. Up until 2010, Converse sales in the EMEA region were concluded primarily via third-party distributors. CN BV played only a minor role. The business was restructured in 2010 with the promotion of CN BV as the Converse headquarters in Europe, and the establishment of AS CV. CN BV thereafter took on all trading and distribution activities concerning Converse branded products[161]. CN BV's activities included regional headquarter functions, marketing management, sales management, ordering, warehousing, distribution, establishing product pricing policies, adapting designs to local market needs, as well as bearing the inventory risk, marketing risk and other business risks. Prior to 2010, CN BV licenced Converse IP directly from Converse, Inc. This included Converse trademarks, trade names, and patents.

AS CV is an LP established in the Netherlands in 2010. Its partners are not resident in the Netherlands making it transparent for Dutch tax purposes, and not subject to Dutch corporate

[159] Ibid C226/37.
[160] *Possible State aid in favour or Nike* (State aid SA.51284 (2018/NN) European Commission [5 July 2019] OJ C226/36, 37.
[161] Ibid C226/39.

income tax. The Netherlands Chamber of Commerce lists the registered address as Beaverton, Oregon, which is the same corporate address used by Nike, Inc. in the US[162]. Since the 2010 restructure up until 2015, AS CV licensed the Converse IP from Converse, Inc. which it in turn sub-licensed to CN BV. In 2015, the Converse IP was transferred from Converse, Inc. to AS CV. This meant that since 2015, AS CV licenced the Converse IP directly to CN BV[163].

Like the above situation with NEON, the taxable profit for CN BV was effectively fixed at a level between 2% and 5%, with any profit above this mark being paid to AS CV as royalties for use of the Converse IP. These royalty payments consequently reduced CN BV's taxable income in the Netherlands[164].

Nike had succeeded in creating a vast European network represented by the Dutch entities NEON BV and CN BV. The company had also succeeded in creating entities not subject to taxes in any jurisdiction (NIL/NI CV and AS CV) and a mechanism for shifting profits to these entities.

3.5.2: Advance Pricing Agreements

The Nike Group had concluded five different APAs with the Dutch tax authority: three with NEON (concerning the Nike brand) and two with CN BV (the Converse brand). The five APAs all endorsed transfer pricing arrangements which determined the royalty fees payable by NEON and CN BV, to NIL (which was later replaced by NI CV) for use of the Nike and

[162] KVK.nl <https://www.kvk.nl/zoeken/handelsregister/?handelsnaam=&kvknummer=32168356&straat=&postcode=&huisnummer=&plaats=&hoofdvestiging=1&rechtspersoon=1&nevenvestiging=1&zoekvervallen=0&zoekuitgeschreven=1&start=0> accessed 15 July 2022.
[163] *Possible State aid in favour or Nike* (State aid SA.51284 (2018/NN) European Commission [5 July 2019] OJ C226/41.
[164] Ibid C226/43.

Converse IP, respectively. The level of those royalties in turn determined the taxable profit, and thus the corporate income tax liability, of both NEON and CN BV in the Netherlands[165].

The three APAs concerning NEON were concluded in 2006, 2010, and 2015, following separate requests made to the Dutch tax authority. All three APAs endorsed the level of royalties that NEON was to pay NIL / NI CV[166] for use of IP rights: NEON's remuneration would be a fixed percentage between 2% and 5% of its total revenue, with the remaining profit being paid to NIL / NI CV representing the royalty fee. Each successive request included progressively more detailed analysis to substantiate NEON's proposed transfer pricing arrangements concerning the royalty fees. Nike's request to the Dutch tax authority in 2006 included a comparability study which identified other independent wholesalers of sportswear and related products similar to those of Nike. That study was used as a benchmark for NEON's remuneration and the resulting royalty fee, claiming that it resulted in an arm's length range. The study did not however include justification or reasoning regarding the choice of the transfer pricing method, nor did it include an analysis of the functions performed by NEON and NIL other than stating that NEON performed "routine functions" which justified the fixed level of remuneration of 2% to 5% of revenue[167].

Nike's request in 2010 proved more substantial: included in the request to the Dutch tax authority was a transfer pricing report which explained that the transactional net margin method (TNMM) was selected due to missing transactional data for transactions between affiliates. The request also included an updated functional analysis, which asserted inter alia that as NIL was the legal owner of the Nike IP, it bore all the risks associated therewith,

[165] *Possible State aid in favour or Nike* (State aid SA.51284 (2018/NN) European Commission [5 July 2019] OJ C226/42.
[166] The APAs concern IP licensing agreements between NEON and NIL in 2006 and 2010, and between NEON and NI CV in 2015 after NI CV had effectively replaced NIL.
[167] *Possible State aid in favour or Nike* (State aid SA.51284 (2018/NN) European Commission [5 July 2019] OJ C226/42.

notwithstanding the fact that NEON was responsible for marketing functions[168]. The 2015 request was similar to that of 2010, but more substantial with regards to the explanation and choice of the transfer pricing method selected. That request also included a transfer pricing report, functional analysis of the entities, and a comparison study to calculate the arm's length remuneration of NEON. All three requests of 2006, 2010, and 2015, had the stated purpose to "document an arm's length return for activities performed by NEON under a licence of intellectual property".

The two APAs concerning CN BV were concluded with the Dutch tax authority in 2010 and 2015 respectively, and mirror to a great extent the three APAs in favour of NEON.

3.5.3: EC Investigation and Decision

The EC had been reviewing Nike's five APAs since 2014, and in January 2019 the provisional conclusion was that the APAs constituted unlawful State aid within the meaning of Article 107(1) TFEU. A formal investigation procedure was then initiated under Article 108(2) TFEU[169]. As basis for this provisional conclusion, the EC put forward three arguments in a similar vein to the *Apple*, *Starbucks*, and *Amazon* cases. Firstly, the EC took the view that the APAs incorrectly endorsed the premise that NEON and CN BV had only performed "routine" distribution functions, as per the various functional analyses put forward by Nike. The EC took the contrasting view that these two companies performed more unique and valuable functions in relation to the Nike and Converse IP assets than the functions performed by the IP-holding entities, NIL/NI CV and AS CV. The application of the chosen TNMM transfer pricing method should therefore necessarily have resulted in a larger remuneration for

[168] Ibid C226/43.
[169] *Possible State aid in favour or Nike* (State aid SA.51284 (2018/NN) European Commission [5 July 2019] OJ C226/65.

NEON and CN BV. This, the EC provisionally concluded, improperly reduced the companies' taxable income in the Netherlands and thereby constituted an advantage.

Secondly, the EC questioned the appropriateness of the choice of transfer pricing method used to determine an arm's length level of remuneration between NEON and NIL/NI CV (concerning the Nike brand), and between CN BV and AS CV (the Converse brand). The EC expressed doubt as to whether the TNMM was the most reliable method, arguing that Nike's own transfer pricing reports indicated comparable uncontrolled transactions that could have been used in a more direct and reliable method, such as the CUP method.

Thirdly, the EC expressed doubt that using total revenues as the basis for calculating NEON's and CN BV's remuneration was correct. The EC held that the fixed percentage set between 2% and 5% should rather have been calculated on only a portion of NEON's and CN BV's respective revenues[170].

These errors in the choice and application of transfer pricing methodology was cause for sufficient doubt that the APAs endorsed a level of royalty fees that reliably approximated arm's length prices. An extract from the EC's press release dated January 2019:

> *"As a result of the [APAs], Nike European Operations Netherlands BV [NEON] and Converse Netherlands BV [CN BV] are only taxed in the Netherlands on a limited operating margin based on sales. At this stage, the Commission is concerned that the royalty payments endorsed by the rulings may not reflect economic reality. They appear to be higher than what independent companies negotiating on market terms would have agreed between themselves in accordance with the arm's length principle".*[171]

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[170] Ibid C226/52.

