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EU Direct Tax Newsalert

EU Commission publishes non-confidential version of its State aid opening decision in Nike

Introduction

On 1 July 2019, the European Commission (EC) made publicly available the non-confidential version of its opening decision of 10 January 2019 in the formal State aid investigation into the Netherlands' tax treatment of Nike. The EC explains the reasons for the initiation of its formal investigation and requests additional information from the Netherlands or any other Nike group company, to reach a final conclusion. This decision represents therefore the opening, not yet the outcome, of the EC's formal investigation into this matter.

Facts outlined in the opening decision

Nike is a US based company involved globally in the design, development, worldwide marketing and sale of athletic footwear, apparel, equipment, accessories, and services. The EC's opening decision focuses on five Advanced Pricing Agreements (APAs) granted from 2006 to 2015 by the Netherlands to two Nike group companies, Nike European Operations Netherlands BV (NEON BV) and Converse Netherlands BV (CN BV). According to the opening decision, NEON BV pursues principal or wholesale distribution activities (among others, product design, sales management and local advertising). CN BV's activities comprise of regional headquarter functions (among others, marketing management, sales management and distribution activities). NEON BV and CN BV acquired licenses (Licence Agreements) to use intellectual property rights (the Nike and Converse EMEA IP) from the legal owners of the IP, which are not taxable in the Netherlands, in return for tax-deductible royalty payments.

More specifically, the EC observes that the five tax rulings granted to Nike by the Dutch tax authorities endorsed a method of calculating the royalty payments made from NEON BV and CN BV to the legal owners of the IP, with the result that the Dutch companies are taxed on a limited operating margin based on sales.

EC's preliminary assessment

According to its opening decision, the EC has reasons to doubt that the transfer pricing arrangements endorsed in the contested APAs

result in transfer prices that resemble what would be charged between independent undertakings negotiating under comparable circumstances at arm's length. More specifically, the EC takes the provisional view that the Dutch tax administration was wrong to endorse the premise that NEON BV and CN BV performed "routine" distribution functions. Instead, the information supporting the APA requests should have led, in the EC's view, the Dutch tax administration to conclude that those companies performed more unique and valuable functions in relation to the Nike and Converse EMEA IP than the functions performed by the legal owners of the IP. In the alternative, the EC has doubts whether the transactional net margin method (TNMM) was in fact the most reliable transfer pricing method to price the NEON BV and CN BV Licence Agreements. In the further alternative, the EC provisionally concludes that even if the TNMM was the most appropriate transfer pricing method and NEON BV and CN BV were correctly selected as the tested party for the application of that method, the profit level indicator that was chosen to determine those companies' remuneration was inappropriate in light of the functional analyses.

The EC mentions in its opening decision that, as all APAs are individual measures, where the EC's provisional conclusion is that they confer an economic advantage, it can be presumed that they are selective in nature. For the sake of completeness, however, it examines the potential selectivity of the APAs in light of the three-step selectivity analysis devised by the Court of Justice of the European Union for aid schemes and concludes that all five APAs are selective measures.

Takeaway

This is another EC opening decision in the area of transfer pricing. If the EC's approach is confirmed in its final decision, further litigation before the European Courts is likely.

