EUROPEAN COMMISSION

Brussels, 16.9.2019
C(2019) 6572 final

In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […]		PUBLIC VERSION This document is made available for information purposes only.

Subject: State Aid SA.53964 (2019/NN) – Belgium
Excess Profit Exemption granted to Luciad

Excellency,

The Commission wishes to inform Belgium 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 11 January 2016, the Commission adopted a negative decision with recovery concerning the "excess profit" tax ruling practice implemented by Belgium from 2004 to 2014 ("the 2016 Decision").[1] In the 2016 Decision, the Commission concluded that that practice constituted a scheme under which recipients of an "excess profit" ruling received unlawful and incompatible State aid. Luciad NV ("Luciad") received two "excess profit" rulings and was identified by Belgium as one of the beneficiaries under the alleged scheme. Following the 2016 Decision, the Belgian authorities recovered unpaid taxes from Luciad.

[1] Commission Decision of 11 January 2016 on the excess profit exemption State aid scheme SA.37667 (2015/C) (ex 2015/NN) implemented by Belgium, OJ 2016 L 260, 27.9.2016, p. 61.

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(2) On 14 February 2019, the General Court of the European Union ("the General Court") concluded that the Commission had wrongly classified the "excess profit" tax ruling practice as a scheme and it annulled the 2016 Decision, without expressing itself on the presence of unlawful and incompatible State aid in each of the individual rulings. On 24 April 2019, the Commission appealed the judgment of the General Court to the Court of Justice of the European Union ("the Court of Justice").[2]

(3) By letter of 5 April 2019, the Commission requested Belgium to submit those "excess profit" rulings that Belgium had not yet submitted under the procedure leading to the adoption of the 2016 Decision. The Commission further informed Belgium that it had reason to believe that the individual "excess profit" rulings granted by Belgium from 2004 to 2014, including those granted to Luciad, could give rise to illegal State aid. The Commission invited Belgium to comment.

(4) By letter of 9 May 2019, Belgium provided the Commission with the outstanding rulings and commented on why it considered those rulings not to give rise to State aid.

2. FACTUAL AND LEGAL BACKGROUND

2.1. Beneficiaries of the contested measures

(5) Luciad is based in Leuven, Belgium, and forms part of the Luciad Group ("the Group"), an international supplier of geographic information system tools and for high performance geospatial situational awareness. The Group has operations in Belgium, France and the United States ("U.S.") and customers in the airline and shipment sectors, as well as in the defence and security sectors.

(6) By the end of 2008, Luciad recorded an annual turnover of EUR 7 million and employed 50 full-time employees in Leuven (Belgium). In 2009, Luciad opened offices in Washington (U.S.) and Paris (France). For 2010/2011, the Group expected to employ an additional 60 employees and for 2012/2013 an additional 100 employees.[3]

2.2. The contested measures

(7) The "contested measures" in this Decision consist of the rulings listed below (the "Rulings") and the Belgian tax authorities' acceptance of Luciad's annual corporate income tax declarations prepared on the basis thereof, by which those authorities granted an "excess profit" exemption to Luciad:

– On 20 April 2010, Luciad obtained an "excess profit" ruling in relation to an internal restructuring, which covers the five-year period from 1 January 2009 to 31 December 2013 (the "2010 Ruling").[4] In the 2010 Ruling, the Belgian tax ruling commission ("*Service des Décisions Anticipées*" in French or "*Dienst Voorafgaande Beslissingen*" in Dutch, hereinafter: "the Ruling Commission") decided that [40-60]% of Luciad's actual earnings before interest and taxes ("EBIT") could be exempted from corporate income tax in Belgium as "excess profit" on the basis of Article 185(2)(b)

[2] Case C-337/19 P *Commission* v. *Belgium and Magnetrol International*.
[3] All data stemming from the 2010 Ruling and the 2013 Ruling, as defined in Recital (7).
[4] Voorafgaande beslissing 2010.106 of 20 April 2010, addressed to Luciad.

of the Belgium Income Tax Code ("*Code des impôts sur les revenus 1992*" (in French) or "*Wetboek van Inkomstenbelastingen 1992*" (in Dutch), hereinafter "BITC").

– The 2010 Ruling was modified by an "Avenant" dated 29 November 2011 (the "2011 Avenant").[5] The 2011 Avenant amended the percentage of "excess profit" Luciad could deduct from its corporate income tax base from [40-60]% to [40-60]% for the years 2012 and 2013.

– The 2010 Ruling was extended by a tax ruling dated 10 December 2013 (the "2013 Ruling").[6] The 2013 Ruling further increased the percentage of "excess profit" Luciad could deduct from its actual EBIT to [50-70]% for the period from 1 January 2014 to 31 December 2018.

2.2.1. The operation for which the Rulings were requested

(8) The 2010 Ruling describes the Group's plan to introduce a "Central Entrepreneur" model, with Luciad in Belgium as principal company responsible for strategic decision-making and high value-adding services (i.e. "the Central Entrepreneur"), and local sales offices in Germany, France and the U.S. operating as agents responsible for routine, low-risk functions. It further explains that Luciad considered maintaining a centralised business model as crucial to support the expected growth potential of the group, while enjoying economies of scale and creating additional synergetic benefits related to centralised R&D, centralised training, centralised consulting services, and centralised sales and sales support services.[7]

2.2.2. The determination of the "excess profit" to be exempted

(9) The 2010 Ruling validates the pricing of intra-group transactions between Luciad and the local sales affiliates within the "Central Entrepreneur" model. More specifically, the 2010 Ruling validates:

– the fact that under the "Central Entrepreneur" model, Luciad is responsible for the most important functions and bears most risks, whereas the local sales entities perform routine functions for the benefit of Luciad;

– the use of the Transactional Net Margin Method ("TNMM") for the remuneration of Luciad's transactions with the local sales entities, where those entities are considered as the "tested" party, i.e. the less complex party, for the purposes of applying the TNMM;

– the results of that TNMM are based on a transfer pricing study indicating that a remuneration of the local sales entities is considered at arm's length if they achieve an operating margin of 3.32% (i.e. their operating profit should equal 3.32% of sales/revenues).

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5 Avenant Voorafgaande beslissing 2010.106 of 20 April 2010, addressed to Luciad
6 Voorafgaande beslissing 2013.510 of 10 December 2013, addressed to Luciad.
7 2010 Ruling, paragraph 24.

(10) The 2010 Ruling explains that Luciad owns and is economically entitled to all existing intangible property ("IP") of the Group and that it will be responsible for all future development of such IP. It then claims that the introduction of the "Central Entrepreneur" model will lead to synergies and other economies of scale which will benefit the entire Group. It therefore considers that "*all group entities, including the central entrepreneur, must receive an arm's length remuneration taking into account their functional and risk profile*".[8] It goes on to claim that, in the case at hand, "*attributing possible additional profits deriving from these synergies and economies of scale to the Belgian central entrepreneur - Luciad – would result in excessive accounting profits*".[9]

(11) The 2010 Ruling then claims that the aforementioned "*excessive accounting profits*", i.e. the profits attributable to synergies and economies of scale, can be established as the difference between:

(i) the profit that Luciad will actually generate and record in its commercial accounts; and

(ii) an alleged "adjusted" arm's length profit for the "Central Entrepreneur" functions of Luciad.

The amount under (i) represents Luciad's residual profit, i.e. the total turnover of the Group from which the arm's length remuneration for the local sales entities and Luciad's own operational expenses are subtracted. The amount under (ii) is determined by performing a second transfer pricing analysis using the TNMM, but this time with Luciad as the less complex, tested party, as a result of which its alleged "adjusted" arm's length profit is benchmarked at an operating margin of 11.4% (i.e. its operating profit should equal 11.4% of sales/revenues). Using the budgeted figures for the Group over the years 2009 to 2013, the 2010 Ruling sets out the annual "excess profit" to be exempted at [40-60]% of Luciad's actual EBIT during those years.

(12) The 2010 Ruling justifies the "excess profit" exemption by referring to paragraph 1.9 of the 1995 OECD Transfer Pricing Guidelines.[10] It then refers to Article 185(2)(b) BITC and the reply of the Belgian Minister of Finance of 13 April 2005, according to which it is not up to the Belgian tax administration to determine which foreign related entity is to include the "excess profit" in its corporate tax base.[11]

(13) The 2010 Ruling declares that Luciad may exempt an amount equal to [40-60]% of its annual EBIT from corporate income taxation in Belgium for a period of five years.[12] That percentage is to be reviewed and adjusted if needed after a period of three years.[13]

(14) In the 2011 Avenant, the percentage of Luciad's EBIT to be exempted as "excess profit" under the 2010 Ruling was adjusted from [40-60]% to [40-60]% for the years 2012 and 2013. That adjustment was made using Luciad's actually recorded profits for 2009 and 2010 and updated budgets for 2011 to 2013. The adjustment

[8] 2010 Ruling, paragraph 32.
[9] *Ibid*.
[10] 2010 Ruling, paragraph 60.
[11] 2010 Ruling, paragraphs 61 and 62.
[12] 2010 Ruling, paragraphs 64 and 66.
[13] 2010 Ruling, paragraph 67.

is justified on the basis of Luciad's reduced profits following a drop in demand due to the on-going financial crisis and continued investments.

(15) In the 2013 Ruling, the 2010 Ruling was modified and extended for another five-year period. The 2013 Ruling agrees that local sales subsidiaries should be remunerated at an operating margin of 2.3% (i.e. their operating profit should equal 2.3% of sales/revenues) based on a transfer pricing study applying the TNMM, with the local sales entities as tested party and Luciad as the more complex party.[14] It further confirms that Luciad owns all IP of the Group and that implementing the "Central Entrepreneur" model will bring about synergies and economies of scale for the entire Group.[15] Following an identical rationale as that set out in Recitals (10) and (11) above, the 2013 Ruling agrees that, based on a new benchmarking study, an operating margin of 6.1% forms an "adjusted" arm's length remuneration for Luciad's "Central Entrepreneur" functions i.e. its operating profit should equal 6.1% of sales/revenues).[16] Using the budgeted figures for the Group over the years 2014 to 2018, the 2013 Ruling declares that Luciad may exempt [50-70]% of its annual EBIT from corporate income taxation in Belgium on an annual basis over the years 2014 to 2018, to be updated after a three-year period.[17]

2.3. The relevant legal and regulatory framework

2.3.1. The taxation of income pursuant to the Belgian corporate income tax system

(16) The BITC establishes the rules for the taxation of income by Belgium. Article 1 defines four income taxes which cover taxation of income of natural persons (Title II: Articles 3 to 178), resident companies (Title III: Articles 179 to 219), other legal persons (Title IV: Articles 220 to 226) and non-resident taxpayers — natural persons, companies, other legal persons (Title V: Articles 227 to 248/3).

