State aid tax cases: *Sine timore aut favore*

ICF, St. Gallen, 20 May 2016

Ladies and Gentlemen:

In September last year, when I was appointed Director General of DG Competition, I was given quite a lot of reading material to prepare for my new job – in fact, a few thousand pages. Enclosed was a sheet with the dates that mark the annual calendar of the competition-enforcement community. The International Competition Law Forum here in St. Gallen was one of the days circled in red. Now I can see why first-hand. It is an honour and a pleasure to be here and I thank Prof. Dr. Carl Baudenbacher for his kind invitation.

The Forum's programme is centred on antitrust and merger discussions. But as you know, EU competition law has a specific feature that does not exist in other jurisdictions. It is the complementarity of antitrust and merger control, on the one hand, and of State aid control, on the other, that makes for a comprehensive system to prevent and control distortions of competition in our Single Market. So I thought that it would be of interest to open a window on this area of the Commission's competition enforcement work.

Rationale of State aid law

It would have been impossible to build a common market in post-war Europe without a confidence-building, equitable, law-based framework for the working of such a market. Setting the rules to integrate the Member States' markets was the task of lawmakers. To make sure that the rules would have their intended effect on the ground through effective enforcement, they empowered the Commission as a supranational authority. And this included enforcing the principle of competitive neutrality.

For almost 60 years now, the Commission has protected what is today the Single Market against distortive practices of private businesses, state-owned enterprises and governments alike. The EU's competition rules are ultimately based on a double rationale:

- As an agreed set of rules, they build economic peace between nations and peoples.
- As rules against anti-competitive practices, they make markets work better and enhance consumer welfare.

In all likelihood, the EU's Single Market will always be work in progress. The financial and economic crisis has clearly shown that. But without its rules, it is difficult to imagine how the EU and its Member States would have been able to to tackle this and other critical developments and build and restore prosperity together.

Swiss-EU relations

Let me open a brief aside on the relations between Switzerland and the EU at this point. As Switzerland has a deep and evolving relationship with the Single Market, the rationale I just sketched out applies in this relationship as well, if we want to make the best of it. The 1972 Free Trade agreement between the EU and Switzerland was a first step in this direction. As with its other main partners, the EU is tabling provisions on State aid control in the context of negotiations for future agreements. The two sides are also discussing in various fora to agree on common principles.

Just as State aid granted in the EU, State aid granted by Switzerland should be designed to achieve policy objectives of common interest – in particular, it should be necessary and proportionate. Ensuring this level playing field is not a one-way street – it works for both sides in the relationship. And at the end of the day avoiding that taxpayers' money finances subsidy races or windfall profits is also a matter of good economic governance.

State aid modernisation

Over the last few years, the Commission has introduced a comprehensive programme to modernise the implementation of State aid rules. Building on a more economic approach, and in line with better regulation principles, it makes it easier for EU countries to grant aid that is unproblematic from a competition point of view.

The new rules allow Member States to further economic development and address equity issues while the Commission can scrutinise more rigorously measures with a significant potential to distort the Single Market. The new rules do so by extending the block exemption possibilities in such a way that nowadays some 90% of all aid measures need no longer be notified to the Commission. There's also a comprehensively new set of compatibility rules for notified aid anchored on the same economic principles.

Just yesterday, the Commission adopted a Notice on the Notion of State aid – a key policy document that completes the State aid modernisation process. This makes today a good day to take a look at one of the workstreams in State aid control that is often in the news these days – our State aid cases on aggressive corporate tax planning practices.

In the field of taxation, the Notice consolidates the Commission's practice and the Court's jurisprudence. As such, it is meant to give guidance on broad principles of State aid control in this field and thus can be useful to national policy makers. Against this background, let me say a few words about our approach to aggressive corporate tax planning practices that may result in selective advantages for some businesses over others.

State aid control and aggressive tax planning

A special Task Force was set up within DG Competition to look into the issue as early as 2013. This was motivated by the gradual emergence of market information suggesting that tax rulings were being exploited to grant selective advantages to certain multinational businesses. I would like to situate our work on aggressive corporate tax planning in a wider context.

Since the financial and economic crisis of 2007-2008, there has been sustained and multifaceted work on the root causes that have led to the instability and imbalances for which we're still paying the price. This is a vast agenda pursued at international, regional and national level.

