STARBUCKS – GENERAL COURT JUDGMENT: COMMENTS AND ANALYSIS

Tom O'Shea*

The General Court's judgment in the *Starbucks* case[1] provided a shock for the European Commission and its campaign against the advanced ruling regimes of the Member States using the EU's state aid rules. The General Court rejected the Commission's arguments that the Netherlands granted state aid to Starbucks. The judgment demonstrates that advance rulings may continue to exist provided that they comply with EU law, in particular the state aid rules.

Selective Advantage

In *World Duty Free*,[2] the CJEU (Grand Chamber) explained the significance of determining the reference system for the purposes of the selectivity analysis. The Court highlighted, in paragraph 54, that the assessment of whether a selective advantage existed –

> "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".

* Dr Tom O'Shea is a Chartered Tax Adviser and Director of the Academy of European and International Taxation, London. He may be contacted at tom@drtomoshea.com.

1 *Netherlands v Commission ("Starbucks"),* Cases T-760/15 and T-636/16, ECLI:EU:T:2019:669.

2 *European Commission v World Duty Free and Others, ("World Duty Free"),* Joined Cases C-20/15 P and C-21/15 P, ECLI:EU:C:2016:981.

In paragraphs 57 and 58, the Court stressed that the Commission must begin by –

> "identifying the ordinary or 'normal' tax system applicable in the Member State concerned, and thereafter demonstrate that the tax measure at issue is a derogation from that ordinary system, in so far as it differentiates between operators who, in the light of the objective pursued by that ordinary tax system, are in a comparable factual and legal situation …
>
> The concept of 'State aid' does not, however, cover measures that differentiate between undertakings which, in the light of the objective pursued by the legal regime concerned, are in a comparable factual and legal situation, and are, therefore, a priori selective, where the Member State concerned is able to demonstrate that that differentiation is justified since it flows from the nature or general structure of the system of which the measures form part".

The Court concluded, in paragraph 60, that –

> "the appropriate criterion for establishing the selectivity of the measure at issue consists in determining whether that measure introduces, between operators that are, in the light of the objective pursued by the general tax system concerned, in a comparable factual and legal situation, a distinction that is not justified by the nature and general structure of that system".

In *Starbucks*, the Court applied this reasoning and established that the reference system for the purposes of the state aid case was the corporate income tax regime of the Netherlands. The Court noted that this regime imposed corporate income tax on all companies established in the Netherlands and on all non-resident companies that carried on an economic activity in the Netherlands.

Therefore, integrated companies, like Starbucks, and stand-alone companies established in the Netherlands were in a comparable legal and factual situation in light of the objective of the Netherlands' corporate income tax system, since they were subject to the corporate income tax regime without distinction.

The Advanced Pricing Agreement

Since Starbucks was a member of an international group of companies, an advanced pricing agreement ("APA") between the Dutch tax authorities and Starbucks was needed to determine the remuneration for Starbucks Marketing BV ("SMBV") for its production and distribution services in the Netherlands. SMBV was mainly responsible for the production of roasted coffee beans and for the distribution of these coffee beans and related products to Starbucks' shops in the Europe, Middle East and Africa region ("EMEA").

The APA was intended to be used for the purposes of SMBV's annual corporate income tax declarations in the Netherlands. It indicated that SMBV licenced certain intellectual property ("the roasting IP") rights from another Starbucks subsidiary, established in the United Kingdom ("Alki") that were necessary to the process of producing coffee and providing it to Starbucks' stores. In return for the roasting IP, SMBV paid a royalty to Alki. The APA provided for a method of determining SMBV's remuneration in accordance with the arm's length principle and endorsed the amount of the royalty paid to Alki for the use of the roasting IP.

Transfer Pricing Methodology

The transfer pricing method chosen for determining an arm's length remuneration for SMBV's services was the transactional net margin method ("TNMM"). The royalty payment from SBMV to Alki was also determined in the APA as being the difference between SMBV's operational profit, before royalty expenses, and SMBV's remuneration. The Court noted that the royalty payment was deductible for Netherlands' corporate income tax purposes and was not subject to withholding tax in the Netherlands.

