



## EUROPEAN COMMISSION

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<p>In the published version of this decision, some information has been omitted, pursuant to articles 24 and 25 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...].</p>		<p style="text-align: center;">PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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**Subject:** State aid SA.38944 (2014/C) – Luxembourg  
Alleged aid to Amazon by way of a tax ruling

Sir,

The Commission wishes to inform Luxembourg that, having examined the information supplied by your authorities on the measure referred to above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union (“TFEU”).

### 1. PROCEDURE

- (1) On 19 June 2013, the Commission sent a letter to Luxembourg requesting information about its tax ruling practice.
- (2) By letter dated 24 June 2014, the Commission sent an additional request for information to Luxembourg regarding its tax ruling practice in relation to the Amazon group.
- (3) In particular, the Commission requested Luxembourg to provide a complete description of the structure of Amazon in Luxembourg, to provide for each of its activities in

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Luxembourg the amount of tax due for the years 2011, 2012 and 2013, and to provide an explanation on how those amounts were determined.

- (4) The Commission also requested the balance sheets and the annual accounts of each legal entity in Luxembourg that is part of the Amazon group for the years 2011, 2012 and 2013.
- (5) Finally, the Commission requested: (i) all tax rulings addressed to the Amazon group (including addressed to any legal entity that is part of the group) which were still in force at the date of the Commission's request for information of 24 June 2014, (ii) all tax rulings granted to the Amazon group (including addressed to any legal entity that is part of the group) since 2004 and until the date of that request for information, and (iii) any element relevant to understand that/(those) tax ruling(s) and, in particular, any transfer pricing report, if any such reports had been provided by Amazon to the Luxembourgish authorities.
- (6) On 4 August 2014, the Luxembourgish authorities transmitted their reply to the Commission's request for information of 24 June 2014. In particular, the Luxembourgish authorities provided a tax ruling addressed to Amazon dated 6 November 2003. They also explained why they consider that that ruling does not entail the grant of State aid to Amazon.

## **2. DESCRIPTION**

### **2.1. Transfer pricing rulings**

- (7) This decision concerns a tax ruling which validates a transfer pricing arrangement, also referred to as advance pricing arrangements ("APAs"). APAs are arrangements that determine, in advance of intra-group transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time<sup>1</sup>. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations. APAs are intended to supplement the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues<sup>2</sup>.
- (8) In this context, transfer pricing refers to the prices charged for commercial transactions between various parts of the same corporate group, in particular prices set for goods sold or services provided by one subsidiary of a corporate group to another subsidiary

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<sup>1</sup> APAs differ in some ways from more traditional private rulings that some tax administrations issue to taxpayers. An APA generally deals with factual issues, whereas more traditional private rulings tend to be limited to addressing questions of a legal nature based on facts presented by a taxpayer. The facts underlying a private ruling request may not be questioned by the tax administration, whereas in an APA the facts are likely to be thoroughly analysed and investigated. In addition, an APA usually covers several transactions, several types of transactions on a continuing basis, or all of a taxpayer's international transactions for a given period of time. In contrast, a private ruling request usually is binding only for a particular transaction. See, OECD Guidelines, paragraph 4.132.

<sup>2</sup> OECD Guidelines, paragraph 4.123. Since APAs concern the remuneration for transactions that have not yet taken place, the reliability of any prediction used in an APA therefore depends both on the nature of the prediction and the critical assumptions on which that prediction is based. Those critical assumptions may include amongst others circumstances which may influence the remuneration for the transactions when they eventually take place.

of that same group. The prices set for those transactions and the resulting amounts calculated on the basis of those prices contribute to increase the profits of one subsidiary and decrease the profits of the other subsidiary for tax purposes, and therefore contribute to determine the taxable basis of both entities. Transfer pricing thus also concerns profit allocation between different parts of the same corporate group.

- (9) Multinational corporations pay taxes in jurisdictions which have different tax rates. The after tax profit recorded at the corporate group level is the sum of the after-tax profits in each country in which it is subject to taxation. Therefore, rather than maximise the profit declared in each country, multinational corporations have a financial incentive when allocating profit to the different companies of the corporate group to allocate as much profit as possible to low tax jurisdictions and as little profit as possible to high tax jurisdictions. This could, for example, be achieved by exaggerating the price of goods sold by a subsidiary established in a low tax jurisdiction to a subsidiary established in a high tax jurisdiction. In this manner, the higher taxed subsidiary would declare higher costs and therefore lower profits when compared to market conditions. This excess profit would be recorded in the lower tax jurisdiction and taxed at a lower rate than if the transaction had been priced at market conditions.
- (10) Those transfer prices might therefore not be reliable for tax purposes and should not determine the taxable base for the corporate tax. If the (manipulated) price of the transaction between companies of the same corporate group were taken into account for the assessment of the taxable profits in each jurisdiction, it would entail an advantage for the firms which can artificially allocate profits between associate companies in different jurisdictions compared to other undertakings. So as to avoid this type of advantage, it is necessary to ensure that taxable income is determined in line with market conditions.
- (11) The internationally agreed standard for setting such commercial conditions between companies of the same corporate group or a branch thereof and its parent company and thereby for the allocation of profit is the “arm’s length principle” as set in Article 9 of the OECD Model Tax Convention. According to this provision, commercial and financial relations between associated enterprises should not differ from relations which would be made between independent companies. More precisely, using alternative methods for determining taxable income to prevent certain undertakings from hiding undue advantages or donations with the sole purpose of avoiding taxation must normally be to achieve taxation comparable to that which could have been arrived at between independent operators on the basis of the traditional method, whereby the taxable profit is calculated on the basis of the difference between the enterprise’s income and charges.
- (12) The OECD Transfer Pricing Guidelines<sup>3</sup> (hereinafter the “OECD Guidelines”) provide five such methods to approximate an arm’s length pricing of transactions and profit allocation between companies of the same corporate group: (i) the comparable uncontrolled price method (hereinafter “CUP”); (ii) the cost plus method; (iii) the resale minus method; (iv) the transactional net margin method (hereinafter “TNMM”) and (v) the transactional profit split method. The OECD Guidelines draw a distinction between traditional transaction methods (the first three methods) and transactional profit

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<sup>3</sup> Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, OECD, 2010.

methods (the last two methods). Multinational corporations retain the freedom to apply methods not described in those guidelines to establish transfer prices, provided those prices satisfy the arm's length principle.

- (13) Traditional transaction methods are regarded as the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are at arm's length<sup>4</sup>. All three traditional transaction methods approximate an arm's length pricing of a specific intra-group transaction, such as the price of a certain good sold or service provided to a related company. In particular, the CUP method consists in observing a comparable transaction between two independent companies and applying the same price for a comparable transaction between group companies. The cost plus method consists in approximating the income from goods sold or services provided to a group company. The resale minus method consists in approximating the costs of goods acquired from or services provided by a group company. Other elements which enter into the profit calculation (such as personal costs or interest expenses) are calculated based on the price effectively paid to an independent company or are approximated using one of the three direct methods.
- (14) The transactional profit methods, by contrast, do not approximate the arm's length price of a specific transaction, but are based on comparisons of net profit indicators (such as profit margins, return on assets, operating income to sales, and possibly other measures of net profit) between independent and associated companies as a means to estimate the profits that one or each of the associated companies could have earned had they dealt solely with independent companies, and therefore the payment those companies would have demanded at arm's length to compensate them for using their resources in the intra-group transaction<sup>5</sup>. For this purpose, the TNMM relies on a net profit indicator which refers, in principle, to the ratio of profit weighted to an item of the profit and loss account or of the balance sheet, such as turnover, costs or equity. To this selected item, a margin is applied which is considered "arm's length" to approximate the amount of taxable profit. When the TNMM is used in combination with a net profit indicator based on costs, it is sometimes referred to as "cost plus" in exchanges between the taxpayer and the tax administration, but this should not be confused with the "cost plus method" described in the OECD Guidelines as described in the previous recital.
- (15) The application of the arm's length principle is generally based on a comparison of the conditions in an intra-group transaction with the conditions in transactions between independent companies. For such comparisons to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences.<sup>6</sup> To establish the degree of actual comparability and then to make appropriate adjustments to establish arm's length conditions (or a range thereof), it is necessary to compare attributes of the transactions or companies that would affect conditions in arm's length transactions. The OECD Guidelines list as attributes or "comparability factors" that may be important when determining

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<sup>4</sup> OECD Guidelines, paragraph 2.3.

