Coordination centres: the end of an era? Not quite ...

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Introduction

On 17 February 2003, the Commission adopted final negative decisions in its State aid investigations into three special tax schemes. They were the coordination centres regime in Belgium (1), the international financing activities (IFA) regime in the Netherlands (2) and the foreign income scheme in Ireland (3). The decisions marked an important step in the Commission’s campaign against fiscal aid schemes. The regimes in question had been three of the fifteen corporate tax measures against which the Commission had opened formal State aid action on 11 July 2001.

I do not intend to review the background to these fifteen cases here. My colleague, Mehdi Hocine, set out the political and legal context to the Commission’s action in his article on fiscal aid measures in the February 2002 edition of the Competition Policy Newsletter (4). But it is worth recalling that the July 2001 initiative represented a concerted assault on certain tax practices across the European Union. And it has not been without controversy. Three of the July 2001 decisions to open formal State investigations have been challenged in the Court of First Instance (5). A fourth challenge followed when the Commission opened its formal investigation into the Belgian coordination centres regime following Belgium’s refusal to agree to phase out the measure (6).

The 17 February decisions

Why are the 17 February decisions so important? First, of the fifteen tax schemes examined, twelve of the investigations had now been closed, leaving just the French headquarters regime and the two Gibraltar ‘offshore’ schemes under scrutiny. But more significantly, two of the schemes concerned, Belgian coordination centres and Dutch international financing activities, were by far the most substantial of the group of fifteen in economic terms. In excess of 200 multinational groups had established coordination centres in Belgium, through which many tens of billions of euros are channelled each year. In the Netherlands, the companies benefiting from the IFA scheme (around 100) had placed many billions of euros into the tax-free reserves provided for by the regime.

The mother of all coordination centres

The Belgian coordination centres regime dates back to 1983. In 1984 the Commission decided that the measure, after certain modifications, did not constitute State aid. A coordination centre is an undertaking forming part of a multinational group. Its purpose is to provide services (such as banking, insurance, marketing, personnel management, public relations, legal advice) to other companies in the group. A company obtains coordination centre status through a renewable ten-year agreement granted by the Belgian tax authorities. Its taxable revenues are determined according to the so-called ‘cost plus’ method.

Cost-plus is an alternative method for determining the taxable income of a company. It is normally aimed at overcoming the difficulties involved in assessing cross-border transactions between companies forming part of the same group (i.e. establishing the price at which the good or service is provided to the related company). It reduces the scope both for tax avoidance and for disputes between the two tax authorities assessing the cross border transactions. In the cost-plus method, the taxable profit is calculated by applying a margin (the ‘plus’) to all the expenses (the ‘cost’) associated with a transaction or group of transactions. With an appropriate margin, the cost plus method arrives at a figure for taxable income comparable to that which would have been obtained if the transactions concerned had been carried out on a fully commercial basis between independent undertakings.

Following the review of Member States’ tax systems as part of the Code of Conduct initia-

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(4) Aides fiscales: la Commission procède a l’examen approfondi du critère de la selectivité dans la domaine de la fiscalité directe des entreprises.
(5) Cases T-195/01, T-207/01 & T-9/02.
(6) Case T-276/02.
tive (1), the Commission reconsidered its 1984 assessment of the Belgian scheme. In accordance with established procedure for existing aid measures (2), the Commission formally proposed to Belgium that the coordination centres regime be phased out. When Belgium refused to accept the proposal, the Commission initiated the formal State aid investigation procedure (3).

With hindsight, in the light of today’s more refined and tougher approach in the policing of State aid, the 1984 decision appears erroneous. At best, it relied on a very generous interpretation of the notion of aid. In its new decision of 17 February against the scheme, the Commission has concluded that Belgium applies the cost-plus method in a way that gives rise to State aid. First, the Belgian authorities systematically use a default margin of 8% for the services provided by a coordination centre without verifying if this rate reflects the economic reality of the underlying transactions. Second, significant operating expenses are excluded from the total costs of the centre when calculating the taxable income. Finally, coordination centres enjoy additional benefits such as exemptions from property taxes, from capital duty and from withholding taxes on the distribution of income.

The offspring

The Belgian regime has been quite successful in persuading multinational companies to establish coordination centres in Belgium. Among them figure some of the best-known global corporations. This success did not go unnoticed. Other tax jurisdictions within the EU enacted similar legislation, with the specific aim, in some cases at least, of providing a tax framework to attract multinational companies. Regimes analogous to the Belgian coordination centres scheme were created in Germany, France, Luxembourg and Spain (4). In its final negative decisions (5) to date against these regimes, the Commission’s analysis of the application of the cost plus method identified the systematic use of low or default margins and the exclusion of certain expenses from the costs of the centre. However, the impact of these regimes was relatively modest. In most cases, only a handful of companies took advantage of these regimes.

