

Multinational enterprises, European state aid and transfer pricing

Citation for published version (APA):

Szotek - Ververken, P. (2020). *Multinational enterprises, European state aid and transfer pricing: a study of the application of EU State Aid Law to transfer pricing and allocation of income to permanent establishments*. [Doctoral Thesis, Maastricht University]. Maastricht University. <https://doi.org/10.26481/dis.20201204ps>

Document status and date:

Published: 01/01/2020

DOI:

[10.26481/dis.20201204ps](https://doi.org/10.26481/dis.20201204ps)

Document Version:

Publisher's PDF, also known as Version of record

Please check the document version of this publication:

- A submitted manuscript is the version of the article upon submission and before peer-review. There can be important differences between the submitted version and the official published version of record. People interested in the research are advised to contact the author for the final version of the publication, or visit the DOI to the publisher's website.
- The final author version and the galley proof are versions of the publication after peer review.
- The final published version features the final layout of the paper including the volume, issue and page numbers.

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VALORIZATION

1. (Relevance) What is the social (or economic) relevance of the results of your research in addition to the scientific relevance?

The financial and economic crisis of 2007-2008 has drawn attention to aggressive corporate tax planning practices, in particular those benefiting undertakings operating as multinational groups.¹⁶¹² In the aftermath the financial crisis, there has been multifaceted work done aimed at preventing any future imbalances and instability, and this vast agenda was pursued at international, regional and national levels. Tackling tax evasion and tax avoidance is a key point in that agenda and a lot of work has been done under this point on the regulatory side (e.g. the OECD Base Erosion and Profit Shifting (BEPS)). Although tax base erosion through profit shifting by multinational enterprises (MNEs) has become a prominent public policy concern¹⁶¹³ in an international context in both developed and developing economies, the European Commission (EC) did not feel that the global actions aimed at tackling these problems were enough.

Emerging allegations about the instances of tax evasion and tax avoidance by MNEs were, for instance, the object of public hearings in the US Senate¹⁶¹⁴ and the UK's House of Commons.¹⁶¹⁵ The EC regarded the media reports and the parliamentary debates of a few years back as market information and decided to look more deeply into the matter, as society nowadays expects the EC to address what could well be tax avoidance structures. In addition, the *Greens/EFA* group in the European Parliament (EP) has commissioned special reports on tax avoidance practices by certain MNEs, which gave the EC more insight into the corporate tax structures and fiscal arrangements that might be also problematic from a State aid perspective.¹⁶¹⁶ These publications have allowed the EC to gain unprecedented insight into this matter. If the advantages granted to selected MNEs are significant, the need to restore the level playing field in the European Single Market has become greater. Thus, the EC, Directorate General for Competition (DG COMP) focuses on transfer pricing arrangements that are used by MNEs to manipulate internal prices in order to shift profits to low-tax or no-tax jurisdictions.

¹⁶¹²R.S. Avi-Yonah (2019), "Globalization, Tax Competition and the Fiscal Crisis of the Welfare State: A Twentieth Anniversary Retrospective" Law & Economics Working Papers, No. 159.

¹⁶¹³ E. Traversa & P.M. Sabbadini (2017), "State Aid Policy and the Fight Against Harmful Tax Competition in the Internal Market: Tax Policy in Disguise?" in W. Haslechner, G. Kofler & A. Rust (eds.), *EU Tax Law and Policy in the 21st Century*, The Hague: Kluwer.

¹⁶¹⁴ See, e.g. Offshore Profit Shifting and the U.S. Tax Code (Apple Inc.) available at:

<https://www.hsgac.senate.gov/subcommittees/investigations/hearings/offshore-profit-shifting-and-the-us-tax-code-part-2>.