<sup>5</sup> OECD Guidelines, paragraph 1.35.

<sup>6</sup> OECD Guidelines, paragraph 1.33.

comparability: the characteristics of the property or services transferred; the functions performed by the parties, taking into account assets used and risks assumed (functional analysis); the contractual terms; the economic circumstances of the parties; and the business strategies pursued by the parties<sup>7</sup>.

## **2.2. The beneficiary: Amazon EU Sarl**

### 2.2.1. Description of the Amazon group

- (16) The present investigation concerns a tax ruling concluded on 6 November 2003 between the Luxembourgish authorities and the Amazon group, consisting of Amazon.com Inc. and its subsidiaries (collectively referred to hereinafter as “Amazon”). Amazon is headquartered in Seattle, Washington, United States of America (“US”).
- (17) Amazon was incorporated in 1994 and operates as an online retailer. It operates 13 global web sites, including amazon.com and five European websites. Amazon has divided its operations into two segments: North America and International. Within those two geographic segments, its primary customer segments consist of consumers, sellers, enterprises, and content creators. Amazon serves consumers through its retail web sites. It also manufactures and sells Kindle devices and offers programs that enable sellers to sell their products on its websites and their own branded websites, and to fulfill<sup>8</sup> orders through Amazon. The company serves developers and enterprises through Amazon Web Services, which provides access to technology infrastructure for different types of business. In addition, Amazon generates revenue through other marketing and promotional services, such as online advertising and co-branded credit card agreements. In 2013, Amazon had worldwide net sales of USD 74 452 million and a post-tax net profit of USD 274 million. Segment sales as a percentage of total net sales for the fiscal year 2013 were 60% North America and 40% International. In 2013, Amazon employed approximately 117 300 full-time and part-time employees worldwide<sup>9</sup>.

### 2.2.2. Structure of Amazon in Luxembourg

- (18) According to the information provided by Luxembourg, Amazon EU Société à responsabilité limitée, a Luxembourg commercial company (hereinafter “Amazon EU Sarl” or “LuxOpCo”), functions as the head office of Amazon for Europe and is the principal operator of the retail and business services offered through Amazon’s European websites. In addition, Amazon EU Sarl performs treasury management functions and holds (directly or indirectly) the other European Amazon subsidiaries that perform merchandising, sales support and marketing functions. Furthermore, according to the information provided by Amazon to the UK House of Commons Committee of Public Accounts, Amazon EU Sarl owns the inventory, earns the profits associated with the selling of products to end customers, and bears the risk of any loss<sup>10</sup>. In 2013, the net turnover of the LuxOpCo amounted to EUR 13 612 449 784.
- (19) Amazon Europe Technologies Holding SCS (hereinafter “Lux SCS”), a Luxembourg limited liability partnership (*société en commandite simple*) that holds all the shares in

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<sup>7</sup> OECD Guidelines, paragraph 1.36.

<sup>8</sup> Fulfilment refers to the process initiated in a company when an order for a product is received. This includes warehousing, finding the item ordered, packaging it, and shipping it to the correct address.

<sup>9</sup> Annual report 2013, Amazon.Com, p. 4, 25 and 36.

<sup>10</sup> <http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpublic/writev/716/m03.htm>.

Amazon EU Sarl, licenses the Amazon group's intellectual property rights (hereinafter "IP") to Amazon EU Sarl to operate the European websites in return for a tax deductible royalty payment (the "Licence Fee").

- (20) Amazon EU third party seller (*i.e.*, marketplace) business<sup>11</sup>, which supports sellers that sell on the European websites, is operated by Amazon Services Europe Sarl, a Luxembourg company owned by Amazon EU Sarl. From Luxembourg, Amazon Services Europe Sarl processes and settles payments from its European customers<sup>12</sup>.
- (21) Amazon's EU digital business (in which MP3s and eBooks are sold) is operated by Amazon Media EU Sarl, a Luxembourg company owned by Amazon EU Sarl. Amazon Media EU Sarl earns the profits associated with the selling of digital products to end customers and bears the risk of any losses. From Luxembourg, Amazon Media EU Sarl processes and settles payments from its European customers<sup>13</sup>.
- (22) The entities of the Amazon group that are liable to corporate income tax in Luxembourg are Amazon EU Sarl, Amazon Media EU Sarl, Amazon Luxembourg Sarl, Amazon Services Europe Sarl, FinLux Sarl and Amazon Payments SCA. These companies form a fiscal unity<sup>14</sup> in which Amazon EU Sarl operates as the parent of the unity. Outside of the fiscal unity, the Amazon group has two other companies in Luxembourg, Amazon Euasia Sarl and Amazon Europe Core Sarl. Both companies are wholly owned by Amazon Europe Technologies Holding SCS, a limited liability partnership registered in Luxembourg<sup>15\*</sup>.
- (23) Amazon employs around 1 000 people in Luxembourg, including strategic management posts that manage the entirety of Amazon's European activities.

### 2.3. The contested measure

- (24) In response to the Commission's request for information of 24 June 2014<sup>16</sup>, the Luxembourgish authorities submitted responses to the Commission's questions as well as a number of supporting documents. Those documents include (i) a guidance paper from 1989 on the rulings practice issued by the Luxembourgish tax administration, (ii) a

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<sup>11</sup> Amazon's marketplace service allows small businesses and sellers to make their goods available through the Amazon's EU websites. In addition, those businesses and sellers can choose to send Amazon their inventory in one country, which Amazon stores at their fulfilment centers, lists on all their websites across Europe, and picks, packs and delivers anywhere in Europe.

<sup>12</sup> <http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/writev/716/m03.htm>.

<sup>13</sup> <http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/writev/716/m03.htm>.

<sup>14</sup> In a fiscal unity (le régime d'intégration fiscale), a parent company may be taxed as a group together with one or more of its subsidiaries. For corporate income tax purposes this means that the subsidiaries are deemed to have been absorbed by the parent company. The main advantages of group taxation are that the losses on one company can be offset against profits from another group company, and that fixed assets may in principle be transferred tax-free from one company to another. To be eligible for a fiscal unity, the parent company must hold, directly or indirectly a participation of 95% or more in the share capital of a subsidiary and both the consolidating parent as the subsidiaries are capital companies resident in Luxembourg that are fully subject to corporate income tax. The consolidation is at least for five accounting years (Article 164bis LIR).

<sup>15</sup> On 31 December 2013, Amazon Europe Core Sarl was not operational. In 2012, Amazon Euasia Sarl had a net revenue of EUR [...].

\* Parts of this text have been hidden so as not to divulge confidential information; those parts are enclosed in square brackets.

