vereniging voor
Belastingwetenschap

Het staatssteunverbod als beleidscompetitie-breekijzer

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Agenda

- Het arm’s length beginsel als mededingingsrecht;
- Verkeersvrijheden, staatssteun, schadelijke belastingconcurrentie, marktdistorsies: convergentie van criteria
- De *Apple* zaak
- Politieke implicaties; vergelijking met VS, WTO/SCM en 1972-verdrag met Zwitserland
- Andere opties om multinationals te laten betalen
- (Pardon my English)

vereniging voor Belastingwetenschap

State Aid is Catching up

- State aid in direct taxation is where free movement in direct taxation was 20 years ago
- Negative integration where harmonization (ATAD etc.) and free movement fail: State aid as a remedy against unfair tax competition and double nontaxation
- Arm's length principle (ALP) as a principle of *competition* law, which obtains irrespective of national law
- Most direct method best approximating a market-based outcome (best method of single outcome?)
- EU State aid Arm's length principle implies minimum harmonization of TP law; blessing in disguise?
- Less and less room for fiscal sovereignty
- Cato the Elder: CCCTB

The Triple Face of the ALP

- Tax base protection and prevention of double taxation; inbound profit allocation
- Smart/Covert tax competition; facilitating undertaxation of multinationals (elsewhere)
- An EU market equality principle? At any rate: a WTO export subsidy criterion (footnote 59 Annex I SCM-agreement)

4 Ways to tell the Apple story

- one-sided technical p.e. attribution for routine functions
- Technical allocation of total profit within a company; nonexistent head office; only the irish presence can explain the profit from trading and manufacturing: where are the IP licenses?
- Gut test: half of Apples'worldwide profits in Cork, Ireland? Or nowhere? *You are now entering Atlantis*
- Check-the-box + ineffective CFC + CSA = a US fiscal capital export subsidy, similar to the WTO-prohibited DISC, FSC, and rewarding, and benefiting from, intra-EU tax competition and tax avoidance elsewhere; foreign tax *credit*; reverse discrimination

Common Ground in the Apple Case

- ASI and AOE were nonresidents in both Eire and the US
- Neither of them had trade or business in the US
- ASI and AOE had beneficial ownership of the IP under the CSA
- IP royalty payments under CSA and all other payments to and by ASI and AOE were arm's length
- ASI and AOE had 1,500 employees in Cork and nothing outside Ireland but occasional board meetings
- Irish corporate tax law ''does not provide guidance on how to determine the chargeable profit of an Irish branch"
- No underlying TP report, analysis or calculation; just a figure suggested by Apple's tax adviser
- No evaluation in 16 years
- Unexplained step-down in cost-plus

The ECJ Case law relied on is unspecific

- C-182/03 and C-217/03, Belgium and Forum 187 v Commission; unrealistic and unexplained cost-plus profit determination excluding many charges
- ECJ: Compare to ordinary tax system for an undertaking operating in free competition
- ECJ: Expenditure charge does not resemble what would be charged in conditions of free competition

(Corresponding) Adjustment?

- Commission suggests retroactive amendment of the CSA or TP adjustments by the US, as well as TP adjustments by other (EU) States (State aid if they don't?)
- Undermines the Commission's stance that the income should be allocated to Ireland
- Commission: reallocation does not bear on the relative profit allocation *within* ASI and AOE (between head office and branch): all substance, activities, risks, and functions of the companies were in the Irish branches
- If the EU Courts agree there was underallocation, it may be hard to find the reference baseline
- Commission does not seem to care where the profit is taxed, provided it is taxed at least once

Eire’s arguments

- Commission ignores the difference between resident and nonresident companies and the absence of p.e. force of attraction
- ALP is not part of EU law, nor of Irish law
- No derogation from any benchmark (difficult argument: discretion)
- People don’t queue overnight outside Apple stores for Apple’s accomplishments in Cork, but for those in Cupertino or elsewhere (difficult argument)
- Breach of legal certainty and legitimate expectations

