The Commission’s interpretation of the 1995 OECD Transfer Pricing Guidelines. Today’s EGC decision has several numbered paragraphs of the General Court of the European Court of Justice (“EGC”) in favor of The Netherlands and Starbucks. The crux of the legal issue is the EU Commission’s contention, required as the third condition for a finding of state aid, that Starbucks’ IP and intangibles are worth some if not all the residual. I just cannot show it through comparables as a toll manufacturer and reseller, was within the arm’s length range of other European coffee roasters, leaving a substantial annual residual. But if the EGC could not explain, or subordinate for itself, the residual...

...I can be certain that the residual nature of the royalty raises questions regarding the economic rationality of the royalty. In the case at hand, the Kingdom of the Netherlands and Starbucks have not provided any convincing explanations justifying the choice of an unusual method to determine the level of the royalty.

... In the same way, I did not jump to the conclusion that Starbucks was winning in its litigation. I think that the Kingdom of the Netherlands and Starbucks are earth some if not all the residual. You cannot show it through comparables with 95%, I have stopped believing that I cannot explain the residual allocation because the EGC also has not provided a good method much less solution to the issue of residual allocation. Instead, it found its peace in the residual nature of the royalty.

In conclusion of my 2015 353d review, I found that Starbucks’ intellectual property and intangibles had zero value for SMBV. The Commission’s contention under CUP that Alki’s IP and intangibles held zero value for SMBV was characterized as a toll roaster called upon to meet surplus demand that was not shown to sell roasted coffee in respect of end consumers on the market.

Moreover, the EGC found that three of the 10 agreements were not even with coffee roasters and thus those agreements were not comparable. The Kingdom of the Netherlands and Starbucks have not provided any convincing explanations justifying the choice of an unusual method to determine the level of the residual.

For the remainder of this article, I am preparing my brief commentary about today’s 15 page decision (43 numbered paragraphs) of the General Court of the European Court of Justice (“EGC”) in favor of The Netherlands and Starbucks’ application of a transaction price method and against the European Commission’s application of the arm’s length price method. For the EGC, the decisive factor was the presence of an arm’s length pricing of SMBV providing low-value services for roasting of coffee beans and for logistics and administrative services. The Commission, under its approach, considered the comparable arm’s length transactions to be those of the Kingdom of the Netherlands and Starbucks focused on the arm’s length pricing of SMBV providing low-value services for roasting of coffee beans and for logistics and administrative services. The Commission, under its approach, considered the arm’s length transactions to be those of the Kingdom of the Netherlands and Starbucks. However, the new astounding aspect of the case continues to be how to allocate the residual between SMBV and Alki. In a footnote (1), it is noted that the Singaporean territories were treated separately. The EGC determined that the comments by Starbucks argued that the three third party agreements into evidence three arm’s length contracts of SMBV and external roasters that did not include pricing for a licensing arrangement and referred to a total of ten such third party agreements in its 2015 decision. The EGC found that the arm’s length transactions were not comparable with the Alki contract.

The EGC determined that the comments by Starbucks argued that the three third party agreements were not even with coffee roasters and thus those agreements were not comparable. The Kingdom of the Netherlands and Starbucks have not provided any convincing explanations justifying the choice of an unusual method to determine the level of the residual.

The EGC found that the arm’s length transactions were not comparable with the Alki contract. Therefore, the EGC determined that the comments by Starbucks argued that the three third party agreements were not even with coffee roasters and thus those agreements were not comparable. The Kingdom of the Netherlands and Starbucks have not provided any convincing explanations justifying the choice of an unusual method to determine the level of the residual.

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Thus, the EGC held that SMBV's payment of a royalty to use the reselling IP is not devoid of all economic rationality. The Commission contended that the resale of coffee products was not the main function of SMBV. The EGC agreed with Starbucks' argument that SMBV was required to use the reselling IP to resell coffee products. The EGC found that the Commission's fiscal reasoning was based on the assumption that SMBV's primary function was the wholesale of coffee-derived products. The EGC ruled that the Commission's economic reasoning was not considered in the contested decision. The Commission was in error in not identifying that SMBV's main function was the resale of coffee products.

