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Transfer Pricing and State Aid in the EU : an OECD Perspective

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Agenda

1. Setting the scene
2. Concept of Transfer Pricing
3. State aid rules
4. *"Relationship"* between the State Aid Framework and the OECD Transfer Pricing Rules?

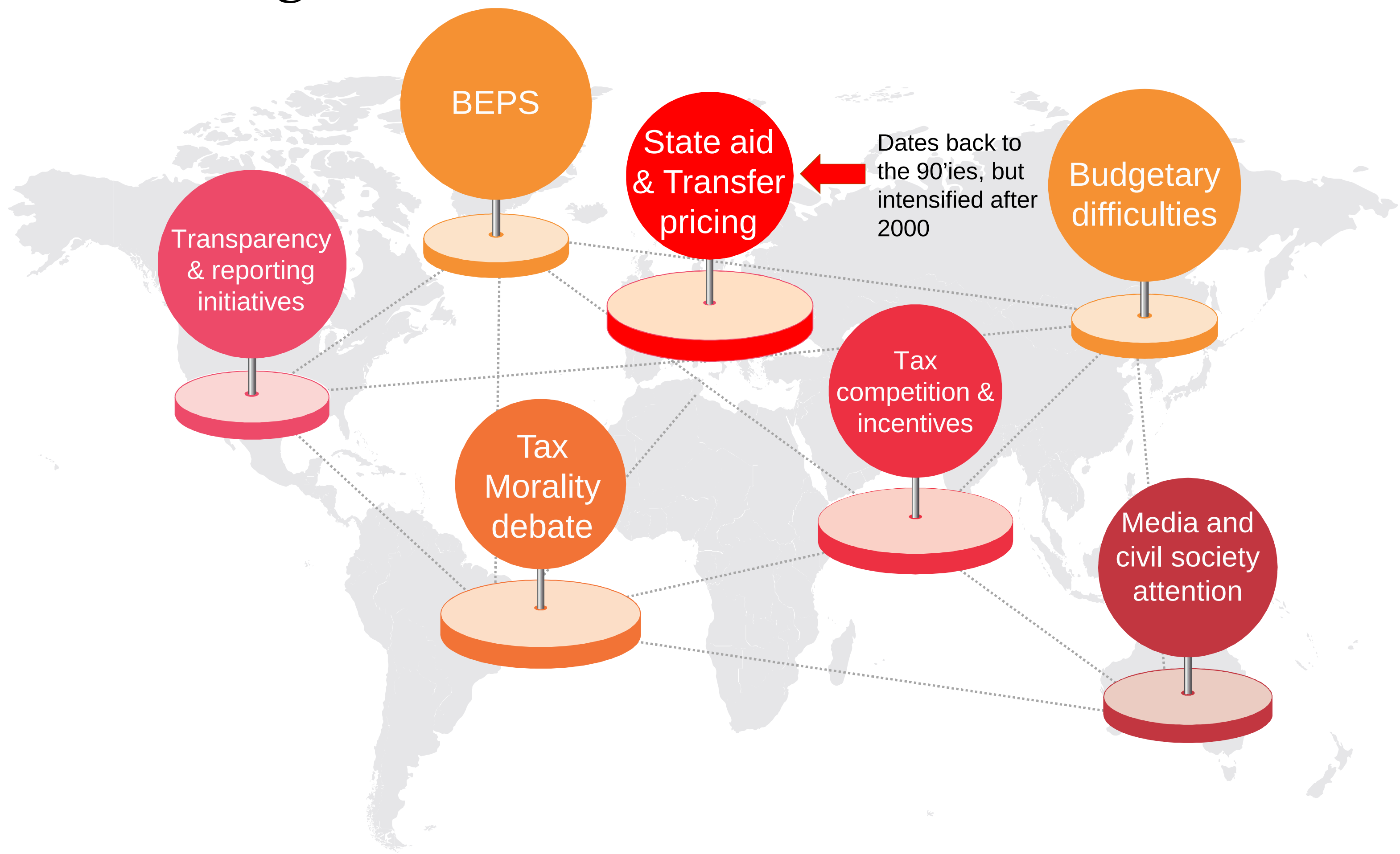
The key to EU Tax Harmonisation ?