(17) Article 183 BITC provides that the income subject to tax according to Title III (for resident companies) is of the same type as that defined in Title II (for natural persons) and that the taxable amount is established following the rules applicable to profit. Article 24 BITC clarifies in that regard that the taxable income of industrial, commercial and agricultural undertakings includes "*all income from entrepreneurial activities such as profit from all the operations handled by those undertakings or through their intermediation*" as well as "*profit from all increases in value of their assets or decrease in value of their liabilities when that profit has been generated or registered in the accounts*".

(18) Article 185(1) BITC provides that companies are taxed on the total amount of their profit before distribution. Read in conjunction with Article 1, Article 24 and Article 183 BITC, this means that the taxable profit under Belgian tax law should include — as a starting point and notwithstanding possible subsequent upward or downward adjustments provided by tax law — the total profit recorded in the taxpayer's accounts.

[14] 2013 Ruling, paragraph 71.
[15] 2013 Ruling, paragraphs 73 and 74.
[16] 2013 Ruling, paragraph 91.3.
[17] 2013 Ruling, paragraphs 98, 101 and 102.

(19) Indeed, the establishment of the tax base under the Belgian income tax code relies on the profit recorded in the taxpayer's accounts as a starting point. A number of upward adjustments (such as non-deductible expenses) or downward adjustments (such as partial exemption of certain dividends received, deduction of losses carried forward, tax incentives) can be applied at subsequent steps in the establishment of the tax base. For each of those operations, taxpayers must provide information to the tax administration through their tax return (Form 275.1) and be able to give justifications for those adjustments. Therefore, while the tax base may not always equal the net profit actually recorded in the taxpayer's annual accounts because of the adjustments applied to that base for tax purposes, the establishment of the tax base should nevertheless rely on the figures recorded in those accounts as a starting point.

2.3.1.1. The Law of 21 June 2004 modifying the BITC

(20) By Law of 21 June 2004,[18] Belgium introduced new fiscal rules regarding cross-border transactions of entities which are associated in a multinational group. In particular, a second paragraph was added to Article 185 BITC with the objective of transposing into Belgian tax law the internationally accepted "arm's length principle" for transfer pricing purposes. Article 185(2) BITC reads as follows:

> "*(…), for two companies that are part of a multinational group of associated companies and in respect of their reciprocal cross-border relationships:*
>
> *(a) when two companies are in their commercial and financial relationships linked by conditions agreed upon or imposed on them which are different from those which would have been agreed upon between independent companies, the profit which — under those conditions — would have been made by one of the companies but is not because of those conditions, may be included in the profit of that company.*
>
> *(b) when profit is included in the profit of one company which is also included in the profit of another company and the profit so included is profit which should have been made by that other company if the conditions agreed between the two companies had been those which would have been agreed between independent companies, the profit of the first company is adjusted in an appropriate manner.*
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> *The first paragraph applies by way of advance ruling without prejudice to the application of the EU Arbitration Convention or of a Double Tax Treaty.*"

(21) Although the wording is different, Article 185(2) BITC is, in its structure and intention, very similar to Article 9 of the Model Tax Convention on Income and Capital prepared by the Organisation for Economic Cooperation and

[18] Loi du 21 juin 2004 modifiant le Code des impôts sur les revenus 1992 et la loi du 24 décembre 2002 modifiant le régime des sociétés en matière d'impôts sur les revenus et instituant un système de décision anticipée en matière fiscale, published in the Official Gazette (Moniteur Belge) of 9 July 2004: http://www.ejustice.just.fgov.be/cgi/article_body.pl?language=fr&caller=summary&pub_date=04-07-09&numac= 2004003278. The law entered into force on 19 July 2004.

Development ("OECD Model Tax Convention"). Article 9 of the OECD Model Tax Convention forms the legal basis for transfer pricing adjustments in most treaties agreed between two jurisdictions to prevent the double taxation of income derived by a resident from one of the jurisdictions ("Double Tax Treaty").

(22) In accordance with the last sentence of Article 185(2) BITC, transfer pricing adjustments performed on the basis of letter (a) or (b) are subject to a compulsory prior authorisation procedure via an advance ruling. The only exception to that condition is where the adjustment results from the application of the Convention on the elimination of double taxation in connection with the adjustment of transfers of profit between associated undertakings ("EU Arbitration Convention") or a Double Tax Treaty.

(23) The Law of 21 June 2004 also introduced an amendment to Article 235, 2° BITC to ensure that the transfer pricing rules established by Article 185(2) BITC apply equally to Belgian permanent establishments of non-resident companies.

2.3.1.2. The Memorandum to the Law of 21 June 2004

(24) The Memorandum to the Law of 21 June 2004 ("the Memorandum") provides guidance on the objective and application of Article 185(2) BITC.[19] According to the Memorandum, Article 185(2) BITC "*is based on Article 9 of the OECD Model Tax Convention on Income and Capital*".[20] The Memorandum further explains that "*[t]he proposed provision aligns Belgian legislation to the internationally accepted norm.*"[21] It also points at the strong link between accountancy law and tax law, as a result of which a deviation from accountancy law for tax law purposes requires an explicit legal basis.[22] The codification of the arm's length principle in the Belgian income tax code was therefore considered necessary to enable transfer pricing adjustments required under internationally agreed norms but deviating from accountancy law. This concerns both primary (upward) adjustments to the detriment of the taxpayer based on Article 185(2)(a)

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[19] DOC 51, 1079/001; Chambre des Représentants de Belgique, 30 April 2004: http://www.lachambre.be/FLWB/pdf/ 51/1079/51K1079001.pdf

[20] *Ibid*, p. 7: "Door de toevoeging van een tweede paragraaf aan artikel 185, BITC, wordt het zogenoemde arm's length principe in de fiscale wetgeving geïntroduceerd. Het is gebaseerd op de tekst van artikel 9 van het OESOmodelverdrag inzake belastingen naar het inkomen en naar het vermogen."/"La notion de principe de pleine concurrence est introduite dans la législation fiscale par l'addition d'un deuxième paragraphe à l'article 185, CIR 92. Il est basé sur le texte de l'article 9 de la convention- modèle de l'OCDE en matière d'impôt sur le revenu et sur la fortune. "

[21] *Ibid*, p. 9 : 'Met de voorgestelde bepaling sluit de Belgische wetgeving nauw aan bij de internationaal aanvaarde norm.'/'La disposition proposée permet à la législation belge de s'aligner sur la norme acceptée internationalement.'

[22] *Ibid*, pp. 5-6: "Nochtans bevat het Belgische fiscale recht geen bepaling die een correctie toestaat van de teveel in de boekhouding opgenomen winst. Er bestaat namelijk een enorm sterke binding tussen het boekhoudrecht enerzijds en het fiscaal recht anderzijds. Zo leggen het Wetboek van vennootschappen en het koninklijk besluit van 30 januari 2001 tot uitvoering van het Wet boek van vennootschappen bepaalde regels op met betrekking tot de waardering. Deze regels moeten ook voor het bepalen van de belastbare grondslag worden aangenomen, tenzij en in de mate dat de fiscale wetgeving er uitdrukkelijk van afwijkt." / "Le droit fiscal belge ne contient toutefois aucune disposition qui autorise une correction des bénéfices surévalués en comptabilité. Il existe plus exactement un lien très fort entre le droit comptable, d'une part, et le droit fiscal, d'autre part. Ainsi le Code des sociétés et l'arrêté royal du 30 janvier 2001 pris en exécution du Code des sociétés imposent des règles précises pour la valorisation. Ces règles doivent également s'appliquer à la détermination de la base imposable, à moins que et dans la mesure où la législation fiscale y déroge."

BITC and corresponding (downward) adjustments to the benefit of the taxpayer based on Article 185(2)(b) BITC.

(25) As regards the corresponding adjustment provided for by Article 185(2)(b) BITC, the Memorandum explains that that provision seeks to avoid or undo a (potential) problem of double taxation. It further confirms that Belgium will only allow a corresponding (downward) adjustment to the extent that the Ruling Commission considers both the principle and the amount of the primary (upward) adjustment justified.

(26) The Memorandum also contains guidance on what is considered a multinational group of associated companies and on the task of the Ruling Commission. In particular, the Memorandum explains that the Ruling Commission shall agree on a methodology which is used, establish functions performed, assets used and risks assumed which are instrumental in determining the tax base.

2.3.1.3. The administrative circular of 4 July 2006

(27) On 4 July 2006, an administrative circular was published containing guidance on the application of Article 185(2) BITC ("the Circular"), both as regards the primary and the corresponding transfer pricing adjustment.[23] The Circular confirms the definitions laid down in the Memorandum of group entities that are part of a multinational group and of cross-border transactions covered by Article 185(2) BITC. The Circular further explains the role, responsibilities and competence of the Ruling Commission.

(28) The Circular refers to the compulsory intervention of the Ruling Commission for corresponding adjustments and its autonomy to set conditions on a case-by-case basis, which should contribute to efficiency and certainty for taxpayers improving the Belgian investment climate.

(29) The Circular confirms that for the purpose of the calculation of the tax base, an appropriate adjustment of profit according to Article 185(2)(b) BITC will take place by way of a so-called "increase of the initial situation of the reserves" in the company's tax return (Form 275.1). Concerning the notion "appropriate" used in Article 185(2)(b) BITC in relation to the corresponding adjustment, the Circular notes that there will be no corresponding (downward) adjustment[24] in cases where the primary (upward) adjustment performed by another tax jurisdiction is exaggerated. The Circular also sets out how the transfer pricing adjustments are to be recorded in the tax accounts of the Belgian company concerned. Finally, the Circular recalls that Article 185(2) BITC applies as of 19 July 2004.

[23] Circular No Ci.RH.421/569.019 (AOIF 25/2006) of 4 July 2007.

[24] A corresponding adjustment is defined by the Glossary of the 2010 OECD TP Guidelines as: "An adjustment to the tax liability of the associated enterprise in a second tax jurisdiction made by the tax administration of that jurisdiction, corresponding to a primary adjustment made by the tax administration in a first tax jurisdiction, so that the allocation of profits by the two jurisdictions is consistent."

2.3.1.4. The Replies of the Minister of Finance to parliamentary questions on the “excess profit” exemption

(30) In reply to a parliamentary question in 2005,[25] the then Belgian Minister of Finance confirmed that the portion of profit recorded by a Belgian multinational group entity that exceeds an arm’s length profit should remain untaxed in Belgium and that it is not the task of the Belgian tax authorities to determine which other foreign group entities should include that “excess profit” in their tax base.