¹⁶¹⁵ See, e.g. UK Parliament, House of Commons, Committee of Public Accounts, Hearings on Tax Avoidance Schemes, available at:

<https://tpcases.com/uk-parliament-house-commons-committee-public-accounts-hearings-tax-avoidance-schemes/>

¹⁶¹⁶ See, e.g.: <https://www.epsu.org/article/unhappy-meal-%E2%82%AC1-billion-tax-avoidance-menu-mcdonalds-0>; and https://www.greens-efa.eu/legacy/fileadmin/dam/Documents/Studies/Taxation/Report_IKEA_tax_avoidance_Feb2016.pdf

Considering the nature of the problem of transfer pricing and income allocation under State aid law, this research recognized that the main objective of the high profile cases it examined is: to prevent distortions of competition in the Single Market caused by ‘transfer mispricing’, which results in excluding certain income from the tax base of an MNE, and in reducing its taxable burden in one Member State (MS). In parallel with State aid investigations and within the EU, the European Commission Directorate General for Taxation and Customs Union (DG TAXUD) adopted the Anti-Tax Avoidance Package,¹⁶¹⁷ which included anti-abuse measures and advocated better exchanges of information among national tax authorities.¹⁶¹⁸ It has been recognized that a coordinated approach is needed in the taxation policy of the EU because “*too often discussions were confined to taxation proposals seen in isolation*”, which was not benefiting the wider context of EU policies and society as a whole.¹⁶¹⁹

The underlying principle of these actions is to have companies pay tax where they make their profits, so where the commercial value originates. State aid control does not substitute this agenda by other means. Nevertheless, the EC feels it bears a special responsibility in the field of State aid control that arises in this context. Therefore, in a busy and often challenging agenda of the DG TAXUD,¹⁶²⁰ State aid investigations into aggressive tax planning strategies of MNEs should not come as a surprise, as the first investigations had already started in the early 2000’s¹⁶²¹ and will surely continue for many more years. According to the EC, some MSs have continued approving selective fiscal advantages in particular to MNEs and have enabled tax planning strategies that have now been discovered in the State aid practice. Hence, the DG TAXUD and the DG COMP work “in tandem”¹⁶²² - which could not be achieved by means of direct harmonization - in order to tackle aggressive tax planning, in response to public allegations, and as addressed by State aid rules. However, the unanswered question was how far one can stretch certain concepts underlying State aid control (i.e. advantage and selectivity requirements) in order to fulfil policy objectives to tackle aggressive tax arrangements? This question is especially relevant due to the fact that certain stakeholders contended that the proposed assessment framework under EU State aid law is flawed and is not fit for purpose.¹⁶²³

¹⁶¹⁷ See, e.g.: https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en.

¹⁶¹⁸ Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, *OJ L 332, 18.12.2015, p. 1–10*.

¹⁶¹⁹ Commission of the European Communities, Taxation in the European Union, Discussion Paper for the Informal Meeting of ECOFIN Ministers, SEC (96) 487 Final, Brussels, 20 March 1996, p. 2.

¹⁶²⁰ See, European Commission, Taxation and Custom Union, Taxation: Business, Company Tax, available at: https://ec.europa.eu/taxation_customs/business/company-tax_en.

¹⁶²¹ See, Commission launches large-scale state aid investigation into business taxation schemes, IP/01/982 (11 July 2001), available at: https://europa.eu/rapid/press-release_IP-01-982_en.htm.

¹⁶²² T. Sprackland (2017) “Pierre Moscovici: The Man With a Plan to Bring Tax Transparency to the EU”, Tax Notes International, p. 1106.

¹⁶²³ See, e.g., U.S. Department of the Treasury White Paper (2016), “The European Commission’s Recent Investigations of Transfer Pricing Rulings”, Paper No. 6.