1/Setting the scene

"One should be taxed by law, and not be untaxed by concession" *J. Walton in Vestey v IRC [1980] AC1148*

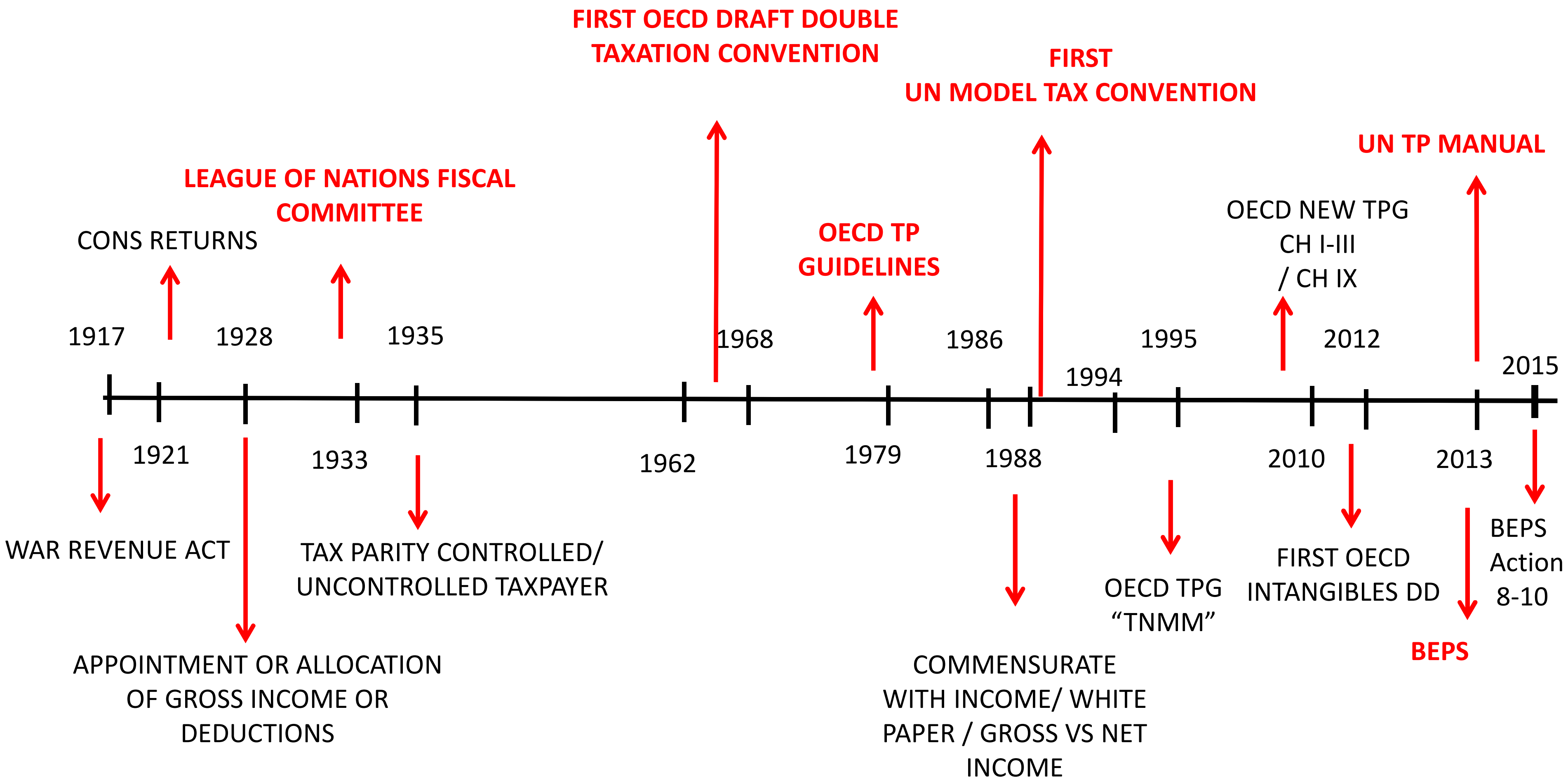
What will we be talking about?