[171] European Commission Press Release IP/19/322, 'State aid: Commission opens in-depth investigation into tax treatment of Nike in the Netherlands' (10 January 2019), https://ec.europa.eu/commission/presscorner/detail/en/IP_19_322.

At the time of writing the EC has not yet reached a Decision on whether the APAs constitute unlawful State aid under Article 107(1) TFEU. However, judging from similarities of the facts in this case with those of *Apple*, *Starbucks*, and *Amazon*, it appears likely that the EC will indeed reach a negative Decision and order the Netherlands to recoup foregone tax revenues from both NEON and CN BV.

3.6: Summary

The corporate structures of the five MNEs analysed in this chapter are dissimilar in design, yet share fundamental similarities in achieving the same result. Apple took advantage of Irish company- and tax laws with the ingenious use of company branches, housing their valuable IP in corporate vehicles that were neither taxable in Ireland, where they were incorporated, nor in the US, where they were headquartered. Starbucks, Amazon, and Nike all used a series of limited partnerships to house their IP in entities that had no European tax footprint, using the applicable tax transparency rules to full effect. McDonald's, much like Apple, took advantage of Luxembourg company- and tax laws and strategically placed company branches, which allowed it to operate in the EU while being considered exempt from taxes.

In all five cases, the MNEs relied on their unique IP as the instrument for shifting profits out of the EU. Another common thread in these five cases is the exploitation of regulatory mismatch between the EU and the US; where the EU considers an entity to be resident and taxable in the US, the US does not. All five of our MNEs achieved double non-taxation, and all five had their double non-taxation schemes legitimised by a Member State; the respective tax administrations of the Netherlands, Luxembourg, and Ireland, all sanctioned and endorsed the complex tax-optimising practises by way of advance tax agreements.

Apart from the *McDonald's* case, all APAs endorsed the use of transactional profit methods (such as the TNMM) for determining transfer prices, methods inherently less accurate than traditional transaction methods (such as the CUP method). A notable difference in the various APAs granted to Apple, Starbucks, Amazon, and Nike, lies in the quality of supporting documentation that substantiated each request for an advance tax ruling. Apple's request to the Irish tax authority in 1991 contained neither a profit allocation study nor a transfer pricing report. Very little analysis was done to find an appropriate arm's length level of the royalty other than a cursory comparison of profits across industries. Apple's own tax advisor at the time confessed that there was no scientific basis for the proposed amount of profits allocated to the operating business[172]. The APA was concluded predominantly by way of negotiation with the Irish tax authority, rather than being substantiated by reference to any comparable transactions. In stark contrast to this stand the APAs concerning Starbucks, Amazon, and Nike. These three MNEs had all included comprehensive transfer pricing reports and related analyses to substantiate their proposals to the relevant tax authorities. Nike's proposals increased in complexity from 2006 through to 2010 and 2015, and Amazon's request for an APA included specific reference to Transfer Pricing Guidelines prepared by the OECD.

Of the five MNEs analysed in this chapter, McDonald's stands apart in that the APA it concluded with Luxembourg contained no mention of the company's intellectual property, a fact that seems counterintuitive given the ubiquitous and instantly recognisable brand. As McDonald's operates primarily as a franchisor, its business model is different to those of Apple, Starbucks, Amazon, and Nike. Consequently, there was no IP licensing agreement, no royalty fees related to the use of IP assets, and therefore no need to find an arm's length transfer price. McDonald's' APA concerned solely the tax treatment of its Luxembourg operating company.

[172] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/11.

Both the similarities and differences in the various APAs discussed above are reflected in the EC's investigative approach, as well as the Decisions eventually adopted in each case. Apple, Starbucks, and Amazon were all found guilty of receiving unlawful State aid from Ireland, the Netherlands, and Luxembourg respectively. In all three cases, the EC relied on the arm's length principle as a metric to determine whether the APAs derogated from normal national tax rules, thereby indicating a selective advantage. The EC applied the arm's length principle even when that principle did not specifically form part of the national tax code, as was the case with Ireland and *Apple*[173]. In order to assess whether the level of royalty fees endorsed by the APAs adhered to the arm's length principle, the EC analysed the transfer pricing methodologies used in each case. Here once again, the EC's findings and angle of attack proved similar in all cases:

i) <u>Functional analyses disputed</u>

The EC held that the various APAs were based on incorrect assumptions as to the different functions performed by the operating- and IP-holding companies. For example, Amazon's APA endorsed royalty fees payable by LuxOpCo to LuxSCS based on the assumption that LuxOpCo performed only routine functions. This justified the vast disparity in the level of profits allocated between the two companies. In all three cases, the EC held that the operating companies performed more unique and valuable functions than what had been claimed.

ii) <u>Errors in transfer pricing methodology</u>

In each case, the EC found that the level of royalty fees payable for the use of IP assets resulted from transfer pricing methods that were either inappropriately selected, incorrectly applied, or critically unsubstantiated. The EC found numerous

[173] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/48.

errors in the choice and application of transfer pricing methodologies which it held was a clear indication that royalty fees were not set at an appropriate arm's length level. Such errors therefore proved sufficient derogation from the normal tax rules for the EC to find evidence of selective advantage.

iii) Commercial substance of IP-holding companies

The EC criticised ASI and AOE for Apple, Alki for Starbucks, and LuxSCS for Amazon, stating that these companies had no commercial substance or business purpose other than holding legal title to the respective IP assets. The EC criticised the fact that none of these entities had any physical presence or direct employees, arguing that they could not therefore have performed the valuable functions attributed to them. In *Starbucks* and *Amazon*, the EC went as far as asserting that neither Alki nor LuxSCS had effectively exploited the respective IP assets, and were merely passive owners. This led the EC to conclude that royalty fees related to the use of these IP assets were necessarily overstated.

No Decision has yet been reached in the *Nike* case, however the similarities in the EC's investigative approach is plain to see: disagreement with the functional analysis of the operating companies (NEON, CN BV) and IP-holding entities (NIL / NI CV, AS CV), criticism of the choice and application of transfer pricing methodology relating to IP royalties, and the assertion that the IP-holding entities lacked commercial substance.

Chapter 4: The European General Court and the Burden of Proof

Unsurprisingly, Apple, Starbucks, and Amazon all appealed the negative Decisions against them, challenging the substantial amounts that each had been ordered to pay for receiving unlawful State aid. The three MNEs were supported by Ireland, the Netherlands, and Luxembourg respectively – those Member States ordered to recover the supposed State aid amounts. The appeals would put to the test the EC's use of State aid provisions in the fight against tax avoidance in the common market.

Article 263 TFEU grants any natural or legal person the possibility, inter alia, to request a review of the legality of acts of the EC which is addressed to that person. The European General Court ("GC"), a constituent court of the Court of Justice of the European Union, is the competent court in such cases and therefore has jurisdiction to hear and determine actions so brought against the EC. In this chapter, the judgments handed down by the GC in the *Starbucks*, *Apple*, and *Amazon* cases are discussed in chronological order.

4.1: GC Judgment – Starbucks

The EC found the Netherlands guilty of providing unlawful State aid to Starbucks on 21 October 2015[174]. In December 2015, the Netherlands brought action against the EC seeking annulment of that Decision[175]. In September 2016, Starbucks followed suit[176]. The two actions for annulment called into question the EC's examination of the APA, arguing that the analysis leading to the conclusion of a selective advantage was erroneous.

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[174] *Netherlands State aid to Starbucks* (State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/502 [2015] OJ L83/114.