(31) A parliamentary question in 2007 concerning rulings and international tax avoidance[26] points to the relationship between letters (a) and (b) of Article 185(2) BITC, as well as to the corresponding paragraphs 1 and 2 of Article 9 of the OECD Model Tax Convention. The Member of Parliament that had submitted the question noted that most Double Tax Treaties concluded by Belgium include only a provision on upward transfer pricing adjustments. In the treaties that do contain a provision on corresponding (downward) transfer pricing adjustments, the corresponding adjustment by Belgium is always a reaction to a primary adjustment by the other contracting State. The Member of Parliament further noted that few taxpayers will apply for an advance ruling requesting a primary (upward) transfer pricing adjustment under Article 185(2)(a) BITC, even though the requirement for an advance ruling legally also applies to those adjustments. Finally, the Member of Parliament asked whether Belgium would make a unilateral corresponding (downward) adjustment by Belgium subject to the condition that the foreign country concerned aligns its primary (upward) adjustment or is – as a minimum – informed on the Belgian corresponding (downward) adjustment.

(32) The then Minister of Finance replied that, indeed, only requests for a corresponding (downward) adjustment had thus far been received. Moreover, the Minister stated that it is not for Belgium to specify to which country “excess profit” ought to be attributed and that it is therefore not possible to determine with which country the information on a Belgian downward adjustment should be exchanged.

(33) In January 2015, following press publications on the so-called “LuxLeaks” affair, several parliamentary questions were again addressed to the Minister of Finance on the (lack of) information exchange between tax administrations, the promotion of the “excess profit exemption” under the slogan “Only in Belgium”, and the opportunities for multinationals offered by Belgium to reduce their corporate tax bill via tax rulings.[27] The Minister of Finance recalled that in “excess profit” rulings the Ruling Commission merely applies the arm’s length principle and confirmed the reply given by the Minister of Finance in 2007 as regards exchanges of information.

[25] Minutes of the Commission on Finance and Budget of 13 April 2005, CRABV 51 COM 559 — 19.
[26] Minutes of the Commission on Finance and Budget of 11 April 2007, CRABV 51 COM 1271 — 06.
[27] Minutes of the Commission on Finance and Budget of 6 January 2015, CRABV 54 COM 043 — 02.

2.3.1.5. The Law of 24 December 2002 introducing an advance tax ruling system

(34) The Law of 24 December 2002 allows the Ministry of Finance to take a position by way of a tax ruling on all requests relevant to the implementation of tax law provisions.[28]

(35) Article 20 of that law defines a tax ruling and establishes the principle that a ruling cannot have the effect of exempting from or reducing the tax due:

> "*Par décision anticipée, il y a lieu d'entendre l'acte juridique par lequel le Service public fédéral Finances détermine conformément aux dispositions en vigueur comment la loi s'appliquera à une situation ou à une opération particulière qui n'a pas encore produit d'effets sur le plan fiscal.*
>
> *La décision anticipée ne peut emporter exemption ou modération d'impôt.*"

(36) Article 22 of the law defines the circumstances under which a tax ruling cannot be granted, for example when the request concerns situations or operations similar to those having already produced effects from a tax point of view. Article 23 of the law establishes the principle that rulings are binding on the tax administration for the future as well as circumstances in which a tax ruling is not binding on the tax administration. This is the case when it turns out that the ruling is not in conformity with the provisions of the treaties, of Union law or of domestic law.

(37) The Law of 21 June 2004 contained an amendment to the Law of 24 December 2002 on the establishment of a system of advance tax rulings, regulating the formation of an autonomous body within the Belgian administration responsible for granting such rulings.[29] On the basis of the Law of 21 June 2004, the Ruling Commission was created by Royal Decree of 13 August 2004 within the central body of the Ministry of Finance competent for delivering rulings ("*Service Public Fédéral Finances*" in French or "*Federale Overheidsdienst Financiën*" in Dutch). The Ruling Commission publishes an annual report on its activities.

2.3.2. OECD Guidance on Transfer Pricing

2.3.2.1. The OECD Model Tax Convention and Transfer Pricing Guidelines

(38) The Organisation for Economic Cooperation and Development ("OECD") provides guidance on taxation for its member countries. The OECD's guidance on transfer pricing can be found in the OECD Model Tax Convention plus its commentary as well as the OECD Transfer Pricing Guidelines for Multinational

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[28] *Loi du 24 décembre 2002 modifiant le régime des sociétés en matière d'impôts sur les revenus et instituant un système de décision anticipée en matière fiscale*, published in the Official Gazette (Moniteur Belge) No 410, second edition, 31 December 2002, p. 58817.

[29] See footnote 18.

Enterprises and Tax Administrations ("OECD TP Guidelines"),[30] which are both non-binding legal instruments.

(39) Given their non-binding nature, the tax administrations of the OECD member countries are simply encouraged to follow the Model Tax Convention, its Commentary and the OECD TP Guidelines. However, in general, both instruments serve as a focal point and exert a clear influence on the tax practices of OECD member (and even non-member) countries. Moreover, in numerous OECD member countries those instruments have been given the force of law or serve as a reference for the purpose of interpreting Double Tax Treaties and domestic tax law. To the extent the Commission cites the Model Tax Convention and the OECD TP Guidelines in this Decision, it does so because those instruments are the result of expert discussions in the context of the OECD and elaborate on techniques aimed to address common challenges.

(40) The OECD Model Tax Convention and its commentary provide guidance on the interpretation of Double Tax Treaties. The OECD TP Guidelines provide guidance to tax administrations and multinational enterprises on the application of the arm's length principle for the determination of transfer prices. Transfer pricing refers to prices charged for commercial transactions between the separate entities of the same corporate group (controlled transactions). The relationship among members of a multinational group may permit the group members to establish special conditions in their intra-group relations, which affect transfer prices (and consequently taxable income), that differ from those that would have been established had the group members been acting as independent enterprises.[31] This can allow profit shifting from one tax jurisdiction to another and provides for an incentive to allocate as little profit as possible to jurisdictions where the group is subject to higher taxation. To avoid these problems, tax administrations should only accept transfer prices between intra-group companies that are remunerated as if they were agreed to by independent companies negotiating under comparable circumstances at arm's length.[32] This is known as the "arm's length principle".

(41) The application of the arm's length principle is therefore based on a comparison of the conditions in a controlled (intra-group) transaction with the conditions in comparable transactions between independent companies under comparable circumstances so that none of the differences (if any) between the situations being compared could materially affect the conditions examined (e.g. price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences.

(42) Both the OECD Model Tax Convention and the OECD TP Guidelines rely on the principle adhered to by OECD member countries, and wider, that the various legal entities jointly constituting a multinational group are treated as separate

[30] The latest version of the guidelines was published on 10 July 2017 (the "2017 OECD TP Guidelines"). Previous versions of the OECD TP Guidelines were published in 2010 (the "2010 OECD TP Guidelines") and 1995 (the "1995 OECD TP Guidelines").

[31] See paragraph 6 of the preface to the 2010 OECD TP Guidelines

[32] Tax administrations and legislators are aware of this problem and tax legislation generally allows the tax administration to correct tax declarations of associated companies that incorrectly apply transfer prices to reduce their taxable income by substituting prices which correspond to a reliable approximation of those agreed to by independent companies negotiating under comparable circumstances at arm's length

entities for corporate tax purposes. A consequence of this "separate entity approach" is that each individual entity within a multinational group is individually taxed on its own income.[33] The separate entity approach has been chosen as an international taxation principle by the OECD member countries with a view to securing the appropriate tax base in each jurisdiction and avoiding double taxation, thereby minimising conflicts between tax administrations and promoting international trade and investment.

(43) Paragraph 1.9 of the 1995 OECD TP Guidelines and paragraph 1.10 of the 2010 OECD TP Guidelines make an explicit reference to the role of economies of scale and the benefits of integration (i.e. synergies) in relation to the separate entity approach that underlies the arm's length principle:

> "*The arm's length principle is viewed by some as inherently flawed because the separate entity approach may not always account for the economies of scale and interrelation of diverse activities created by integrated businesses. There are, however, no widely accepted objective criteria for allocating the economies of scale or benefits of integration between associated enterprises*"

(44) The 2017 OECD TP Guidelines[34] clarify that in some circumstances group synergies can be favourable to the group and the associated enterprises that comprise it. Those guidelines recommend that if the synergy effects arise as a result of deliberate concerted group actions, they should be taken into account and their advantages and disadvantages should be shared in proportion to the contribution of the members to the creation of the synergistic effects.[35] In the absence of deliberate concerted group actions, such synergy effects should not be separately compensated or specifically allocated among group members, but should be considered as being incidental to group membership.[36]

2.3.2.2. The arm's length principle

(45) The authoritative statement of the arm's length principle is found in Article 9 of the OECD Model Tax Convention. Since the flexibility in the arrangement of transfer prices in cross-border controlled transactions might lead to shifting the tax base from one jurisdiction to another, the authoritative presence of the arm's length principle in Double Tax Treaties serves the purpose of those treaties, i.e. the avoidance of double taxation and the prevention of fiscal evasion.

(46) Article 9 of the OECD Model Tax Convention sets out how and when transfer pricing adjustments of the tax base should take place in practice.

- Article 9(1) determines that a Contracting State may increase the tax base of a taxpayer resident in its territory when it believes that the transfer prices applied by it for the controlled transactions in which it was involved have led to a too low taxable base and allow that State to tax it accordingly. This is

[33] See paragraph 5 of the preface of the 2010 OECD TP Guidelines.
[34] Paragraphs 1.157 et seq. of the 2017 OECD TP Guidelines.
[35] Paragraph 1.162 of the 2017 OECD TP Guidelines.
[36] Paragraph 1.158 of the 2017 OECD TP Guidelines.

referred to as the "primary (upward) adjustment" and results in the tax administration increasing the taxable profit declared by a taxpayer.[37]

– Article 9(2) aims to prevent that the profit so taxed by the Contracting State making the primary (upward) adjustment in accordance with the first paragraph is also taxed at the level of an associated company resident in the other Contracting State.[38] It does this by committing that other Contracting State to either decrease the tax base of that associated company with the amount of adjusted profit taxed by the first Contracting State following the primary adjustment or to provide a refund of taxes already collected. Such a downward adjustment by the other Contracting State is, however, not automatically made, not even if there is no doubt that the profit concerned is also included in the tax base abroad following a primary (upward) adjustment. If the other Contracting State considers that the primary (upward) adjustment of another State is not justified, either in principle or as regards the amount, it may and usually will refrain from making a downward adjustment.[39] The downward adjustment made by the other Contracting State on the basis of Article 9(2) is referred to as a "corresponding adjustment" and, when granted, effectively prevents that the same profit is taxed twice.