<sup>16</sup> Described in recitals (2) to (5) above

letter by Amazon dated 23 October 2003 requesting the acceptance of the Luxembourgish tax authorities of the pricing arrangement between Lux SCS and Amazon EU Sarl (referred to in that letter as LuxOpCo)<sup>17</sup> for Luxembourg corporate income tax purposes, as described in that letter, and (iii) a letter by the tax advisor of Amazon on behalf of Amazon dated 31 October 2003, requesting the approval of the Luxembourgish tax authorities of the legal structure of Amazon for Luxembourg corporate income tax purposes, as described in that letter.

- (25) That submission also contained a letter dated 6 November 2003 from the Luxembourgish tax authorities addressed to Amazon. In that letter, those authorities state that they approve of the content of the letters of 23 October 2003 and of 31 October 2003 regarding the proposed tax treatment by the Luxembourgish tax authorities of Amazon's future activities.
- (26) Finally, the submission by the Luxembourgish authorities contained a chart of the legal structure of Amazon in Luxembourg and the financial accounts of the legal entities of the Amazon group established in Luxembourg for the years 2011, 2012 and 2013.
- (27) The measure under assessment in the present decision is the letter of 6 November 2003 of the Luxembourgish tax authorities to Amazon ("the contested tax ruling"), approving the transfer pricing arrangement described in the letter by Amazon to those authorities of 23 October 2003 and the structure of the Amazon group described in its letters of 23 October 2003 and 31 October 2003. More specifically, the present decision assesses the transfer pricing agreement approved in the contested tax ruling and is without prejudice to the assessment of other measures contained in that ruling.

### 2.3.1. Structure of the group described in the ruling request

- (28) According to the letters of 23 October 2003 and 31 October 2003 (hereinafter jointly referred to as the "ruling request"), Amazon intended to restructure its European business operations by establishing its European headquarters in Luxembourg. The target structure described in the ruling request seems to have been effectively put in place and did not substantially change<sup>18</sup> before the end of 2013.
- (29) In the target structure, LuxOpCo<sup>19</sup> would function as the principle operator of the retail and business services offered through Amazon's European websites consisting of the websites identified by the URLs [www.amazon.co.uk](http://www.amazon.co.uk), [www.amazon.de](http://www.amazon.de), [www.amazon.fr](http://www.amazon.fr) and any new European URLs through which Amazon would launch a business. According to the ruling request, Amazon functions as the seller of the record in Amazon's retail business segment. The retail business includes a range of products, including electronics, computers, books and outdoor living items. Amazon purchases these products from vendors and fulfills them either through its fulfilment centers or through outsourced fulfilment providers. Amazon's business service consists of Amazon's Merchants@, Marketplace, Auctions and zShops programs. Each of these

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<sup>17</sup> Amazon EU Sarl will be referred to as LuxOpCo in the remainder of this decision to ensure consistency with the contested tax ruling and the ruling request.

<sup>18</sup> According to the Luxembourgish authorities, the structure would have changed as from 1 July 2014. In particular, a new entity Amazon Europa Core S.à.r.l. would have been put in place dedicated [...].

<sup>19</sup> The ruling request refers to Lux OpCo. Lux OpCo is identified in the replies by Luxembourg to be Amazon EU Sarl.

programs allows third party individuals and businesses to sell new, used or collectible products or services through Amazon's websites.

- (30) LuxOpCo was to operate all European websites, through which it was to offer retail products and third-party vendor services, primarily to customers located in Europe. It was anticipated at the moment of the ruling request that Amazon's existing affiliated entities located in Germany, the UK and France would provide various support services with respect to the EU web sites by performing customer referral, merchandising and sales support functions, marketing and advertising in order to attract end users, and fulfillment services for the retail business.
- (31) Regarding the legal structure of the Amazon group, the ruling request describes the following ownership relations within that group which are relevant from a Luxembourgish tax perspective:

§ Amazon [Company 1 based in the US] (>95%] limited partner) and Amazon [Company 2 based in the US] (<5%] general partner), both US resident companies, participate as partners in a Luxembourg Société en Commandite Simple (Lux SCS), a limited liability partnership<sup>20</sup>. Lux SCS is a separate entity, but it does not have a separate tax personality from that of its partners. This means that Lux SCS is a transparent entity for tax purposes. As a result, in principle not Lux SCS itself will be subject to Luxembourg corporate income tax and net wealth tax, but only the participating partners to which the profits of Lux SCS will be allocated on a yearly basis<sup>21</sup>.

§ Lux SCS holds all the shares in LuxOpCo.

§ Lux SCS functions as an intangibles holding company and assists in the ongoing development of certain intangible property used in the operation of the European websites through a buy-in<sup>22</sup> licence and cost-sharing agreement with Amazon.com, Inc and other US affiliates of the Amazon group. Lux SCS licenses this IP to LuxOpCo in return for a tax deductible royalty payment (Licence Fee). Lux SCS will retain all risk associated with the ownership of the IP rights. Lux SCS also enters into loan agreements with LuxOpCo and other group companies in order to loan surplus cash back to group companies.

§ LuxOpCo operates all of Amazon's European websites (at the time of the ruling: Amazon.de, Amazon.fr and Amazon.co.uk) and holds (directly or indirectly) all the shares in the EU Marketing subsidiaries outside Luxembourg. LuxOpCo owns and uses the Luxembourg-based transaction processing servers to complete the processing of, and authorize payments for, customer and third-party seller

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<sup>20</sup> According to written evidence from Amazon EU Sarl, provided in response to the hearing on Amazon in the House of Commons, Amazon Europe Holding Technologies SCS is now owned by Amazon.com Int'l Sales, Inc., Amazon.com, Inc., and Amazon Europe Holding, Inc., all of which are U.S. companies.

<sup>21</sup> However, due to a mismatch in the classification of Lux SCS (transparent or non-transparent due to US check-the-box rules) between Luxembourg and the US, the taxation of the partners in the US can be deferred indefinitely as long as none of the profit is repatriated to the US.

<sup>22</sup> A buy-in payment is a payment made by a new entrant to an already active cost-sharing agreement to obtain an interest in any results of prior cost-sharing agreement activity. [...].

transactions, including payments to third-party merchants. Lux OpCo also provides intra-group loans to other group members of the Amazon group.

§ Out of the [20-50] full-time employees that were envisaged to work in Luxembourg for LuxOpCo, [5-20] would work in management. The remaining full-time employees (approximately [15-30]) would function in areas such as marketing, technology and account payable.

(32) The ruling request does not contain any further specification of the functions to be performed by LuxOpCo than the considerations described above in recitals (28) to (31). The IP held by Lux SCS is used in the operation of the EU websites by LuxOpCo according to the ruling request. However, the ruling request does not contain any information about the IP itself and what the IP rights consist of.