The current global environment



The debate on where to tax profits…

A long history and seasoned principles



The arm's length principle… a continuing debate

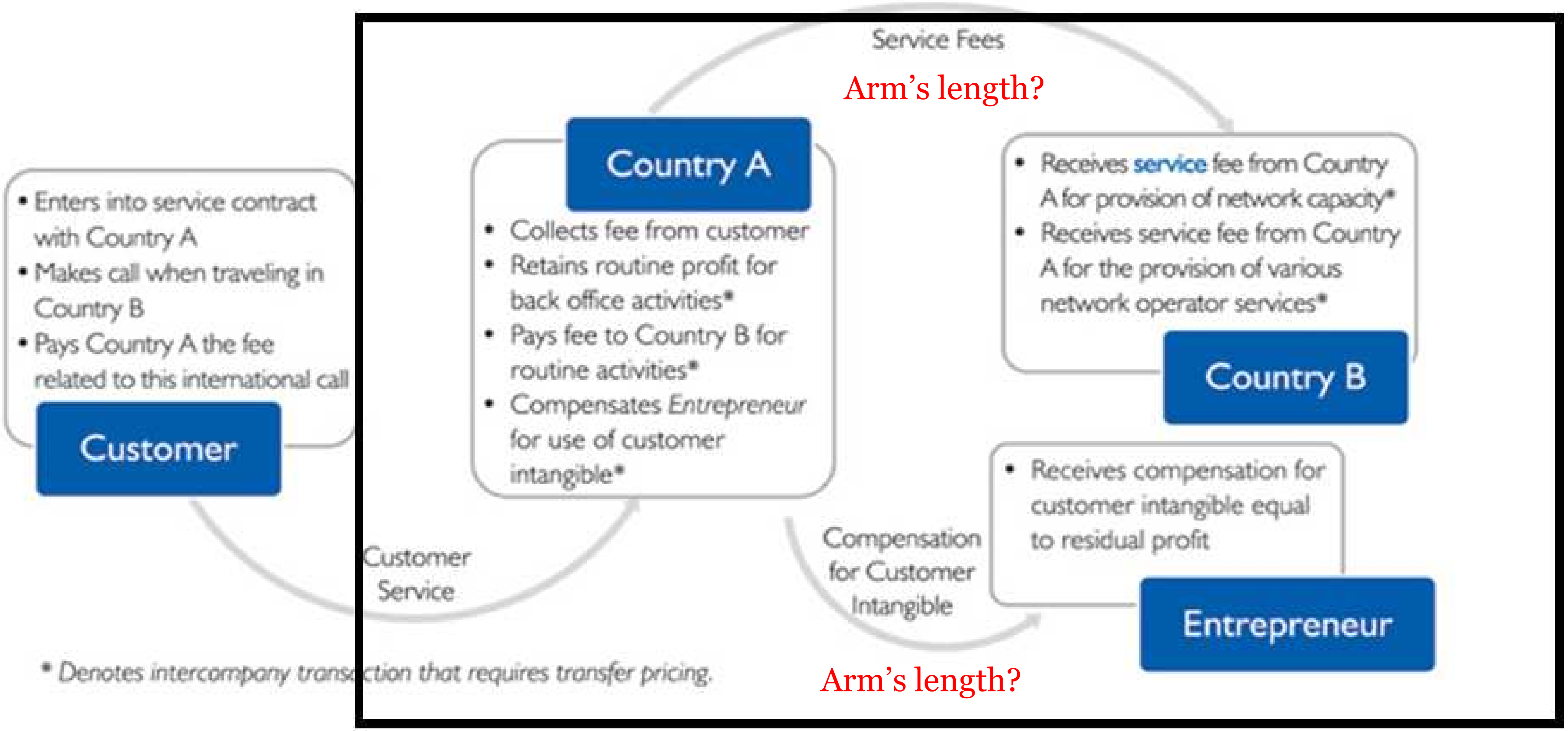
"My arm hurts."