(47) The 2010 OECD TP Guidelines provide five 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; (ii) the cost plus method; (iii) the resale price method; (iv) the TNMM and (v) the transactional profit split method. The 2010 OECD TP Guidelines draw a distinction between traditional transaction methods (the first three methods) and transactional profit methods (the last two methods). Multinational corporations retain the freedom to apply transfer pricing methods not described in those guidelines provided those methods result in arm's length transfer prices.[40]

(48) The TNMM is one of the "indirect methods" to approximate arm's length prices of transactions and profit allocation between companies of the same corporate

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37 Article 9(1) provides: "Where […] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

38 Article 9(2) provides: "Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other."

39 If there is a dispute between the parties concerned over the amount and character of the appropriate adjustment the mutual agreement procedure provided for in Article 25 of the OECD Model Tax Convention should be implemented, even in the absence of a provision such as Article 9(2). The competent authorities involved are under a duty merely to use their best endeavours, but not to achieve a result, so double taxation could not be solved if an arbitration clause has not be agreed in the Tax Treaty in place between Contracting States.

40 According to paragraph 2.9 of the 2010 OECD TP Guidelines: "*Such other methods should however not be used in substitution for OECD- recognised methods where the latter are more appropriate to the facts and circumstances of the case.*"

group. The TNMM examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realises from a controlled transaction. The net profit indicator of the taxpayer from the controlled transaction at stake should be established by reference to the same net profit indicator that would have been earned by independent companies in comparable uncontrolled transactions.[41]

(49) When applying the TNMM, it is necessary to choose the party to the controlled transaction for which a net profit indicator is selected and tested. As a general rule, the "tested party" within a TNMM-based analysis is the less complex of the two related parties involved in the controlled transaction under assessment. The choice of the less complex entity is determined on the basis of a "functional analysis", i.e. an analysis of the functions performed by the associated enterprises, taking into account the assets used and the risks assumed.[42] If a company performs "routine" functions[43], uses non-unique assets, assumes low risks and therefore does not make any unique and valuable contribution to the controlled transaction, it will normally be considered the less complex entity.

(50) Once the operating profit of the less complex entity has been determined, the residual profit from the controlled transaction (i.e. the combined profit from the controlled transactions minus the operating profit of the less complex entity) will be allocated to the more complex party (i.e. the non-tested party).[44] The more complex entity, by virtue of its unique and valuable functions (taking into account the assets used and risks assumed), is thus assumed to be entitled to the excess return from the transactions after the less complex entity has been remunerated by use of the TNMM.

3. POSITION OF BELGIUM

(51) Belgium claims that the "excess profit" exemption granted by the contested measures does not give rise to State aid. In support of that claim, it refers to and

[41] A "net profit indicator", also called a "profit level indicator", is defined by the Glossary of the 2010 OECD TP Guidelines as: "*The ratio of net profit to an appropriate base (e.g. costs, sales, assets).*" According to paragraph 2.80 of the 2010 OECD TP Guidelines, "net profit" does not include non-operating items of the profit and loss account such as interest income and expenses, income taxes and exceptional and extraordinary items of a non-recurring nature. Indeed, the net profit indicated by the 2010 OECD TP Guidelines corresponds to the operating profit. In particular, in applying the TNMM, the net profit indicator generally can be the ratio of the operating profit to sales, to the total operating costs (COGS plus operating expenses) or to assets, depending on facts and circumstances of the case. "COGS" stands for cost of goods sold, and represents mainly the direct and indirect costs attributable to the production of a company, while operating expenses indicate expenditures that a business incurs to engage in any activities not directly associated with the production of goods or services related to the enterprise as a whole, such as supervisory, general, and administrative expense. Revenue in the income statement minus COGS corresponds to the company's gross margin. See 1995 OECD TP Guidelines paragraphs 2.14 and 2.15 and 2010 OECD TP Guidelines, paragraphs 2.21 and 2.22.

[42] The Glossary to the 1995 and 2010 OECD TP Guidelines describes a functional analysis as "*[a]n analysis of the functions performed (taking into account assets used and risks assumed) by associated enterprises in controlled transactions and by independent enterprises in comparable uncontrolled transactions.*" That analysis "*seeks to identify and compare the economically significant activities and responsibilities undertaken, assets used and risks assumed by the parties to the transactions*." See 1995 OECD TP Guidelines, paragraph 1.20. See also 2010 OECD TP Guidelines, paragraph 1.42, and 2017 OECD TP Guidelines, paragraph 1.51. See also Glossary to the 2017 OECD TP Guidelines.

[43] The 2010 OECD TP Guidelines do not define the term "routine". The Commission understands this term to refer to functions that are not unique, i.e. "benchmarkable" functions for which uncontrolled comparable transactions can be found.

[44] See paragraph 9.10 of the 2010 OECD TP Guidelines.

summarises certain arguments it made in its application for annulment and its reply in Case T-131/16 before the General Court.

(52) Belgium considers that it cannot tax profits which fall outside of its fiscal jurisdiction and that the "excess profit" exempted as a result of the contested measures has its origin in synergies, economies of scale and other elements linked to membership of an international group and thus do not fall within Belgium's tax jurisdiction under international tax law. It therefore considers that the exemption neither constitutes an advantage nor entails a discrimination, but is the consequence of a factual disparity. Belgium notes that the tax rate applicable to the corporate tax base after correction is the same applicable to all taxpayers.

(53) For the purpose of assessing selectivity, Belgium argues that the reference framework is the Belgian corporate income tax system, whose objective is the taxation of all entities subject to taxation in Belgium. Belgium considers Article 185(2)(b) BITC to be an inherent part thereof. Since Belgium furthermore considers the contested measures to reflect the normal and correct application of that provision, Belgium argues that the contested measures cannot constitute a derogation and therefore are neither an advantage nor selective.

(54) Belgium further argues that Article 185(2)(b) BITC does not require effective or potential double taxation to allow a corresponding (downward) adjustment, unlike Article 9(2) of the OECD Model Tax Convention. Belgium argues that the application of a one-sided transfer pricing method (cost-plus, resale price or TNMM) embodies a "price continuum" problem, because the reasonableness of a price is established only from one dimension (the tested party) allocating the residual consolidated profit to the more complex party. Belgium argues that this residual profit does not necessarily reflect the "pure arm's length profit" of that more complex party because it includes profit elements that could not have been achieved without forming part of a larger group.

(55) Finally, Belgium also challenges the consideration that "excess profit" rulings *de facto* require a group reorganization and argues instead that the requirement is that a ruling cannot be delivered when the request concerns situations or operations similar to those having already produced effects from a tax point of view.

4. ASSESSMENT OF THE CONTESTED MEASURES

4.1. Existence of aid

(56) 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, is incompatible with the internal market, in so far as it affects trade between Member States. For a measure to be categorised as aid within the meaning of Article 107(1) TFEU, all the conditions set out in that provision must be fulfilled. First, the measure must be the result of an intervention by the State which is financed through State resources. Second, the measure must be liable to affect

trade between Member States. Third, it must confer a selective advantage on its recipient. Fourth, it must distort or threaten to distort competition.[45]

4.2. Imputability and State resources

(57) As regards the first condition, the Rulings were issued by the Ruling Commission, which is part of the Belgian tax administration, an organ of the Belgian State. Luciad in turn relied on those Rulings to prepare its annual corporate income tax declarations and determine the amount of corporate income tax due on the basis thereof, which were accepted by the Belgian tax administration. The Commission therefore provisionally concludes that there is a measure which is imputable to Belgium.

(58) As regards the financing of the contested measures through State resources, the Court of Justice has consistently held that a measure by which the public authorities grant a tax exemption entails the use of State resources, notwithstanding the absence of a direct transfer of such resources, since the result of such an exemption is the renunciation by the Member State of tax revenue which it would normally have received.[46] The Rulings allowed Luciad to exempt a portion of its otherwise taxable profit from taxation in its annual corporate income tax declarations. By accepting those declarations and the amount of corporate income tax paid on the basis thereof, the Belgian State has renounced tax revenue that it would have otherwise been entitled to collect from Luciad absent the contested measures. The Commission therefore provisionally concludes that the contested measures give rise to a loss of State resources.

4.3. Effect on trade between Member States

(59) As regards the second condition for a finding of aid, i.e. that the contested measures are liable to affect trade between Member States, Luciad is part of the Group, a multinational group operating throughout the world, including in several Member States. Luciad is responsible for the worldwide development and commercialization of the Group's geographic information system solutions. The products and services concerned by those activities are subject to trade between Member States, so that any State intervention by Belgium in Luciad's favour is liable to affect intra-Union trade.[47] On that basis, the Commission provisionally concludes that the second condition for a finding of State aid is met.

4.4. Distortion of competition

(60) A measure granted by the State is considered to distort or threaten to distort competition when it is liable to improve the competitive position of an undertaking as compared to other undertakings with which it competes.[48] To the extent the contested measures relieve Luciad of corporate income taxes it would otherwise have been obliged to pay in their absence, the potential aid granted as a

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[45] Joined Cases C-20/15 P *Commission* v *World Duty Free* EU:C:2016:981, paragraph 53 and the case law cited.

[46] Case C-387/92 *Banco Exterior de España*, EU:C:1994:100, paragraph 14; Case C-156/98 *Germany v Commission*, EU:C:2000:467, paragraphs 26 to 28; and Case C-66/02 *Italy v Commission*, EU:C:2005:768, paragraphs 76 to 81.

[47] Case C-494/06 P *Commission v Italy and Wam* EU:C:2009:272, paragraph 54 and the case law cited. See also Case C-66/02 *Italy v Commission* EU:C:2005:768, paragraph 112.

[48] Case 730/79 *Phillip Morris* EU:C:1980:209, paragraph 11. Joined Cases T-298/97, T-312/97 etc. *Alzetta* EU:T:2000:151, paragraph 80.

result of those measures constitutes operating aid, in that they relieve Luciad from a charge that it would normally have to bear in its day-to-day management or normal activities. The Court of Justice has consistently held that operating aid distorts competition,[49] so that any such aid should be considered to distort or threaten to distort competition by strengthening the financial position of its recipient on the markets on which it operates. The Commission therefore provisionally concludes that the fourth condition for a finding of aid is present as regards the contested measures.

