The Starbucks decision of the General Court (Cases T-760/15 and T-636/16): Stepping stone towards a sustainable solution?

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1. Introduction

The interaction between EU law and international tax law has always been a source of discontent and confusion for tax specialists. One may for example think of the groundbreaking *Schumacker* case of the CJEU (C-279/93) that shed new light on the generally accepted distinction in international tax law between resident and non-resident taxpayers. It should not come as a surprise therefore that the initiatives of the European Commission to review advance pricing agreements ("APAs") of Member States have given rise to a substantial amount of critical commentary in academic literature.[1]

Essentially, these initiatives of the European Commission are concerned with the interaction between EU State aid law (as laid down in Article 107 of the TFEU) and the norms of national and international tax law that regulate the allocation of profits within a multinational company (i.e "transfer pricing law"). Given the central importance of the arm's length principle as the core of transfer pricing law, it is not surprising that the very introduction of the so-called EU arm's length principle, as being an element of EU State aid law, has given rise to a substantial number of disapproving comments.[2] The European Commission has reverted to this principle to challenge APAs concluded by Member States, like the Netherlands and Luxembourg, that adhere to the arm's length principle on the basis of their respective national tax law. These include, amongst others, APAs concluded with Starbucks and FIAT.[3] Even more intriguingly, the European Commission has challenged Ireland, which did not follow the arm's length principle at the time when it concluded the contested APA with Apple.[4]

Given the ongoing uncertainty about the relationship between EU State aid law and transfer pricing law, the rulings of the General Court of the European Union (the "Court") in the Starbucks case[5] and the FIAT case[6] have been eagerly awaited.[7] The

1 See, for example, D. Kyriazis, *From soft law to soft law through hard law: The commission's approach to the state aid assessment of tax rulings*, European State Aid Law Quarterly 2016, pp. 428–439 and D. Smit, *International income allocation under EU tax law: tinker, tailor, soldier, sailor*, EC Tax Review 2017, pp. 67–74.

2 See, for example, R. Bonnici, *The European Commission's arm's length standard: relationship and compatibility with the arm's length principle under transfer pricing*, International Transfer Pricing Journal 2019, pp. 57–64 and F. Todhe, *The rise of an (autonomous) arm's length principle in EU state aid rules?*, European State Aid Law Quarterly 2019, pp. 249–263.

3 Decision of the European Commission of 21 October 2015 in the Starbucks case (SA.38374) and the decision of the European Commission of 21 October 2015 in the FIAT case (SA.38375).

4 Decision of the European Commission of 30 August 2016 in the Apple case (SA.38373).

5 General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669.

6 General Court, 24 September 2019, joint cases T-755/15 and T-759/15, *Grand Duchy of Luxembourg and FIAT vs. European Commission,* ECLI:EU:T:2019:670.

7 The decision of the General Court of 14 February 2019 in the Belgian excess profits case provided the first insights into this subject-matter. General Court, 14 February 2019, joint cases T-131/16 and T-263/16, *Kingdom of Belgium and Magnetrol International vs. European Commission,* ECLI:EU:T:2019:91.

purpose of this chapter is to analyse the decision regarding the APA of Starbucks Manufacturing EMEA BV ("Starbucks" or "SMBV") from the point of view of the aforementioned tension between EU State aid law and transfer pricing law.[8] The research question investigated in this chapter is to ascertain what the decision of the Court in the Starbucks case makes clear about the interaction between EU State aid law and transfer pricing law and to what extent this ruling can serve as a stepping stone towards a sustainable interaction between these fields of law. To this end, the chapter analyses the following aspects of the EU arm's length principle: the mere existence and function of the principle (sections 2 and 3), the conditional application of the principle (section 4), the substantive scope of the principle (section 5) and the burden of proof (section 6). This analysis leads to a proposal for a sustainable solution on the basis of the decision of the Court (section 7) and a conclusion (section 8).