Under Netherlands' law, the arm's length principle ("ALP") was an integral part of that law. The Court noted that the ALP test compared the conditions of a transaction between independent companies with the conditions of a similar transaction between intra-group companies or affiliated companies. In applying the ALP, the Netherlands' authorities took into consideration the OECD's Transfer Pricing Guidelines ("TPG") and accepted that the taxpayer was free to choose the transfer pricing methodology as long as that methodology resulted in an outcome that approximated the ALP.

Commission's State aid Case

The Commission submitted that state aid was granted to Starbucks since the APA conferred a selective advantage on SMBV and the Starbucks group. It argued that the choice of the transfer pricing method reduced the corporate income tax paid by SMBV as compared to a stand-alone company resident in the Netherlands, whose taxable profits were determined under market conditions. It also contended that the royalty payable to Alki should have been set at zero because SMBV generated no profit from the use of the roasting IP rights since it did not exploit them on the market. Consequently, the Commission considered that the profits paid to Alki should have been fully taxed in the Netherlands.

The Commission argued that the ALP was a tool or "benchmark" for assessing the price level of intra-group transactions and was part of its assessment under Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU"). It explained that the ALP was used to determine whether the taxable profit of a group company for Netherlands' corporate income tax purposes had been determined on the basis of a methodology that resulted in an approximation of market prices, so that the company was not treated more favourably under the Netherlands' general corporate income tax system as compared to another Netherlands' company whose taxable profits were determined under market conditions.

The General Court's Response

The General Court stressed, in paragraph 147 of *Starbucks*, that –

> "in order to determine whether there is a tax advantage, the position of the recipient as a result of the application of the measure at issue must be compared with his position in the absence of the measure at issue … and under the normal rules of taxation".

Therefore, for the purposes of a state aid assessment under Article 107(1) TFEU, the comparator examines the fiscal burden of an integrated company resulting from the application of the APA and compares it to the fiscal burden resulting from an application of the reference system, or normal rules of corporate income taxation in the Netherlands, to an undertaking carrying on its activities in conditions of free competition.

The General Court accepted, in paragraph 151, that –

> "Article 107(1) TFEU allows the Commission to check whether that pricing corresponds to pricing under market conditions, in order to determine whether there is, as a result, any mitigation of the burdens normally included in the budget of the undertaking concerned, thus conferring on that undertaking an advantage within the meaning of that article. The arm's length principle … is thus a tool for making that determination in the exercise of the Commission's powers under Article 107(1) TFEU. The Commission also stated, correctly … that the arm's length principle was a 'benchmark' for establishing whether an integrated company was receiving, pursuant to a tax measure determining its transfer pricing, an advantage within the meaning of Article 107(1) TFEU".

Whilst the General Court accepted that the Commission could use the ALP to determine whether a selective advantage had been granted by the Member State in question, it stressed, in paragraph 152, that –

> "when the Commission uses that tool to check whether the taxable profit of an integrated undertaking pursuant to a tax measure corresponds to a reliable approximation of a taxable profit generated under market conditions, the Commission can identify an advantage within the meaning of Article 107(1) TFEU only if the variation between the two comparables goes beyond the inaccuracies inherent in the methodology used to obtain that approximation".

In other words, the ALP involves an estimate or an approximation of the taxpayer's tax base and is not an absolute measurement or calculation.

The General Court also stressed, in paragraph 154 of *Starbucks*, that –

> "the Commission cannot be criticised for having used a methodology for determining transfer pricing that it considers appropriate in this instance in order to examine the level of transfer pricing for a transaction or for several closely connected transactions that is part of the contested measure. The Commission is nevertheless required to justify its choice of methodology".

The General Court accepted that the Commission had the power under Article 107(1) TFEU to assess whether the transactions took place at arm's length or under market conditions. It went on to explain, in paragraph 159, that –

> "While, in the absence of EU rules governing the matter, it falls within the competence of the Member States to designate bases of assessment and to spread the tax burden across the different factors of production and economic sectors … it does not mean that every tax measure, which affects, inter alia, the basis of assessment taken into account by the tax authorities, will escape the application of Article 107 TFEU … It follows that the Commission does not have, at this stage of the development of EU law, competence to allow it to define in an autonomous manner the 'normal' taxation of an integrated undertaking, by disregarding national tax rules. However, although 'normal' taxation is defined by national tax rules and although the very existence of an advantage must be established by reference to them, the fact remains that, if those national rules provide that stand-alone companies and integrated companies must be dealt with under the same conditions, Article 107(1) TFEU allows the Commission to verify whether the price level of intra-group transactions, accepted by the national authorities for determining the tax base of an integrated undertaking, corresponds to a price level of a transaction which has been negotiated in market conditions".