4.5. Selective advantage

(61) As regards the third condition – the grant of a selective advantage – a distinction is made between the conditions of advantage and selectivity to ensure that not all State measures that confer an advantage on an undertaking result in the grant of State aid. Only those measures that grant such an advantage in a selective manner to certain undertakings, certain categories of undertakings, or certain economic sectors constitute State aid.[50] At this stage, the Commission considers the contested measures to grant Luciad a selective advantage because they allowed that undertaking to reduce its annual taxable profit and thus its annual corporate income tax liability under the Belgian corporate income tax system, without any legal basis or justification for that reduction.

4.5.1. Advantage

(62) An advantage is present for the purposes of Article 107(1) TFEU whenever a measure adopted by the State improves the net financial position of an undertaking.[51] In establishing the existence of an advantage, reference is to be made to the effect of the measure itself.[52] As regards fiscal measures, an advantage may be granted through different types of reduction in a company's tax burden and, in particular, through an exemption or reduction in the applicable tax rate, taxable base or in the amount of tax due.[53]

(63) The Commission takes the provisional view that the contested measures confer an advantage on Luciad in that they allow that undertaking to exempt from corporate income taxation in Belgium a portion of profit actually generated by it, initially allocated to it, and effectively recorded in its commercial accounts. As explained in Recital (9), the Rulings begin by validating the pricing of intra-group transactions concluded between Luciad and associated foreign counterparties of the Group. That transfer pricing exercise, which is based on the TNMM, results in those counterparties being attributed a remuneration for their alleged routine functions equal to an operating margin, while the residual profit from the

[49] Case C-128/16 P *Commission* v. *Spain* EU:C:2018:591 paragraph 84. See also C-271/13 P *Rousse Industry v Commission* EU:C:2014:175, paragraph 44; Joined Cases C-71/09 P, C-73/09 P and C-76/09 P *Comitato "Venezia vuole vivere" and Others v Commission* EU:C:2011:368, paragraph 136; Case C-172/03 *Heiser* EU:C:2005:130, paragraph 55; and Case C-156/98 *Germany* v *Commission* EU:C:2000:467, paragraph 30, and the case-law cited.

[50] See Case C-20/15 P *Commission v World Duty Free Group* EU:C:2016:981, paragraph 56 and Case C-6/12 *P Oy* EU:C:2013:525, paragraph 18.

[51] Case C-417/10 *3M Italia* EU:C:2012:184, paragraph 38.

[52] Case 173/73 *Italy v. Commission* EU:C:1974:71, paragraph 13.

[53] Case C-66/02 *Italy v Commission* EU:C:2005:768, paragraph 78; Case C-222/04 *Cassa di Risparmio di Firenze and Others* EU:C:2006:8, paragraph 132; and Case C-522/13 *Ministerio de Defensa and Navantia* EU:C:2014:2262, paragraphs 21 to 31.

aforementioned intra-group transactions is attributed to Luciad. That residual profit is then recorded in the commercial accounts of Luciad and provides the basis for its EBIT.

(64) As a result of the contested measures, Luciad was allowed to exempt a portion of its EBIT as "excess profit" from corporate income taxation in Belgium from 1 January 2009 to 31 December 2018. Luciad was only allowed to exempt that "excess profit" from taxation by relying on the contested measures. In the absence of those measures, that "excess profit" would have been fully subject to Belgian corporate income tax as constituting Luciad's total profit within the meaning of Article 185(1) BITC. The Commission's provisional conclusion is therefore that the contested measures confer an advantage upon Luciad, since that undertaking's net financial position has been improved as a result of them, in the form of a tax base reduction.

4.5.2. Primary provisional finding of selectivity: The contested measures are individual in nature

(65) As regards the selectivity of the contested measures, the Commission provisionally considers the aforementioned advantage to be selective because it is granted to Luciad by means of an individual measure. The Court of Justice has made a distinction between general schemes and individual measures for establishing whether a particular measure discriminates in favour of its beneficiary/-ies. According to the Court, when examining a general scheme, "*it is necessary to identify whether the measure in question, notwithstanding the finding that it confers an advantage of general application, does so to the exclusive benefit of certain undertakings or certain sectors of activity*."[54] In contrast, when assessing an individual measure, "*the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective.*"[55]

(66) Article 1(d) of Regulation 2015/1589 defines a "scheme", insofar as relevant, as "*any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner*". Article 1(e) of Regulation 2015/1589 defines "individual aid", insofar as relevant, as "*aid that is not awarded on the basis of an aid scheme*". A measure can therefore be a "scheme" or "individual aid".

(67) In its judgment of 14 February 2019, the General Court annulled the 2016 Decision on account of the Commission having mischaracterised the administrative practice by which Belgium granted "excess profit" rulings, including the contested measures, as a "scheme" within the meaning of Article 1(d) of Regulation 2015/1589. Given that the Commission has provisionally concluded that the contested measures grant an advantage to Luciad in the form of a reduction of its corporate income tax base and given that those

[54] Case C-15/14 P *Commission v. MOL* EU:C:2015:362, paragraph 60. See also Joined C-20/15 P and C21/15 P *Commission v. World Duty Free Group* EU:C:2016:981, paragraph 55; Case C-211/15 P *Orange v. Commission* EU:C:2016:798, paragraph 53 and 54; and Case C-270/15 P *Belgium v. Commission* EU:C:2016:489, paragraph 49.

[55] *Ibid*.

measures should be considered individual in nature, the Commission may provisionally presume that they are also *prima facie* selective.

4.5.3. Subsidiary provisional findings of selectivity: The contested measures discriminate in favour of Luciad as compared to comparable undertakings

(68) Where the presumption of selectivity is relied upon, it is not necessary for the Commission to effectively demonstrate that the measure places its beneficiary in a more favourable position compared to other economic operators which are in a comparable factual and legal situation.[56] Rather, it is for the Member State to demonstrate that all companies in a comparable legal and factual situation can benefit from a similar advantage.[57] Nevertheless, for the sake of completeness, the Commission will also demonstrate why it provisionally considers the contested measures to discriminate in favour of Luciad as compared to undertakings in a comparable factual and legal situation.

(69) First and foremost, the Commission will explain in Section 4.5.3.1 why it considers, at this stage, that those measures discriminate in favour of Luciad as compared to all other corporate income taxpayers, because they allow that undertaking to reduce its taxable base although there is no legal basis to do so in Belgian tax law. That is because the contested measures misapply Article 185(2)(b) BITC in granting the "excess profit" exemption.

(70) Belgium argues that Article 185(2)(b) BITC constitutes a legal basis for exempting from taxation the profit recorded by a multinational group entity that exceeds a fictitious amount of profit equal to the average profit of deemed comparable routine undertakings, which the Commission contests. Nevertheless, Section 4.5.3.2 explains by a further subsidiary line of reasoning that, even if Article 185(2)(b) BITC constituted such a legal basis (*quod non*), the contested measures discriminate in favour of Luciad since the "excess profit" exemption is not available to all corporate taxpayers that generate what Belgium deems to constitute "excess profit".

4.5.3.1. First subsidiary finding of selectivity: the contested measures misapply Article 185(2)(b) BITC

(71) In order to classify a national tax measure as selective, the Commission must begin by identifying the ordinary or "normal" tax system applicable in the Member State concerned, i.e. the "reference system", and thereafter demonstrate that the tax measure at issue is a derogation from that system, in so far as it differentiates between operators who, in the light of the objective pursued by that system, are in a comparable factual and legal situation.[58] The reference system constitutes the framework against which the existence of a selective advantage is to be assessed.[59] It defines the boundaries for examining whether certain

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56 Case T-314/15 *Greece v. Commission* EU:T:2017:903, paragraph 79.

57 In which case, the measure could either be part of a State aid scheme or it is a general (non-selective) measure.

58 Case C-374/17 *A Brauerei* EU:C:2018:1024, paragraph 36 and the case-law cited.

59 See Case C-203/16 P *Dirk Andres v Commission* ("*Sanierungsklausel*") EU: C:2018:505, paragraph 88: "*The examination of the selectivity condition therefore implies, in principle, the determination, first, of the reference framework within which the measure concerned falls, that determination being of greater importance in the case of tax measures, since the very existence of an advantage may be*

undertakings benefit from a derogation from the normal rules forming that reference system as a result of which those undertakings are treated in an advantageous way as compared to other undertakings subject to the normal rules of the reference system in otherwise comparable legal and factual situations.

(72) The reference system is therefore composed of a consistent set of rules that generally apply – on the basis of objective criteria – to all undertakings falling within its scope as defined by its objective. Typically, those rules define not only the scope of that system, but also the conditions under which the system applies, the rights and obligations of undertakings subject to it, and the technicalities of the functioning of the system. In the case of fiscal measures, the identification of the reference system is based on factors establishing *inter alia* what is taxed (the taxable event or object), who the tax is levied upon (the taxable persons or subjects), and how the tax due is calculated (the tax base and the tax rates).[60]

(73) The contested measures allow Luciad to exempt from corporate income taxation in Belgium a portion of the profit it generated, that was initially allocated to it and that was recorded in its commercial accounts. The Commission therefore considers the Belgian corporate income tax system, in particular the general rules for establishing a corporate taxpayer's corporate income tax base, to be the wider reference framework under which those measures were adopted and against which they should be examined to establish a selective advantage.

(74) According to Article 185(1) BITC, companies are taxed on the total amount of their profit before distribution. As explained in Recital (18), the amount of profit liable to Belgian corporate income tax is determined by taking – as a starting point and notwithstanding possible subsequent upward or downward adjustments provided by tax law – the total profit recorded in the taxpayer's accounts. In a judgment of 20 February 1997, the Belgium Court of Cassation explained in this regard that "*except in cases of an explicit derogation in fiscal law, the taxable profit of companies is determined in line with accountancy law rules*".[61]

(75) The contested measures and the tax reduction to which they give rise are purportedly based on Article 185(2)(b) BITC. Article 185(2) BITC provides a legal basis for possible adjustments to the accounting profit of a Belgian corporate taxpayer to account for cross-border intra-group transactions concluded by that taxpayer that do not reflect market conditions. That provision, which codifies the arm's length principle in the Belgian corporate income tax system, foresees two possible adjustments to the accounting profit to arrive at the taxable profit of a Belgian corporate income taxpayer belonging to a multinational group:

– Article 185(2)(a) BITC determines that Belgium's taxing rights are extended to profits not actually recorded by a Belgian corporate taxpayer

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established only when compared with 'normal' taxation." See also Case C-88/03 *Portugal v Commission*, EU:C:2006:511, paragraph 56 and Case C-524/14 P *Commission v Hansestadt Lübeck*, EU:C:2016:971, paragraph 55.