The maverick of the family is the Dutch IFA regime. Under the scheme, multinational companies are able to place up to 80% of their foreign-source financial profits in a tax-free reserve for up to 10 years. Depending on the purpose for which they are used, funds released from the reserve escape tax altogether or are taxed at a reduced rate. Although in substance it bears only a slight resemblance to its siblings, the Commission believes that when established in 1996, the IFA regime constituted a response by the Dutch authorities to Belgium’s success in attracting the corporate treasury functions of multinational companies. As with the rest of the family, the Commission has found that the tax benefits of the IFA regime constitute State aid.

Where there is discord, let there be harmony

Some commentators have suggested that the Commission is using its powers under Articles 87-88 of the EC Treaty to pursue a tax harmonising agenda. This is not the case. The Commission is simply fulfilling its role of controlling State aid. Commissioner Monti has said, for example, that ‘State aid action can not be used as an alternative tool to achieve harmonisation in the field of taxation, which concerns the alignment of the general fiscal systems in Member States’ (6). With coordination centres, the Commission has been very clear: cost-plus, when correctly applied, does not give rise to State aid.

Another observation has been that the Commission is widening the notion of specific or selective (7). Although it may be true that the Commission has only recently turned its attention to measures such as coordination centres, this does not mean that there has been any attempt to widen the definition of State aid. The Court of Justice has repeatedly ruled that the qualification of a measure

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(4) Legislation was adopted in Viscaya as well as in Navarra, Álava and Guipúzcoa. In the latter three provinces, no coordination centre was established and the legislation was repealed before July 2001. As a result, only the Viscaya scheme was subject to a formal State aid investigation.
(6) Speech at Universiteit Nyenrode, 22.1.2002.
(7) One of the four cumulative criteria that a measure must fulfil if it is to constitute State aid is that it must be specific or selective in that it favours ‘certain undertakings or the production of certain goods’. The others are that it grants an advantage, that the advantage is financed through State resources and that the measure distorts or threatens to distort trade and competition between Member States.
as State aid is objective (1). The fact that such objectivity is applied by the Commission in its assessment of novel situations is entirely natural and ought not to give rise to either comment or alarm. A specific regime for coordination centres is by its very nature selective. But if it grants no advantage, then it is not State aid.

No recovery

As an ‘existing’ measure, the legality of the Belgian coordination centres regime in State aid terms was not in doubt. Accordingly, in its decision considering the scheme to constitute State aid incompatible with the common market, the Commission could order the abolition of the scheme, but it could not order the recovery of tax benefits enjoyed in the past. In fact, in line with usual practice in existing aid cases, the Commission has provided for a transitional period to allow for a smooth phasing-out of the regime. So although no new coordination centres can enter the regime, the benefits for those already approved will cease by the end of 2010 at the latest.

In contrast, all the other coordination centres regimes in other Member States were illegal: they had not been notified to the Commission, still less approved under the State aid rules. It is a well-established principle of Community law that diligent businessmen/businesswomen can very easily establish from the Member State concerned whether or not a particular measure has been notified and approved in accordance with the State aid acquis. They cannot therefore escape the obligation to repay illegal State aid if it is subsequently found to be incompatible with State aid rules.

However, the approval of the Belgian regime was in the public domain. The Commission had also made a public statement to the effect that flat-rate tax provisions in certain Member States for the headquarters of multinational groups did not constitute State aid. When used correctly, it does not give rise to State aid but merely produces a figure for profit comparable to that which would have been obtained if the transactions concerned had taken place between independent companies. However, in each of these cases, cost-plus was incorrectly applied, granting tax advantages to the companies in the scheme, or at least creating a risk that a tax advantage could be obtained.

The end of an era?

Not quite. A phoenix could yet arise from the smouldering ashes of the Belgian coordination centres scheme.

There is one common feature in all the final negative decisions on coordination centres. The Commission has been very careful to make clear that there is nothing wrong, in principle, in using the cost-plus method for determining taxable income where there are difficulties in establishing cross-border transfer prices. When used correctly, it does not give rise to State aid but merely produces a figure for profit comparable to that which would have been obtained if the transactions concerned had taken place between independent companies. However, in each of these cases, cost-plus was incorrectly applied, granting tax advantages to the companies in the scheme, or at least creating a risk that a tax advantage could be obtained.

The renaissance might start at the heart of Europe. Belgium has notified a replacement regime on which the Commission has opened a formal investigation. The problems with the notified scheme relate primarily to the plans of the Belgian authorities to maintain the exemptions from capital duty and from withholding taxes. In addition, the Commission has misgivings about the apparent exemption from Belgian taxes of special advantages granted to coordination centres by other firms in the group, such as inflated payments for services rendered. However, the Commission has already approved (2), in principle, the broad outline of the cost-plus methodology envisaged under this new coordination centres regime. Nevertheless, it remains to be seen whether a regime approved under the State aid rules, completely shorn of its tax advantages, will be sufficiently attractive to multinational companies for them to create separate companies located in Belgium to ‘coordinate’ some of their intra-group activities.
