



TAX ALERT
12 May 2021

The Amazon (State aid) Case: Luxembourg and Amazon vs. European Commission (T-816/17 and T-318/18)

A. Background: Amazon business model and the European Commission Decision

From 2006, the Amazon group pursued its commercial activities in Europe through two companies established in Luxembourg, namely Amazon Europe Holding Technologies SCS (“**LuxSCS**”), a Luxembourg limited partnership, the partners of which were US entities of the Amazon group, and Amazon EU Sàrl (“**LuxOpCo**”), a wholly owned subsidiary of LuxSCS.

According to Amazon’s business model carried out between 2006 and 2014, LuxSCS (i) held the intangible assets necessary for the Amazon group’s activities in Europe, and (ii) concluded a license agreement (“**License Agreement**”) with LuxOpCo, the main operator of the Amazon group’s business in Europe. Under the License Agreement, LuxOpCo undertook to pay a royalty to LuxSCS in return for the use of the intangible assets held by the latter.

On 6 November 2003, the Luxembourg tax authorities granted to Amazon group a tax ruling (“**Tax Ruling**”), which (i) confirmed that LuxSCS was not subject to Luxembourg corporate income tax because of its legal form and, (ii) endorsed the method of calculating the annual royalty to be paid by LuxOpCo to LuxSCS under the License Agreement. In particular, according to the Tax Ruling, the arm’s length royalty to be paid by LuxOpCo to LuxSCS under the License Agreement were calculated according to TNMM, using LuxOpCo as “tested party”.

Following an in-depth State aid investigation launched in October 2014, the European Commission (“**EU Commission**”) concluded, in its decision (EU) 2018/859 of 4 October 2017 on State aid SA.38944 (“**Decision**”), that in so far as it had endorsed the “arm’s length” nature of the method of calculating the royalty under the License Agreement, the Tax Ruling (implemented from 2006 to 2014) constituted State aid for the purpose of Article 107 TFEU, unlawful and incompatible with the internal market.

In particular, according to the EU Commission's Decision, the Tax Ruling enabled Amazon to shift the vast majority of its profits from an Amazon group company that is subject to tax in Luxembourg (LuxOpCo) to a company which is not subject to tax (LuxCoSCS). Therefore, under EU Commission's view, the Tax Ruling endorsed the payment of a royalty from LuxOpCo to LuxSCS, which significantly reduced Amazon EU's taxable profits.

The Decision was based on a primary finding ("**Primary Finding**") as regards to the choice of the "tested party" for the purposes of applying the TNMM, as well as on other three subsidiary findings ("**Subsidiary Finding**"), concerning some alleged errors with respect to: (i) the choice of the TNMM as such, (ii) the choice of the profit level indicator as a relevant parameter for the application of the TNMM and (iii) the inclusion of a ceiling mechanism in the context of the TNMM.

The Decision has been appealed both by Luxembourg (Case T-816/17) and Amazon companies (T-318/18) before the General Court of the European Union ("**General Court**"), which today has issued its relevant decisions.

B. The General Court judgment

The judgment issued on 12 May 2021 annuls the contested Decision because – according to the General Court – the EU Commission did not succeed, inter alia, in demonstrating that there was an advantage for Amazon group for the purposes of Article 107(1) TFEU.

In particular, by also relying on principles previously set out with respect to the criteria for the identification of a "State aid" in the context of tax rulings, in the judgement the General Court provides important clarifications as regards the scope of the EU Commission's burden of proof in establishing the existence of an "advantage".

In this respect, in the judgment the General Court notes that the very existence of a tax advantage may be established only by comparing the position of the recipient as a result of the application of the measure at issue with the position of the same in the absence of such measure and under the "normal" rules of taxation.

In this regard, the General Court points out that, in a tax ruling context, the EU Commission can find an advantage **only if it demonstrates** that the methodological errors which, in its view, affect the transfer pricing do not allow a reliable approximation of an arm's length outcome to be reached, but rather lead to a **reduction in the taxable profit of the company concerned compared with the tax burden resulting from the application of normal taxation rules**.

Based on those principles, in the judgement the General Court examined the EU Commission's analysis in support of its finding that the Tax Ruling granted an unlawful tax advantage to LuxOpCo and to Amazon group.

In particular, with regards to the Primary Finding, the General Courts held that the analysis performed by the EU Commission is incorrect in several respects as:

- (i) **the EU Commission did not demonstrate that the Luxembourg tax authorities had incorrectly chosen LuxOpCo as the "tested party" in order to determine the amount of the royalty under the License Agreement.** This because, according to the General Court, the EU Commission (a) relied on its own functional analysis of LuxSCS

in order to assert that the company was merely a passive holder of the intangible assets at issue, whilst (b) not due taking into account the functions performed by LuxSCS for the purposes of exploiting the intangible assets in question or the risks borne by that company in that context. In this respect, according to the General Court's judgement, the EU Commission has neither demonstrated that it was easier to find undertakings comparable to LuxSCS than undertakings comparable to LuxOpCo, or that choosing LuxSCS as the tested entity would have made it possible to obtain more reliable comparison data;

- (ii) even if the "arm's length" royalty should have been calculated using LuxSCS as the "tested party" in the application of the TNMM, the EU Commission **did not establish the existence of an advantage since it was also unfounded in asserting that LuxSCS's remuneration could be calculated on the basis of the mere passing on of the development costs of the intangible assets** borne under other agreements entered into by the same LuxSCS, without in any way taking into account the subsequent increase in value of those intangible assets;
- (iii) the EU Commission also erred in evaluating the remuneration of LuxSCS under arm's length principle. Indeed, under General Court view, the relevant functions of LuxSCS **cannot be treated in the same way as the supply of "low value adding" services.**

On the basis of the foregoing, in the judgement is concluded that the elements put forward by the EU Commission in support of its Primary Finding **are not able of establishing that LuxOpCo's tax burden was artificially reduced** as a result of an overpricing of the royalty.

In addition, after examining the Subsidiary Findings, the General Court also held that the **EU Commission failed to prove that the methodological errors identified had necessarily led to an undervaluation of the remuneration that LuxOpCo** and the consequent existence of an "advantage" consisting of a reduction of its tax burden. More in detail, according to General Court's judgment:

- (i) although the EU Commission could validly consider that certain functions performed by LuxOpCo in connection with the relevant intangible assets went beyond mere "management" functions, it nevertheless **did not appropriately justify to the requisite legal standard the methodological choice** it inferred from;
- (ii) the EU Commission did not demonstrate why LuxOpCo's functions, as reviewed under EU Commission's analysis, should necessarily have **led to a higher remuneration for LuxOpCo;**
- (iii) as regards both (a) the choice of the most appropriate profit level indicator and (b) the ceiling mechanism endorsed by the Tax Ruling for the purposes of determining LuxOpCo's taxable income, even if they were erroneous, the EU Commission did not satisfy the evidential requirements it is required to meet.

On the basis of the foregoing arguments the General Court concluded that none of the findings set out by the EU Commission in the Decision **are sufficient to demonstrate the existence of an advantage** for the purposes of Article 107(1) TFEU, with the result that it must be annulled in its entirety.

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