Shooting one's foot

- US Senate hearing – see Antony Ting, *iTax*, [2014] BTR 1, at 40
- Apple confirmed profits recorded in AOE and ASI were arm's length;
- Board minutes state that ASI and AOE perform R&D, but, as the Commission is informed, only "to satisfy U.S. law";
- If the substance of the non-US Apple profit is attributable to the consumer States, to Cupertino (know how, IP, personnel, strategy) and to China (factories), then why was it all recorded in ASI and AOE?
- If 1,500 employees in Cork cannot explain $ 100 billion profit, then how can 5 non-employed part-time managers in the US? And if they can, then why doesn't the US tax that profit?
- If ASI and AOE have no US trade or business and the CSA is arm's length, then how could their profit be US profit?
- TP profit shifters and States facilitating them must face their inconsistencies and contradictions before one single international Court, looking at both sides

Angry US Senate Finance Committee

- Commission State Aid Decisions are a ‘direct threat to US interests’
- ‘novel interpretation’ of State aid law – retro-active taxation
- discrimination against US Companies; call for application of section 891 IRC
- Frustration/override of US tax treaties with EU Member States
- US taxpayer is ‘footing the bill’ for ‘billions of dollars in tax assessments’

Which Baseline/benchmark?

- Other multinationals? (Commission checked all other Irish p.e. attribution rulings)
- Resident standalone company?
- Standalone company managed in the same way from Taiwan?
- (Nonexistent) national law?
- OECD soft law?
- General market equality principle (EU ALP)?
- A ‘market economy operator’ (MEO) does not levy any tax

Discrimination or State Aid or both? Benchmark approach or discrimination test?

- Case C-169/08 *Regione Sardegna* (Tax on touristic stopovers)
- Case C-66/14 *Finanzamt Linz* (domestic purchased goodwill write-off)
- Cases C-164/15 P *Aer Lingus* and C-165/15 P *Ryanair* (differentiated Irish Air Travel Tax)
- Cases C-20/15P and C-21/15P World Duty Group and *Banco Santander* (foreign purchased goodwill write-off)

World Duty Free judgment:

54 (…) it is clear from (…) settled case-law of the Court that the assessment of [selectivity] requires a determination whether, under a particular legal regime, a national measure is such as to favour ‘certain undertakings or the production of certain goods’ over other undertakings which, in the light of the objective pursued by that regime, are in a comparable factual and legal situation and who accordingly suffer different treatment that can, in essence, be classified as discriminatory (see, (…) Mediaset v Commission, C 403/10 P, (…) Commission and Spain v Government of Gibraltar and United Kingdom, C 106/09 P and C 107/09 P, (…) Eventech, C 518/13, (…) Commission v MOL, C 15/14 P (…)).

World Duty Free judgment

71 (….) the analytical method applicable to selectivity in tax matters that may be deduced from the Court’s settled case-law, which essentially involves ascertaining whether the exclusion of certain operators from the benefit of a tax advantage that arises from a measure derogating from an ordinary tax system constitutes discrimination with respect to those operators, (…)

World Duty Free judgment:

- 74 (…). That measure [the Gibraltar tax regime] accordingly operated de facto discrimination against undertakings that were in a comparable situation in the light of the objective pursued by that regime, in that case the objective of putting in place generalised taxation of all resident companies

World Duty Free judgment:

86 It follows that a condition for (…) tax aid may be grounds for a finding that that aid is selective, if that condition leads to a distinction (…) between undertakings despite the fact that they are, in the light of the objective pursued by the tax system concerned, in a comparable factual and legal situation, and if, therefore, it represents discrimination against undertakings which are excluded from it.

World Duty Free judgment:

93 It follows (…) that the General Court erred in law, in (…) omitting to determine whether the Commission, (…) had established that that measure was discriminatory.

94 (…), indeed, that examination must be carried out rigorously and (…) sufficient reasons must be stated to permit full judicial review, in particular of the question whether the situation of operators benefiting from the measure is comparable with that of operators excluded from it and, where appropriate, of the justification for discrimination relied on by the Member State concerned, (…).