[60] See Case C-374/17 *A Brauerei* EU:C:2018:1024, paragraph 37. See also, Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (OJ C 262, 19.7.2016, p. 1), paragraph 134.

[61] Belgium Court of Cassation, 20 February 1997 (Pas.,1997, I, no 100, & RCJB, 2000, p. 525): *« sauf dérogation expresse de la loi fiscale, les bénéfices imposables des entreprises sont déterminés conformément aux règles du droit comptable ».*

to the extent that non-arm's length pricing with a foreign associated counterparty has reduced its recorded profits. This is referred to as a *primary* or *upward (transfer pricing) adjustment.*

– Article 185(2)(b) BITC determines that Belgium need not enforce its taxing rights to the recorded profits of a Belgian corporate taxpayer derived from non-arm's length pricing with a foreign associated counterparty, provided those profits were also included in the tax base of the foreign counterparty concerned by those non-arm's length transactions. This is referred to as a *corresponding* or *downward (transfer pricing) adjustment.*

(76) The structure, wording and scope of Article 185(2) BITC is logically consistent with Article 9 of the OECD Model Tax Convention. The Memorandum to the Law of 21 June 2004 also clearly distinguishes between Article 185(2)(a) BITC as the basis for primary upward (transfer pricing) adjustments, which is also the purpose of Article 9(1), and Article 185(2)(b) BITC as the basis for corresponding downward (transfer pricing) adjustments, which is the purpose of Article 9(2).[62]

(77) As follows from Recital (20), Article 185(2)(b) BITC provides that profits derived from a cross-border relationship between a Belgian corporate taxpayer (such as Luciad) and a foreign associated counterparty may only be adjusted if two cumulative conditions are met:

(a) the adjusted profit must concern profit that is also included in the profit of the foreign associated counterparty; and

(b) the adjusted profit would have been recorded by that foreign associated counterparty if the intra-group relationship had respected arm's length conditions.

(78) In Recitals (79) to (93), the Commission will explain why it provisionally considers that neither of the two aforementioned cumulative conditions for a corresponding downward (transfer pricing) adjustment were fulfilled as regards the tax reduction granted to Luciad by the contested measures. As a result, the Commission provisionally concludes that those measures misapply Article 185(2)(b) BITC in favour of Luciad, as a result of which that undertaking was allowed to exempt a portion of its annually recorded profit from corporate

[62] See Memorandum to the Law of 21 June 2004, p. 11: "*De «passende» correlatieve aanpassing vermeld in de littera b), moet eveneens worden vastgesteld conform het arm's length principe, zodat de verwijzing naar het arm's length principe noodzakelijk is voor deze aanpassing. Zonder arm's length principe zou er immers geen standaard of basis bestaan voor de vaststelling van een correlatieve aanpassing. […] Te dien einde kan hier ook nog worden vermeld dat de in het ontwerp gebruikte verwijzing naar een op «passende» wijze uitgevoerde herziening rechtstreeks voortkomt uit de bepalingen die terzake in de internationale context worden gebruikt.*" / "*L'ajustement corrélatif « approprié » mentionné au littera b) doit également être établi conformément au principe de pleine concurrence, de sorte que le renvoi au principe de pleine concurrence s'avère nécessaire pour cet ajustement. Sans principe de pleine concurrence il n'y aurait en effet aucune base pour l'établissement d'un ajustement corrélatif. […] A cette fin on peut mentionner que la référence en projet à un ajustement fait de manière « appropriée » découle directement des dispositions qui sont utilisées en la matière dans un contexte international.*"

income taxation in Belgium without any legal basis to do so, thus constituting a derogation from normal taxation.

(a) The exempted "excess profit" is not included in the profits of a foreign associated company

(79) First and foremost, there is no indication in any of the Rulings that the "excess profit" exempted from Luciad's corporate income tax base was also included in the tax base of a foreign associated company. The Rulings grant the exemption in a precautionary manner, thus before any profit has been generated, and unilaterally, thus not in response to or conditional upon a primary upward adjustment performed by another tax jurisdiction. The Rulings do not even identify the foreign associated company or companies that, according to what the Rulings consider arm's length conditions, should or could have generated those profits.

(80) Rather, paragraph 62 of the 2010 Ruling and paragraph 96 of the 2013 Ruling rely on the 2005 reply of the Belgian Minister of Finance to a parliamentary question that it is not up to the Belgian tax administration to establish in the tax base of which foreign associated company the exempted profit should be included. While it is true that the Belgian tax administration is not required to establish the tax base of foreign associated counterparties over which Belgium has no tax jurisdiction, Belgium does have tax jurisdiction over profits generated by, initially allocated to and recorded by Belgian corporate taxpayers in their commercial accounts, such as Luciad.

(81) Article 185(2)(b) BITC establishes that Belgium will only refrain from exercising its tax jurisdiction over profit recorded in the commercial accounts of a Belgian corporate taxpayer when the profit so adjusted "*is also included in the profit of another company*". A requirement is thus imposed on the Belgian tax administration to verify that that condition has been met before agreeing not to exercise Belgium's tax jurisdiction to the benefit of an individual corporate taxpayer.

(82) Given that the Rulings allow Luciad to exempt a portion of its recorded profit from taxation both in a precautionary manner and unilaterally, without ever assessing whether the exempted profit is also included in the profit of an associated foreign counterparty, the Commission takes the provisional view that Article 185(2)(b) BITC has been misapplied by the contested measures. As a result, the downward adjustment made by the contested measures to Luciad's accounting profit to arrive at its annual taxable profit is made without a legal basis in Belgian tax law.

(b) The exempted "excess profit" does not derive from non-arm's length transactions between Luciad and foreign associated counterparties

(83) Without prejudice to the provisional conclusion in the preceding Recital, which is in itself sufficient to establish that the contested measures misapply Article 185(2)(b) BITC in favour of Luciad, the Commission has also reached the provisional conclusion that the "excess profit" exempted under the contested measures does not derive from non-arm's length transactions between Luciad and foreign associated counterparties, as required by that provision.

(84) As explained in Recital (9), the Rulings begin by validating the pricing of Luciad's intra-group transactions with local affiliates. That is done by performing a transfer pricing analysis using the TNMM, with the local affiliates of the Group as the less complex and thus the tested party to those transactions. The result of that analysis – which does not form the subject matter of this Decision – is that an arm's length "routine" remuneration is established for those affiliates. The logical consequence of applying the TNMM in that analysis to the local affiliates is that any residual profit remaining from those controlled transactions, after those affiliates have been remunerated at arm's length, accrues to Luciad and is recorded in its commercial accounts as its arm's length profit.

(85) That consequence is not only logical, based on the rationale of applying the TNMM in itself, it also makes economic sense. The most complex entity, by virtue of its non-routine (i.e. unique and valuable) contributions, is both entitled to the excess return from those transactions as well as bears the risk of a loss in case the combined transactions under examination do not generate a commercial return. The notion of "residual profit" is transaction-specific and refers to the specific controlled transaction(s) under examination that generate(s) that profit. The residual profit is the profit derived from a set of combined transactions that remains after the less complex party (as tested party) has been remunerated for its routine functions through the application of the TNMM. Consequently, since the TNMM has been chosen to price Luciad's intra-group transactions and since the Rulings accept that method and accept that entity's designation as "Central Entrepreneur", the residual profit from those transactions is its arm's length profit and it is recorded as such in its accounts.

(86) Nevertheless, the Rulings reason that, because of the "Central Entrepreneur" model[63] introduced by the Group, Luciad, as "Central Entrepreneur", will generate "*excessive accounting profits*" in the form of synergies and economies of scale.[64] They further reason that "*[c]ontrary to Article 9(2) of the OECD Model Tax Convention, Article 185(2)(b) BITC provides a legal basis to depart from the accounting profits and to reduce the taxable profits outside the bookkeeping without a need for (effective or potential) double taxation. It is sufficient to demonstrate that the profit recorded by the Belgian group entity is excessive (not at arm's length).*"[65] The Rulings argue that that reduction should be determined as the difference between: (i) the EBIT that Luciad, as "Central Entrepreneur", is expected to generate following the residual profit approach described in Recital (84); and (ii) the EBIT it would be expected to generate if it operated independently from the group to which it belonged.[66] To determine the latter, the Rulings apply the TNMM a second time, but this time with Luciad as the tested

[63] The 2010 OECD TP Guidelines do not define the term "central entrepreneur". Paragraph 9.2 of those guidelines introduces the term "principal" as the counterparty to a foreign associated enterprise acting as a limited risk distributor, agent, commissionaire or toll/contract manufacturer for the principal, but those guidelines do not further define the term "principal". Other examples where an entity is referred to as the principal within a controlled transaction are given in paragraph 9.26 and 9.27 of the 2010 OECD TP Guidelines. In a group structure, a separation of functions whereby, for example, one entity ensures strategic business decisions and another entity ensures production or execution functions may be economically rational. To this end, such a structure must be in line with market conditions in order to comply with the arm's length principle.

[64] 2010 Ruling, paragraph 32.

[65] 2010 Ruling, paragraph 33 and 2013 Ruling, paragraph 76.1.

[66] 2010 Ruling, paragraphs 39 and 40; 2013 Ruling, paragraph 76.4.

party and without identifying any controlled transaction to be priced nor any associated party that would be the more complex party to that transaction. It is that aforementioned difference that the contested measures exempt from taxation as "excess profit".

(87) Contrary to what the Rulings claim, Article 185(2)(b) BITC does not provide a legal basis to exempt from taxation the profit recorded by a multinational group entity that exceeds a fictitious amount of profit equal to the average profit of deemed comparable routine undertakings. That provision codifies the arm's length principle in Belgian tax law. Contrary to what the Rulings appear to argue, that principle is not about ensuring that companies belonging to a multinational group achieve the same profit or profit margin as standalone entities deemed to be engaged in comparable activities achieve in similar circumstances. The essence of the arm's length principle is about ensuring that when there are conditions made or imposed between two associated enterprises in their intra-group transactions (i.e. "controlled transactions") which differ from those that would be made between independent enterprises in comparable transactions and comparable circumstances (i.e. in "comparable uncontrolled transactions"), an adjustment in the price of intra-group transactions is performed to include profits not accrued because of those conditions. Controlled transactions are thus both the object of and their presence is a condition for the application of the arm's length principle.[67] This means that, if there is no controlled transaction to price, there can never be an adjustment of profits under the arm's length principle.

