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The US Treasury White Paper on Transfer Pricing and State Aid

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On 24 August 2016, the US Treasury Department issued a White Paper on "The European Commission's Recent State Aid Investigations of Transfer Pricing Rules" (the "White Paper"), denouncing the Commission's "new approach" as "an unforeseeable departure from the status quo" whose retroactive application "would be inconsistent with EU legal principles" and "undermine the G20's efforts to improve tax certainty" and "undermines the international consensus on transfer pricing standards". This is the latest in a number of attempts by the US government to influence the on-going investigations, following up on the letter sent by Treasury Secretary Jacob Lew to Commission President Jean-Claude Juncker and several direct talks between officials from the US Treasury and the EU Commission. It came on the eve of the release of the latest — and biggest — of the relevant cases: The Commission's decision to demand the recovery of 13 billion EUR in taxes from Apple was published on 30 August 2016.

The White Paper makes **three main arguments** that reflect the "concerns" of the US Treasury:

1. the Commission's approach to investigate possible state aid given via advance transfer pricing agreements (APAs) constitutes a **departure from previous practice** as well as case law
2. consequently, the Commission's approach **should not be applied retroactively** — doing so would undermine efforts to improve tax certainty (and potentially breach EU principles)
3. the Commission's approach is inconsistent with the OECD Transfer Pricing Guidelines (OECD TPG), thereby **threatens the international consensus** on transfer pricing standards and **calls into question Member States' ability to honour their bilateral tax treaties**

Throughout the document's 25 pages, the Treasury makes several catchy statements, which have duly found their way into the popular press, such as the claim that the Commission appears to turn itself into a **"supra-national tax authority"**. Nevertheless, the overall tone of the White Paper appears to be more technical and less confrontational than previous interventions, although it is plainly a political paper. Notable by its absence is the claim made by Secretary Lew in his letter that the Commission "appears to be **targeting U.S. companies disproportionately**" — although the White Paper manages to add that it "remains concerned about this possibility" (FN 14 on p. 5).

In the following, I will describe and briefly comment on the arguments made in the White Paper. I will focus on the legal rather than the more political questions.

(1)The Commission applies a "New Approach" in its investigations by collapsing advantage

and selectivity and comparing multi-nationals to domestic companies

The first complaint goes right to the heart of the matter that State aid experts have been discussing for some time in Europe: The question whether or not the Commission is correct to find "state aid" in the various analysed transfer pricing rulings based on existing legal doctrine. The White Paper goes into quite some detail analysing the requirements and principles of state aid law based on previous decisions, and criticizes particularly two elements of the Commission's "New Approach".

First, the somewhat technical point of conflating two separate elements of state aid analysis, advantage and selectivity:

"A review of … 65 cases reveals that **the Commission consistently assessed the existence of an advantage and the selective nature of the measure separately**. […]
The **Commission departed from this practice** in the opening decisions in Apple and Amazon, finding that selectivity was met simply because the ruling deviated from the arm's length principle—the same analysis used to find economic advantage. […]
The Commission's **new approach therefore reduces a State aid inquiry to whether the Commission believes that a transfer-pricing ruling satisfies its view of the arm's length principle**. This shift in approach appears to expand the role of the Commission's Directorate-General for Competition ("DG COMP") beyond enforcement of competition and State aid law under the TFEU into that of a supra-national tax authority that reviews Member State transfer price determinations." (pp. 8-9)

Second, the White Paper criticizes the comparison of multinational companies as a group to purely domestic companies, citing several cases where preferential treatment of multinationals as compared to (domestic) standalone companies was not sufficient for a finding of state aid:

"[I]n each case where multinational companies were implicated, there were additional conditions that distinguished the multinational companies that benefited from those that did not. […]
Furthermore, in *Hungarian Intra-Group Interest*, the Commission agreed that **standalone companies are not necessarily an appropriate comparison when determining whether a measure available only to multinational companies** is selective, stating that intercompany loans are not comparable to loans with unrelated parties because '[w]ith respect to debt financing activities, related companies are not in a comparable legal and factual situation with unrelated companies.'" (pp. 10-11)

However, the White Paper also recognises that the Commission's somewhat more aggressive approach, while rejected by the General Court in *Autogrill España*, is still pending on appeal before the Court of Justice. It thus — no doubt sensibly — does not deny that the Commission's approach might be in line with EU law (although it does have doubts based on the "traditional selectivity analysis", but contents itself with the conclusion that such would anyway be a **novel approach**.

I substantively agree with the White Paper's criticism of the Commission's methodology on the basis that multinational and standalone companies are not (by default) in a comparable legal or factual situation and that one ought to explore more thoroughly whether there was indeed a deviation from general principles of taxation governing all companies in respect of specific transactions. It will be up to the Court of Justice to decide whether the Commission can instead rely on its simpler approach.