[175] Case T-760/15: Action brought on 23 December 2015 — *Netherlands v Commission* (15 February 2016) OJ C59, p. 50–51

[176] Case T-636/16: Action brought on 5 September 2016 — *Starbucks and Starbucks Manufacturing Emea v Commission* (12 December 2016) OJ C 462, p. 25–25

In its judgment, the GC first focused on the question of whether the arm's length principle can legally be applied in the examination of an APA in the context of State aid law. The Netherlands argued that the arm's length principle does not form part of EU law, nor should EU law be used to examine an APA since only the national laws of the Member State concerned are applicable for the enforcement of State aid under Article 107(1) TFEU[177]. This application of EU law to national laws, argued Starbucks and the Netherlands, amounted to a veiled attempt at harmonising national laws which encroached on Member States' fiscal autonomy[178].

The GC referred to settled case law[179] which holds that while direct taxation falls within the exclusive competence of the Member States, that competency must be exercised consistently with EU law. Citing further case law, the GC confirmed its view that an economic advantage in terms of a tax measure can only be established when compared to "normal" taxation[180]. Therefore, the fiscal position of the recipient of a tax measure needs to be compared with his position in the absence of that measure. In the context of determining the fiscal position of an integrated group company within an MNE, the GC noted that the pricing of intra-group transactions is not determined by external market conditions. Where there is no difference in national tax laws concerning the corporate taxation of integrated companies as opposed to stand-alone companies, if follows that such tax laws are intended to tax integrated companies as though their profits had arisen from transactions carried out at market prices[181]. For the purpose of examining a tax measure under Article 107(1) TFEU, the GC therefore held that the EC could compare the fiscal burden of an integrated company under said tax measure, with the fiscal burden of a stand-alone company operating under market conditions if placed

[177] Case T-760/15: Action brought on 23 December 2015 — *Netherlands v Commission* (15 February 2016) OJ C59, p. 50–51
[178] Judgment of 24 September 2019, Netherlands and Starbucks v European Commission (Cases T-760/15 & T-636/16, ECLI:EU:T:2019:669) paras. 131-136.
[179] Judgment of 12 July 2012, *Commission v Spain* (C-269/09, EU:C:2012:439) para. 47 and the case-law cited.
[180] Judgment of 24 September 2019, Netherlands and Starbucks v European Commission (Cases T-760/15 & T-636/16, ECLI:EU:T:2019:669) para. 146.
[181] Ibid paras. 148 -149.

in a comparable factual situation. Put differently, the EC can check whether the pricing endorsed by a tax measure corresponds to prices that would have been charged under market conditions[182]. The arm's length principle is consequently merely a tool for determining if a tax measure resulted in an advantage in terms of Article 107(1) TFEU. The EC had not exceeded its powers conferred on it by that Article, and was therefore vindicated in its use of the arm's length principle to investigate APAs in terms of State aid provisions[183].

While this outcome certainly represented a victory for the EC, the GC did however highlight the innate difficulties of using the arm's length principle as a tool, and touched on the immense burden of proof that the EC faces in that regard. In its judgment, the GC stated that the EC will only be able to identify an advantage within the meaning of Article 107(1) TFEU if it is able to show that the variation in a company's taxable profit pursuant to an APA on the one hand, and a reliable approximation of taxable profit under market conditions on the other, goes beyond the inherent inaccuracies of the methodology used in obtaining that approximation[184]. The GC therefore accepts some margin for error in the application of a transfer pricing methodology, and tasks the EC with the burden of proving that any identified differences exceed that margin.

In its examination of the *Starbucks* case, the GC scrutinised the different lines of reasoning put forward by the EC in their finding that the APA conferred a selective advantage. Concerning the choice of appropriate transfer pricing method (the first line of reasoning) the EC's assertion that one transfer pricing method is more appropriate than another, without a detailed comparison being carried out with the result that would have been obtained using that other method, does not necessarily demonstrate the existence of an advantage. The GC held

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[182] Ibid para. 153.
[183] Ibid para. 160.
[184] Judgment of 24 September 2019, Netherlands and Starbucks v European Commission (Cases T-760/15 & T-636/16, ECLI:EU:T:2019:669) para. 152.

that the mere identification of errors in the choice or application of a transfer pricing method, does not suffice for the application of Article 107(1) TFEU[185].

Following a similar tack, the GC then examined the EC's second line of reasoning that no royalties should have been paid by SMBV to Alki for the use of the latter's IP assets. The EC had argued that as SMBV did not exploit the IP directly on the open market, it should not rationally have paid any royalty fees to Alki. This argument was not upheld by the GC, which found that using the IP was a necessary part of SMBV being able to exercise its economic activity, namely the production of roasted coffee according to Starbucks' specifications. SMBV's royalty payments to Alki was therefore not devoid of economic rationality[186]. The GC also found fault with the EC's comparability analysis whereby ten similar manufacturing contracts between Starbucks and other competitors were analysed, to show that third party entities in comparable situations did not pay any similar royalty fees. The GC examined each one of these ten contracts, and found that only a single agreement was in fact comparable to that between SMBV and Alki. The GC was therefore unconvinced of the EC's finding that the royalty fees paid by SMBV should have been zero[187].

The EC's final line of reasoning revolved around errors that it had identified with regards to the functions performed by SMBV. These errors, it argued, led to an erroneous application of the chosen transfer pricing method which could not therefore have resulted in an appropriate arm's length approximation of royalty fees. As the use of that transfer pricing method led to a reduction of SMBV's tax liability, and as it was endorsed by the APA, the EC found that a selective advantage was conferred on SMBV for the purposes of Article 107(1) TFEU. To this line of reasoning the GC once again emphasised the strict burden of proof that needs to be met in matters concerning State aid:

[185] Ibid paras. 210 – 212.
[186] Ibid paras. 257 – 262.
[187] Ibid para. 345.

"...the mere finding of non-observance of the methodological requirements for the determination of transfer pricing is not sufficient to establish that there is State aid within the meaning of Article 107 TFEU. The [EC] must also demonstrate that the methodological errors that it identified do not enable an approximation of an arm's length outcome to be reached and that they resulted in a reduction of the taxable profit compared to a profit that would have been calculated in accordance with the arm's length principle"[188].

In its 2015 Decision, the EC merely asserted that the errors it had identified in the application of SMBV's chosen transfer pricing methodology led to a reduction in taxable profit. No further reasons were given, and no assessment of how the identified errors did not enable an appropriate approximation of an arm's length outcome. Without proof to the contrary, it cannot be said that even a flawed application of a given transfer pricing methodology could not enable an arm's length outcome to be achieved[189].

In a blow to the European Commission, the GC ruled that none of the lines of reasoning followed in the 2015 Decision sufficiently demonstrated that the APA had conferred a selective advantage within the meaning of State aid provisions in Article 107(1) TFEU. In September 2019, the GC annulled that Decision in its entirety[190].

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[188] Judgment of 24 September 2019, Netherlands and Starbucks v European Commission (Cases T-760/15 & T-636/16, ECLI:EU:T:2019:669) para. 427.
[189] Ibid para. 436.
[190] Ibid paras. 559 – 563.

4.2: GC Judgment – Apple

Apple's negative Decision was handed down by the EC in August 2016[191]. By the end of the year, both Ireland and Apple had brought actions for annulment of that Decision under Article 263 TFEU, losing no time in appealing the monstrous amount that Ireland had been ordered to recover from ASI and AOE[192] [193]. As in the *Starbucks* case above, Ireland and Apple had disputed the EC's use of State aid provisions in the assessment of national tax matters, arguing that it encroached on Member States' fiscal autonomy. The GC made quick work of this argument, citing the same settled case-law as it had in its *Apple* judgment[194] to again find that the EC was justified in using the arm's length principle as a tool to examine the appropriateness of a tax measure within the ambit of State aid provisions. This vindication for the EC aside, the GC then focused on the remaining pleas in law as described in the two actions for annulment.