In light of the foregoing, the legal analytical framework under European State aid law developed and applied by the EC to address aggressive tax planning through transfer pricing and income allocation arrangements was central to this research. More specifically, this research addressed the central research question: *How should transfer pricing and rules on allocation of income to Permanent Establishments (PEs) applicable to MNEs be assessed under European State aid law?*

The conclusion of the research consists of recommendations for an improved (new) legal analytical framework of EU State aid rules applicable to the analysis of transfer pricing and income allocation measures that is fit to achieve the effective and legitimate objective of tackling aggressive tax planning and transfer mispricing provided through agreements between national tax authorities and MNEs. These recommendations focus primarily on the fiscal transfer pricing values applicable at international and national levels that should be added to the EC's analytical legal framework under EU State aid rules, in particular, when making an analysis of selectivity and advantage criteria. If these recommendations were implemented by the EC, many transfer pricing issues that currently fall outside of the scope of State aid rules, mainly due to the limits and 'marginal' reviews imposed by the current State aid framework, could be tackled. Because the recommendations do not ignore the policy rationale under State aid law, they may be feasible and could eventually improve the State aid framework and lead to changes that would more effectively tackle the social side of the problem, namely that society nowadays expects the EC to address what could well be tax avoidance structures, and to do this by any legal means available to it.

2. (Target groups) For whom, outside academic circles, are your research results of interest and why?

Considering the topic of this research, its results are of particular relevance for the EC and European Courts, more particularly for the Task Force on Tax Planning Practices, which was set up within the DG COMP in order to follow up on public allegations of favourable tax treatments of MNEs voiced in the media and in national parliaments as well as the judges and Advocates General to the Court of Justice of the European Union (CJEU). The author hopes that they could become inspired by these recommendations and the results of this research to consider the impact of State aid law on direct taxation, especially on principles, rules, administrative practices, and guidelines on the taxation of MNEs. As such, they should consider the fiscal arm's length principle and the guidelines - implemented at the OECD and national levels - as a leading point to solve issues of competition arising from transfer mispricing through aggressive tax planning strategies by MNEs within the context of State aid more effectively. The author recognizes that this approach would mean that the EU arm's length principle recently endorsed by the General Court would diminish and the CJEU would have to take a turn and refer the cases back to the General Court, and that this research could help them with the arguments they would need.

This results of this research may also be relevant for MSs and their lawmakers as well as national relevant (tax) authorities that need to reconcile both legal frameworks within their national laws and administrative practices, as well as for national judges and lawyers who apply European State aid and the OECD transfer pricing and income allocation frameworks to national fiscal provisions. There has been uncertainty as to the exact legal scope and practical application of EU State aid rules to transfer pricing and income allocation measures following the emergence of high-profile cases. A valuable example is the case of Cyprus that has consulted the EC on national legislation on tax treatment of financing companies.¹⁶²⁴ The request for a dialogue with the EC came in the aftermath of the emergence of the high-profile cases on transfer pricing and the arm's length principle, and Cyprus wanted to ensure that the new transfer pricing regulation on financing companies would not violate EU competition rules, due to the fact that there has been no clear guidance provided on this approach.

In that context, the author believes that in fiscal cases the guidance on how to comply with State aid law comes often after a given national measure is investigated by the EC, which reflects the intrinsic dynamics of the State aid system with the underlying principle that it must be effective, and the EC should not be prevented from developing it and control it. This can be additionally supported by the fact that any guidance that is provided by the EC is only clarifying the *status quo* based on the EC's Decisions and the European Court's judgments. This research indicated that despite this lack of absolute certainty in the area and approach of the EC under State aid law and due to this framework being very dynamic, it should not be perceived as being arbitrary. The author thinks that it is a fair balance that MSs can be 'creative' in developing fiscal rules and at times trying to 'hide' (e.g., in non-transparent measures) certain measures, while the EC can search for new legal means under State aid rules to tackle their distortive effect on competition in the EU. However, leaving this statement without offering the possibility of increasing legal certainty would not be desirable, taking into account the complexity of the topic addressed in this research.