2. Confirmation of an EU arm's length principle

The starting point of the analysis of the relationship between EU State aid law and transfer pricing law is the question whether there actually exists such a thing as an EU arm's length principle. The most notable part of the decision of the Court is therefore the confirmation by the Court that there actually is such a principle. After intense debate about the policy choices of the European Commission and the use of its legitimation narratives,[9] it is actually almost reassuring to read that the Court introduces the EU arm's length principle with the help of the well-known dictum that "*[a]ccording to settled case-law, while direct taxation, as EU law currently stands, falls within the competence of the Member States, they must nonetheless exercise that competence consistently with EU law*".[10] This means, in other words, that the national competence of the Member States to grant APAs does not escape from the scrutiny of EU fiscal State aid control.[11] It is, in my view, without a doubt correct that the Court firmly rejects the arguments of The Netherlands and the taxpayer that such supervision would amount to de facto tax har-

8 The fact pattern of this case and the initial steps in the process are already well enough known. See, for example, E. Kemmeren, *The Netherlands I: Fiscal Unity, Groupe Steria's Per-Element Approach and Currency Losses relating to a Non-Resident Subsidiary (C-399/16[X NV]); Starbucks and State Aid (T-760/15 and T-636/16)*, in M. Lang, P. Pistone, A. Rust, J. Schuch, C. Staringer, & A. Storck (eds.), *CJEU – Recent Developments in Direct Taxation 2016* (Vienna: Linde Verlag, 2017), pp. 117–162 and B. Vos, *State aid, taxation & transfer pricing: illegal fiscal state aid granted to Starbucks?*, EC Tax Review 2018, pp. 113–120.

9 See C. Peters, Tax Policy Convergence and EU Fiscal State Aid Control, EC Tax Review 2019, pp. 6–17 and C. Peters, The legitimacy of EU fiscal state aid control: What is your legitimation narrative? in C. De Pietro (eds.), New perspectives on fiscal state aid: Legitimacy and effectiveness of fiscal state aid control (Alphen aan den Rijn: Kluwer Law International BV, 2019), pp. 5–30.

10 General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, para. 142.

11 See also General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, paras. 158-159.

monization. This rejection is well-founded, since it is difficult to understand why the *"incoming tide of EU law"*, to borrow Lord Denning's famous metaphor, would need to stop at this very point of European integration. On the basis of the supremacy of EU law there simply can be no doubt that EU State aid law sets aside (the selective application of) national tax law in the event that it could have the effect of distorting competition within the internal market.

In order to justify the existence of an EU arm's length principle, the Court seems to rely strongly on the argument that Article 107(1) of the TFEU presupposes a principle of equal treatment.[12] This follows most explicitly from paragraph 149 where the Court explicitly draws a conditional (see below in section 4) comparison between integrated undertakings and stand-alone undertakings. We read in that paragraph that the European Commission derives from Article 107(1) the power to "*compare the fiscal burden of such an integrated undertaking resulting from the application of that fiscal measure with the fiscal burden resulting from the application of the normal rules of taxation under national law of an undertaking, placed in a comparable factual situation, carrying on its activities under market conditions*." Even though this foundation seems rather clear, it is my view that a somewhat more elaborative foundation for this equality-inspired interpretation of Article 107(1) of the TFEU would have added to the persuasiveness of the dictum. Nevertheless, the Court should be applauded for taking away the worries of the Netherlands and Ireland, and some scholars,[13] that Article 107(1) of the TFEU amounts to a "*general principle of equal treatment in taxation that would allow no different treatment of the profits of stand-alone companies and integrated companies.*"[14] The Court usefully specifies that the EU arm's length principle should be seen in the specific context of testing whether inter-company transactions are remunerated as if they were agreed upon by independent parties.

The first, and most significant, conclusion of this ruling is therefore that the Court is confirming that the conclusion of APAs does not escape the application of EU fiscal State aid control. In this regard, the Court makes clear that the so-called EU arm's length principle should oversee the application of transfer pricing law. The contextualization of the EU arm's length principle within the framework of transfer pricing law illustrates that the Court is at pains to manoeuvre between the arm's length principle that we know from national and international tax law and the EU arm's length principle that is now supposed to be part of Article 107(1) of

12 The Court regards the judgment of the ECJ in the Forum 187 case (C-182/03 and C-217/03) to be of a supportive nature in this respect. See paragraph 150. A critical analysis of this particular argument can be found in T. Joris and W. de Cock, *Is Belgium and Forum 187 v. Commission a suitable legal source for an EU 'at arm's length principle'?*, European State Aid Quarterly 2017, pp. 607–616.

13 See S. Buriak and I. Lazarov, *Between state aid and the fundamental freedoms: the arm's length principle and EU law*, Common Market Law Review 2019, pp. 919–922.