The General Court also confirmed that the Commission had made it clear in its Starbucks Decision[3] that the arm's length principle existed independently of the incorporation of that principle into the national legal system. The Commission also made clear that it had not examined whether the APA complied with the arm's length principle laid down in Netherlands law. The General Court pointed out that the Commission asserted that the ALP which it applied was distinct from that enshrined in Article 9 of the OECD Model Tax Convention on Income and on Capital.

The General Court noted, in paragraph 164, that the Commission argued that –

> "if a Member State chooses, in the context of its national tax system, the approach of the separate legal entity, according to which tax law is concerned

3 See https://ec.europa.eu/competition/state_aid/cases/253201/253201_1762441_575_2.pdf .

> with legal entities, and not with economic entities, the arm's length principle is necessarily a corollary of that approach, which is binding in the Member State concerned, independently of whether the arm's length principle has, expressly or impliedly, been incorporated into national law".

Accordingly, the General Court concluded that the Commission was entitled to use the ALP as a criterion for assessing the existence of state aid.

Choice of the Transfer Pricing Method

Next, the General Court investigated whether the choice of the transfer pricing method by the Netherlands and Starbucks led to a selective tax advantage being granted contrary to Article 107(1) TFEU. In paragraph 196, the General Court indicated that –

> "it was for the Commission to show, in the contested decision, that the requirements for a finding of State aid, within the meaning of Article 107(1) TFEU, were met. In that regard, it must be held that, while it is common ground that the Member State has a margin of appreciation in the approval of transfer pricing, that margin of appreciation cannot lead to the Commission being deprived of its power to check that the transfer pricing in question does not lead to the grant of a selective advantage within the meaning of Article 107(1) TFEU. In that context, the Commission must take into account the fact that the arm's length principle allows it to verify whether the transfer pricing accepted by a Member State corresponds to a reliable approximation of a market-based outcome and whether any variation that may be identified in the course of that examination does not go beyond the inaccuracies inherent in the methodology used to obtain that approximation".

The General Court went on to highlight, in paragraph 199, in relation to whether the chosen transfer-pricing method delivered an ALP, that –

> "when using that tool in carrying out its assessment under Article 107(1) TFEU, the Commission must take into account its approximate nature. The purpose of the Court's review is therefore to verify whether the errors identified in the contested decision, and on the basis of which the Commission found there to be an advantage, go beyond the inaccuracies inherent in the application of a method designed to obtain a reliable approximation of a market-based outcome".

The General Court concluded, in paragraph 201, that the Commission had to demonstrate –

> "that the methodological errors that it identified in the APA do not allow a reliable approximation of an arm's length outcome to be reached and that they led to a reduction in the taxable profit compared with the tax burden resulting

> from the application of normal taxation rules under national law on an undertaking placed in a comparable factual situation to SMBV and carrying out its activities under market conditions. Thus, the mere finding of a methodological error does not in itself suffice, in principle, to demonstrate that the APA conferred an advantage on SMBV and, thus, to establish that there is State aid within the meaning of Article 107 TFEU".

In paragraph 203, the Court held that –

> "the mere fact that, according to the Commission, neither the transfer pricing report nor the APA identified the royalty as the transaction for which a transfer price was in reality determined in the APA and that they did not analyse whether the royalty was in conformity with the arm's length principle does not suffice to demonstrate that that royalty was not actually in conformity with the arm's length principle. That finding alone therefore did not prove that the APA conferred an advantage on SMBV".

Therefore, the General Court concluded that the Commission wrongly found that the absence of a separate analysis of the royalty payment in the transfer pricing report and in the APA conferred an advantage on SMBV.

In relation to the issue of whether the "CUP" (comparable uncontrolled price) method or the "TNMM" (transactional net margin method) should have been used in the APA to determine the level of the royalty payment between SMBV and Alki, the General Court held that the two methods are applied to calculate the price level of different intra-group transactions. It explained, in paragraph 209, that the Commission –

> "cannot mandate the examination of another transaction than that for which the APA determined a transfer price on the basis of the TNMM solely because, for that other transaction, a transfer price should have been determined on the basis of the CUP method".