Tackling tax evasion and tax avoidance is a key point in that agenda. A lot of the work done under this point is on the regulatory side. Think of the OECD's Base Erosion and Profit Shifting project. The organisation has worked on the project with G20 countries on an equal footing and over 80 more countries have been involved.

Within the EU, the Commission has put forward an Action Plan to reform corporate taxation, increase transparency and close loopholes. At the start of the year, the Anti-Tax Avoidance Package was adopted. It included – among other things – anti-abuse measures and better exchanges of information among national tax authorities. Just last month, new rules were proposed requiring multinational groups to report on profits made and taxes paid on a country-by-country basis.

The underlying principle of these reforms is to have companies pay tax where they make their profits. Our work in State aid control does not substitute or replace this agenda by other means. But the Commission's special responsibility in the field of State aid control arises in this context as naturally as in others. Let me turn to how DG Competition approaches this task.

Fiscal aid *is* State aid

Since our aggressive corporate tax planning cases were formally opened, some commentators were surprised that the Commission would look into tax arrangements on the basis of State aid rules. I must say that they seem to have a rather short memory. Before this expert audience, the point that State aid can come in many forms – including fiscal aid – should nevertheless be obvious.

When government measures distort competition in the Single Market, it doesn't matter whether they come as direct subsidies or tax relief to certain economic operators. The European Court of Justice confirmed this principle in 1974 with its seminal judgment in Case 173/73 Italy v Commission. It's the effect that counts – and the effect is not negligible. More than one third of non-crisis State aid is granted in the form of fiscal advantages.

In plain language, State aid control of tax practices and other fiscal arrangements is old hat for the Commission. I will give you a few examples.

As far back as 1998, the Commission found that an Irish 10% corporate tax rate for the manufacturing sector was incompatible aid and ordered its phase-out. In the same year, to give guidance to national authorities, it also issued a Communication on the application of State aid rules to direct business taxation.

In 2001, then Competition Commissioner Mario Monti announced the launch of a large scale investigation into business taxation schemes involving twelve Member States. The main competition concern at the time were preferential tax arrangements – the so-called 'coordination centres' – which multinational corporations used to determine their tax bills.

The Commission later closed the most significant cases and found incompatible fiscal aid in Belgium, Germany, Spain, France, the Netherlands, Finland, the UK, Ireland, Greece, Italy and Sweden. The Member States were requested to terminate the measures. The crux of the matter was that these practices were only benefitting a selected number of multinationals and many of them were not in compliance with the arm's length principle.

The idea behind this principle is quite straightforward. The terms of commercial transactions between two companies belonging to the same group should reflect conditions observed in the market for similar transactions between independent companies.

The European Court of Justice later confirmed the Commission's approach. The arm's length principle – the Court said – was the correct yardstick the Commission could use to ensure that multinationals would be taxed in the same way as non-integrated, standalone companies.

Fiscal aid today

Commissioner Monti's initiative came in the wake of efforts to tackle harmful tax competition among EU Member States in the late 1990s. For example, in 1997 the Council of Economy and Finance Ministers adopted a Code of Conduct for direct business taxation.

As I have mentioned, the context is different today. The financial and economic crisis has drawn attention to aggressive corporate tax planning practices, in particular those benefiting multinational corporations operating as groups. Some economic operators seem to have been pushing the limits of aggressive corporate tax planning very far. In doing so, a number of them have taken advantage of so-called tax rulings and other fiscal arrangements that are available in certain EU Member States.

Allegations about these instances were, for instance, the object of public hearings in the US Senate and the UK's House of Commons. The Commission regarded the media reports and the parliamentary debates of a few years back as market information. The Commission listened and decided to look deeper into the matter.

In response to this, the Task Force mentioned earlier was set up under Vice-President Joaquín Almunia. Its task was looking into aggressive corporate tax planning practices, with an emphasis on tax rulings. The Task Force set out to collect factual evidence by studying the tax ruling practices of Member States and analysing nearly 1,000 rulings.

Given that fiscal secrecy had barred scrutiny hitherto; this has allowed the Commission to gain an unprecedented insight into this matter. While certain practices in favour of businesses relying on tax rulings have always been at odds with State aid rules, their scale had never surfaced before. If the advantages granted to selected multinationals are significant, the need to restore the level playing field has become greater.

Member States' corporate taxation law as reference system

Let me address a criticism sometimes addressed to us that our State aid cases call into question existing corporate taxation law of EU Member States.