In its first and primary line of reasoning, the EC contended that all profits derived from the exploitation of Apple's IP assets should rather have been allocated to the Irish branches of ASI and AOE, where they would have been subject to Irish taxation and not allocated to the head offices where the profits went untaxed. In examining this assertion, the GC referred to the 2010 OECD Profit Attribution Report[195] which defines when and how profits are allocated between branch and head office. In that report, it is necessary to establish the functions performed, risks incurred, and assets employed by each company so that profits can be allocated accordingly. The EC argued that the IP assets should have been allocated to the Irish

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[191] *State aid implemented by Ireland to Apple* (State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP)) Commission Decision 2017/1283 [2016] OJ L187/109.

[192] Case T-778/16: Action brought on 9 November 2016 — *Ireland v Commission* (6 February 2017) OJ C 38, p.35 & 36.

[193] Case T-892/16: Action brought on 19 December 2016 — *Apple Sales International and Apple Operations Europe v Commission* (20 February 2017) OJ C 53, p37 – 39.

[194] Judgment of 12 July 2012, *Commission v Spain* (C-269/09, EU:C:2012:439) para. 47 and the case-law cited.

[195] OECD (2010), '2010 Report on the Attribution of Profits to Permanent Establishments' (22 July 2010, Centre for Tax Policy and Administration) available at < https://www.oecd.org/ctp/transfer-pricing/45689524.pdf>. The 2010 OECD Profit Attribution Report describes the Authorised OECD Approach to the application of the arm's length principle as per the OECD Transfer Pricing Guidelines in order to allocate profits to a permanent establishment.

branches based on the assumption that the head offices were incapable of managing the assets, but not based on any assessment of whether the branches had actually performed the activities related to management and control of the IP assets. The GC therefore found that the EC had incorrectly applied a functional analysis of the activities performed by the branches with regards to the OECD approach, which was mirrored in Irish tax law. It follows that neither ASI nor AOE had derogated from the normal tax rules which meant that the EC's first line of reasoning was found to be without merit[196].

The second line of reasoning focused on the EC's assessment that errors in the profit allocation method endorsed by the APA had not led to arm's lengths profits, and had thereby conferred an advantage to ASI and AOE[197]. Mirroring the *Apple* case, the GC reiterated its view, citing OECD Transfer Pricing Guidelines, that merely identifying methodological errors is in itself insufficient to demonstrate that a tax measure has conferred a selective advantage. The EC is faced with the additional burden of proof to also demonstrate that those errors have led to a reduction in the tax burden faced by the company, compared to the tax burden it would have faced in the absence of such a tax measure[198]. The GC noted that the EC had not put forward any evidence to prove that the errors which it had identified had resulted in a reduction of chargeable profits for either ASI or AOE[199]. Apple's assertion that the Irish branches of ASI and AOE performed more complex functions than what the APA endorsed, was made without providing any evidence to the fact[200]. The GC therefore ruled that the EC had failed to show to the requisite legal standard that the errors it had identified had led to an advantage within the meaning of Article 107(1) TFEU[201].

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[196] Judgment of 15 July 2020, Ireland aid to Apple (Cases T-778/16 & T-892/16, ECLI:EU:T:2020:338) paras. 241 – 245.
[197] Ibid para. 318.
[198] Ibid para. 319.
[199] Ibid para. 333.
[200] Ibid para. 340.
[201] Ibid paras. 479 – 481.

The clearest indication of the immense burden of proof that the EC faces can be inferred from the GC's judgment concerning the glaring lack of information in support of the APAs. The 1991 and 2007 APAs were endorsed without any transfer pricing reports, functional analyses, profit allocation reports, or any other additional information to support the transfer pricing arrangements. The EC, perhaps logically so, argued that this lack of documentary support could not possibly have led to a level of royalty fees that resembled arm's length transactions on the open market. The mere identification of this error without any supporting evidence, self-evident as it may have been, was still insufficient for the purposes of Article 107(1) TFEU. In the words of the GC:

> "*...the [EC] has not submitted any evidence in connection with its subsidiary line of reasoning to demonstrate that such a methodological defect, resulting from the lack of information submitted to the Irish tax authorities, led to a reduction in the tax base of ASI and AOE as a result of the application of the contested tax rulings.*[202]"

As well as:

> "*…the [EC] did not conduct its analysis in such a way as to demonstrate that, as a result of that calculation, the tax actually paid by ASI and AOE on the basis of the contested tax rulings was less than that which should have been paid under the normal rules of taxation, had the contested tax rulings not been issued.*[203]"

In July 2020, less than a year since the *Starbucks* ruling, the GC held that the EC had not succeeded in showing that the Irish tax authorities had conferred a selective advantage on ASI and AOE for the purposes of Article 107(1) TFEU. Another significant blow was dealt to the

[202] Judgment of 15 July 2020, Ireland aid to Apple (Cases T-778/16 & T-892/16, ECLI:EU:T:2020:338) para. 350.

[203] Ibid para. 434.

EC as its €13 billion Decision was annulled with costs[204]. While the EC accepted the *Starbucks* judgment, it appealed the General Court's judgment in the above case on 25 September 2020. As of the time of writing, the case is still ongoing[205].

4.3: GC Judgment – Amazon

The EC charged Luxembourg with granting unlawful State aid to Amazon in October 2017. In December of 2017, Luxembourg brought an action for annulment of that Decision under Article 263 TFEU, followed by Amazon some months later in May 2018[206]. The two actions for annulment disputed the separate lines of reasoning that the EC followed in its conclusion of the existence of a selective advantage. The judgment follows a familiar pattern: firstly, the GC set out the conditions under which a national tax measure may fall foul of State aid provisions per Article 107(1) TFEU[207]. Secondly, the GC noted the strict burden of proof that the EC must overcome[208]. Lastly, the GC analysed the EC's separate lines of reasoning to ascertain if the finding of a selective advantage was established to the requisite legal standard.

The EC's first line of reasoning focused on the functional analysis of LuxSCS and LuxOpCo. The EC held inter alia that LuxSCS did not perform "unique and valuable" functions in relation to Amazon's IP assets for which it held legal title. The chosen transfer pricing method was therefore incorrectly applied, leading to an outcome that was not in line with the arm's length principle. This argument was not upheld by the GC, which rather found that that Amazon's IP constituted a unique and valuable contributor that enabled Amazon to thrive in a competitive market characterised by narrow margins. The GC was instead convinced by

[204] Ibid paras. 505 – 509.
[205] Case C-465/20 P: Appeal brought on 25 September 2020 – *Ireland and Others v Commission* (1 February 2021) OJ C 35, p22 & 23.
[206] Judgment of 12 May 2021, Luxembourg aid to Amazon (Cases T-816/17 & T-318/18, ECLI:EU:T:2021:252)
[207] Ibid paras. 114 – 124.
[208] Ibid paras. 125 – 129.

Amazon's argument that its IP was an asset for which no comparable existed[209]. It could therefore not be said that LuxSCS did not exploit the IP, regardless of the fact that it had no employees[210]. Furthermore, the level of remuneration for LuxSCS that the EC had proposed in their 2017 Decision was found to be arbitrary, vitiated with errors, and insufficiently reliable in achieving an arm's length outcome[211].

The second line of reasoning that the EC followed focused on three errors which it argued had led to an incorrect choice and application of transfer pricing method. Before assessing these alleged errors, the GC referred to the EC's own assertion that after identifying the errors, it had not attempted to determine a precise arm's length remuneration for LuxOpCo – yet another allusion to the strict burden of proof which needs to be met[212]. The GC's assessment of the three methodological errors returned mixed results, in some cases agreeing with the EC's conclusions, and other cases not. Regardless of these findings, the GC criticised the EC in making assumptions about what LuxOpCo's remuneration would have been under a different transfer pricing method, without seeking to apply that method in a detailed analysis[213]. The EC had not demonstrated the existence of an advantage, but had, at most, demonstrated the probability of the existence of an advantage[214].