With respect to the above, tax certainty is a priority for the G20 and is high on the agenda of the Economic and Financial Affairs Council (ECOFIN).¹⁶²⁵ Providing tax certainty to investors and business is an important aspect of the Single Market, in order to maintain and increase its attractiveness. Indeed, legal uncertainty undermines the investment climate in Europe, as business likes predictability. The need for more clarity in relation to State aid and tax rulings is not only important for business, but also for MSs as can be learned, e.g., from a report of the German Government¹⁶²⁶. The results of that research are directed at stakeholders and society as a whole, as they contribute to the transparency of the State aid framework used to analyse transfer pricing and

¹⁶²⁴ Statement/17/2110, Vestager, 21 July 2017 "Statement by Commissioner Vestager on changes made by Cyprus to national legislation on tax treatment of financing companies.

¹⁶²⁵ Platform for tax good governance – tax certainty – meeting of 15 June 2017.

¹⁶²⁶ The November 16 opinion on the Commission's recent state aid enforcement actions and their effects on Member State competence in tax policy.

income allocation rules and call for an increased certainty through the solutions recommended on how this framework should be changed. Hence, the findings in this research question are intended for anyone interested in transfer pricing and EU State aid rules: fiscal and legal practitioners as well as students.

3. (Activities/products) In which actual products, services, processes, activities or commercial activities will the results of your research be applied and given shape?

The author wishes to adapt this research into a commercial edition, which would allow the research results to be properly distributed amongst the various interest groups and maximize its (potential) academic and social impact. The main research results are the recommendations for a new and improved legal analytical framework to assess transfer pricing and income allocation individual measures under EU State aid law, the values and legal approaches that such a framework should fulfil in order to respect national fiscal sovereignty, fiscal sensitivity of the measures being assessed, and the objective of EU competition policy. The author hopes that these recommendations will provide interested groups (as identified under point 2) with a strong foundation for overcoming uncertainty that the current legal State aid framework may create. The author intends to disseminate these legal and policy recommendations in other media as well, for instance via a journal or articles.

Furthermore, part one of this research provides a detailed overview of the leading economic and international trade theories on MNEs as well as the international (OECD) and national (EU MSs) fiscal frameworks on transfer pricing and income allocation values through historical perspectives, which was missing from the literature. Part two, in addition, analyses and explains the EU arm's length principle applicable to the analysis of "selective advantage" in high-profile cases and identifies specific questions related to those cases and completed by considerations of the relevant OECD's and national provisions, which completes the existing debate on this subject. Hence, the research results can be seen as proposals for reforming the EU State aid analytical legal framework, or for aligning national approaches with that legal framework, which would benefit national tax authorities, lawmakers and the judiciary.

4. (Innovation) To what extent can they be called innovative compared to the existing range of products, services, processes, activities and commercial activities?

Scholars have approached State aid investigations into tax rulings and transfer pricing from different angles of legal analysis. There are a considerable number of scholarly works on the application of State aid rules to tax measures. Some publications have already dealt with the decisions of the EC in tax rulings cases with respect to the principles raised in relation to the specific elements of the State aid test, which is embedded in the Treaty on the Functioning of the European Union (TFEU) as well as

with respect to high-level aspects of certain profit allocation and determination rules and methods used by States to determine the taxable base of an MNE's affiliates that are economically active within their territories. Roughly, two different approaches are deployed in these publications: (i) the competition law and constitutional law angles, which are aimed at assessing the impact of the EC's method under State aid law on the sovereign tax powers of EU MSs; and (ii) the fiscal angle of generally or specifically formulated allocation principles and rules that evaluate their compatibility with State aid rules.

Although this research discussed certain arguments of the research above, it suggests a new approach to address the topic, which extracts different conclusions from those made by other scholars. This research dealt with the *application* of principles used by the EC to the fiscal discipline of transfer pricing and allocation of income to PEs by examining the legal analytical approach of the EC in the high-profile cases reviewed. Accordingly, the main outcome of this study reveals the *impact* of the EC's approach on national and international transfer pricing rules, which is especially relevant if the CJEU upholds the approach of the EC and the General Court in the high-profile cases. In addition, this research suggests some necessary improvements to the current legal analytical framework of the EC to analyse transfer pricing and individual income allocation measures. Other researches argue that the current framework may not be fit to prevent distortions of competition through transfer mispricing and aggressive tax and pricing strategies by MNEs, but none of them suggested a comprehensive framework that could supplement or amend the current framework.