(88) That notion also underpins Article 185(2) BITC which, according to the Belgian legislator, is modelled on Article 9 of the OECD Model Tax Convention. That provision refers to an appropriate adjustment of profits "*in respect of the[] reciprocal cross-border relationships [of] two companies that are part of a multinational group of associated companies*". That can only be understood as a reference to a transaction between those two companies. Consequently, another condition for the application of Article 185(2)(b) BITC is that the adjustment made to the taxpayer's accounts must concern non-arm's length profits derived from a controlled transaction that is arguably mispriced.[68] In contrast, the contested measures apply that provision to reduce Luciad's taxable base although there are no intra-group transactions to be priced or being priced.

(89) As regards the Rulings' claim that the "excess profit" exempted by the contested measures has its origin in synergies, economies of scale and other elements linked to membership of an international group, the Commission first observes that

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67 That the focus in transfer pricing is on the pricing of intra-group transactions clearly follows from paragraph 1.6 of the 2010 OECD TP Guidelines: "*Because the separate entity approach treats the members of an MNE group as if they were independent entities, attention is focused on the nature of the transactions between those members and on whether the conditions thereof differ from the conditions that would be obtained in comparable uncontrolled transactions. Such an analysis of the controlled and uncontrolled transactions, which is referred to as a "comparability analysis", is at the heart of the application of the arm's length principle*." This focus on the pricing of intra-group transactions is reaffirmed in paragraph 1.33 of the 2010 OECD TP Guidelines: "*Application of the arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions in transactions between independent enterprises. […]*".

68 The transactional nature of the arm's length principle is emphasised in the text of paragraph 1.36 and 1.42 of the 1995 OECD TP Guidelines.

synergies and economies of scale are neither transactions nor intangibles.[69] Under specific circumstances, group synergies can be a comparability factor that can give rise to an adjustment under the arm's length principle. Such an adjustment can be acceptable provided synergistic benefits are properly identified and quantified. The proper way of dealing with profits derived from synergies and economies of scale under the arm's length principle is (i) to ascertain that such synergistic effects exist;[70] (ii) to identify the group companies that have undertaken deliberate concerted actions contributing to the creation of the profits from synergies and economies of scale; (iii) to quantify the relative contribution of each of those group companies and identify the controlled transactions between those companies; and (iv) to adjust the prices of those controlled transactions so that each group company's increase in profits reflects that group company's contribution to the overall synergy benefits.[71]

(90) None of this is done in the Rulings. The Rulings simply assume that such benefits or gains will be created as a result of the planned business re-organisation, without clearly identifying to what extent that re-organisation would effectively increase the profitability of the Group,[72] which deliberate concerted actions would be responsible for that increase, and of which controlled transactions the prices should accordingly be adjusted. The Rulings instead accept that the profit generated by Luciad, initially allocated to it following arm's length intra-group transactions, and recorded in its commercial accounts should be reduced to align it with the hypothetical profit it would have allegedly generated if it operated independently of the Group.

(91) Finally, the Commission observes that neither paragraph 1.9 of the 1995 OECD TP Guidelines nor paragraph 1.10 of the 2010 OECD TP Guidelines can be relied upon to support an exemption of "excess profit", as is done in the Rulings.[73] Those paragraphs mention the difficulty and lack of consensus in attributing profit from synergies or economies of scale to the separate entities of a multinational group. They by no means recommend that the arm's length profit of a multinational group entity should exclude profits resulting from synergies and economies of scale from a group company's taxable base, without (re)attributing them to another jurisdiction where they should be taxed. Those paragraphs imply that profit deriving from synergies, in the exceptional case that such synergies can be ascertained, should be allocated to the jurisdiction where they arise.[74]

(92) In any event, even if the planned reorganisation were to result in profits from synergies or economies of scale and even if the deliberate concerted actions, the group companies performing those actions and the controlled transactions between those group parties had been properly identified (*quod non*), the Rulings appear to indicate that those profits would need to be (re)allocated to Luciad. More specifically, the 2010 Ruling states that "*in order to create synergies, Luciad chose to become a multidivisional, vertically integrated multinational*

[69] See 2017 OECD TP Guidelines, paragraph 6.30.
[70] See 2017 OECD TP Guidelines, paragraphs 1.157 and 1.163.
[71] See in that regard paragraphs 1.161 and 1.164 to 1.173 of the 2017 OECD TP Guidelines.
[72] For example, the Rulings do not identify which expenses would be reduced or which cost savings could be generated, nor do they identify how revenues would be increased.
[73] 2010 Ruling, paragraph 60 and 2013 Ruling, paragraph 93.
[74] This is further clarified in the 2017 OECD TP Guidelines (see Recital (89)).

enterprise by centralising strategic decision-making, and important value- and synergy-creating functions as well as internal audit functions at the level of the top management in Belgium".[75] That indicates that any additional profitability created through the reorganisation of the Group stems from contributions made by Luciad in Belgium and therefore was rightfully recorded in its commercial accounts as its arm's length profit.

(93) Consequently and without prejudice to the conclusion in Recital (82), the Commission provisionally concludes that the downward adjustment made by the contested measures to Luciad's accounting profit to arrive at its annual taxable profit misapplies Article 185(2)(b) BITC and is therefore made without a legal basis in Belgian tax law.

(c) The misapplication of Article 185(2)(b) BITC in favour of Luciad leads to discrimination between comparable undertakings

(94) To establish selectivity in cases in which the presumption invoked in Recital (65) is not relied upon, it must be demonstrated that a measure discriminates in favour of one or several undertakings as compared to other undertakings that are in a comparable factual and legal situation. According to the case-law, the comparability analysis for the purposes of establishing selectivity depends on the objective of the reference system under which the measure was adopted.[76]

(95) In Recital (73), the Commission provisionally concluded that the reference system against which the contested measures should be assessed is the Belgian corporate tax system. The objective of the Belgian corporate income tax system, as expressed in Article 185(1) BITC, is to tax corporate taxpayers on their total profit. As further explained in Recital (74), the determination of a corporate taxpayer's total taxable profit takes – as a starting point and notwithstanding possible subsequent upward or downward adjustments provided by tax law – the total profit recorded in the taxpayer's accounts.

(96) Recitals (79) to (93) provisionally conclude that the contested measures misapply Article 185(2)(b) BITC in favour of Luciad as a result of which that undertaking is granted a tax base reduction for which there is no legal basis under Belgian tax law. The contested measures therefore constitute a derogation from the general rules for establishing a corporate taxpayer's income tax base and thus its income tax liability under the Belgian corporate income tax system. By granting Luciad a tax base reduction for which there is no legal basis under Belgian tax law, the contested measures discriminate in favour of that undertaking as compared to all other corporate taxpayers in Belgium, which cannot reduce their accounting profits to establish their taxable profits without an explicit provision in fiscal law and which are therefore taxed, as a starting point and notwithstanding general adjustments provided by law, on the total profit recorded in their commercial accounts.

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[75] 2010 Ruling, paragraphs 24 and 24.1.

[76] Joined Cases C-106/09 P and C-107/09 P *Commission v. Government of Gibraltar and United Kingdom*, EU:C:2011:732, paragraph 75; Joined Cases C-20/15 P and C-21/15 P *World Duty Free Group*, EU:C:2016:981, paragraph 54 and Case C-374/17 *A Brauerei* EU:C:2018:1024, paragraphs 33, 36 and 38.

4.5.3.2. Second subsidiary finding of selectivity: the "excess profit" exemption is not available to all corporate taxpayers

(97) Without prejudice to the provisional conclusions in Recital (67) and in the preceding Recital, the Commission also considers by a further subsidiary line of reasoning that the contested measures selectively favour Luciad even if Article 185(2)(b) BITC could be said to constitute a legal basis for exempting from taxation the profit recorded by a multinational group entity that exceeds a fictitious amount of profit equal to the average profit of deemed comparable routine undertakings, which the Commission has contested in Recital (87).

(98) That is because, by allowing Luciad to exempt a part of its recorded profit from taxation on account of that profit allegedly being attributable to synergies or economies of scale, the contested measures discriminate in favour of that undertaking as compared to other corporate taxpayers in Belgium, which are not entitled to such a downward adjustment although they may also generate what Belgium deems to constitute "excess profit".

(99) First, the Commission provisionally considers the contested measures to selectively favour Luciad as compared to Belgian corporate taxpayers forming part of a multinational group that do not or cannot obtain an "excess profit" ruling.[77] Those undertakings, which may also generate profit from synergies and economies of scale, are taxed by default on that profit, which is part of their total profit within the meaning of Article 185(1) BITC.

(100) Second, the Commission provisionally considers the contested measures to selectively favour Luciad as compared to entities belonging to a domestic corporate group. Such entities may also generate profit from synergies and economies of scale, but are ineligible to obtain an "excess profit" ruling, since Article 185(2)(b) BITC is reserved to entities forming part of a multinational group. As a result, those undertakings are taxed by default on their profit derived from synergies and economies of scale, which is part of their total profit within the meaning of Article 185(1) BITC.

(101) Third, the Commission provisionally considers the contested measures to selectively favour Luciad as compared to standalone entities. Those entities are taxed, as a starting point, by taking the profit recorded in their accounts, which profits, moreover, reflect market prices. By contrast, the contested measures reduce Luciad's taxable profit below the level of its arm's length profit recorded in its commercial accounts, as explained in Recital (85). Moreover, standalone entities may obtain similar benefits by pooling activities either internally or with other standalone entities to achieve better prices or conditions on the market, thus achieving synergies and cost savings similar to those obtained by a multinational group. Nevertheless, those companies cannot obtain an "excess profit" ruling,

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[77] That concerns, for example, Belgian corporate taxpayers belonging to a multinational corporate group that operate under existing business models in Belgium. As follows from Article 185(2)(b) BITC, the adjustment provided by that provision can only be granted by way of an advance ruling. According to Articles 20 and 22 of the Law of 24 December 2002, an advance ruling may only be granted in relation to a situation or operation that has not yet produced effects from a tax perspective. Thus, to request an "excess profit" ruling, a taxpayer must present a "new situation" to the Belgian tax administration, such as the merger or restructuring of production activities, the construction of new facilities, the increase of production capacity of existing facilities or the internalisation of supply activities.

since Article 185(2)(b) BITC is reserved to entities forming part of a multinational group. As a result, those undertakings are taxed by default on their profit derived from synergies and economies of scale, which is part of their total profit within the meaning of Article 185(1) BITC.