14 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, paras. 167–169.

the TFEU. It is, in other words, making an attempt to illustrate that this EU arm's length principle is an element of EU *competition law* that is needed to test the *application* of the arm's length standard that we know from *national and international tax law*. In this way, the Court is clearly operating along the lines of the position of Wattel who usefully categorized the EU arm's length principle, as it was being used by the European Commission, as an element of EU competition law that should be distinguished from the arm's length principle that we know from national and international tax law.[15] This principle is therefore, in Wattel's words, "*aimed at protecting a level playing field for all economic operators in the internal market, i.e. at protecting free competition, rather than at tax base protection or prevention of double taxation*."[16]

3. The function of the EU arm's length principle: tool or principle?

The mere recognition of an EU arm's length principle makes it necessary to better understand the function that this principle is supposed to perform at the interface of EU State aid law and the national and international norms of transfer pricing law. In this regard it seems confusing that the Court is constantly labelling the "'EU arm's length principle' as a "tool".[17] In this way, it is wholeheartedly reproducing the somewhat semantic terminology of the European Commission that was, incidentally, only introduced during the hearing.[18] During the hearing, the European Commission had labelled the EU arm's length principle, for the first time, as "*a tool for assessing the price level of intra-group transactions*".[19] The Court follows this definition, for example, in paragraph 157 where reference is made to "*a useful tool that can be used to verify that intra-group transactions are remunerated as if they had been negotiated between stand-alone undertakings*."[20]

These references of the Court should be seen in the light of its efforts to make clear what function the EU arm's length principle performs as an element of EU

15 See P. Wattel, *Stateless Income, State Aid and the (Which?) Arm's Length Principle*, Intertax 2016, pp. 791–801. It is a separate question whether the EU arm's length principle is an autonomous part of competition law or of internal market law. Compare C. Peters, *Staatssteun en tax rulings: over competitie tussen staten en de doodlopende weg van het recht*, Weekblad Fiscaal Recht, 2017/87.

16 P. Wattel, *Stateless Income, State Aid and the (Which?) Arm's Length Principle*, Intertax 2016, pp. 791–801.

17 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, paras. 151, 152, 157, 163, 169 and 199.

18 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, para. 138.

19 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, para. 138.

20 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, para. 157.

competition law. With the consistent use of the word "tool" it is trying to make clear that the principle should first of all be seen as a way to give substance to the existence of an *advantage* within the meaning of Article 107(1) of the TFEU. With reference to the existing case law of the CJEU it rules in paragraph 146 that "*[i]n the case of tax measures, the very existence of an advantage may be established only when compared with 'normal' taxation*". This particular context also explains why the Court relates this tool not only to the determination of relevant *prices*, but also to the comparison of the *taxable profit* of an integrated company with the taxable profit that is generated under market conditions.[21] The particular character of integrated companies (where inter-company transactions are not determined by market forces) makes it ultimately necessary to make such a comparison in order to determine the existence of a tax advantage. The Court is very well aware of this distinct character of the transfer pricing problem, since it expressly emphasizes this issue in the context of its analysis of the advantage test.[22] The application of the advantage test in this specific context requires investigation into what the taxable profit of an integrated company would amount to if it were not determined by the specific transfer pricing rules currently being used.[23]

The prudent approach of the Court to tweak the advantage test (i.e. EU State aid law) to the particular requirements of the transfer pricing problem (i.e. national and international tax law) confirms that the current case law of the CJEU is simply not up to this particular task. The imprecise and somewhat subjective nature of determining transfer prices simply cannot be squared with the need to establish the existence of a tax advantage (as part of the State aid requirements laid down in article 107(1) of the TFEU) in an objective and clear-cut way.[24] It is exactly this troublesome relationship between the existing case law concerning the advantage test and the application of the arm's length standard in individual cases that has set the European Commission on an adventurous course to find its way. The use of the market economy operator test and the conflation of the advantage test and selectivity test into the EU arm's length principle, which is now considered to be a "tool", are merely efforts to adjust the application of the advantage test to the particular exigencies of the transfer pricing problem.[25]

21 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, para. 152.

22 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, para. 148.

23 See also General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, para. 147 where the Court rules that "*in order to determine whether there is a tax advantage, the position of the recipient as a result of the application of the measure at issue must be compared with his position in the absence of the measure at issue (…) and under the normal rules of taxation.*"

24 See J. Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (Alphen aan den Rijn: Kluwer Law International B.V. (EUCOTAX Series), 2018, pp. 136–144.

25 See C. Peters, supra footnote 12.

The efforts of the Court to provide clarity on the function of the EU arm's length principle within the context of the interaction between EU State aid law and transfer pricing law are applaudable. The only question is whether it has provided sufficient clarification on the interaction between EU State aid law and transfer pricing law. Section 5 will therefore deal with the way that the Court has actually given substance to the EU arm's length principle. This should make it possible to analyse whether the approach chosen by the Court in this Starbucks case constitutes a proper solution to the problem of applying the advantage test in the context of transfer pricing law. For now, it is sufficient to conclude that the way in which the Court has framed the problem is a good starting point in this respect.