Secondly, the EGC sided with the Netherlands that the 1995 OECD Guidelines indicate that the associated costs of a controlled party should be treated as part of the cost base of the tested party. The Netherlands replied that the 1995 OECD TPG did not constrain the taxpayer from choosing which of the transfer pricing method to apply as long as the method chosen is one that could reasonably be applied to the tested party. To resolve this question, the EGC held that the 1995 OECD TPG did not constrain the taxpayer from choosing which of the transfer pricing method to apply as long as the method chosen is one that could reasonably be applied to the tested party. In the case at hand, the Kingdom of the Netherlands and Starbucks have not provided any convincing explanation justifying the choice of a particular transfer pricing method.

The EGC found the following facts agreed by both parties:

The Commission argued that the 1995 OECD Transfer Pricing Guidelines (thereof at the time of the entering into the 1995 OECD Transfer Pricing Guidelines, or the OECD TPG) are the appropriate tool for the resolution of transfer pricing disputes. This is, the OECD TPG did not address the question of whether the roasting IP was necessary to perform the main function of SMBV. The EGC agreed that the 1995 OECD TPG did not address the question of whether the roasting IP was necessary to perform the main function of SMBV. The EGC found that the 1995 OECD TPG did not address the question of whether the roasting IP was necessary to perform the main function of SMBV. The EGC found that the 1995 OECD TPG did not address the question of whether the roasting IP was necessary to perform the main function of SMBV.

The Commission argued that the 1995 OECD TPG did not constrain the taxpayer from choosing which of the transfer pricing method to apply as long as the method chosen is one that could reasonably be applied to the tested party. In the case at hand, the Kingdom of the Netherlands and Starbucks have not provided any convincing explanation justifying the choice of a particular transfer pricing method.

The EGC found the following facts agreed by both parties:

The Netherlands use of TMIP

The Netherlands use of TMIP, and specifically the use of the interquartile range, was a key factor in determining the arm's length profit margin. The Commission argued that it is economically rational for Starbucks to pay the royalty to SMBV to access the roasting IP. The EGC agreed with the Commission's argument that it is economically rational for Starbucks to pay the royalty to SMBV to access the roasting IP.
the costs of green coffee beans (cost of raw materials),

the negotiability and distribution costs for services provided by third parties,

the remuneration for activities provided by third parties under so-called "consignment manufacturing contracts,

and

the royalty payments to Alki LP.

The Commission focused on the fact that half of the sales revenue attributed to SMBV is generated from non-coffee sales that are booked for invoice consolidation convenience by SMBV. Starbucks alleges that these ancillary activities are not part of a "roasting" operation. The administration itself, Starbucks contends, is a low margin activity. The EU Commission challenged the tax advisor's exclusions, stating that the distinction between costs that pertain to value-added activities and costs that would not pertain to such activities does not exist in accounting rules and that such classification of costs relies solely on the judgment of the tax advisor, not upon the OECD Guidelines.

Based on the above approach and comparability filter, the tax advisor regressed out COGs and financing of COGs from the pool's companies. Based on these adjusted Operating Costs, the median net margin increased to 9.9 percent, but correspondingly applying to a smaller base.

Professor William Byrnes is an author of Practical Guide to U.S. Transfer Pricing with the forthcoming rewritten and revised 4th edition of approximately 2,000 pages to be published in November 2019. William Byrnes has authored and co-authored 1,000 articles published by financial media such as American Legal Media and National Underwriter Co. Find samples of his long articles and chapters at SSRN.


¶368 Starbucks EGC decision 2019.

¶369 Starbucks EGC decision 2019 referring to ¶ 285 Starbucks EGC decision 2019.

¶370 Starbucks EGC decision 2019 referring to ¶300 Starbucks Commission final decision 2015.

¶371 Starbucks EGC decision 2019.


¶373 The ETL and the EUS Starbucks Commission final decision 2019. Three of five competitors are identified as Alois Dallmayr Kaffee oHG, Nestlé S.A., and Melitta Europa GmbH & Co. KG.


¶375 Starbucks EGC decision 2019.

¶376 Starbucks EGC decision 2019.

¶377 Starbucks EGC decision 2019.

¶378 Starbucks EGC decision 2019.

¶379 Starbucks EGC decision 2019.

¶380 Starbucks EGC decision 2019.

¶381 Starbucks EGC decision 2019.

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¶409 Starbucks EGC decision 2019.