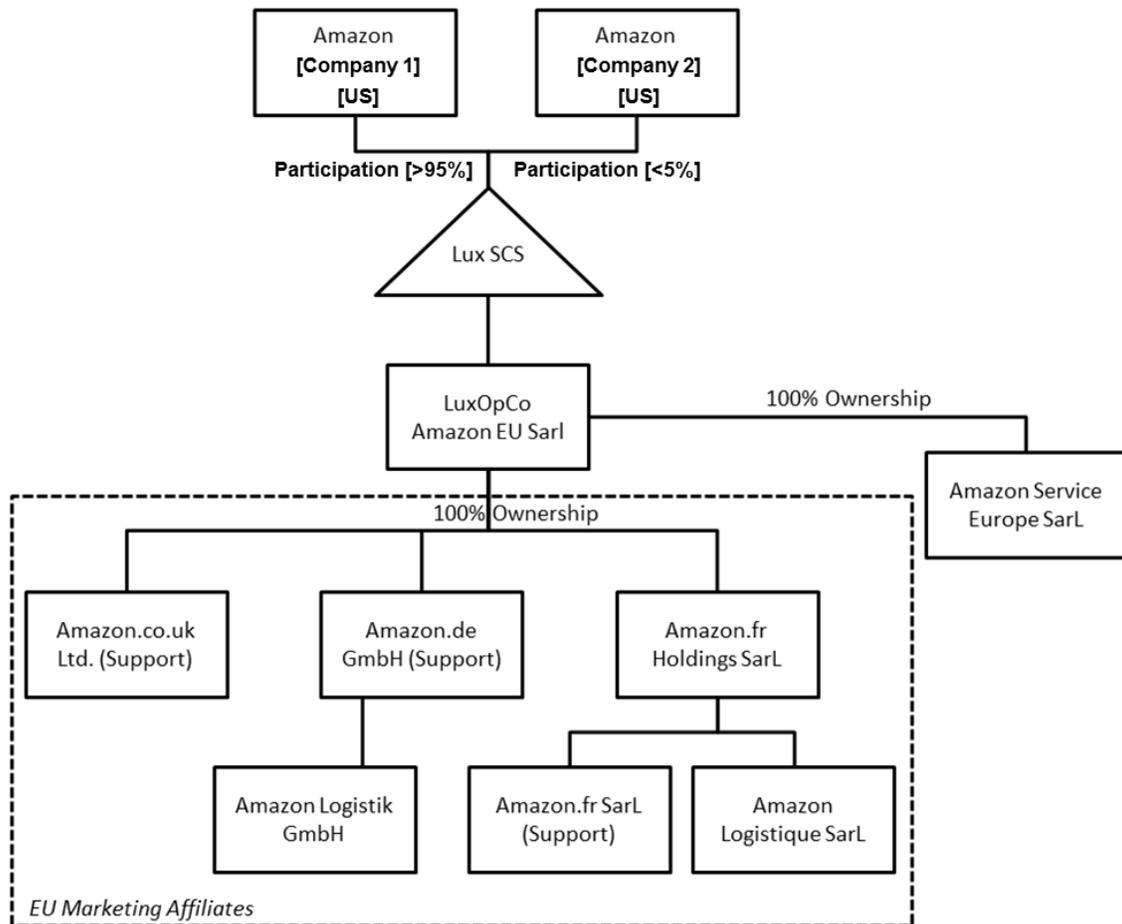
(33) Additional information on the functions performed by Amazon in Luxembourg was presented during the hearing of the UK House of Commons Committee of Public Accounts, as described in recital (18) above. In that hearing, Amazon indicated that all strategic functions for Amazon's business in Europe are based in Luxembourg, specifying that this concerns Amazon's retail business, Amazon's third-party business, Amazon's transportation teams, Amazon's customer service, human resources and finance, which functions are led by people who are physically based in Luxembourg<sup>23</sup>. Amazon also indicated in the hearing that the inventories of goods that are in Amazon's fulfilment centres across Europe belong to LuxOpCo and do not belong to the local entities that Amazon may have across Europe, and that the UK subsidiary of Amazon does not own inventory<sup>24</sup>.

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<sup>23</sup> See Q366 and Q373 in HM Revenue & Customs: Annual Report and Accounts 2011–12, House of Commons Committee of Public Accounts, 2012.

<sup>24</sup> See Q407 and Q383 in HM Revenue & Customs: Annual Report and Accounts 2011–12, House of Commons Committee of Public Accounts, 2012.

Figure 1 – Envisaged legal structure of the group described in the ruling request



### 2.3.2. The transfer pricing agreement

- (34) According to the ruling request, Lux SCS would obtain the right, in the context of the reorganisation of the Amazon group, to exploit intangibles owned and developed in the US in exchange for a buy-in licence and a cost-sharing agreement. Although not determined at the time of the ruling request, the terms and conditions of those agreements would be, according to Amazon's tax advisor, at arm's length. Lux SCS would consequently license the Amazon group's IP rights to LuxOpCo.
- (35) Amazon's letter of 23 October 2003 to the Luxembourgish tax authorities describes how the level of the royalty would be set. In that letter, Amazon indicated that it presented an economic analysis of functions and risks that LuxOpCo was anticipated to undertake. A copy of that analysis was supposedly attached to that letter, but was not submitted by Luxembourg to the Commission in response to the latter's request for information of 24 June 2014.
- (36) The letter of 23 October 2003 further indicated that, based on that economic analysis, Amazon developed a specific transfer pricing arrangement, under which the licence fee

that LuxOpCo will be required to pay to Lux SCS for the use of the Amazon group's IP (the Licence Fee) would be established. The Licence Fee was approved by the contested tax ruling.

(37) According to that letter, the Licence Fee would be computed each year and would be equal to a percentage of all revenue (the "Royalty Rate") received by LuxOpCo in connection with its operation of the European Web Sites. The Royalty Rate is determined as follows:

- (1) Compute and allocate to LuxOpCo the "LuxOpCo Return", which is equal to the lesser of (a) [4-6] % of LuxOpCo's total EU Operating Expenses for the year and (b) total EU Operating Profit attributable to the European Web Sites for such year;
- (2) The Licence Fee shall be equal to EU Operating Profit minus the LuxOpCo Return, provided that the Licence Fee shall not be less than zero.
- (3) The Royalty Rate for the year shall be equal to the Licence Fee divided by total EU Revenue for the year.
- (4) Notwithstanding the foregoing, the amount of the LuxOpCo Return for any year shall not be less than 0.45% of EU Revenue, nor greater than 0.55% of EU Revenue.
- (5) (a) In the event that the LuxOpCo Return determined under step (1) would be less than 0.45% of EU Revenues, the LuxOpCo Return shall be adjusted to equal the lesser of (i) 0.45% of Revenue or EU Operating Profit or (ii) EU Operating Profit  
(b) In the event that the LuxOpCo Return determined under step (1) would be greater than 0.55% of EU Revenues, the LuxOpCo Return shall be adjusted to equal the lesser of (i) 0.55% of EU Revenues or (ii) EU Operating Profit.

(38) For the purpose of the Royalty Rate Computation:

- § "EU COGs" means Costs of Goods Sold, computed using US GAAP, (Generally Accepted Accounting Principles), attributable to LuxOpCo's operation of the European Web Sites.
- § "EU Operating Expense" means LuxOpCo's total costs, including intercompany expenses, but excluding: EU COGs, the Licence Fee, currency gains and losses and interest expense, calculated under US GAAP.
- § "EU Revenues" means total net sales revenue earned by LuxOpCo through the EU Web Sites, which shall be equal to the sum of (a) the total sales prices of products sold by LuxOpCo, stated on the invoices which are issued to customers, including revenue attributable to gift wrapping and shipping and handling, less: value added taxes, returns and other allowances, and (b) total services revenue earned by LuxOpCo in connection with the sale of products or services by unrelated parties through the EU Web Sites, less value added taxes.

§ “EU Operating Profit” means EU Revenue minus: EU COGs and EU Operating Expenses.

