EU Direct Tax Newsalert

EU's General Court annuls the EC's State aid decision in Starbucks

On 24 September 2019, the General Court of the European Union (GC) rendered its judgment (T-760/15 and T-636/16) regarding the action brought by Starbucks Corp. and Starbucks Manufacturing EMEA BV (SMBV) and the Netherlands for the annulment of the final State aid decision of the European Commission (EC) of 21 October 2015 on Starbucks (SA.38374). The GC annulled the EC's decision because the EC did not demonstrate the existence of an economic advantage within the meaning of EU State aid rules.

Background and facts

In its final State aid decision on Starbucks, the EC concluded that the Advance Pricing Agreement (APA) obtained by SMBV from the Dutch tax authorities (DTA) concerning the transfer pricing (TP) methodology determining an arm's length (AL) remuneration for SMBV's production and distribution activities constitutes State aid. Click here for our EUDTG newsalert.

The Netherlands and Starbucks appealed the EC's decision criticising the EC for: (1) having used an erroneous reference system for the examination of the selectivity of the APA; (2) having examined whether there was an advantage in relation to an arm's length principle (ALP) particular to EU law and thereby violated the Member States' fiscal autonomy; (3) having considered the selection of the transactional net margin method (TNMM) for determining SMBV's remuneration to constitute an advantage; and (4) having considered the detailed rules for the application of that method as validated in the APA to confer an advantage on SMBV.

The GC's judgment

The GC first examined the existence of an ALP in the field of State aid control and compliance with the principle of Member States' fiscal autonomy. The GC ruled that the EC did not err in identifying an ALP as a criterion for assessing the existence of State aid. In the GC's view, where national tax law does not make a distinction between integrated and stand-alone undertakings for the purposes of their liability to corporate income tax, that law is intended to tax the profit arising from the economic activity of such integrated undertakings as though it had arisen from transactions carried out at market prices. The ALP is the tool that allows the EC to check that intra-group transactions are remunerated as if they had been negotiated between independent companies. Therefore, in the light of Netherlands tax law, that tool falls within the competence of the EC in State aid matters.

Second, the GC reviewed the merits of the various lines of reasoning set out in the contested decision to demonstrate that the APA conferred an economic advantage on SMBV within the meaning of State aid rules. In that regard, it ruled that the EC failed to demonstrate the existence of such an advantage. More specifically, the GC decided that mere non-compliance with methodological requirements for the determination of TP (such as the choice of the TP method and the lack of analysis of the royalty payments in the APA) does not necessarily lead to a reduction of the tax burden and that the EC would have had to demonstrate that the methodological errors identified in the APA did not allow a reliable approximation of an AL outcome.

In addition, the Court ruled that the EC, when comparing the royalties provided for in the coffee roasting agreements concluded by Starbucks with third parties and against similar licensing agreements 'on the market', failed to demonstrate that the level of the royalty paid by SMBV to Alki (a Starbucks group entity) should have been zero. The EC also failed to demonstrate that the level of the royalty should have been lower than the level endorsed by the APA. Concerning the price of green coffee beans paid by SMBV to another Starbucks group entity, the GC ruled that the price of those beans was an element of SMBV's costs that was outside the scope of the contested APA and that, in any event, the EC's findings did not suffice to demonstrate the existence of an advantage in respect of the price paid for those beans. Finally, the CG found that the EC did not demonstrate that the various errors it identified in the detailed rules for the application of the TNMM (SMBV as the tested party, choice of profit level indicator or the working capital adjustment) had the effect of reducing the level of SMBV's taxable profit in such proportions that it did not correspond to a reliable approximation of an AL outcome, thereby conferring an advantage on SMBV.

Takeaway

Whilst the GC appeared to agree with the EC that the ALP was not necessarily synonymous with Art 9 of the OECD model convention, it also indicated that the OECD TP guidelines are a useful and relevant aid for applying the ALP. It further acknowledged that TP by its very nature involves a degree of approximation and accordingly Member States are to be afforded a margin of discretion. It remains to be seen how far this extends and whether this judgment is appealed to the European Court of Justice.

It is noted that on 24 September 2019 the Dutch State Secretary of Finance responded to the present judgment. In his view, the judgment means that the DTA did not treat Starbucks any differently or more favourably than other companies. Commissioner Margrethe Vestager commented that the judgment gives important guidance on the application of EU State aid rules in the area of taxation and confirms that, while Member States have exclusive competence in determining their laws concerning direct taxation, they must do so in respect of EU law, including State aid rules.

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