2/Concept of Transfer Pricing

“ (…) Transfer Pricing is not an exact science but does require the exercise of judgment on the part of both the tax administration and taxpayer.” *The OECD Guidelines 1005, Paragraph 1.12.*

It is all about…

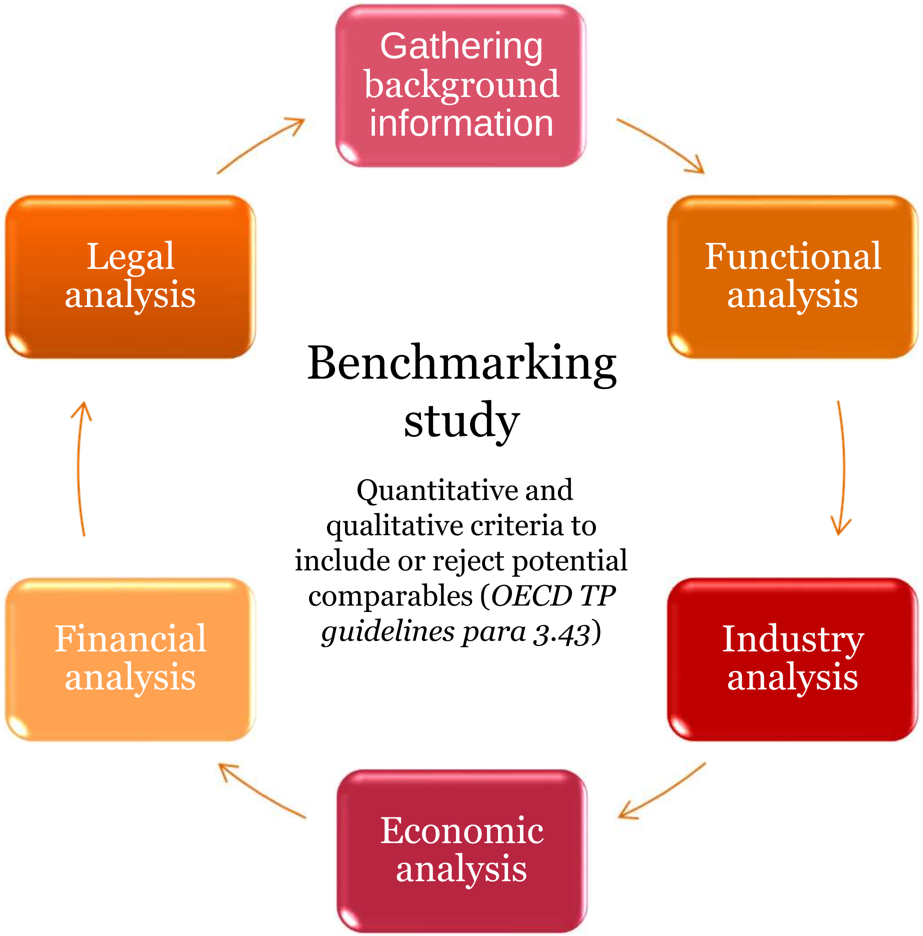
The 'Mobile Company' Inc



…pricing

Finding arm's length comparables

Transfer Pricing process



3/State aid rules

"The main reason behind our state aid action is the realization that <u>governments can distort competition</u> in the Single Market not only by granting subsidies but also <u>by offering sweetheart tax deals</u>." *Comm. Almunia, 2014.*

The EU "Fiscal" State Aid debate

Combatting tax competition or …?

Article 107(1) TFEU

"Save as otherwise provided in the Treaties, any aid granted to 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."

There is no separate definition for Fiscal State Aid

Status of the main recent fiscal State aid investigations

Apple
11.06.2015
Pending Investigation

Belgian Excess Profit
11.01.2016
Recovery Decision
APPEALED

Starbucks Coffee
21.10.2015
Recovery Decision
APPEALED

FIAT
21.10.2015
Recovery Decision
APPEALED

Amazon
07.04.2014
Pending Investigation

McDonald's
03.12.2015
Pending Investigation

Time frame?... A look into our crystal ball...

2014	2015	2016	2017	2018	2019	2020 and beyond
Opening investigation	Negative decision + appeal		*Decision General Court?*		*Decision CJEU?*	
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Opening investigation		*Negative decision + appeal?*		*Decision General Court?*		*Decision CJEU?*
	Opening investigation	*Negative decision + appeal?*		*Decision General Court?*		*Decision CJEU?*
Opening investigation		*Negative decision + appeal?*		*Decision General Court?*		*Decision CJEU?*

4/ "Relationship" between State Aid Framework and Transfer Pricing?

"I will take swift and decisive action against breaches of the rules, as in the case of the EU-wide investigation on tax rulings (...). We have to find out what the precise decisions were in these individual cases and learn from them." *Comm. Vestager, 2014.*

State Aid vs. Transfer Pricing

The future of the arm's length principle

"My arm hurts."