### 2.3.3. Requested confirmation regarding the status of Lux SCS

- (39) As explained in recital (19), Lux SCS is a *société en commandite simple*, a Luxembourg limited liability partnership (“SCS”). A SCS is considered to be a transparent entity for Luxembourgish tax purposes. That means that all the royalties received from the licensing agreement and interest received from intra-group loans by Lux SCS will in principle not be taxed in Luxembourg but in the country of residence of the partners in Lux SCS to whom the profits of Lux SCS are allocated on a yearly basis<sup>25</sup>.
- (40) However, despite the fact that a SCS is considered transparent for tax purposes, the non-resident partners of the SCS or the SCS itself could still be taxed in Luxembourg if they operate through a permanent establishment in Luxembourg. For this reason, in addition to the transfer pricing arrangement, Amazon also requested confirmation from the Luxembourgish tax authorities that neither the partners of Lux SCS nor Lux SCS itself will have any tangible presence in Luxembourg (offices, employees etc.) so that in the absence of a fixed place of business, Lux SCS will not be deemed to operate through a permanent establishment in Luxembourg, nor will the partners in Lux SCS be regarded as having a permanent establishment in Luxembourg. That means that Lux SCS will also not be subjected to municipal business tax, nor will the [...] partners, as tax non-residents in Luxembourg, be subjected to corporate income tax in Luxembourg on their partnership interest in Lux SCS.

## 3. POSITION OF LUXEMBOURG

- (41) Luxembourg submits that the contested tax ruling does not constitute State aid.
- (42) Luxembourg claims that its ruling practice is based on Article 164 of the Luxembourgish tax code of 1967 (“LIR”), which does not provide any discretion to its tax authorities. Given the absence of any formal discretion in its tax ruling practice, Luxembourg argues that a ruling should consequently not be able to give rise to State aid unless the law was misapplied, which could, however, be judged solely by an assessment of the national law. In addition, in view of the competence of the Member States in the area of taxation, the Commission would only be able to intervene in such matters in cases of a manifest error. Finally, Luxembourg submits that the tax ruling of Amazon is in line with the general tax ruling practice of multinationals in Luxembourg and with the OECD principles.
- (43) The Luxembourgish authorities state that an analysis was conducted for the purposes of the transfer pricing arrangement based on agreements between Amazon and non-related third parties, from which it would result that the same or substantially the same IP was made available to third parties. On the basis of that analysis, an arm’s length royalty was determined, expressed as a percentage of the sales of LuxOpCo.

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<sup>25</sup> However, as explained in footnote 21 above, the taxation of the partners in the US can be deferred indefinitely as long as the profits are not repatriated to the US.

- (44) The Luxembourgish authorities further explain that, in parallel, the profit split method was applied to analyse the functions and risks of LuxOpCo and Lux SCS. Luxembourg claims that LuxOpCo is the entity with the functions and risks which are most obvious. The functions of LuxOpCo were compared to determine an appropriate level of remuneration. The residual profits would be then attributed to Lux SCS in the form of a royalty.
- (45) According to the Luxembourgish authorities, the two methods produced analogous results and the profit split method was chosen.

#### **4. ASSESSMENT**

##### **4.1. Existence of aid**

- (46) According to Article 107(1) TFEU, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the provision of certain goods shall be incompatible with the internal market, in so far as it affects trade between Member States.
- (47) The qualification of a measure as aid within the meaning of Article 107(1) therefore requires the following cumulative conditions to be met: (i) the measure must be imputable to the State and financed through State resources; (ii) it must confer an advantage on its recipient; (iii) that advantage must be selective; and (iv) the measure must distort or threaten to distort competition and have the potential to affect trade between Member States. Article 107 (1) TFEU also applies in the field of taxation notwithstanding the fact that the competence of the Union to regulate direct taxation is limited under the TFEU<sup>26</sup>.
- (48) The main question in the present case is whether the contested tax ruling confers a selective advantage upon Amazon in so far as it results in a lowering of its tax liability in Luxembourg. If the existence of a selective advantage can be shown, the presence of the other conditions for a finding of State aid under Article 107(1) TFEU is relatively straightforward.
- (49) As regards the imputability of the measure, the contested tax ruling was issued by the Luxembourgish tax authorities, which is part of the Luxembourgish State. In the present case, the contested tax ruling was used by Amazon to calculate its corporate income tax base in Luxembourg. The Luxembourgish tax authorities have accepted those calculations through that ruling and on that base set the tax due.
- (50) As regards the measure's financing through State resources, provided it can be shown that the contested tax ruling resulted in a lowering of Amazon's tax liability in Luxembourg, it can also be concluded that that ruling gives rise to a loss of State resources. That is because any reduction of tax for Amazon results in a loss of tax revenue that otherwise would have been available to Luxembourg<sup>27</sup>.

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<sup>26</sup> Commission notice on the application of the State aid rules to measures relating to direct business taxation (OJ No C 384, 10.12.98, p. 3).

<sup>27</sup> Judgment in *Commission and Spain v Government of Gibraltar and United Kingdom* C-106/09 P and C-107/09 P, EU:C:2011:732, paragraph 72.

- (51) As regards the other conditions for a finding of aid, Amazon is a globally active firm, operating in various Member States. Any aid in its favour distorts or threatens to distort competition and has the potential to affect intra-Union trade.
- (52) Finally, as regards the presence of a selective advantage, it follows from the case-law that the notion of aid encompasses not only positive benefits, but also measures which in various forms mitigate the charges which are normally included in the budget of an undertaking<sup>28</sup>. At the same token, treating taxpayers on a discretionary basis may mean that the individual application of a general measure takes on the features of a selective measure, particularly where the exercise of the discretionary power goes beyond the simple management of tax revenue by reference to objective criteria.<sup>29</sup>
- (53) In order to determine whether a method of assessment of the taxable income of an undertaking gives rise to a favourable treatment, i.e. an advantage, it is necessary to compare that method to the ordinary tax system, based on the difference between profits and losses of an undertaking carrying out its activities under normal market conditions. Thus, where a tax ruling concerns transfer pricing arrangements between related companies within a corporate group, that arrangement should not depart from the arrangement or remuneration that a prudent independent operator acting under normal market conditions would have accepted<sup>30</sup>.
- (54) In this context, market conditions can be arrived at through transfer pricing established at arm's length. The Court of Justice of the European Union has confirmed that if the method of taxation for intra-group transfers does not comply with the arm's length principle<sup>31</sup>, and leads to a taxable base inferior to the one which would result from a correct implementation of that principle, it provides a selective advantage to the company concerned<sup>32</sup>.
- (55) The OECD Guidelines are a reference document recommending methods for approximating an arm's length pricing outcome and have been retained as appropriate guidance for this purpose in previous Commission decisions<sup>33</sup>. The different methods

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<sup>28</sup> Judgment in *Adria-Wien Pipeline*, C-143/99, EU:C:2001:598, paragraph 38.

<sup>29</sup> Judgment in *France v Commission (Kimberly Clark Sopalin)*, C-241/94, EU:C:1996:353, paragraphs 23 and 24.

<sup>30</sup> Commission Decision 2003/755/EC of 17 February 2003 on State aid C 15/02, Belgian Coordination centres, OJ L 282, 30.10.2003, p. 25, recital 95.

<sup>31</sup> In particular, rulings allowing taxpayers to use improper transfer pricing methods for calculating taxable profits, e.g. the use of fixed margins for a cost-plus or resale-minus method for determining an appropriate transfer pricing may involve State aid- See Commission Decision 2003/438/EC of 16 October 2002 on State aid C50/2001, Luxembourg Finance Companies, OJ L 153, 20.6.2003, p. 40, recitals 43 and 44; Commission Decision 2003/501/EC of 16 October 2002 on State aid C 49/2001, Luxembourg Coordination centres, OJ L 170, 9.7.2003, p. 20, recitals 46-47 and 50; Commission Decision 2003/755/EC of 17 February 2003 on State aid C 15/02, Belgian Coordination centres, OJ L 282, 30.10.2003, p. 25, recitals 89-95 and the related Judgment in *Belgium and Forum 187 v. Commission*, C-182/03 and C-217/03, EU:C:2006:416, paragraphs 96 and 97; Commission Decision 2004/76/EC of 13 May 2003 on State Aid C 45/2001, French Headquarters and Logistic Centres, OJ L 23, 28.1.2004, p. 1, recitals 50 and 53.