The General Court went on to indicate that the Commission provided no evidence to show that the choice of the TNMM leads to a result that is not in keeping with the ALP. It accepted, in paragraph 214, that –

> "the taxpayer is in principle free to choose a transfer pricing method as long as the method selected leads to an arm's length outcome for the transaction in question. Even though the taxpayer is expected to take into account, when choosing a transfer pricing method, the reliability of that method in the situation in question, that step does not specifically seek to incentivise the taxpayer to assess all methods and then justify how the method he has chosen produces the best result under the conditions present".

Accordingly, the General Court held that the Commission was not entitled to insist on the CUP method over the TNMM.

Zero Royalty

The Commission's next submission related to the royalty between SMBV and Alki. It argued that the royalty rate should have been zero and that it resulted in a tax advantage for SMBV within the meaning of Article 107(1) TFEU. In other words, the Commission contended that no royalty should have been paid. Since the royalty was deductible under Netherlands tax law, its payment reduced SMBV's taxable base in the Netherlands. Therefore, the level of such a transaction should be determined in market conditions at ALP.

The General Court noted that the royalty was paid for the use of the roasting IP. It also highlighted, in paragraph 259, that –

> "First, … the roasting IP was, in principle, capable of representing an economic value. Second, … SMBV is a roaster that was obliged to use the roasting IP to roast its coffee. Third, the Commission maintains that Starbucks stores, both affiliated and unaffiliated, are required to purchase roasted coffee from SMBV and that SMBV is thus also the vendor of the roasted coffee".

The General Court concluded, in paragraphs 260-262, that the Commission was wrong –

> "to focus its analysis on the premiss that the value of the roasting IP is exploited only where the products are sold to final consumers. The question of who ultimately bears the costs corresponding to the compensation of the value of the IP used for coffee production is clearly separate from the question of whether the roasting IP was necessary to allow SMBV to produce roasted coffee according to the criteria stipulated by Starbucks stores, to which it sells, on its own behalf, the coffee …
>
> In the event that SMBV sells the coffee it has roasted to Starbucks stores which require coffee to have been roasted according to Starbucks' specifications, it is plausible that, in the absence of the right to use, or … exploit the roasting IP, SMBV would not have been in a position to produce and supply roasted coffee according to Starbucks' specifications in stores of the same name ...
>
> SMBV's payment of a royalty to use the roasting IP is not devoid of all economic rationality. The IP was, after all, necessary for exercising SMBV's economic activity, namely, the production of roasted coffee according to Starbucks' specifications. It follows that SMBV does indeed derive added value from the use of the roasting IP, without which it could not then resell the roasted coffee to Starbucks stores".

In relation to the variable nature of the royalty, the General Court accepted that this raised questions regarding the economic rationality of the royalty payment. However, it explained, in paragraph 367, that –

> "the residual nature of that royalty simply means that it was calculated, in principle, from the determination of the level of other relevant charges and incomes as well as from an estimate of the level of SMBV's taxable profit. If those parameters were correctly identified, the mere residual nature of the royalty would not preclude the level of the residual royalty from corresponding to its economic value".

Accordingly, the Court rejected the Commission's arguments that the royalty should have been set at a lower level than that endorsed by the APA.

SMBV as the "tested party"

The Commission also submitted that SMBV should not have been chosen as the "tested party" for the purposes of the TNMM. The General Court pointed out, in paragraph 428, that –

> "in the examination of advantage within the meaning of Article 107 TFEU, in order to satisfy its obligation to state reasons … the Commission was obliged to set out the reasons why it had found that the error as to the choice of the tested entity had 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 arm's length outcome, thereby leading to a reduction in SMBV's tax burden".

The General Court determined that the Commission had not provided sufficient reasons for its decision that choosing SMBV as the tested party led to a reduction in SMBV's taxable profits. It also stressed, in paragraph 433, that –

> "Even assuming that the Commission could review the APA in the light of the 1995 version of the OECD Guidelines, as were available in April 2008, and that it could infer the existence of an advantage from the non-conformity with the requirements contained in those guidelines, those guidelines do not lay down a strict rule on the identification of the tested party".