In May 2021, the GC annulled the EC's 2017 Decision for failing to demonstrate to the requisite legal standard that the APA had conferred an advantage within the meaning of Article 107(1) TFEU. The EC had found methodological errors in the calculation of LuxOpCo's remuneration without showing that those errors had the effect of artificially reducing LuxOpCo's remuneration to such an extent that it could not have occurred under

[209] Judgment of 12 May 2021, Luxembourg aid to Amazon (Cases T-816/17 & T-318/18, ECLI:EU:T:2021:252) paras. 190 – 192.
[210] Ibid para. 218.
[211] Ibid para. 296.
[212] Ibid para. 313.
[213] Ibid para. 517.
[214] Ibid para. 520.

normal market conditions[215]. In July 2021, the EC appealed the judgment; as of the time of writing, the case is ongoing[216].

4.4: Summary of GC Judgments and Nike

The judgments in *Starbucks*, *Apple*, and *Amazon* show a consistent approach by the General Court which mirrors the similarities between those cases. In all three cases, the EC had argued that royalty payments related to intellectual property assets were not indicative of arm's length prices, because the methods used to determine the value of those payments were fraught with errors. In all three cases, the EC held that the erroneous choice or application of a transfer pricing methodology constituted sufficient proof that that method did not deliver a reliable approximation of prices that would have been established under competitive market conditions, necessarily an indication of a selective advantage. In none of the three cases however did the EC succeed in showing that the purportedly erroneous transfer pricing methods had indeed led to an outcome that did not approximate an arm's length outcome. The GC has made it abundantly clear that any infringement had to be established, no merely presumed.

In order to successfully show that *Nike* had received a selective advantage from the APAs granted by the Netherlands, the EC therefore needs meet the strict burden of proof. Quoting the GC in the *Amazon* judgment:

> *"…when the [EC] applies the arm's length principle to check whether the taxable profit of an integrated undertaking pursuant to a tax measure (first comparable) corresponds to a reliable approximation of a taxable profit generated under market conditions (second comparable), the [EC] can identify an advantage within the*

[215] Ibid paras. 587 – 592.
[216] Case C-457/21 P: Appeal brought on 22 July 2021 – *Luxembourg and Amazon v Commission* (8 November 2021) OJ C 452, p10 & 11.

meaning of Article 107(1) TFEU only if the variation between the two comparables goes beyond the inaccuracies in the methodology used to obtain that approximation.

It follows that, to demonstrate that an advance tax ruling used to calculate an undertaking's remuneration confers an economic advantage, the Commission must prove that that remuneration deviates from an arm's length outcome to such an extent that it cannot be regarded as remuneration that would have been received on the market under competitive conditions.[217]*"*

In *Starbucks*, *Apple*, and *Amazon*, the EC had stopped short of showing that the transfer pricing methodologies, though ostensibly erroneous in choice and application, did not in fact lead to an outcome that could have been considered arm's length. This lack of evidence constitutes the immense burden of proof faced by the EC. Even in extreme cases such as *Apple*, where there was an almost complete lack of evidence that the APA led to an arm's length royalty fee for the use of Apple's IP, the EC did not provide sufficient proof that the APA *did not* lead to an arm's length royalty fee. Absence of evidence is not evidence of absence. The onus is therefore on the EC to prove a negative, a requirement made all the more difficult by the unique nature of intellectual property assets and the wide range of acceptable transfer prices that may be applicable to them.

Based on the similarities in the EC's approach to all the cases discussed above, it appears likely that the EC will also find that Nike had received unlawful State aid from the Netherlands in terms of Article 107(1) TFEU. The EC had put forward familiar arguments in its initial Decision to investigate Nike's APAs: error in the choice and application of a transfer pricing method; erroneous analysis of the functions performed by the various companies;

[217] Judgment of 12 May 2021, Luxembourg aid to Amazon (Cases T-816/17 & T-318/18, ECLI:EU:T:2021:252) paras. 307 – 308.

error in assuming that the IP-holding companies performed unique and valuable functions; criticising the IP-holding companies for not having any employees nor performing any economic activities[218]. As at the time of writing, the EC has not yet reached a Decision, however from the above it appears reasonable that it could find Nike and the Netherlands in breach of Article 107(1) TFEU in the same vein as its Decisions in *Starbucks*, *Apple*, and *Amazon*. What remains to be seen is whether the EC will also endeavour to demonstrate that the transfer pricing methods endorsed by Nike's APAs *did not* lead to royalty payments that could be considered arm's length. The practicalities of this are questionable, given the large margin of error that transfer pricing affords MNEs, especially with regards to unique IP assets that have little or no equivalents on the open market. Coupled with the fact that the GC seems to grant MNEs a certain leeway in the choice of transfer pricing methodology in approximating the arm's length principle[219], it is unknown to what extent the EC will have to compare and evaluate transfer pricing methodologies and whether meaning comparison could even be possible.

[218] European Commission Press Release IP/19/322, 'State aid: Commission opens in-depth investigation into tax treatment of Nike in the Netherlands' (10 January 2019), https://ec.europa.eu/commission/presscorner/detail/en/IP_19_322.
[219] Sandra Marco Colino, 'The Long Arm of State Aid Law: Crushing Corporate Tax Avoidance' (Fordham International Law Journal, 44:2, 2020) p458.

Chapter 5: Representation Without Taxation

The failures of the European Commission in its attempts to police tax avoidance by US multinational enterprises through the lens of State aid provisions are plain to see. The General Court annulled the EC's Decisions in all three high-profile cases: *Starbucks*, *Apple*, and *Amazon*, due to errors and omissions in the EC's reasonings. In *McDonald's*, the simplicity of the company's corporate structure meant that the EC had no angle of attack; the arm's length principle could not have been violated simply because there was no arm's length principle to violate. Notwithstanding the monetary loss to the EU on these three cases (approaching a staggering €14 billion which is around 8% of the EU's €170 billion budget for 2022[220]) arguably the bigger blow to the EC is the fact that these MNEs as well as many others not discussed here, have essentially been vindicated in their corporate tax avoidance schemes. The corporate structures that were designed to shift profit and tax revenue away from the EU tax net have been phenomenally successful. Not only were the various schemes sanctioned by Member States, they also survived scrutiny from the GC on the legality thereof in an EU-wide context.

The novel use of State aid provisions in the fight against harmful tax practices meant that the EC could consistently apply EU rules to national tax laws, even though those national tax laws are the exclusive competency of each Member State. The use of the arm's length principle, although not specifically part of EU law, was also given the green light by the GC as an appropriate tool in the application of State aid rules. In light of this, some commentators have argued that the EC now possesses a formidable instrument with which to crack down on tax avoidance[221]. While this sentiment cannot be completely refuted, it does ignore the enormous burden of proof that the EC needs to overcome before this formidable instrument

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[220] Council of the EU Press release, 'Agreement reached on 2022 EU budget' (16 November 2021) <https://www.consilium.europa.eu/en/press/press-releases/2021/11/16/eu-budget-for-2022/> accessed a5 September 2022.

[221] Sandra Marco Colino, 'The Long Arm of State Aid Law: Crushing Corporate Tax Avoidance' (Fordham International Law Journal, 44:2, 2020) p466.

can be successfully applied. Given the vast leeway that an MNE is granted in determining a reliable approximation of arm's length prices, it seems the application of State aid provisions against national tax matters might simply not be practical.