<sup>32</sup> Judgment in *Belgium and Forum 187 v. Commission*, C-182/03 and C-217/03, EU:C:2006:416, paragraph 95.

<sup>33</sup> Cf. Commission Decision 2003/755/EC of 17 February 2003 on State aid C 15/02, Belgian Coordination centres, OJ L 282, 30.10.2003, p. 55, recitals 89 to 95 and Commission Decision 2003/512/EC of 5 September 2002 on State Aid C 47/01, German Coordination Centres, OJ L 177, 16.07.2003, p. 17, recitals 27 and 28.

explained in the OECD Guidelines can result in a wide range of outcomes as regards the amount of the taxable basis. Moreover, depending on the facts and circumstances of the taxpayer, not all methods approximate a market outcome in a correct way. When accepting a calculation method of the taxable basis proposed by the taxpayer, the tax authorities should compare that method to the prudent behaviour of a hypothetical market operator, which would require a market conform remuneration of a subsidiary or a branch, which reflect normal conditions of competition. For example, a market operator would not accept that its revenues are based on a method which achieves the lowest possible outcome if the facts and circumstances of the case could justify the use of other, more appropriate methods.

- (56) Accordingly, tax rulings should not have the effect of granting the undertakings concerned lower taxation than other undertakings in a similar legal and factual situation. Tax authorities, by accepting that multinational companies depart from normal tax conditions in setting the conditions for intra-group transactions through a practice of tax rulings, may renounce taxable revenues in their jurisdiction and thereby forego State resources, in particular when accepting conditions which depart from conditions prevailing between independent economic operators<sup>34</sup>.
- (57) It is in the light of these general observations that the Commission will examine whether the contested tax ruling complies with the arm's length principle or whether it gives rise to a selective advantage conferred by the Luxembourgish tax authorities upon Amazon.
- (58) As a preliminary matter, Luxembourg argues that, in the absence of any formal discretion in its tax ruling practice, a tax ruling cannot give rise to a selective advantage and thus cannot constitute State aid, unless the law was misapplied, which can solely be judged by looking at the applicable national law.
- (59) The Commission notes that through the contested tax ruling the Luxembourgish tax authorities approved, on the basis of Article 164 LIR, the transfer pricing arrangements proposed by Amazon in the ruling request. Article 164 LIR constitutes the legislative basis in Luxembourg for transfer prices and thereby implements Article 9 of the OECD Model Tax Convention, which lays down the arm's length principle. On the basis of that principle, in order to prevent a transaction from leading to tax avoidance, the transfer price must be comparable to that which would have been arrived at between independent operators on the basis of the traditional method, according to which the taxable profit is calculated on the basis of the difference between the company's income and charges<sup>35</sup>. Any result that deviates from that outcome and lowers the tax basis has the effect of providing an advantage to the taxpayer concerned<sup>36</sup>.
- (60) That advantage provides the taxpayer with a more favourable treatment as compared to other companies which are in a similar factual and legal situation. Those companies are either domestic, i.e. non- multinational companies whose taxable profit is calculated on

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<sup>34</sup> If, instead of issuing a ruling, the tax administration simply accepted a method of taxation based on prices which depart from conditions prevailing between independent economic operators, there would also be State aid. The main problem is not the ruling as such, but the acceptance of a method of taxation which does not reflect market principles.

<sup>35</sup> State aid C 49/2001, Luxembourg Coordination centres, OJ L 170, 9.7.2003, p. 20, recital 46.

<sup>36</sup> State aid C 49/2001, Luxembourg Coordination centres, OJ L 170, 9.7.2003, p. 20.

the basis of the difference between a company's income and charges or, if they are multinational companies, their taxable profit is derived at on the basis of a correct application of the arm's length principle. Therefore, an approval of a transfer pricing arrangement which does not reflect a market outcome and which favours a particular undertaking must be considered as *prima facie* selective, the selective treatment deriving from a deviation or misapplication of the arm's length principle, as set out in the OECD Model Tax Convention and the OECD Guidelines and incorporated in national law pursuant to Article 164 LIR.

- (61) According to paragraph 22 of the Notice on Direct Business Taxation; “*every decision of the administration that departs from the general tax rules to the benefit of individual undertakings in principle leads to the presumption of State aid [...]*”<sup>37</sup>. Although, as the Luxembourgish authorities rightly argue, the OECD Guidelines provide some flexibility with respect to the application of the arm's length principle, that flexibility is limited by the principle that the a remuneration arrived at should reflect what a prudent independent operator acting under normal market conditions would have accepted.
- (62) At this stage, the Commission has the following doubts as regards the compliance of the contested tax ruling with that principle.
- (63) First, Luxembourg did not submit to the Commission any transfer pricing report prepared by Amazon in support of the transfer pricing arrangement in the ruling request approved by the contested tax ruling, although it was requested to do so.<sup>38</sup> Amazon's letter of 23 October 2003 refers to the existence of an economic analysis presented by Amazon to the Luxembourgish tax authorities of the functions and risks that LuxOpCo was expected to carry out. It is, however, not clear whether that analysis, to the extent that it exists, constitutes a transfer pricing report with a comparability analysis for the purposes of determining arm's length pricing between LuxOpCo and Lux SCS. Section V of the OECD Guidelines, although non-binding, lists the types of information that may be useful when determining transfer pricing for tax purposes in accordance with the arm's length principle, including a transfer pricing analysis. In the absence of a transfer pricing report, the Commission has doubts whether the Luxembourgish tax authorities properly confirmed by the contested tax ruling that the transfer pricing arrangement presented in Amazon's ruling request reflected what a prudent independent operator acting under normal market conditions would have accepted. The Commission further notes that the ruling request by Amazon was assessed within eleven working days from the receipt of the first letter constituting the ruling request<sup>39</sup>, which is a very short period of time had a transfer pricing report been submitted and assessed in this case.
- (64) Second, the Commission recalls that the OECD Guidelines set certain requirements for the choice of the appropriate transfer pricing method to comply with the arm's length principle. The method proposed by Amazon's tax advisor in the ruling request and accepted by the Luxembourgish tax authorities in the contested tax ruling does not seem to correspond to any of the methods listed in the OECD guidelines, described in recitals

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<sup>37</sup> Commission notice on the application of the State aid rules to measures relating to direct business taxation (OJ No C 384, 10.12.98, p. 3).

<sup>38</sup> See recital (5) above.

<sup>39</sup> From 23 October 2003 to 6 November 2003.

(13) and (14) above. While those methods are not exhaustive<sup>40</sup>, the Commission has doubts, particularly in the absence of a transfer pricing report, whether the Luxembourgish tax authorities properly confirmed that the transfer pricing arrangement presented in Amazon's ruling request was in line with market conditions.