(102) In light of the foregoing, the Commission provisionally concludes that the contested measures selectively favour Luciad as compared to each of the three aforementioned comparable undertakings, even if Article 185(2)(b) BITC could be said to constitute a legal basis for exempting from taxation the profit recorded by a multinational group entity that exceeds a fictitious amount of profit equal to the average profit of deemed comparable routine undertakings, which the Commission contests.

4.5.4. Objective justification

(103) A measure that creates an exception to the application of a general rule may be justified if the Member State concerned can show that that measure results directly from the basic or guiding principles of the reference system. In that connection, a distinction must be drawn between, on the one hand, the objectives attributed to a particular reference system which are extrinsic to it and, on the other, the mechanisms inherent in the system itself which are necessary for the achievement of such objectives.[78] It is also necessary to ensure that the measure is proportionate and it does not go beyond what is necessary to achieve the legitimate objective being pursued, in that the objective could not be attained by less far-reaching measures.[79]

(104) The Commission takes the provisional view that it is not possible to objectively justify a misapplication of the law, since such a misapplication can never result directly from the basic or guiding principles of the reference system. Since the contested measures misapply Article 185(2)(b) BITC in favour of Luciad, as a result of which that undertaking is granted a tax reduction with no legal basis in Belgian tax law, the Commission provisionally considers that the *prima facie* selectivity to which those measures give rise cannot be objectively justified.

(105) Without prejudice to that provisional conclusion, the Commission also does not accept, at this stage, Belgium's claim that the contested measures are justified by the objective of preventing double taxation. Double taxation refers to situations in which income is taxed twice in respect of the same taxpayer (also referred to as legal double taxation) or in respect of two different taxpayers (i.e. economic double taxation). The need to avoid double taxation may constitute a possible justification for derogating from the general rules of corporate income taxation.[80] There is, however, no indication that the contested measures actually serve that purpose, contrary to the proper application of Article 185(2)(b) BITC.

(106) First, as explained in Recitals (79) to (82), the replies given by the Minister of Finance on which the Rulings rely allow a downward adjustment to be performed to a portion of Luciad's recorded profit that is not included in the tax base of an associated foreign group entity in another tax jurisdiction. The absence of any requirement to demonstrate the inclusion of the same profit in the tax base of both

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[78] Case C-374/17 *A Brauerei* EU:C:2018:1024, paragraph 48 and the case-law cited.

[79] Joined Cases C-78/08 to -80/08, *Paint Graphos* EU:C:2011:550, paragraphs 73 and 75.

[80] Case C-374/17 *A Brauerei* EU:C:2018:1024, paragraph 52.

associated companies (one abroad, one in Belgium) is an important element distinguishing "excess profit" rulings from transfer pricing rulings authorising a corresponding downward transfer pricing adjustment pursuant to the proper application of Article 185(2)(b) BITC. For the latter type of rulings, the downward adjustment responds to a situation in which the profit recorded in Belgium and exempted from taxation has also been included in the taxable profit of an associated group entity in another tax jurisdiction, either because it was declared in the (supplementary) tax return by that entity or – more likely – because a primary upward adjustment was carried out by a foreign tax administration on the taxable profit of that associated foreign entity. The Rulings do not verify, nor do they consider it necessary to verify, whether the exempted "excess profit" is also included in the tax base of a foreign associated company.

(107) Second, the exempted "excess profit" does not seem capable, by its very nature, of ever being included in the profit of another associated group company. That is because, as explained in Recitals (83) to (93), that profit does not derive from non-arm's length transactions between Luciad and foreign associated counterparties. That profit forms a part of the profit that that undertaking actually generated, that was initially attributed to it and that was recorded in its accounts. That profit can therefore never also be recorded in the accounts of a foreign associated counterparty. Additionally, the Commission considers that that profit can never be included in the taxable profit of such a counterparty following a primary (upward) transfer pricing adjustment abroad, considering the lack of an identified controlled transaction. As a result, no situation of double taxation could ever arise in relation to what Belgium deems to constitute "excess profit".

(108) Consequently, the contested measures cannot be said to address situations of actual or even potential double taxation. Nor has Belgium put forward any other justification for the derogation to which the contested measures give rise.

(109) For these reasons, the Commission provisionally concludes that the tax reduction granted by the contested measures does not derive directly from the intrinsic basic or guiding principles of the reference system and is not the result of inherent mechanisms necessary for the functioning and effectiveness of that system. The discrimination to which those measures give rise therefore cannot be objectively justified.

4.6. Provisional conclusions on the existence of aid and the beneficiaries of that aid

(110) For all the foregoing reasons, the Commission provisionally concludes that the contested measures confer State aid to Luciad in the form of a tax exemption.

(111) For the purpose of the application of the State aid rules, separate legal entities may be considered to form one economic unit. That economic unit is then considered the relevant undertaking benefitting from the aid measure. As the Court of Justice has previously held, "*[i]n competition law, the term 'undertaking' must be understood as designating an economic unit […] even if in law that economic unit consists of several persons, natural or legal.*"[81] To determine whether several entities form an economic unit, the Court of Justice

[81] Case C-170/83 *Hydrotherm* EU:C:1984:271, paragraph 11. See also Case T-137/02 *Pollmeier Malchow v. Commission* EU:T:2004:304, paragraph 50.

looks at the existence of a controlling share or functional, economic or organic links.[82]

(112) In the present case, Luciad is the parent company of the Group. That company manages and controls the associated group entities of the Group. Moreover, the Commission assumes that it was the Group that decided to set up a "Central Entrepreneur" model, with Luciad as "Central Entrepreneur", as a result of which that company could obtain an "excess profit" ruling allowing it to exempt a portion of its recorded profit from corporate income taxation in Belgium without a legal basis to do so.

(113) Consequently, notwithstanding the fact that the Group is organised in different legal personalities, the companies forming part of that Group must be provisionally considered as a single undertaking benefitting from the contested measures.[83] Therefore, the Commission provisionally considers that the Luciad Group, in addition to Luciad, has benefitted from State aid as a result of the contested measures within the meaning of Article 107(1) TFEU.

4.7. Unlawfulness of the aid

(114) Article 108(3) TFEU provides that the Member States must notify any plans to grant new aid in advance to the Commission in sufficient time to allow the Commission to form a view on whether it constitutes State aid and, if so, whether it is unlawful or compatible State aid (the notification obligation).[84] It further provides that notifiable new aid must not be put into effect before the Commission has taken, or is deemed to have taken, a decision authorising such aid (standstill obligation).[85] Article 1(f) of Regulation 2015/1589 defines new aid put into effect in contravention of Article 108(3) TFEU as "unlawful aid".

(115) Since the Commission has provisionally concluded that the contested measures give rise to State aid, it may also provisionally conclude that that aid is unlawful in nature, since those measures were not notified to the Commission before they were put into effect.

4.8. Compatibility with the internal market

(116) State aid is deemed compatible with the internal market if it falls within any of the grounds listed in Article 107(2) TFEU[86] and it may be deemed compatible with the internal market if it is found by the Commission to fall within any of the

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[82] Case C-480/09 P *Acea Electrabel Produzione SpA v. Commission* EU:C:2010:787 paragraphs 47 to 55; Case C-222/04 *Cassa di Risparmio di Firenze SpA and Others* EU:C:2006:8, paragraph 112.

[83] See, by analogy, Case 323/82 *Intermills* EU:C:1984:345, paragraph 11 "*It is clear from the information supplied by the applicants themselves that following the restructuring both SA Intermills and the three manufacturing companies are controlled by the Walloon regional executive and that , following the transfer of the plant to the three newly constituted companies, SA Intermills continues to have an interest in those companies . It must therefore be accepted that, in spite of the fact that the three manufacturing companies each has a legal personality separate from the former SA Intermills, all those undertakings together form a single group , at least as far as the aid granted by the Belgian authorities is concerned […]*."

[84] Regulation 2015/1589, Article 2.

[85] Article 108(3) TFEU; Regulation 2015/1589, Article 3.

[86] The exceptions provided for in Article 107(2) TFEU concern: (a) aid of a social character granted to individual consumers; (b) aid to make good the damage caused by natural disasters or exceptional occurrences; and (c) aid granted to certain areas of the Federal Republic of Germany.

grounds listed in Article 107(3) TFEU.[87] It is the Member State granting the aid which bears the burden of proving that State aid granted by it is compatible with the internal market pursuant to Article 107(2) or (3) TFEU.[88]

(117) Belgium has not invoked any compatibility grounds for the State aid granted to Luciad and to the Group as a whole through the contested measures, nor is the Commission able to identify any.

(118) The Commission notes, in particular, that since the tax treatment afforded through the contested measures appears to result in a reduction of charges that should normally be borne by the undertaking concerned in the course of its business, that reduction should therefore be considered to constitute operating aid. According to the case-law, such aid cannot normally 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.[89]

5. CONCLUSION

In light of the foregoing, the Commission reaches the provisional conclusion that the “excess profit” rulings granted to Luciad NV by Belgium and the acceptance by Belgium of that undertaking’s annual corporate income tax declarations prepared on the basis of those rulings led to the grant of unlawful and incompatible State aid to that undertaking and the group to which it belongs. The Commission, acting under the procedure laid down in Article 108(2) TFEU, therefore requests Belgium to submit its comments and to provide all such information as may help to assess those measures. This concerns in particular:

– the annual accounts of Luciad NV for the years in which the Rulings were relied upon by that undertaking to determine its taxable profit and the corporate income tax returns and corporate income tax assessments of Luciad NV over those years;

– any information demonstrating that the “excess profit” exempted by the aforementioned rulings has been included in the tax base of a foreign associated company;

– all transfer pricing reports and other documents relating to or submitted in relation to the Rulings;

– an updated structure chart describing the current ownership structure of the Group.

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87 The exceptions provided for in Article 107(3) TFEU concern: (a) aid to promote the development of certain areas; (b) aid for certain important projects of common European interest or to remedy a serious disturbance in the economy of the Member State; (c) aid to develop certain economic activities or areas; (d) aid to promote culture and heritage conservation; and (e) aid specified by a Council decision.

88 Case T-68/03 *Olympiaki Aeroporia Ypiresies v. Commission* EU:T:2007:253, paragraph 34.

89 Case T-308/11 *Eurallumina* v *Commission*, EU:T:2014:894, paragraphs 85 and 86.

Belgium is requested to provide this information within one month of the date of receipt of this letter. It requests your authorities to forward a copy of this letter to the potential recipient of the aid immediately.

The Commission wishes to remind Belgium that Article 108(3) TFEU has suspensory effect, and would draw your attention to Article 16 of Council Regulation (EU) 2015/1589, which provides that all unlawful aid may be recovered from the recipient.

The Commission warns Belgium 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 should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission