II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION
of 5 September 2002
on the aid scheme implemented by Germany for control and coordination centres

(notified under document number C(2002) 3298)

(Only the German text is authentic)

(Text with EEA relevance)

(2003/512/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 88(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to the provisions cited above [1],

Whereas:

I. PROCEDURE

(1) By letter dated 12 February 1999 (D/50716), the Commission asked Germany to submit more detailed information on the scheme of direct company taxation for control and coordination centres of foreign companies. The scheme had not been notified to the Commission. By letter EC3-714725/12 dated 26 May 1999, Germany submitted a description of the scheme and answered the points the Commission had made.

(2) By letter dated 11 July 2001 (SG 2001 D/289745), the Commission informed Germany that it had decided to initiate the procedure laid down in Article 88(2) of the EC Treaty in respect of the scheme. Germany submitted its comments on 11 September 2001 by letter EC3-F2516-101/01.

(3) The Commission decision to initiate the procedure was published in the *Official Journal of the European Communities* [2]. The Commission invited interested parties to submit their comments on the scheme.

(4) The Commission received no comments from interested parties.

II. DETAILED DESCRIPTION OF THE MEASURE

(5) The treatment of control and coordination centres of foreign companies in Germany used to be governed by a Federal Finance Ministry Order, the Administrative Order for the treatment of control and coordination centres of foreign companies in accordance with German double taxation Treaties (hereinafter 'the Order'; see letter of the Federal Finance Minister dated 24 August 1984) (Verwaltungsanweisung für die Behandlung von Kontroll- und Koordinierungsstellen ausländischer Konzerne nach den deutschen Doppelbesteuerungsabkommen) [3]. According to information available, the Order was repealed with effect from 31 December 2000.

(6) The Order applies to control and coordination centres that control and/or coordinate the activities of subsidiaries and permanent establishments of foreign companies in Germany and other countries.

(7) The Order describes what kind of activities control and coordination centres may carry on in order to be eligible for special tax treatment. It is clear from the description that the tasks allowed are exclusively activities to service the needs of the group (e.g. accounting, consolidation reports, marketing, production plans and research coordination). The control and coordination centre cannot act as headquarters of the group, such activity having to be carried out by another entity within the group.

[1] OJ C 304, 30.10.2001, p. 2.
[2] See footnote 1.
[3] *Bundessteuerblatt* 1984, Part I, p. 458.

(8) The taxable profit of control and coordination centres is not established according to the normal method, i.e. as the difference between income and expenditure, but according to the cost-plus method [1]. This consists in control and coordination centres applying to the costs they bear a profit margin (mark-up). The resulting amount is then subject to the standard corporate tax rate. The Order sets the range of acceptable mark-ups between 5 % and 10 %. This is, according to Germany, in keeping with general practice in Germany.

(9) In practice, it is the control and coordination centre itself that first determines its mark-up within the 5 to 10 % range. There is no advance agreement between the taxpayer and the tax authorities on what rate to choose within that range. A mark-up rate lower than 5 % is not accepted. The tax authorities will in no case impose a mark-up rate higher than 10 %, although the taxpayer is free to choose such a rate. As a rule, all mark-up rates in the 5 to 10 % range are checked retrospectively by the tax authorities.

III. GROUNDS FOR INITIATING THE PROCEDURE

(10) On the basis of the information submitted to it by Germany in the course of the preliminary examination provided for in Article 10 of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty [2], the Commission came to the conclusion that the existence of a maximum mark-up of 10 % might constitute State aid since this upper limit could artificially reduce the tax liability of control and coordination centres.

(11) On the basis of the information submitted in the course of the preliminary examination, the Commission doubted in particular whether the exceptions laid down in Article 87(2) and (3) of the EC Treaty were applicable to the scheme. It therefore had doubts about the compatibility of the scheme with the common market.

(12) Accordingly, the Commission initiated the procedure laid down in Article 88(2) of the EC Treaty.