- (65) Third, the contested tax ruling concerns a transfer pricing arrangement which determines *inter alia* the royalty payments (Licence Fee) owed by LuxOpCo to Lux SCS for the use of IP rights. According to paragraph 6.16 of the OECD Guidelines “a royalty would ordinarily be a recurrent payment based on the user’s output, sales, or in some rare circumstances, profits.” In the present case, the royalty payment approved by the contested tax ruling is not related to output, sales, or to profit. Although the royalty rate is expressed as a percentage of all revenues<sup>41</sup>, as described in recital (37), the royalty payment is only presented and not calculated in the form of a royalty rate over revenue<sup>42</sup>.
- (66) Instead, the royalty is calculated as a residual profit. This means that instead of calculating an arm’s length value for the royalty itself, the pricing method accepted by the contested tax ruling proceeds to calculate, out of the entire European profit earned by LuxOpCo through the EU websites, the profit that is attributable to other functions, that is, the functions performed by LuxOpCo. The part of the profit that is not attributed to other functions is paid out to Lux SCS in the form of a royalty. Indeed, the remuneration for LuxOpCo for the functions performed by it is established on the basis of the method described in recital (37), referred to as “LuxOpCo Return”, while the tax deductible royalty paid to Lux SCS is calculated as the difference between the actual profit recorded by LuxOpCo and that remuneration, calculated on the basis of the transfer pricing arrangement in Amazon’s ruling request and considered as sufficient by the Luxembourgish tax authorities in the contested tax ruling.
- (67) Fourth, as follows from recital (37), point (2), the royalty is a residual, and point (3) indicates that the royalty will be “expressed” as a percentage of revenues<sup>43</sup>. The fact that the ruling request indicates that the royalty rate will be expressed as a percentage of revenues does not comply with paragraph 6.16 of the OECD Guidelines, as described in recital (65) above. Rather than being expressed as a percentage of revenues, the royalty should be calculated based on revenues. In fact, the rule described in recital (37), point (2), seems to contain a cosmetic arrangement for how to present the royalty and has no bearing on the amount of the royalty. In particular, it does not affect the fact that the royalty is determined as a residual profit based on point (2).

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<sup>40</sup> Paragraph 2.9 of the OECD Guidelines does not exclude the use of other methods by the tax payer but requires a demonstration why the five methods described in the OECD Guidelines do not provide appropriate results. Information on whether such demonstration took place is not available.

<sup>41</sup> The ruling request uses the term revenue other terms which could designate the same accounting entry are turnover or sales.

<sup>42</sup> More concretely, the royalty would be calculated based on revenue if a fixed percentage was applied to the revenues figure declared each year and this would have been the amount paid in the form of royalty to Lux SCS each year. Contrary to such calculation based on revenues, in this case the amount of the royalty is determined first as a residual profit and only then this amount is divided by the amount of revenues to arrive at a percentage, which percentage however can therefore vary from year to year.

<sup>43</sup> It is recalled that the ruling request uses the term revenue other terms which could designate the same accounting entry are turnover or sales.

- (68) In its reply to the Commission, Luxembourg indicated that the royalty payment is set as a residual because LuxOpCo is considered to perform less complex functions than Lux SCS (see recital (44)). It is true that, according to article 3.18 of the OECD Guidelines, “*as a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner i.e. it will most often be the one that has the less complex functional analysis*”. However, based on the description of functions performed by LuxOpCo and the risks assumed<sup>44</sup>, it appears that the functions performed and the risks assumed by LuxOpCo are complex. LuxOpCo performs many functions and serves as the headquarters of Amazon for Europe. In particular, based on the description of the functions of LuxOpCo in the ruling request, it seems that LuxOpCo is taking strategic business and commercial decisions and assuming commercial risk, among others, inventory risk as well as operational risks related to the operating of the websites. The description of the functions currently performed by LuxOpCo, as described in recital (18) and (33), seems to confirm that LuxOpCo does not perform a routine function with limited risk.
- (69) For the purpose of a transfer pricing analysis and in particular for the purpose of determining whether LuxOpCo performs less complex functions than Lux SCS, a more extensive functions and risk analysis would be required, which is not contained in the ruling request, see recital (32). The ruling request for example indicated that both the existing EU entities and the LuxOpCo would be performing a marketing function and it is not clarified whether this is the same function, see recitals (30) and (31) above. The ruling request does also not contain information about the ownership of inventories, which is contained in the UK House of Commons Committee of Public Accounts, see recital (33), and which is relevant for the assessment of the risks of LuxOpCo.
- (70) By comparison, the IP for which Lux SCS is remunerated is not described in the ruling request or by the Luxembourgish authorities. It is therefore impossible to conclude on that basis that Lux SCS performs more complex functions than LuxOpCo. In any event, Lux SCS only seems to have as its function the sublicensing of IP that was not developed by it. Although Lux SCS is said to retain all risks associated with the ownership of that IP<sup>45</sup>, the risks of holding an existing IP are not specified and appear limited, in particular, compared to all the entrepreneurial risks assumed by LuxOpCo.
- (71) It also follows from the above that Amazon has a financial incentive to exaggerate the amount of the royalty when applying the transfer pricing arrangement approved in the contested tax ruling. This is because the royalty is deducted from the taxable profit of LuxOpCo in Luxembourg and paid to Lux SCS, which is a transparent entity from the perspective of Luxembourgish tax law. As Lux SCS also does not have any permanent establishment in Luxembourg according to the contested tax ruling, Lux SCS is not subject to taxation in Luxembourg, as explained in recital (39) and (40) above, so that, if the royalty is exaggerated, it would unduly reduce the tax paid by Amazon in Luxembourg by shifting profits to an untaxed entity from the perspective of corporate taxation.
- (72) Fifth, the contested tax ruling also determines the remuneration due to LuxOpCo for the functions it performs. The Luxembourgish authorities, in approving the ruling request,

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<sup>44</sup> As described in recitals (18), (29) and (31) above.

<sup>45</sup> See recital (31) above.

considered [4-6] % of operating expenses to be a sufficient remuneration, as follows from recital (37), point (1). If LuxOpCo's remuneration is established on that basis, it would seem to be based on the TNMM. The TNMM is one of the two indirect methods for estimating an arm's length remuneration<sup>46</sup>. According to that method, an arm's length remuneration is obtained from a comparison of net profit indicators between independent and associated companies as a means to estimate the profits that one or each of the associated companies could have earned had they dealt solely with independent companies, and therefore the payment those companies would have demanded at arm's length to compensate them for using their resources in the intra-group transaction. In this case, a net profit indicator based on operating costs appears to have been selected. However, based on the information provided to the Commission, the margin applied in the present case of [4-6] % does not appear to have been obtained from any comparability analysis.

- (73) Furthermore, the Commission's decisional practice, as well as the OECD Guidelines<sup>47</sup>, set a preference for the use of direct methods for setting an appropriate level of taxable profits. In particular, where possible, the CUP method is considered best at approximating conditions close to normal competition<sup>48</sup>. Therefore, the preference of the tax authorities for an indirect method as described in recital (44) does at this stage not seem justified, even less so as the authorities indicate that a direct pricing method was available.
- (74) Moreover, the level of that margin appears to constitute [only a part] of an arm's length remuneration in comparison to previous cases. Thus, in relation to Apple<sup>49</sup> and Starbucks<sup>50</sup>, the Commission expressed doubts with respect to the level of remuneration accepted by the respective tax authorities. In both cases, the TNMM was applied using the operating costs for the pricing of activities presented as routine activities with limited risk. Nevertheless, in both cases the margin considered as arm's length by the respective tax authorities was more than double than the [4-6] % margin accepted by the Luxembourgish tax authorities in relation to Amazon. Levels of arm's length remuneration can vary across markets and depend on economic circumstances. In this case, although the period covered by the ruling is also in part covered by the rulings assessed in the Apple and Starbucks decisions and all rulings concern the European market, it cannot be concluded in absence of a complete functional analysis that the remuneration is too low. Yet, the functions of Amazon performed and the risks assumed by LuxOpCo seem complex. They are presented in the functional analysis as central and strategic commercial decisions concentrating the business risk of the entire European market. Therefore, the method approved (the residual profit method), does not seem appropriate, whereas the level of margin accepted seems relatively low.
- (75) In addition, it follows from recital (34), points (1), (4) and (5), that a floor and a cap have been set to the remuneration of LuxOpCo, calculated as [4-6]% of operating costs, the floor being 0.45% of European turnover and the cap being 0.55% of the same

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<sup>46</sup> See recital (14) above.