These failures aside, the novel attempts at combating tax avoidance in the common market has delivered success in other areas, if only indirectly. Since 2014, the EC's investigations into APAs through the lens of State aid provisions have exposed the methods and extent to which MNEs and Member States sanction tax avoidance. These revelations have been a political windfall for the EC, allowing it to heavily and publicly criticise MNEs for their tax practices which it labelled as "unfair". Following the EC's Decision in 2019 on *Starbucks* for example, Commissioner Margrethe Vestager released a statement saying:

> "*All companies, big and small, should pay their fair share of tax. If Member States give certain multinational companies tax advantages not available to their rivals, this harms fair competition in the EU. It deprives the public purse and EU taxpayers of much needed funds to fight climate change, to build infrastructure, to invest in innovation…*"[222]

Political statements such as these hold sway over public sentiment; when its aggressive tax practices were being investigated, *Starbucks* suffered a boycott that directly affected its bottom line[223]. Political statements were also shrewdly included in the EC's Decisions, such as criticisms it made during the *Amazon* investigation that the IP-holding company, LuxSCS, had no physical presence or employees during the relevant period[224] and that it was an empty

[222] European Commission Statement 19/5831, 'Statement by Commissioner Margrethe Vestager' (24 September 2019).
[223] Tom Bergin, 'Starbucks suffers first UK sales drop after tax criticism' (24 April 2014, Reuters) <https://www.reuters.com/article/uk-starbuckstaxbritain-idUKBREA3N0X020140424> accessed 16 September 2022).
[224] *Luxembourg aid to Amazon* (State aid SA.38944 (2014/C) (ex 2014/NN)) Commission Decision 2018/859 [4 October 2017] OJ L153/11.

shell created solely for tax purposes[225]. While arguments such as these hold no legal footing, they undoubtedly serve to further the EC's political narrative that large MNEs are guilty of using unfair tax practices not available to everyday taxpayers. The EC has used sensationalist arguments such as these to win public opinion. Using this political clout, it has succeeded in passing a ream of new legislation both at national- and EU levels with the eye on combating tax avoidance. For example, following pressure from the EU in the years immediately prior, Ireland took steps to amend its corporate- and tax laws in January 2015 to specifically address those rules which made the *Double Irish* arrangement possible[226], i.e., rules which allowed a company to be registered in Ireland but not resident there for tax purposes, an arrangement that had been spectacularly successful for MNEs in Ireland[227].

Perhaps the most significant change to EU law stemming from the EC's investigations into harmful tax practices under State aid provisions has been the introduction of the Anti-Tax Avoidance Directive ("ATAD"). The ATAD was first was adopted in 2016 and amended in 2017[228]. It represents a separate initiative from the OECD's October 2015 work on Base Erosion Profit Shifting (BEPS), however it is designed to complement these proposals in an attempt by the EU to harmonize the adoption of anti-BEPS measures into national laws across EU Member States[229]. The Directive includes five specific measures to combat tax avoidance: limits on interest deductions, exit taxation, a general anti-abuse rule, controlled foreign company rule, and tackling hybrid regulatory mismatches. Member States were obliged to transpose the Directive into their national laws by 1 January 2019. The third instalment of the

[225] Judgment of 12 May 2021, Luxembourg aid to Amazon (Cases T-816/17 & T-318/18, ECLI:EU:T:2021:252) para. 278.
[226] Ronald A. Marini, 'Death of the "Double Irish Dutch Sandwich"? Not so Fast' (12 November 2014, The Tax Times) <https://www.thetaxtimes.com/2014/11/death-of-double-irish-dutch-sandwich.html> accessed 19 September 2022.
[227] Mark Redmond, 'Denouncing Ireland as a tax haven is as dated as calling it homophobic because of our past' (21 June 2018) <https://www.independent.ie/business/irish/denouncing-ireland-as-a-tax-haven-is-as-dated-as-calling-it-homophobic-because-of-our-past-37032219.html> accessed 19 September 2022.
[228] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (OJ L 144, 7 June 2017) p. 1–11.
[229] KPMG, 'EU Anti-Tax Avoidance Directive' (2022) <https://home.kpmg/xx/en/home/insights/2022/08/eu-anti-tax-avoidance-directive.html> accessed 22 September 2022.

Directive was proposed by the EC in December 2021 and is intended to be transposed into national law by Member States by 30 June 2023[230]. The three ATAD proposals represent a direct attempt by the EC to harmonise EU law in order to address the shortcomings identified during its State aid investigations.

It remains to be seen whether this push to harmonisation of EU rules over the last few years will be effective in fighting aggressive tax avoidance. The ATAD Directives, though a direct attempt to address specific tax avoidance practices, are reactionary in nature and not retrospective. MNEs can adapt to regulatory changes much quicker than the EC can, due in no small part to the vast resources that are made available for this task. This means that the EC will always be playing catch-up, putting it at a severe disadvantage in effectively combating harmful tax practices. As there will always be incentive for an MNE to minimise its tax bill, it follows that there will always be scope for aggressive tax planning in order to pay as little tax as legally possible. Undoubtedly the most effective way to combat aggressive albeit legal tax avoidance, would be the introduction of a truly harmonised tax law that would apply regardless of how an MNE is structured.

The concept of a minimum corporate tax rate was introduced to the EU at least as early as 1992. A report presented to the Commission of the European Communities by the Ruding Committee recommended that:

> "*a draft directive be prepared by the Commission prescribing a minimum statutory corporation tax rate of 30% in Member States for all companies, regardless of whether profits are retained or distributed*"[231].

[230] Simon Bird, 'Article: ATAD III – What is it and how will it work?' (BDO, 20 April 2022) <https://www.bdo.co.uk/en-gb/insights/tax/corporate-international-tax/atad-iii-what-is-it-and-how-will-it-work> accessed 22 September 2022.

[231] Onno Ruding, '*Executive Summary, Report of the Committee of Independent Experts on company taxation'* (March 1992, EU Commission Working Document) <http://aei.pitt.edu/8702/1/8702.pdf> accessed 22 September 2022.

While the report from 1992 failed to bring about any meaningful changes, the same sentiments are reflected nearly three decades later in the Base Erosion and Profit Shifting Project, or BEPS Project, which was spearheaded by the OECD. The BEPS Project has its origin in 2012 when it was first proposed by the OECD to the G20, an intergovernmental forum comprising the EU and 19 other influential countries. Specifically citing the various tax scandals since the 2008 global financial crisis, the BEPS Project was envisioned to limit the risk of tax avoidance by MNEs. The stated goal was to eliminate double taxation per OECD standards, but at the same time to stop facilitating double non-taxation[232]. This was borne out of an increasingly strong sense of unfairness with perceived loopholes in international tax rules that allowed MNEs to artificially, yet legally, shift their profits to low- or no-tax jurisdictions.

In 2015, the OECD/G20 BEPS Project unveiled an Action Plan detailing 15 actions with the goal of combating tax avoidance, improving the coherence of international tax rules, and ensuring greater tax transparency. By 2016, the OECD/G20 Inclusive Framework on BEPS was established to ensure greater participation by interested countries and jurisdictions in the development of standards on BEPS related matters, and to ensure that the OECD/G20 BEPS Project could be effectively monitored and implemented[233]. In January 2020, the Inclusive Framework on BEPS announced a two-pillar approach to implementing its 15-point Action Plan. By October 2021, 137 countries and jurisdictions had agreed to the global tax reform, representing more than 90% of global GDP[234]. Pillar One concerns the reallocation of profits in certain circumstances, to jurisdictions where an MNE's consumers or users are located, regardless of whether the MNE has a physical presence in those jurisdictions. Pillar Two

[232] Organisation for Economic Co-operation and Development, 'History of the G20 & BEPS' (7 June 2019, OECD) <https://www.oecd.org/tax/beps/about/> <https://www.youtube.com/watch?v=vyrzdg8kFB8> accessed 22 September 2022.

[233] OECD (2020), 'Flyer on OECD/G20 Inclusive Framework on BEPS' (2020, OECD, Paris) <https://www.oecd.org/tax/beps/flyer-inclusive-framework-on-beps.pdf> accessed 22 September 2022.