I believe that the claim is misguided. To establish whether a tax measure raises State aid concerns, we examine whether it gives a selective advantage to one or several economic operators over others. To that end, we compare the tax treatment of the companies that benefit from them to the ordinary tax treatment reserved to companies in comparable circumstances under national law.

So, the truth is that we take ordinary corporate-tax law in each Member State as the very reference against which we assess whether the tax treatment in individual cases departed from national law or practice. Let me make this even clearer using tax rulings as an example.

In general, granting tax rulings is a normal and justified practice in so far as they provide legal certainty to taxpayers. Provided the rulings do not grant selective advantages to specific companies, but clarify individual situations in line with tax rules as applied to everybody else in comparable factual and legal situations, they do not raise issues under EU State aid law.

The Commission is not in the business of second-guessing the work of national tax authorities with regard to every single tax ruling. The Commission has subjected to deeper scrutiny those rulings where taxation did not reflect actual economic reality – in particular regarding transactions between companies that belong to the same group.

Selective advantages and competition distortions

When determining selectivity we are comparing the tax treatment of the company benefitting from a tax ruling or a special tax regime to the ordinary tax treatment of companies under national law.

The profits made by standalone companies are taxed in the jurisdiction where they are recorded according to the rules and rates that apply in that jurisdiction. In contrast, a multinational group can record its profits in different entities and across multiple jurisdictions. What happens when the multinational needs to allocate profits between the companies it controls?

These internal allocations raise no concern when taxes are paid where profits are generated. Things can become problematic when profits are shifted from high-taxation to low-taxation jurisdictions – or even to jurisdictions where companies are allowed to pay almost no taxes. To be more precise, things become problematic when this is done by agreeing inflated prices for the transfer of goods and services between group companies that don't reflect market conditions – and with tax rulings that confirm these agreements.

Many rulings also determine a company's tax basis as a mark-up on performance indicators. Often, taxable profits are calculated as a percentage of operating expenses. In principle, this system could be justified when the value-added of a group company is closely linked to the type of expenses used in the calculation and when the contribution the company makes to the overall operations of the group is not substantial. However, concerns may arise when indicators like these are used in a way that fails to capture the company's actual commercial value and thus artificially reduce the group's taxable profits.

And here the matter goes beyond the mere mis-application of national tax law or discrimination between taxpayers. The matter becomes a distortion of competition. Subsidies – including selective forms of tax relief – have the potential to distort the ability of companies to compete on the merits.

Moreover, economic activity generated on the back of such arrangements may lack a sound economic rationale and be unsustainable. Activity created in this fashion in one EU Member State could come at the expense of another EU Member State which is not in a position to offer tax advantages. Benefits granted to selected operators can harm their rivals.

These distortions eventually translate into economic inefficiencies and, possibly, even into macroeconomic imbalances because activities and capital flows are displaced. Many factors influence companies' investment and expansion decisions, such as infrastructure, labour skills and costs, and proximity to customers. Of course, tax rates can also be a legitimate consideration. However, these decisions should not be driven by the possibility for specific, selected operators to artificially lower their tax bases and effective taxation. And there should be no financial-capacity distortion between economic operators by allowing a few to build up war chests thanks to untaxed profits.

Let me add that standalone companies are not the only ones that are harmed by these practices. Large integrated companies that pay their taxes in different countries following the arm's length principle are also at a disadvantage.

By analysing the situations that give rise to these concerns with a view of restoring level competition conditions, the Commission therefore fulfils the classic State aid mission – that is, identifying and correcting competition distortions that are not justified. If a company has received undue advantages, State aid law specifies in which cases it should return them in order to restore competitive conditions in the markets.

The rules are clear. Here, this means recovering unpaid taxes – up to a period of ten years – and making sure that taxes are paid correctly in the future. Obviously, the rules specify that the company cannot be asked to return the money if it has legitimate expectations – that is, if the Commission has previously expressed a different view or assessment. Also, there is no recovery when the legal certainty principle can be invoked. A typical example is when the Commission takes a decision on a novel case. However – as we will see presently – neither of these conditions applied in the State aid decisions the Commission has taken so far.

Decisions taken so far

So far, formal proceedings were opened on tax arrangements in Luxembourg, the Netherlands, Ireland and Belgium between 2014 and 2015. In the meantime, following the proposals of Competition Commissioner Margrethe Vestager, the Commission has taken three decisions.