4. Application depends on choice of the Member State: equality by choice?

The mere recognition of an EU arm's length principle and the attempt of the Court to define the function of this principle in the particular context of the interaction between EU State aid law and transfer pricing law are important milestones arising from the ruling. Another crucial element of the ruling is the condition that the Court has attached to the application of the EU arm's length principle. Crucially, the application of EU fiscal State aid control is made dependent on the taxation of integrated companies under national tax law. We read in the central paragraph 149 that "*[w]here national tax law does not make a distinction between integrated undertakings and stand-alone undertakings for the purposes of their liability to corporate income tax, that law is intended to tax the profit arising from the economic activity of such an integrated undertaking as though it had arisen from transactions carried out at market prices.*" Subsequently, the Court makes clear that the application of the EU arm's length tool is triggered only when this particular condition is met. After all, this deliberate choice of the Member State implies that it wants to establish equal treatment between the taxation of stand-alone companies and the taxation of integrated companies. This particular aspect of national tax law therefore has the effect, according to the Court, that it is up to EU State aid law to supervise whether the Member State is actually delivering this promise of equal treatment. Consequently, in the words of the Court in the same paragraph, *"the Commission may compare the fiscal burden of such an integrated undertaking resulting from the application of that fiscal measure with the fiscal burden resulting from the application of the normal rules of taxation under national law of an undertaking, placed in a comparable factual situation, carrying on its activities under market conditions."* The Court seems therefore to conclude, without an explicit analysis, that stand-alone companies and integrated companies are in a comparable (factual and legal) situation from the point of view of the application of national corporate income tax.[26]

26 This position is not undisputed. See, for example, R. Luja, *Taxation, state aid and distortions of competition: General Report Topic II – FIDE Conference 2018*, XXVIII FIDE Congress – Volume 2, Coimbra, Almedina 2018, para. 4.3.

This conditional application of the EU arm's length principle is predominantly an attempt to substantiate the delineation of competences between the Member States and the relevant European institutions in relation to EU fiscal State aid control. It suggests that the Member States are still able to make autonomous choices about the taxation of multinational companies. More particularly, this line of reasoning implies that the Member States have autonomy in choosing the 'allocation method' needed to organize the international allocation of the profits of multinational companies.[27] At the same time, it goes without saying that the Netherlands (in this case) and the very great majority of other Member States are actually applying the arm's length standard to perform this allocative function. This effectively makes the conditional nature of the application of Article 107 of the TFEU a dead letter in this particular context. The use of the arm's length standard in a national corporate income tax system automatically enforces the application of the EU arm's length principle that should supervise whether the application of this arm's length standard establishes the envisaged equal treatment between the taxation of stand-alone companies and the taxation of integrated companies.

Obviously, this leads to the fundamental question whether a Member State, let's say Ireland, may also choose *not* to include an allocation method in its corporate income tax system. Or does EU competition law prescribe that the proper functioning of the internal market is impaired when a corporate income tax system does not attempt to guarantee equal treatment between integrated companies and stand-alone companies? These are the fireworks we are anxiously waiting for in the pending Apple case. In my view, the Court is not yet putting its cards on the table in this Starbucks decision. At the same time, the decision leaves me with the impression that Apple and Ireland will lose their case. Briefly put, my conclusion boils down to fact that in a properly functioning internal market it is simply a reckless choice for a Member State to tax the separate legal entities of a multinational company in an independent way, while not drawing the conclusion from this starting point that there should be an allocation mechanism in place that does justice to the particularities of taxing such multinational companies. The Court does not wholeheartedly reject this argument (in paragraph 164) in the Starbucks case, but obviously since it is a case about the Dutch corporate income tax system, it did not have to do so. At the same time, it is undoubtedly true that the Court has explicitly followed- up on the already mentioned 'incoming tide' metaphor when it rules "*that the Commission does not have, at this stage of the development of EU law, competence to allow it to define in an autonomous manner the 'normal' taxation of an integrated undertaking, by disregarding national tax rules*".[28] That

27 Compare the analysis of J. Monsenego, supra footnote 21.

28 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, para. 159.

phrase would seem to suggest that Ireland does not have to include the arm's length standard in its national tax law to guarantee equal treatment between multinational companies and stand-alone companies. Upon closer reading, however, this formulation does not provide clarity on the question of the competence of a Member State (like Ireland) to choose *not* to include an allocation method in its corporate income tax system. In my view, the Court only wants to make clear with this reference that the mere fact that the application of the EU arm's length principle is triggered (resulting from the aforementioned 'autonomous' choice of the Member State), does not imply that the European Commission is at liberty to *prescribe* the substantive scope of such a principle (tool) in a completely autonomous way. I will get back to this in the next section.