<sup>47</sup> OECD Guidelines, paragraph 2.3.

<sup>48</sup> See, recital (13) above. It is further noted that even in a low risk environment of a toll manufacturer the CUP is recommended by the OECD Guidelines in particular regarding raw material pricing where the raw material is a commodity, see OECD Guidelines, paragraph 9.165.

<sup>49</sup> See Commission Decision of 11 June 2014 in case SA.38373, not yet published.

<sup>50</sup> See Commission Decision of 11 June 2014 in case SA.38374, not yet published.

turnover. This floor and this cap effectively override the pricing method based on operating expenses described in recital (37), point (1). There is no explanation as to why such a combination of methods would be appropriate. It appears that the floor and the cap are used to ensure a relatively predictable level of taxable profit; they do not seem to be based on any arm's length reasoning. Moreover, if the overall profit of the EU business is lower than the level of the floor, the floor of 0.45% of turnover no longer applies, according to recital (37), point (5), sub (a). Therefore, the transfer pricing arrangement put in place by Amazon and accepted by the contested tax ruling effectively contains a cap on a remuneration which seems too low.

- (76) Sixth, as regards the duration of the contested tax ruling, that ruling was granted more than ten years ago, but it was provided by Luxembourg as a ruling still in force in response to the Commission's request for information of 24 June 2014.<sup>51</sup> This means that the remuneration accepted in that ruling is still accepted as being at arm's length by the Luxembourgish tax authorities more than ten years later, without any revision. Even if the transfer pricing arrangement in the ruling request could have been considered to comply with the arm's length principle when that request was made to the Luxembourgish tax authorities, *quod non*, the appropriateness of the remuneration over the years should have been called into question, given the changes to the economic environment and required remuneration levels. The Commission notes, in particular, that that duration is much longer than the length of tax rulings currently concluded by Member States<sup>52</sup>.
- (77) On the basis of these observations, the Commission is of the opinion that the Amazon ruling does not comply with the arm's length principle. Accordingly, the Commission is of the opinion that through the contested tax ruling the Luxembourgish authorities confer an advantage on Amazon. That advantage is obtained every year and on-going, when the annual tax liability is agreed upon by the tax authorities in view of that ruling.
- (78) That advantage is also granted in a selective manner. While tax rulings that merely contain an interpretation of the relevant tax provisions without deviating from administrative practice do not give rise to a presumption of a selective advantage, rulings that deviate from that practice have the effect of lowering the tax burden of the undertakings concerned as compared to undertakings in a similar legal and factual situation. To the extent the Luxembourgish authorities have deviated from the arm's length principle as regards the contested tax ruling, the measure should also be considered selective.
- (79) Since the contested tax ruling fulfils all four conditions under Article 107(1) TFEU, the Commission takes the view, at this stage, that it constitutes State aid within the meaning of that provision.

#### **4.2. Compatibility of aid**

- (80) As the measure appears to constitute State aid, it is necessary to examine whether that aid could be considered compatible with the internal market. State aid measures can be considered compatible with the internal market on the basis of the exceptions listed in

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<sup>51</sup> See recital (5) above.

<sup>52</sup> See also doubts expressed in Commission's Decision of 11 June 2014 in Case SA.38373 - Apple, not yet published, recital 65 and the standard duration of APA agreements, recital 45.

Article 107(2) and 107(3) TFEU. The Luxembourgish authorities did not present any arguments to indicate that any of the exceptions provided for in those provisions apply in the present case.<sup>53</sup>

- (81) The exceptions provided for in Article 107(2) TFEU, which concern aid of a social character granted to individual consumers, aid to make good the damage caused by natural disasters or exceptional occurrences and aid granted to certain areas of the Federal Republic of Germany, do not seem to apply in this case.
- (82) Nor does the exception provided for in Article 107(3)(a) TFEU seem to apply, which allows aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious unemployment, and for the regions referred to in Article 349 TFEU, in view of their structural, economic and social situation.
- (83) As regards the exceptions laid down in Article 107(3)(b) and (d) TFEU, the aid in question does not appear to be intended to promote the execution of an important project of common European interest, nor to remedy a serious disturbance in the economy of Luxembourg, nor is it intended to promote culture or heritage conservation.
- (84) Finally, according to Article 107(3)(c) TFEU, aid granted to facilitate the development of certain economic activities or of certain economic areas could be considered compatible where it does not adversely affect trading conditions to an extent contrary to the common interest. The Commission has no elements at this stage to assess whether the tax advantages granted by the contested measure are related to specific investments eligible to receive aid under the State aid rules and guidelines, to job creation or to specific projects.
- (85) At this stage, the Commission considers that the contested tax ruling appears to result in a reduction of charges that should normally be borne by the entity concerned in the course of its business, and should therefore be considered as operating aid. According to the case law of the Court of Justice and Commission's decisional practice, such aid cannot be considered compatible with the internal market in that it does not facilitate the development of certain activities or of certain economic areas, nor are the incentives in question limited in time, digressive or proportionate to what is necessary to remedy to a specific economic handicap of the areas concerned.
- (86) Accordingly, the Commission has no indication at this stage that the contested measure can be considered compatible with the internal market.

In light of the foregoing considerations, the Commission's preliminary view is that the tax ruling of 5 November 2003 by Luxembourg in favour of Amazon constitutes State aid within the meaning of Article 107(1) TFEU and the Commission has doubts at this stage as to that ruling's compatibility with the internal market. The Commission has therefore decided to initiate the procedure laid down in Article 108(2) TFEU with respect to that measure.

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<sup>53</sup> The Commission recalls that according to the case law, the burden is on the Member State to show that aid is compatible with the internal market, see judgment of 12 September 2007, *Olympiaki Aeroporia Ypiresies v Commission*, T 68/03, EU:T:2007:253, paragraph 34.

The Commission further requests Luxembourg to submit its comments and to provide all such information as may help to assess the aid/measure, within one month of the date of receipt of this letter. In particular:

- to provide a copy of the economic analysis referred to in recital (35), if such an economic analysis exists
- to explain the reasons for deviating from the OECD transfer pricing methods when setting the remuneration of LuxOpCo.
- to provide a detailed description of the IP for which Lux SCS receives a royalty from LuxOpCo
- to provide the amounts of the royalties paid by LuxOpCo over the past ten year accounting period to Lux SCS and the accounting figures on the basis of which the royalty has been calculated in each accounting period.

The Commission requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

The Commission wishes to remind Luxembourg that Article 108(3) of the Treaty on the Functioning of the European Union has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999<sup>54</sup>, which provides that all unlawful aid may be recovered from the recipient.

The Commission warns Luxembourg that it will inform interested parties by publishing this letter and a meaningful summary of it in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the *Official Journal of the European Union* and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

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<sup>54</sup> OJ L 83 of 27.3.1999, p. 1, last amended by Regulation 734/2013 of 22 July 2013 OJ L 204 of 31.7.2013, p.15.

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Yours faithfully,  
For the Commission

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Vice-President