Analysis as proposed by the EC in the State aid assessment:

- Reference framework: National CIT system
- Principle of equal treatment in fiscal matters
- Does TP method chosen to establish prices lead to the market result/ does it reflect commercial value (preference for CUP)?
- Comparables: multinational companies and stand-alone companies

OECD TP approach:

- Reference framework: OECD TP Guidelines and Article 9 OECD MTC ("Soft law" unless implemented in tax treaty)
- Arm's length principle
- Does TP method chosen lead to an arm's length result?
- Comparables: benchmark study (quantitative and qualitative criteria to include or reject potential comparables (para 3.43))
- Full comparability analysis including factual and functional analysis

Breaking point in the evolution?

EU "arm's length principle"

EC's Notice on the application of State aid to direct taxation & Code of Conduct for Business Taxation

No aid if: (i) tax measures of a purely technical nature, or (ii) pursuing general economic policy objectives.

Gentlemen's agreement to refrain from introducing any harmful tax measures, which may affect the location of business activity in the EU, and which provide for significantly lower level of taxation from that generally applicable in the Member State concerned.

Belgian, German, French, Luxembourg, Spanish Coordination centres cases (C(2002) 3298, C(2002) 3740, C(2002) 3741).

The EC analysis of **the cost plus method**: this method leads to systematic use of low or default margins and the exclusion of certain expenses from the cost of the centre.

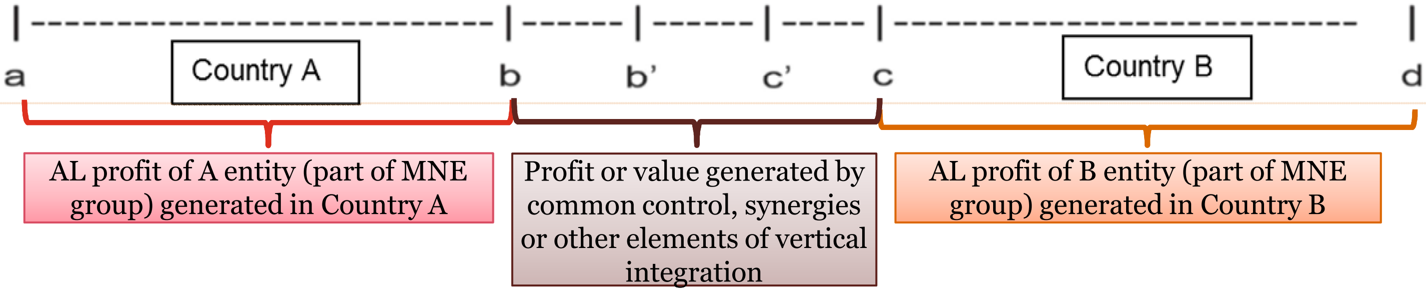
In principle, nothing is wrong with the cost plus method, unless it is applied incorrectly, or other TP method(s) could be used (e.g. preference CUP).

Current TP and State aid cases (e.g. Starbucks, Fiat, Apple, Amazon, EPR.)

CUP method is always preferred, as it leads to the most reliable result to establish the arm's length price.

The EC seems to suggest that when there is lack of comparable independent enterprises on the market which would have agreed on making the same or similar payments, and the CUP method cannot be applied due to lack of sufficient data, transaction at stake should be disregarded?

Arm's length principle



- Country A may be of the view that they should tax the interval a-b'
- Country B may be of the view that they should tax the interval c'-d
- Views over which interval each country may tax may be different and may even lead to overlapping intervals
- It can also happen that certain parts are left untaxed.

*'The arm's length principle is sound in theory since it provides the closest **approximation** of the workings of the open market [...]. This reflects the economic realities of the controlled taxpayer's particular facts and circumstances and adopts as a benchmark the normal operation of the market'*. (Para. 1.14 OECD TPG).

Key technical discussion points in the ongoing State aid investigations

OECD vs EU rules vs Domestic rules	1	Is the reference framework applied by the EC correct?
Tax treaties vs State aid rules	2	Do State aid rules overrule tax treaty rules?
Difference stand alone company vs MNC = State aid?	3	Is a stand alone company comparable to a MNC?
CUP method vs other TP methods	4	CUP as the default method?

Thank you!

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