[234] Jorge Liboreiro, 'Hungary blocks EU deal on 15% minimum corporate tax' (17/06/2022, EoroNews) <https://www.euronews.com/my-europe/2022/06/17/hungary-blocks-eu-deal-on-15-minimum-corporate-tax> accessed 22 September 2022.

concerns a global minimum corporate tax rate, which is intended to deliver a 15% minimum effective tax rate for MNE's as well as their subsidiaries[235].

In December 2021, the EC proposed a Directive for the implementation of a 15% minimum effective tax rate for the global activities of large MNEs into the national laws of Member States[236]. This proposed Directive closely follows the Pillar Two recommendations of the OECD/G20 Inclusive Framework on BEPS agreement. The Directive will apply to any MNE with revenues of at least €750 million per year, where either a parent company or a subsidiary is situated in an EU Member State. Commissioner for Economy, Paolo Gentiloni, said:

> "*In October of [2021], 137 countries supported a historic multilateral agreement to transform global corporate taxation, addressing longstanding injustices while preserving competitiveness. Just two months later, we are taking the first step to put an end to the tax race to the bottom that harms the European Union and its economies. The directive we are putting forward will ensure that the new 15% minimum effective tax rate for large companies will be applied in a way that is fully compatible with EU law*."[237]

Despite widespread support for the proposed Directive, its political frailty came to the fore in June 2022 during the final scheduled meeting of the Economic and Financial Affairs Council of the EU, where it was hoped that the proposal would be accepted by all Member States. Hungary opposed the Directive's adoption, essentially a veto as unanimity is required on tax matters. Hungarian Foreign Minister Péter Szijjártó argued that a hike in corporate taxes from

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[235] OECD (2020), 'Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy' (January 2020, OECD, Paris) <www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf> accessed 22 September 2022.

[236] European Commission, 'Proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union' (22 December 2021) COM (2021) 823 final.

[237] European Commission Press Release IP/21/7028, 'Fair Taxation: Commission proposes swift transposition of the international agreement on minimum taxation of multinationals' (22 Dec 2021, IP/21/7028).

the current 9% would be harmful to employment in the country, and a blow for European competitiveness during the war in Ukraine. Commentators have speculated that Hungary's reluctance could be politically motivated as the country faces accusations and criticism elsewhere in the EU related to corruption, cronyism, and fraud[238]. The Czech Republic has subsequently taken over the EU Council's rotating presidency, and is now tasked with bringing the discussions to a successful conclusion.

Global corporate tax harmonisation has the potential to completely eradicate the problem of profit shifting, as tax havens would simply disappear[239]. The large number of countries and jurisdictions that have endorsed the OECD's vision for global tax reform means that successful implementation thereof is not unthinkable. The OECD expects the new 15% minimum global corporate tax rate to be effective from 2023 onwards; it remains to be seen if this will be accomplished given the immense political task which it represents.

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[238] Jorge Liboreiro, 'Hungary blocks EU deal on 15% minimum corporate tax' (17/06/2022, EoroNews) <https://www.euronews.com/my-europe/2022/06/17/hungary-blocks-eu-deal-on-15-minimum-corporate-tax> accessed 22 September 2022.

[239] Ludvig Wier, 'Tax havens cost governments $200 billion a year. It's time to change the way global tax works' (27 February 2020, World Economic Forum) <https://www.weforum.org/agenda/2020/02/how-do-corporate-tax-havens-work/> accessed 22 September 2022.

Chapter 6: Conclusion

Corporate tax avoidance requires the establishment of a group entity that is not subject to taxes in any jurisdiction, and a method of transferring profits to that entity. This is aided by the exploitation of regulatory mismatches between countries. Lacking any meaningful harmonisation within the EU in terms of corporate- and tax laws, Member States' fiscal autonomy have granted MNEs several different possibilities in achieving this. Advance pricing agreements concluded with the tax authority of a Member State can give an MNE assurance that its corporate tax strategies adhere to local laws. Successful corporate tax avoidance schemes are those that have been sanctioned by the very tax authority they aim to avoid.

US Multinational Enterprises operating in the common market are best positioned to take advantage of regulatory mismatches between the US and the EU. This is due to having a foothold in both jurisdictions, in-depth knowledge of the respective tax laws, and virtually unlimited resources with which to exploit the differences. Aggressive tax planning with the goal of exploiting regulatory mismatches cannot be said to be illegal if neither set of local rules is broken. To illustrate this, it is helpful to refer to the General Court's ruling on the appeals brought against the European Commission's Decision in which it found that Amazon and Luxembourg had breached State aid provisions:

> "*The mere fact that an entity belonging to a group of companies was created solely for the purposes of tax optimisation and that it receives a royalty for intangible assets developed within the group of companies in question is not sufficient, in itself, to support the conclusion that there was a tax advantage…*
>
> *In the present case, it is true that the different tax treatment of LuxSCS in Luxembourg (LuxSCS was 'fiscally transparent' in Luxembourg) and the United States (LuxSCS was 'fiscally non-transparent' in the United States) arises from a 'hybrid mismatch',*

that is to say, a difference in the tax rules applicable in Luxembourg and the United States as regards the identification of the taxpayer.

However, ... the consequences of that mismatch (the non-taxation of profits) are not the subject of the contested decision. The relevant question in the context of the present action is therefore not whether LuxSCS was created purely for tax purposes, nor whether the income which it generated was actually taxed in the United States in the hands of its partners, but rather whether LuxOpCo paid a royalty which was overpriced and whether, as a result, LuxOpCo's remuneration and, therefore, its taxable base were artificially reduced."[240]

In 2013, Tim Cook, the chief executive officer of Apple Inc., responded to accusations that the company avoids vast amounts of taxes by shifting profits to "foreign affiliates". Mr Cook was quoted as saying: "We pay all the taxes we owe — every single dollar"[241]. While this statement was factually and legally correct, it elicited incredulous reactions from lawmakers and citizens alike, considering that one of the most ostensibly profitable companies in the world paid virtually no tax whatsoever.

Since the global financial crash of 2008 there have been several high-profile leaks of confidential financial information from so-called offshore tax havens. These were referred to as, for example, Offshore Leaks in 2013, LuxLeaks in 2014, Panama Papers in 2016, Paradise Papers in 2017, and Pandora Papers most recently in 2021. The leaked documents detailed undisclosed accounts, advance tax agreements, and tax avoidance schemes for wealthy

[240] Judgment of 12 May 2021, Luxembourg aid to Amazon (Cases T-816/17 & T-318/18, ECLI:EU:T:2021:252) paras. 279 – 281.
[241] NBC News wire services, 'Apple CEO Tim Cook: 'We pay all the taxes we owe'' (21 May 2013, NBC News) <https://www.nbcnews.com/business/business-news/apple-ceo-tim-cook-we-pay-all-taxes-we-owe-flna6c10015491> accessed 23 September 2022.

individuals, prominent individuals, politicians, and MNEs alike[242]. Notwithstanding the scandalous nature of these revelations, the International Consortium of Investigative Journalists was forced to admit: “These arrangements are legal”[243], referring to the advance pricing agreements and complex tax-savings plans implemented by MNEs following the LuxLeaks scandal. The supposed legality of these arrangements, much like the statements from Mr Cook, drew the ire from the international community and further reinforced a feeling of unfairness in global tax practices perpetrated by MNEs.

Since 2013 the European Commission has been investigating several of these supposedly legal advance tax arrangements within the EU using State aid provisions under Articles 107 and 108 TFEU. This novel approach has given the EC the power to investigate aggressive tax strategies used by MNEs and endorsed by Member States, to determine if any undue advantage led to an artificial reduction in taxes. This meant that the EC could apply EU law to national fiscal matters, which are usually the exclusive competence of the individual Member States – a significant boon for the EC in the fight against tax avoidance. During its review of various APAs the EC developed the use of the arm’s length principle as a tool to apply State aid provisions. Where an APA endorsed a certain level of royalty fees charged for the intra-group use of intellectual property (a transfer price) the arm’s length principle was used to determine if that transfer price was a reliable approximation of prices that would have been charged between third parties under competitive market conditions. If the royalty fee did not adhere to the arm’s length principle, then the APA would have endorsed transfer prices that artificially lowered an MNE’s tax bill, thereby conferring a selective advantage in violation of State aid provisions. The EC had succeeded in developing a comprehensive method of policing aggressive tax avoidance schemes in the common market.

