

An aerial photograph of a city, showing a complex highway interchange with multiple overpasses and ramps. The surrounding area is filled with various buildings, including high-rise apartment complexes and commercial structures. The image is partially obscured by an orange overlay on the left side.

Tax Insight

# European Union *State Aids*

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## Background

The aim of Tax Administrations (TA) around the world is to avoid base erosion and profit shifting (BEPS). They try to assure that multinational groups (MNG) pay taxes in such countries where they actually conduct their business activities and generate value. Regulations on transfer pricing (TP) allow for the distribution of profits obtained by MNG in such countries where they have carried out their business. In some cases, multinationals separated revenue from business activities that generate it, shifting it to countries of low or null taxation (BONT).

In order to have legal certainty about TP and avoid disputes in connection with the market value of operations, the MNG has signed unilateral Advance Pricing Agreements (APAs). An APA enables to determine a set of criteria (methodology, comparables, adjustments and critical hypothesis on future events) before the associated operations take place so as to determine what the applicable TP is with regard to said operations during a particular period. APA may be unilateral when they engage only one TA and one taxpayer, or multilateral when they engage two or more TAs. In other cases, States have issued unilateral tax resolutions whereby tax benefits are granted.

**Although APAs and unilateral fiscal resolutions are effective legal instruments, they have recently been under the spotlight of the European Union (EU), after it was pointed out that in some cases they artificially reduced tax burden of a company from the MNG and affected cross-border commerce, contributing to company inequality.**

**State Aid** is the aid granted to companies or sectors by means of public resources. Pursuant to the Treaty on the Functioning of the European Union (TFUE), **it is prohibited any selective aid granted** by a Member State of the EU or through state resources which, in any form whatsoever, affects trade between Member States and distorts or threatens to distort competition. Having said this, **state aids may be authorized provided they pursue an objective of common interest**. The EU countries shall notify the European Commission (EC) about the aids they grant. From 2013, the EC has been investigating tax regimes in countries of the EU and fiscal resolutions passed by the States to certain MNG.

In this presentation, we will comment on both the investigations carried out by the EC and the final decisions it has adopted in connection with *Starbucks (the Netherlands)* and *Fiat (Luxembourg)*. Additionally, we will comment on the details concerning state aids granted by *Belgium*.

# State Aids Starbucks

## Case

The business activities carried out by Starbucks Manufacturing EMEA BV (SMBV), with its registered office in the Netherlands, involve coffee roasting for Starbucks in Europe and the sale thereof to Starbucks in Europe, the Middle East and Africa. In order to conduct business, SMBV pays a fee for technical know-how on coffee roasting to an associate company which has its registered office in the United Kingdom. Moreover, SMBV buys green coffee beans from an associate company that has its registered office in Switzerland.

SMBV has signed an **APA with the TA in the Netherlands** in connection with the fee.

## Questioning

The EC questioned the methodology that was used in the APA for the analysis of the operations with the above associate companies and concluded that such methodology did not agree with the arm's length principle and meant an advantage for SMBV.

The EC determined that the EU regulations on state aids call for the recovery of unlawful aids, such aids granted for the purpose of reducing the tax burden or affecting competition. In its resolution, the EC set forth the methodology to calculate the value of the competitive advantage obtained by SMBV and quantified the difference between what SMBV actually paid and what SMBV would have paid without the tax resolution. The TA in the Netherlands is in charge of determining the amount of tax that shall be recovered according to the method set forth in the resolutions made by the EC.

## Conclusions

The **General Court of the European Union revoked the verdict issued by the EC** on the basis that **it could not be evidenced that the APA brought a benefit to SMBV** in connection with state aids regulations of the EU. Specifically, the General Court found that although the APA did not comply with all the elements necessary for an accurate analysis on transfer pricing (e.g. selection of the most appropriate method or lack of analysis and justification of the amount of the fee), it was not possible to prove that TP artificially reduced SMBV's tax base. Additionally, the EC overlooked other errors that had been detected, such as the selection of the part under analysis, the performance indicator used and adjustment of capital accounts, which affected tax calculation basis.

With regard to the acquisition of green coffee beans, the Court found that such operations were excluded from APA and that the EC failed to prove it did not agree with the market price.