5. Substantiation of the EU arm's length principle: what is the benchmark for determining the normal level of taxation?

These considerations lead in turn to the more problematic parts of the decision of the Court namely, the explication of the substantive scope of the EU arm's length principle and the subsequent application of the principle to the facts of the case. A considerable part of the debate about the EU arm's length principle was focused on whether it has an autonomous meaning and to what extent the national transfer pricing regulations and the OECD Transfer Pricing Guidelines are relevant for its interpretation.[29] In my view, the Court has unfortunately not managed to find a proper solution to the challenging task of tweaking the advantage test to the particularities of the transfer pricing problem. Its decision to follow the Commission's semantic use of the word "tool" has the effect that the definition and the application of this tool goes awry.

It is in itself understandable that the Court denies the claim of the Netherlands that the European Commission has failed to substantiate the content of the EU arm's length principle.[30] Any principle that is derived from the principle of equality has an empty 'shell' that needs to be 'substantiated'. This implies however that a Court which is applying such a principle should provide clear insight into the criteria that are relevant for its equality-based analysis. In the context of the case under review, this would imply that the Court should have made it crystal-clear which *sources* of law are relevant to give substance to the EU arm's length principle. Only such a clear indication of the relevant sources of law would make it possible to establish the relevant reference system in an unequivocal way. However, the Court fails to give complete clarity on this crucial matter.

29 Compare, for example, A. Gunn and J. Luts, *Tax rulings, APA's and state aid: legal issues*, EC Tax Review 2015, pp. 119–125.

30 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, para. 157.

In any case, the Court does not explicate wholeheartedly that Dutch national tax law constitutes the relevant source of tax law to determine the required benchmark of the advantage test. It definitely alludes to this starting point several times, but it does not completely exclude that other *sources of law* could also be relevant. We can read for example in paragraph 137 that it should be assessed whether "*the APA derogates from the general Netherlands corporate income tax system*".[31] In paragraph 171 the Court even dismisses the claim of the Netherlands and Starbucks that the European Commission failed to determine the existence of an advantage on the basis of national tax law. It explains that it was clear from the relevant decision that the European Commission examined this issue "*by reference to the general Netherlands corporate income tax system*". These clear references to Dutch national tax law are however alternated with some paragraphs that leave room for a broader interpretation of the EU arm's length principle. In particular, the Court does not dismiss the possibility that the European Commission may apply any other 'appropriate methodology', provided that it is properly justified, to determine the existence of an advantage in the context of determining transfer prices.[32] This leaves open the possibility that the EU arm's length principle has a different meaning than the arm's length principle that is laid down in Dutch national tax law.

When it comes to the application of the "tool" however, it seems that the Court is effectively relying exclusively on Dutch national tax law to determine the applicable prices and – consequently – the normal level of taxation. This reliance on Dutch national tax law is most unequivocal in paragraphs 237–239 where the Court follows the position of the European Commission that "*the rules of the general Netherlands corporate income tax system*" (paragraph 238) constitute the relevant set of rules to assess the APA. In other parts of the judgment, this explicit reliance on Dutch national tax law is unfortunately somewhat less clear.

With regard to the role of the OECD Transfer Pricing Guidelines on the other hand, the Court seems somewhat more explicit in the judgment. It establishes in paragraph 155 that "*those guidelines are based on important work carried out by groups of renowned experts, that they reflect the international consensus achieved with regard to transfer pricing and that they thus have a certain practical significance in the interpretation of issues relating to transfer pricing*". The Court makes this rather firm statement to illustrate that the European Commission cannot simply put aside the OECD Transfer Pricing Guidelines in order to give a more explicitly autonomous interpretation to the EU arm's length principle. Even though it is certainly true that it leaves open such an autonomous interpretation

31 Compare also the references to "the normal rules of taxation under national law" (para. 149), "the normal rules of taxation in Netherlands law" and "the normal tax rules under Netherlands law" (both in para. 153).

32 See General Court, 24 September 2019, joint cases T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks vs. European Commission*, ECLI:EU:T:2019:669, paras. 154 and also 172.