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[242] Davis VanOpdorp, ‘From Panama to Paradise: The biggest tax evasion data leaks in history’ (7 November 2017, DW.com) <https://p.dw.com/p/2nCHf> accessed 23 September 2022.
[243] Gerard Ryle and others, ‘About This Project: Luxembourg Leaks’ (5 November 2014, ICIJ) <https://www.icij.org/investigations/luxembourg-leaks/about-project-luxembourg-leaks/> accessed 23 September 2022.

The practical application of that method is however fraught with difficulties. The EC could only apply its State aid method to APAs where transfer pricing was at play. This meant that the EC had no way of penalising McDonald's even though the company had effectively avoided paying any tax at all on profits generated in the EU. In *Apple*, *Amazon*, and *Starbucks*, where the applicable APAs endorsed transfer pricing arrangements related to intra-group IP assets, the EC found all three parties guilty of receiving unlawful State aid from Ireland, Luxembourg, and the Netherlands respectively. While this was widely lauded as a success in the fight against unfair corporate tax practices, the victory was short-lived. The General Court annulled all three of the EC's Decisions on appeal. The GC judged that the EC had not proven to the requisite legal standard that the transfer pricing methods endorsed by the various APAs had led to royalty fees which indeed departed from the arm's length principle. Merely identifying errors in the transfer pricing methods used by the MNEs was insufficient grounds to find that those methods, regardless of any errors, did not lead to an outcome that could have been achieved under normal market conditions between third parties; that finding had to be proven, not merely assumed. Thus, in the context of regulating aggressive tax avoidance schemes, the GC had laid down a formidable burden of proof for the successful application of State aid rules.

This burden of proof is made particularly formidable when the pricing of intra-group transactions relate to intellectual property assets. Where IP assets are unique with little or no comparison on the open market, an acceptable transfer price might fall within a wide range, as opposed to having an exact value. This provides considerable leeway in what constitutes an arm's length price, a significant advantage for an MNEs in the business of shifting profits. For State aid control, the EC is set the dreadful task of proving that a chosen transfer price does not fall within the wide range of acceptable arm's length prices. The difficulty of this task is therefore immense and perhaps not practically possible. The EC's *Nike* investigation is still

ongoing and it is doubtful whether it will be able to convincingly show that the company had received unlawful State aid. Another such a failure would further showcase the inherent shortcomings of using State aid provisions to police tax avoidance schemes concerning valuable intellectual property.

Regardless of the EC's failures in *Apple*, *Starbucks*, and *Amazon*, or what the *Nike* outcome will be, the overwhelming success of using State aid provisions to uncover and investigate aggressive tax avoidance strategies should not be downplayed. Where the various tax leak scandals have brought attention to large scale tax avoidance in the EU, State aid provisions have enabled the EC to scrutinise these schemes at an unprecedented level. Under Article 108 TFEU and the associated procedural Regulation[244], the EC can request any information it deems necessary to determine if a measure complies with State aid rules. This makes it a remarkably powerful investigative tool. The EC's investigations and Decisions are ultimately published in the public domain, meaning State aid provisions are most effective in identifying and exposing harmful tax practices. While it is true that the EC has failed to claw back any foregone taxes in high-profile cases such as *Apple*, *Starbucks*, and *Amazon*, it has managed to expose those tax avoidance schemes in detail. The apparent legality of these schemes merely serves to further highlight the need for tax reform on a global basis to address the regulatory mismatches that allow them.

It is no coincidence that the largest changes in global tax reform have taken place in the last decade, since the EC began its State aid review of aggressive tax avoidance schemes. The Common Reporting Standard (CRS) is an OECD initiative from July 2014 aimed at increased tax transparency and automatic exchange of information with other jurisdictions[245]. CRS was

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[244] Council Regulation (EU) 734/2013 amending Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty [2013] OJ L204/15 – 22.

[245] OECD, 'What is the CRS?' (OECD, 2022) <https://www.oecd.org/tax/automatic-exchange/common-reporting-standard/> accessed 26 September 2022.

introduced into EU law by the Directive on Administrative Co-operation[246] (DAC), which also include other automatic exchange of information and tax transparency measures. The DAC underwent several iterations from 2013 up to the latest version, DAC7, being introduced in 2021[247]. The US equivalent of CRS is the Foreign Account Tax Compliance Act (FATCA), introduced into US law in 2010[248]. The Anti-Tax Avoidance Directive (ATAD) was introduced in 2016 and amended in 2017[249]. Finally, the OECD/G20 BEPS Project, a bold attempt at introducing a global minimum tax rate, was introduced in 2015. A proposed Directive is currently under debate at the Council of the EU to incorporate the proposal into EU law. All these measures were introduced in efforts to combat harmful tax practices, and all of them were introduced following the exposure of complex and successful tax avoidance schemes, undoubtedly assisted by the European Commission's novel use of State aid rules to investigate advance pricing agreements in the common market.

State aid provisions might not have recovered the billions that the EC had hoped for, but perhaps that is a small price to pay for helping to find a cure to global regulatory mismatch.

[246] Council Directive 2014/107/EU as regards mandatory automatic exchange of information (9 December 2014) OJ L359.

[247] Council Directive (EU) 2021/ on administrative cooperation in the field of taxation (22 March 2021) OJ L 104.

[248] Andrew C. Liazos and Todd A. Solomon, 'What You Need to Know About Foreign Account Tax Compliance Act's (FATCA) Impact on Non-U.S. Retirement Plans' (22 March 2013, The National Law Review) <https://www.natlawreview.com/article/what-you-need-to-know-about-foreign-account-tax-compliance-act-s-fatca-impact-non-us> accessed 26 September 2022.

[249] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries (7 June 2017) OJ L 144 p. 1–11.

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13. Case T-760/15, Action brought on 23 December 2015 — Netherlands v Commission (15 February 2016)

14. Case T-778/16, Action brought on 9 November 2016 — Ireland v Commission (6 February 2017)
15. Case T-892/16, Action brought on 19 December 2016 — Apple Sales International and Apple Operations Europe v Commission (20 February 2017)
16. Commission Decision (EU) 2017/1283 of 30 August 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple
17. Commission Decision (EU) 2017/502 of 21 October 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks
18. Commission Decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon
19. Commission Decision (EU) 2019/1252 of 19 September 2018 on tax rulings SA.38945 (2015/C) (ex 2015/NN) (ex 2014/CP) granted by Luxembourg in favour of McDonald's Europe
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21. Judgment of 1 December 2011, Commission v Hungary (C-253/09, ECLI:EU:C:2011:795)
22. Judgment of 12 July 2012, Commission v Spain (C-269/09, ECLI:EU:C:2012:439)
23. Judgment of 12 July 2012, Commission v Spain (C-269/09, EU:C:2012:439)
24. Judgment of 12 May 2021, Luxembourg aid to Amazon (Cases T-816/17 & T-318/18, ECLI:EU:T:2021:252)
25. Judgment of 15 July 2020, Ireland aid to Apple (Cases T-778/16 & T-892/16, ECLI:EU:T:2020:338)
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27. Judgment of 20 January 2011, Commission v Greece (C-155/09, ECLI:EU:C:2011:22)
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29. Luxembourg alleged aid to McDonald’s (State aid SA.38945 (2015/C) (ex 2015/NN) European Commission [15 July 2016]
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