# State Aids

## FIAT

### Case

Fiat Finance and Trade (FFT), with its registered office in Luxembourg, renders financial services to other member companies of the MNG Fiat. FFT **signed an APA with the TA** in Luxembourg.

### Questioning

The **EC questioned** the methodology that was used in the APA for the analysis of the operations with the above associate companies and concluded that such methodology did not agree with the arm's length principle and meant an advantage for FFT.

The EC found that, given the business activities FFT conducts can be compared to those carried out by a bank, its taxable profits may be determined likewise, that is, calculating the return on capital employed by the company for the purpose of its financing activities. However, through the fiscal resolution, an artificial and complex method is approved which cannot be applied to calculate the taxable profits in line with the conditions of the market (*arm's length principle*). Specifically, it artificially reduces taxes paid by FFT.

### Conclusions

**The Court confirmed the verdict issued by the EC** in connection with the assessment of the state aid granted to FFT. Specifically, the Court stated that the tax resolution artificially reduced taxes paid by FFT owing to a series of suppositions and adjustments to the economic reduction in the capital taken into account for the application of the transactional net margin method (TNMM) and, therefore, in the estimated compensation (fee) that derives from such capital (much more reduced) for tax purposes.

# State Aids

## Belgium

### Case

Belgian regulations on income taxes require that companies be taxed on the basis of the profits obtained from the activities carried out in Belgium. However, Belgian tax resolutions allow for multinational entities in Belgium to reduce their taxes in connection with excess profits. This is a tax benefit which seeks to apply income tax to only the economic profits of an operation agreeing with the arm's length principle. Belgian companies can adjust their tax base to the arm's length value (therefore, being able to make upward or downward adjustments unilaterally) before determining the tax amount.

The Belgian State is being investigated by the EC since it determined the tax policy on excess profits, applied in accordance with tax resolutions, could constitute a selective state aid. The investigation comprises 39 cases in which the Belgian TA conferred such profits.

### Questioning

The EC is questioning whether the profits conferred upon resolution constitute a selective state aid. The EC sets forth that the resolutions defending unilateral downward adjustments to the tax base of the beneficiaries may not be legal. Additionally, the EC states that, in reality, such benefits could have contributed to discrimination (that is, the TA could have granted the benefit in favor of certain multinational companies and, in so doing, discriminated Belgian companies).

### Conclusions

The EC seeks further clarification on the existence of state aids with the Court. The latter is yet to state whether tax exemptions on the basis of profit excess, in the context of tax resolutions issued by the TA, constitute selective state aids.

There have been conducted prior investigations to the EC's in connection with other incentives granted by the Belgian State, some of which were appealed by the companies before the Court and overruled for not constituting an infringement to the economic aid rules of the States. Other cases are still in the process of appeal.

## Closing remarks

- As we mentioned before, tax resolutions or unilateral APAs are tools used by the TAs. Its inappropriate use, leading to the artificial reduction of the tax burden of the multinationals, has been questioned by the EU.
- Questionings **at an international level** come in those cases in which **tax resolutions and APAs contravene the law by granting selective tax benefits which artificially reduce the taxes payable by companies and affect trade between countries.**
- The EC and the Court have deemed it **possible that the selective state aid be granted** in, among others, the following cases:
  - Tax resolution or APA derive in tax benefits (reduction or exemption of taxes) in the EU.
  - Tax resolution or APA involves entities with a limited economic substance.
  - The methodology employed, for instance, to determine transfer prices or the distribution of benefits among offices is not consistent with that of the OCDE or does not involve a comprehensive analysis of the companies in several States (that is, takes into account a unilateral approach only).
- The battle against erosion of the tax base and profit shifting among jurisdictions is one of the EC's priorities. The recently conducted investigations seek to eliminate and/or sanction selective state aids that do not agree with the regulations of the EU. In line with this, the EC has occasionally ordered States to recover taxes that would have been otherwise applicable to multinationals if such help had not been granted, as well as to discontinue the future application of the benefit. Notwithstanding this, in some cases the Court later revoked the verdict issued by the EC (for not sharing the results of the investigation) and, in other cases, investigations are still being carried out.
- Apart from the execution of the arm's length principle, another element that is introduced for companies to take into account is the exact definition of operations conducted by companies in every country they have established business and their business (rationale) justification.

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