On that matter, and in order to be as comprehensive and feasible as possible, this research first identified and used internal (i.e. standards that are part of the legal frameworks studied, their principles and values) and external (i.e. theories that provide such standards) normative systems of both areas of legal studies: European State aid law and the OECD fiscal frameworks on transfer pricing and income allocation to PEs, which are part of national direct corporate taxation and international tax law. In order to answer the research question(s) and construct a theory, it was necessary to define basic concepts and to explain how these concepts relate to each other. Thus, it was first necessary to look for certain basic principles, rules and values that are stated or presupposed in both legal frameworks subjected to this study (i.e. to define an internal normative framework). Both areas of law studied in this research consist of internal basic principles, rules and values on their own. However, more work needed to be done to clearly formulate explicit as well as implicit principles in order to apply them. Hence, this research first identified both internal (i.e. implicit principles and rules) and external (i.e. policy aims and rationale) frameworks for the analysis of State aid rules and the OECD international and national transfer pricing and allocation of income guidelines, and subsequently applied the principles and rules identified when evaluating and answering the main research question. Such an approach to the statement of the problem can be seen as innovative, as it attempted to study not only legal rules and values provided by both frameworks, but also policy objectives and the rationale behind these

legal approaches in order to improve the feasibility of the research results and limit any potential bias as to the potential workable solution proposed in this research. Therefore, this research presents the legal analytical framework of State aid, which actually can be seen as a comprehensive solution to all the problems previously identified in relation to it: (i) the approach of the EC seen as not being fiscally sensitive and violating the fiscal autonomy of EU MSs, and (ii) being inherently flawed and not transparent, and thus not being able to effectively prevent distortions of competition in the EU.

More generally, it could be said that this research is innovative in its approach as it takes an interdisciplinary approach and aims to reconcile State aid law and policy with fiscal transfer pricing and income allocation values applicable at both levels: international and national.

5. (Planning and Implementation) How will this (these) valorization plan(s) be implemented? What is the schedule, what are the possible risks, what are the market opportunities, and what are the costs?

The author intends to look for a publisher that would agree to publish a commercial edition of this book and a journal article on the main conclusions. In addition, the author plans to present the results of this research at one of the respected conferences (academic and/or organized by the EU institutions, or other stakeholders) in order to engage in debate and spread the outcome of this research among interested academics and stakeholders. On that matter, the results of this research can be also placed in the wider context of the current OECD international tax reform (Pillars 1 and 2), which includes discussions and proposals on digital tax as a corporate tax (following recent OECD works within and beyond the arm's length principle in transfer pricing), and a minimum level of taxation levied on corporations. This is the first time that the OECD has attempted to go beyond the allocation of taxing rights into seeking an agreement on the minimum level of tax. Some of the related discussions on this topic suggested replacing the arm's length principle with certain elements of formulary apportionment, hence while the international organizations debate possibly moving away from the arm's length principle and the post-BEPS framework towards formulary solutions, the DG COMP evaluates possible outcomes to tax where value is being created in the context of MNEs on the basis of current rules. As suggested in this research, the EC should employ the fiscal arm's length principle in its assessment under EU State aid rules, as also there is no final agreement at the OECD level that would soon depart from the widely applied arm's length principle. However, such a possibility cannot be neglected, as also States may act unilaterally on that matter (e.g., if an international solution is not reached) and further discussions on aligning national and international frameworks with an EU State aid analysis that build on or go beyond the questions raised and the solutions proposed in this research should not be precluded.

The author is also trying to engage with new media such as blogs and social networks as well as engage in direct contact (e.g. by seeking an internship at the EC), which

would allow the author to reach stakeholders more easily, hoping that the research results can convince them to implement the recommendations.