World Duty Free judgment:

110 (…), the rules governing the free movement of capital do not preclude a measure such as the measure at issue. While that measure involved different treatment that favours acquisitions of shareholdings abroad, that is at most reverse discrimination which is compatible with the fundamental freedoms.

Comparison of Instruments and Criteria

Rule of Reason (Arts. 45-65 TFEU) hard law - 1 State issue - only interstate	**State Aid** (Arts. 107-109 TFEU) hard law - 1 State issue - mainly in*tra*state	**Code of Conduct** (Open method of coordination (OMC)) soft law - 1 State issue - interstate	**Market Distorting Disparities** (Arts. 116-117 TFEU) hard law, but paper tiger - 2 or more States - interstate issues
Prima facie discrimination?	Advantage Through State resources	Significantly lower tax level lack of substance lack of transparency lack of arm’s length	Differences in law or in administrative action
Objective difference?	Selectiveness	ring-fencing off-shore effect	
	Affecting interstate trade	Significant influence on establishment	Distorting conditions of competition in the internal market
Justification in mandatory public interest (coherence/ balanced allocation/ abuse/supervision)? - appropriateness; - proportionality	Justification in the nature or general scheme of the tax? - proportionality		Which need to be eliminated (necessity, proportionality) **NB**: qualified majority suffices

(No) State Aid in 3rd States

- EU State aid law is rather special;
- No direct equivalent to the EU State aid prohibition in WTO, US or Swiss law
- Both direct subsidies and tax exemptions are very common with little legal limits
- US Commerce clause only prohibits discrimination in favour of local firms;
- *Cuno v DaimlerChrysler*: 10 year property tax holiday and a 13.5% investment credit against State corporation tax; value $ 280 million; prohibited by the Court of Appeal because the credit coerced the company to produce locally)

EU - WTO

- WTO: SCM-Agreement (Agreement on subsidies and countervailing measures)

- EU state aid rules are much more stringent than WTO subsidies rules:

- WTO: only ‘financial contribution by a government or any public body’ are subsidies; EU rules prohibit assistance in any form whatsoever, whether or not financial;
- default position in WTO rules: subsidies are generally allowed; EU rules consider subsidies to be generally illegal; WTO does not outright prohibit many subsidies; alsmost all of them are ‘actionable’, allowing ‘countervailing measures’ (retaliation);
- EU rules apply also domestically; WTO rules only in international trade.
- State aid rules prohibit assistance even if it does not actually affect international trade but the subsidised good or service is ‘theoretically tradable’. WTO rules require another country to demonstrate that its domestic industry is hurt.
- EU rules are applied prospectively (legality must be proved before awarding); WTO rules only apply reactive, and
- only if a member country complains;

WTO SCM-Agreement

“Annex I

Illustrative List Of Export Subsidies

(…)

(e) The full or partial exemption, remission, or deferral specifically related to exports, of direct taxes or social welfare charges paid or payable by industrial or commercial enterprises [footnote 59]”

WTO SCM Treaty Annex I

Footnote 59:

"The Members recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected. The Members reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under (...) the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm's length. Any Member may draw the attention of another Member to (...) practices which may contravene this principle and which result in a significant saving of direct taxes in export transactions. (...) the Members shall normally attempt to resolve their differences using (...) existing bilateral tax treaties or other specific international mechanisms, without prejudice to the rights and obligations of Members under GATT 1994, including the right of consultation created in the preceding sentence.

Paragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member."

EU - Switzerland

Article 23 of the 1972 Tree Trade Agreement Between the European Economic Community and The Swiss Confederation:

"1 . The following are incompatible with the proper functioning of the agreement in so far as they may affect trade between the community and switzerland:

(i) (…) [cartels];

(ii) abuse (…) of a dominant position (…);

(iii) any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods.

2 . Should a contracting party consider that a given practice is incompatible with this article, it may take appropriate measures under the conditions and in accordance with the procedures laid down in article 27."