(2)The Commission Should Not Order Recovery of Back Taxes

The White Paper's second point follows directly from the assessment of the Commission having changed its approach; it is plainly the more important for the US Treasury, whose **real concern is the retroactive change of tax rules** to the detriment of US companies (and, by way of its own tax credit mechanism, potentially to the detriment of its own coffers). The White Paper presents the case against retroactivity in a mix of technical and normative arguments:

- the first argument is that recovery of taxes would be inconsistent with the principle of legal certainty governing EU law, since the Commission changed its approach without sufficient (or sufficiently clear) advance notice. Although framed as a legal argument, the paper seems more inclined to try to reason with the Commission in order to find a palatable compromise. It seems unconvincing to argue that the Commission would be barred from ordering recovery merely because it had not started investigating transfer-pricing rulings earlier. The omission of more extensive policing can hardly be argued as a strong basis for legitimate expectations against a later more thorough approach, although the White Paper asserts that "the principle is the same", so that its "longstanding inaction … warrants the Commission declining to impose retroactive recoveries." (p. 16)
- The second argument against recovery is that it would undermine the "efforts taken by the international community to improve tax certainty" via such institutions as the G20, the OECD and the IMF. It further warns that the "Commission's pursuit of retroactive recoveries … sets an undesirable precedent that could lead to other tax authorities … to seek large and punitive retroactive recoveries from both U.S. and EU companies." (p. 17)

(3)The Commission Undermines the International Tax System

The third point is not based on any legal argument, but turns on the EU's role in the international community.

Lauding the "multilateral efforts to address transfer pricing" most recently furthered by the OECD and the G20 as part of the BEPS project, the White Paper lambasts the Commission as **a "non-tax agency** that is not tasked with applying the [OECD TPG] and was not involved in their development" which "**will now have its own concept of the arm's length principle** … [thereby becoming] an arbiter of when a transfer price relevant for determining taxable income in a Member State satisfies [that] principle" (pp. 19-20).

Despite the shortcomings of the OECD TPG and the arm's length principle in general, one can easily agree that the creation of a separate competing standard will not be conducive to a more certain tax environment. The Commission's response that its "focus is on cases where there us a manifest breach of the arm's length principle" (DG Working Paper June 2016 § 23) is of little comfort as long as the Commission does not more clearly explain its own standard. The White Paper pointedly refers to the uncertainty as to whether the relative tax rates of the countries involved in a transaction might affect the arm's length analysis (pp. 21-22)

It further asserts that the Commission's approach "raises serious concerns about the ability of EU Member States to honor their obligations under bilateral tax treaties with the United States" (p. 23), since a company may not be able to rely on a tax treaty or an MAP concluded in accordance with it.

The White Paper thereby recognizes the **friction between Member States' competence in tax matters and the increasingly assertive approach of the Commission** to review a country's tax rules in minute detail. While this is a concern from an international perspective (although it is in this respect little different from any treaty override), more interesting questions arise for the constitutional structure of the EU. First, under Art 351 TFEU, the EU treaties do not affect a Member State's rights and obligations towards a third country from agreements prior to 1958 or the later accession date. Where a taxpayer can rely on a tax treaty dating back further, it might therefore be protected at least against retroactive recovery. Second, as a practical matter, taxpayers and tax authorities would be well advised to involve the Commission in any transfer pricing MAPs. Eventually, one may wonder **whether the Commission should take over external relations in tax matters** for the Member States — it might well be able to argue its competence in that respect in a similar way as it did for the creation of the Anti-Tax-Avoidance Directive.

Ultimately, the US Treasury White Paper is unlikely to have much impact on the Commission's position. Even if one would — as I do — agree with several of the legal arguments and policy concerns raised by it, it is nevertheless reassuring to know that the Commission is not swayed in its conviction (however misguided) by a third country's interests. The Treasury may support "its" multinationals in Court (informally or possibly as an applicant as a "directly concerned party" under Art 263(4) TFEU). This is undoubtedly the right forum to put forward (some of) the White Paper's arguments.

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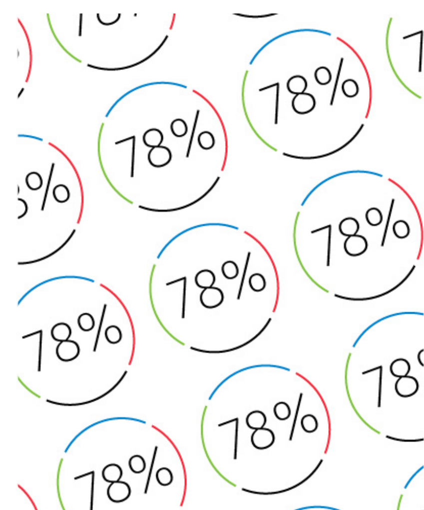

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This entry was posted on Wednesday, August 31st, 2016 at 10:07 am and is filed under EU/EEA, OECD, Transfer Pricing
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