The General Court explained, in paragraphs 434 and 435, that –

> "paragraph 3.43 of the 1995 OECD Guidelines indicates that the associated company, to which the TNMM is applied, must be the company for which reliable data on the most directly comparable transactions can be identified. It is next specified that that will often entail selecting the associated enterprise that is the least complex of the enterprises involved in the controlled transaction and that does not own valuable intangible property or unique assets. It follows that the guidelines do not necessarily oblige choosing the least complex entity, but merely advocate choosing the entity for which the most reliable data are available …

> The Commission does not, however, prove that more reliable data were available to apply the TNMM to Alki. It is necessary inter alia to note that, first, the purpose of the APA is to determine the level of taxable profit of SMBV and not that of Alki and that, second, Alki was a third party to the procedure aimed at determining SMBV's fiscal situation in the Netherlands".

Choice of Profit-level Indicator

Next, the General Court investigated whether the Commission proved that the choice of the profit-level indicator – operating costs of SMBV – led to an outcome that was not in conformity with the ALP. It accepted that operating costs could be a profit-level indicator that could lead to an arm's length outcome and held, in paragraph 474, that –

> "the Commission has not demonstrated to a requisite legal standard that the choice of operating costs as profit level indicator did not allow a reliable approximation of a market-based outcome to be reached".

Choice of Adjustments

Starbucks and the Netherlands submitted that the Commission has not demonstrated that the adjustments proposed in the transfer pricing report to increase the comparability between SMBV and the comparable companies were such as to confer an advantage on SMBV.

The General Court, in paragraph 512, recalled what it had said in paragraphs 151 and 152 of *Starbucks*, that –

> "in order to determine whether the APA conferred an advantage on SMBV in the case at hand, it is for the Commission to show that the transfer pricing method endorsed in the APA led to a reduction of SMBV's tax burden and, more specifically, to show that the level of SMBV's profits, calculated under the transfer pricing method, is reduced to such an extent that it cannot be regarded as being a reliable approximation of a market-based outcome".

The first adjustment excluded certain items from SMBV's cost base that was used as a profit-level indicator. These excluded the costs of an unaffiliated manufacturing company. The General Court held that the Commission did not prove that this resulted in an advantage for SMBV. It accepted that SMBV did not provide added value in relation to these excluded activities.

In relation to the second, "working capital" adjustment, the Commission maintained that the application of this adjustment meant that the method proposed in the transfer pricing report did not result in a reliable approximation of a market-based outcome in line with the arm's length principle. The General Court rejected this submission, pointing out that the Commission had not shown that such an adjustment resulted in an advantage for SMBV or lowered its profits.

The Conclusions of the General Court

The General Court concluded that the Commission had not demonstrated that the APA had conferred an advantage on SMBV within the meaning of Article 107(1) TFEU. Since there was no advantage, there was no state aid in this case.

Analysis

The *Starbucks* judgment of the General Court has raised a number of issues concerning the correct comparator; the use of the ALP; the choice of transfer pricing methods; the burden of proof; the concept of "advantage" within the meaning of Article 107(1) TFEU; the use of the OECD's Transfer Pricing Guidelines (2010 and 1995); the margin of appreciation granted to Member States in transfer pricing situations and the scope of the General Court's review in relation to such matters that fall within the scope of Article 107(1) TFEU. This analysis will focus on some of the main issues arising from the judgment.

The Arm's Length Principle

The General Court accepted that the Commission was entitled to use the ALP in assessing whether a transfer pricing situation complied with Article 107(1) TFEU. In coming to this conclusion, the General Court accepted that the Commission was not bound by the OECD Transfer Pricing Guidelines and it was merely trying to determine whether the Netherlands tax administration had conferred a selective advantage on SMBV contrary to Article 107(1) TFEU. As such, the Commission could use the ALP as a tool or benchmark for determining whether a transaction was conducted under market conditions (or at arm's length).

The Commission explained that the ALP is a tool for assessing the price level of intra-group transactions and formed part of its assessment under Article 107(1) TFEU. It stressed that it applied "irrespective of whether the Member State had incorporated that principle into its national legal system". The General Court accepted this submission. This is a correct finding by the General Court and has implications for its forthcoming judgment in the *Apple/Ireland* case.[4]

In paragraph 139 of *Starbucks*, the General Court noted that the Commission indicated that "the arm's length principle which it was applying was a general principle of equal

---

4 See https://ec.europa.eu/competition/state_aid/cases/253200/253200_1851004_674_2.pdf

treatment in taxation, which fell within the application of Article 107 TFEU. Again, this is a correct analysis since the national rules in question endeavoured to tax Dutch companies and non-resident companies with economic activities in the Netherlands in the same way for corporate income tax purposes. In situations where comparability is shown to exist (legal and factual), both situations should be treated in the same way for corporate income tax purposes. Allowances, of course, have to be made for the fact that transfer pricing is not an exact science and involves an estimation or approximation of the actual tax base. The principle of equal treatment that is built into the "selective advantage" criterion contained in Article 107(1) TFEU ensures that comparable situations are treated in the same way by the Dutch corporate income tax regime, otherwise a selective advantage may exist for the purposes of the state aid assessment.

The suggestion that the Commission's use of the ALP is a "major departure from prior law" [5] is well off the mark. Equally, the suggestion that the General Court's judgment represents a "judicial reallocation of power [that] is not supported by the text or prior interpretation of the TFEU and it should not be upheld by the CJEU" [6] fails to understand that Article 107(1) TFEU is the law of each Member State since they joined the EU. The supremacy of EU law over the direct tax systems of the Member States has been established since the *Humblet* decision from 1960.[7]

The Court's first state aid case [8] involving the direct tax rules (reduction of certain social charges in the textile industry) of a Member State dates from 1974 and the *Commission Notice on the application of the State aid rules to measures relating to direct business taxation* was introduced in 1998.[9] Consequently, there is no "judicial reallocation of power" at stake in the *Starbucks* judgment of the General Court.

The direct tax rules of the Member States have been subject to the state aid rules since they became Members of the EEC, the EC or EU.[10] Interpretation of the rules of the TFEU (and earlier Treaties) has always been entrusted to the Court of Justice of the European Union and the General Court (since its establishment).[11]

---

5 See Ruth Mason, "Implications of the Rulings in Starbucks and Fiat for the Apple State Aid Case", Tax Notes International, Oct. 7, 2019.

6 See Mason, fn 5, supra.

7 See *Jean Humblet v Kingdom of Belgium ("Humblet"),* Case C-6/60-IMM, ECLI:EU:C:1960:48.

8 *Italy v Commission,* Case 173/73, ECLI:EU:C:1974:71.

9 See *Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384, 10.12.1998, p. 3–9.*

10 See Tom O'Shea, *EU Tax Law and Double Tax Conventions* (Avoir Fiscal, London, 2008).

11 See Tom O'Shea, "Main Role of Judicial Actors in the EU: Interpreting EU Law", ECTJ, 17, 2016-17, 67-131.

In *Starbucks*, the General Court is merely interpreting EU law. Article 107(1) TFEU requires the Commission to carry out an assessment of the selectivity criterion. To carry out this task, a comparison needs to be made between tax treatment under the "normal" national tax regime and treatment under the APA. If tax treatment under the APA gives an advantage to a company that should be taxed in a similar way to a company taxed under the "normal" tax regime, state aid may have occurred. The ALP is one method for determining whether market conditions have been applied in dealings between connected companies. That is not to say ALP is the only method but this has been the practice of states internationally for many years in transfer pricing situations.

Whilst it is correct to say that "the allocation of profits has always been recognised as a sovereign choice" of States,[12] it is incorrect to say this in relation to the EU's Member States, because their direct tax rules and double tax conventions must comply with EU law, in particular, in this discussion, with the state aid rules contained in Article 107(1) TFEU. Therefore, the Commission is entitled to devise its own arm's length rule because all it is doing is applying Article 107(1) TFEU which requires it to conduct an assessment under the "selectivity" criterion. The Commission is not applying the OECD's Transfer Pricing Guidelines, although these are obviously persuasive. The issue is not, therefore, the Commission asserting its own ALP to allocate "taxable income among related parts of an enterprise – regardless of a Member State's own domestic allocation rules". [13] The Commission is simply enforcing the state aid rules contained in the TFEU and the General Court is interpreting EU law rules. In coming to its decision, the General Court (and the Commission) may take the OECD's Transfer Pricing Guidelines into account but it is not bound by them.

The Reference ("Normal") Tax System

The reference system or "normal" tax system in this case is correctly identified by the Commission and the General Court as being the corporate income tax system of the Netherlands, that taxes all Dutch resident companies and non-resident companies with economic activities in the Netherlands on their Dutch profits. There is nothing to suggest in the Dutch rules that the situations in *Starbucks* are not comparable.

Deviations from the "normal" tax system (such as possibly under the APA in this case) can result in selective advantages being granted to affiliated companies in transfer pricing situations. Such deviations or derogations can be justified by the Member State where they flow "from the nature or general structure of the system of which the measures form part" (as highlighted above in *World Duty Free*). In transfer pricing situations, it is the Member State that must apply its national rules and its

12 See Mason, fn 5, supra.

13 See Mason, fn 5, supra.

transfer pricing laws to determine the appropriate taxable base in its territory, in accordance with the ALP. Therefore, the *Starbucks* judgment has no impact on this whatsoever.

It is important not to confuse identification of the reference system and the use of the ALP by a Member State within that tax regime, and use by the Commission of the ALP in its enforcement obligations under Article 107(1) TFEU. These are two entirely different issues.

In the latter situation, the Commission is merely applying Article 107(1) TFEU to determine whether the Member State in question has complied with the state aid rules, in particular, the selectivity criterion. In the former situation, the Member State is applying its own domestic / double tax convention rules in a transfer pricing situation. However, it is important to note that these national rules must comply with EU law.

OECD Transfer Pricing Rules

As noted above, the OECD's Transfer Pricing Guidelines are not binding on the Member States. The General Court also accepts that they are not binding on the Commission. However, when such transfer pricing rules are implemented into national law, as they were in *Starbucks*, they form part of the legal background to the case. As such, they are required to comply with EU law, in particular, the state aid rules. The Commission's function is to determine whether the Member State in question has exercised its transfer pricing rules (including through an APA) in a way which complies with EU law. This allows the Commission the opportunity to challenge situations where it is able to demonstrate that the national transfer pricing rules or an APA confer a selective advantage on a taxpayer in a comparable factual and legal situation to another taxpayer operating under the "normal" tax regime.

Final Thoughts

Even though the ALP can be interpreted in different ways and may involve different transfer pricing methodologies, that is not the issue in these transfer pricing / state aid cases. The Commission applied Article 107(1) TFEU to determine whether a Member State has breached state aid rules. One of these rules contains the "selectivity" criterion. In all situations, the national tax authority and the taxpayer will determine the transfer pricing method to comply with the ALP. The Commission's function is to determine whether the Member State's application of its transfer pricing rules granted a selective tax advantage to the taxpayer.

It is important to note the difference between identification of the reference system and the Commission's use of ALP to determine compliance with Article 107(1)

TFEU. The reference system will always be determined by national law, in *Starbucks*, by the national corporate income tax system.

One comment on the forthcoming *Apple* case, is that Ireland did nothing wrong in focusing on the Irish branches of ASI and AOE as the taxable bases for determining the mark-ups/margins. The question is whether the Commission actually showed that the methods adopted by the Irish Revenue Commissioners did not deliver an outcome in keeping with the ALP. Ireland had to be trying to tax the Irish branches of ASI and AOE on an ALP basis if taxing the activities, functions, assets and risks of those branches.[14] The burden of proof, following *Starbucks*, is clearly on the Commission to show that the Irish method did not result in ALP remuneration for those branches.

The residual income, again similar to *Starbucks* situation, is not relevant to the transfer pricing situation related to the remuneration for the activities, functions, assets and risks of the Irish branches, since the taxation of the non-resident companies residual profits is not a matter for Ireland given that the chosen transfer pricing method is a cost-plus/TNMM type method which focuses on the cost-bases of the Irish branches.

---

14 See Commission Decision in Apple, para. 53 (at fn 3, supra) and footnote 17 of the Commission Decision in Apple. See also Irish double tax convention practices which included Article 9 of the OECD Model Tax Convention in numerous Irish double tax conventions. For example, article 9 of Ireland-Hungary (1995) available at https://www.revenue.ie/en/tax-professionals/tax-agreements/double-taxation-treaties/h/hungary.pdf .