Commission State Aid Decision C(2007)411 final against Switzerland

- Joint Committee discussions did not yield any result
- Therefore: Commission Decision:

"Art. 1: The State aid schemes implemented by Switzerland in the form of special company tax regimes for management, mixed and holding companies which grant favourable tax rates for income generated abroad [PJW: in the cantons of Zug and Schwyz] are incompatible with the proper functioning of the agreement.

Art. 2 Switzerland should abolish or amend these tax regimes by removing the differentiated tax treatment of domestic and foreign source income.

Art. 3: The Commission reserves the right to propose the adoption of safeguard measures (….)."

Press release IP/07/176

- All Swiss Cantons fully or partially exempt profits generated abroad. (…) a formidable incentive for the headquarters, co-ordination and distribution centres of multinationals active in the EU market to be based in Cantons such as Zug and Schwyz, in order to minimize their tax liabilities;
- The Commission is not against tax competition or low rates, but cannot accept differentiation between domestic and foreign source income;
- In 1972, all EFTA countries concluded identical agreements with the EU. Similar action against State aid has been taken on the basis of the corresponding provisions in agreements with other EFTA countries.
- Tax regimes like the Swiss ones are not allowed inside the EU and the Commission has taken action against Member States.
- Member States have committed themselves to abolishing similar preferential tax measures in the Code of Conduct for Business Taxation and to promoting the Code standards with third countries.

EU-CH joint statement on company tax issues (Oct. 2014)

- The term ‘State aid’ does not occur;
- ‘shared principles and shared political intentions to solve company tax issues that (…) have the potential to distort business operations and opportunities’;
- ‘recognise the essential features constituting harmful tax competition; acknowledge that at international level these features are reflected in specific principles and criteria at the OECD and within the EU at EU level’;
- ‘concur that tax avoidance and tax evasion need to be countered appropriately’;

EU-CH joint statement on company tax issues (Oct. 2014)

“**3. Swiss Company Tax Policy**

The Swiss Federal Council intends to (…) remove the following five tax regimes (subject to approval by the appropriate legislators (…)):

- the cantonal administrative company status;
- the cantonal mixed company status;
- the cantonal holding company status;
- Circular Number 8 of the Federal Tax Administration on principal structures, and
- the current practice of the Federal Tax Administration regarding finance branches.

Moreover, the Swiss Federal Council has expressed an intention that any possible replacement measures will need to be in line with generally accepted international standards (…). The Swiss Federal Council (…) intends to adopt draft legislation and open the compulsory consultation process with the cantons, political parties and other interested groups as soon as possible.”

EU-CH joint statement on company tax issues (Oct. 2014)

“**4. Tax policy in EU Member States**

(…) the Member States, meeting within the Council of the EU, acknowledge that in the situation where an above mentioned Swiss regime is effectively removed, then any Member States’ countermeasures which are expressly targeted at such a regime should also be removed.”

2017 Swiss Tax Reform rejected

- The Swiss Corporate Tax Reform Act III (2017) should abolish the low cantonal taxation of holding, management and mixed companies, replacing it for internationally accepted (i) low taxation of patents (Patentbox), (ii) more than 100% deduction of R&D expenses, and (iii) an allowance for corporate equity;
- horizontal, but in fact benefiting mainly R&D-intensive and internationally mobile undertakings;
- A 12 February 2017 referendum rejected the reform; in both popular vote and cantonal vote;
- 59,1 per cent voted against, apparently for fear of losses of tax revenue and having to make up for these losses;
- Now what? (compare Basque tax regimes)

Other Options

- Never mind about residual profits; raise the rate or tax the distribution;
- Formula apportionment; CCCTB
- Hybrid: regular methods for routine functions/formula for residual profit
- Partial solutions: (i) defiscalize debt financing (CBIT) or (ii) allowance for corporate equity (ACE) or (iii) allowance for corporate capital (CAP: notional capital cost deduction)
- Replace corporation tax for Cash flow taxes (CFT's: taxing inbound cash flow and refunding tax on outbound cash flow; like VAT, but cash flow based rather than transaction based)
- Ecofin Council 16 september 2017: change p.e. concept and attribution rules to catch Big Tech; France wants to tax on the basis of sales after losing *Google* for lack of a p.e.