The first two came in October last year, when the Commission found that the tax rulings offered to Fiat Finance & Trade in Luxembourg and to Starbucks in the Netherlands were illegal forms of State aid. To level the playing field, each of the two groups was ordered to return an estimated €20-30 million – broadly equivalent to the tax rebates they had unduly received. Let me tell you what we have found in these cases in a nutshell.

With a tax ruling, a tax authority tells a company in advance the amount of tax it will pay given certain conditions. In principle – as I said – there is nothing wrong with tax rulings. They need not pose competition concerns. In fact, they are useful to companies, which can better predict their costs. In contrast, the rulings that were sanctioned in our decisions endorsed artificial systems that did not reflect economic reality and granted selective advantages.

In the cases of Starbucks and Fiat, the systems worked on the basis of transfer prices. These are the prices that a company within a group pays for things such as a loan or royalties to another company belonging to the same group. Once again, transfer prices are fine as long as they follow the arm's length principle. But the transfer prices of Starbucks and Fiat did not meet these requirements.

The Dutch Starbucks roaster paid a substantial royalty to another group company for coffee-roasting know-how, although no other Starbucks or independent roaster in a similar situation paid such royalty. The end result was that – because of this royalty payments – Starbucks ended up paying little tax in the Netherlands.

Fiat Finance & Trade is based in Luxembourg and provides financial services, such as intra-group loans, to other Fiat Group companies. As these activities can be compared to those of a bank, the taxable profit can also be determined similarly to that of a bank. However, here the tax ruling endorsed an artificial method lowering both the capital basis and its remuneration. As a result, Fiat Finance & Trade has only paid taxes on a small portion of its actual capital at a very low remuneration that is not in line with market rate.

The decisions the Commission took last year will offer guidance to tax administrations in the EU. They must make sure that the transfer prices they accept are credible and in line with market terms.

The third and latest decision taken by the Commission is from last January and involves Belgium's so-called Excess Profit scheme, where we found a different method to reduce the tax burden. The scheme was open only to multinational groups and their actual profits were compared to a notional profit they would have made if they had been standalone companies.

The excess profit that resulted from this hypothetical comparison was not taxed. As a result, the multinationals that were part of the scheme – and only them – got tax discounts of more than 50% and in some cases of up to 90%. To bring things back to balance, the Commission ordered Belgium to recover from the more than 30 companies that had received the undue rebates an estimated €700 million in total.

Cases in the pipeline

These are the three decisions the Commission has taken. There are ongoing investigations as well, with openings so far involving Apple in Ireland, and Amazon and McDonald's in Luxembourg.

Moreover, the Task Force has been reviewing over a thousand tax rulings from the LuxLeaks files and from EU countries, which we requested a few years ago. The review reveals that the majority of rulings are not used for aggressive corporate tax planning. Most are well documented and aim at allocating profits between companies with genuine economic activities.

The rule that tax be paid where profit is made seems to be respected more often than not. So, most rulings don't seem to grant a selective advantage. But there seem to be outliers. Our ongoing review is looking for rulings that may grant individual companies terms that are not available to others in comparable circumstances.

Ladies and Gentlemen:

As you can see, what is sometimes depicted as an extraordinary and unprecedented initiative is in fact deeply rooted in the Commission's enforcement work. The extraordinary part are the practices the Commission has to correct – not the fact that the Commission is correcting them.

As far as the Commission is concerned, all cases are equal and none is more equal than others. Every case – regardless of its visibility – is investigated and assessed on its own merits. We try to obtain the best possible information; we look at the facts; and we reach a decision based on evidence and the law.

Our assessment is based at all times on applicable State aid rules and the jurisprudence of the European Court of Justice. Finally – and perhaps most importantly – we take great care to respect due process and the right of defence of the administrations and companies involved. There's a Latin phrase that sums up our approach: *sine timore aut favore*. We will continue to enforce the rules without fear or favour.

This is a message that I would like to send to the law-abiding competitors of the corporations that receive illegal aid, which end up sustaining higher costs. The message also goes to tax authorities in EU countries, which must check the final result of the arrangements they make with corporations.

But above all the message goes out to the people, who expect businesses to play by the rules – more so since each and every citizen is expected to play by the rules. In this sense, State aid rules are part of good governance. The financial and economic crisis has shaken the people's belief in economic governance. Our work can help restore that belief.

Thank you.