IV. COMMENTS FROM GERMANY

(13) Firstly, Germany considers that the scheme is not intended to confer any tax benefit. The setting of a ceiling below which no objections will be raised serves only to ease administration and create legal certainty by avoiding disputes.

(14) On the basis of the reports by the *Länder* tax administrations covering the period from 1 January 1996 to 31 December 2000, Germany argues that the Order did not actually result in taxable persons deriving any benefit from the fact that profit was not determined on the basis of an arm's-length price. It claims in particular that there is no evidence of cases where a mark-up over 10 % would have been necessary.

(15) According to Germany, from 1996 onwards there were only seven identified cases involving group control and coordination centres within the meaning of the Order. In three cases, the transfer price [3] had been determined without applying the Order, either by using a different attribution method or by basing the price on arm's-length transactions with foreign companies.

(16) Germany considers that, of the four cases in which the Order was applied, a mark-up within the range was accepted without an individual check being carried out in only one case. In the three remaining cases, the mark-up was checked during a company audit. In one of these three cases, an objection was made and the transfer price was recalculated on the basis of experience with other transfer price cases, producing a result within the 5 to 10 % range. In another case, the company auditors accepted the result without correction, while in the remaining one (where activities ceased in the first quarter of 1996) the company auditors fixed a mark-up rate of 5 %.

(17) In Germany's view, these figures reflect the limited material scope of the Order, covering only group establishments which perform a support function in relation to the group headquarters and for which, in accordance with the arm's-length principle, only small profit margins are justified. According to Germany, the small number of cases found shows that taxable persons have not viewed the scheme as a tax concession comparable to State aid. This is demonstrated by the case of the coordination centre which ceased its activities in the first quarter of 1996 despite the fact that the mark-up was set at the low threshold rate of 5 %.

(18) As regards the information requested by the Commission on its selective character, Germany argues that the scheme does not contain any criteria for geographical or material demarcation such as would make the scheme selective.

[1] On the use of alternative methods of taxation, see point 27 of Commission notice 98/C 384/03 on the application of the State aid rules to measures relating to direct business taxation (OJ C 384, 10.12.1998, p. 3).
[2] OJ L 83, 27.3.1999, p. 1.
[3] Transfer prices are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises (see preface to the 1995 OECD transfer pricing guidelines).

(19) Germany considers it impossible to recover any amounts. The arguments put forward are as follows. The tax assessment becomes definitive one month after it has been issued; re-assessment of the tax retrospectively in such cases is impossible. Tax offices would accordingly be unable to recover taxes in the one (and only) established case where the rules contained in the Order were applied without examining the individual case and where, therefore, it is theoretically possible that the mark-up had been set too low. Moreover, Germany would have to prove that the arm's-length principle provided for in section 1 of the German Foreign Tax Relations Act had not been observed. In conclusion, it considers that there is no practical or legal possibility of, or necessity for, reversing the application of the Order.

V. ASSESSMENT OF THE AID

1. Applicability of Article 87(1) of the EC Treaty

(20) Under Article 87(1) of the EC Treaty, State 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 production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

(21) To be caught by the prohibition under Article 87(1), a measure must fulfil the following four criteria:

(a) the measure must confer on recipients an advantage that relieves them of charges that are normally borne from their budgets;

(b) the advantage must be granted through State resources;

(c) the measure must affect competition and trade between Member States;

(d) the measure must be specific or selective in that it favours certain undertakings or the production of certain goods.

(22) Firstly, as regards the requirement that the measure must afford beneficiaries an advantage, the Commission takes the view that the existence of an upper limit of 10 % for the determination of the mark-up in the cost-plus method can confer an advantage on control and coordination centres and the multinational groups to which they belong. This limitation to 10 % may artificially reduce the tax burden of control and coordination centres in cases where actual margins exceed 10 %.

(23) Germany's argument that the existence of a ceiling is not intended to create a tax benefit but serves only to ease administration and create legal certainty by avoiding disputes cannot be accepted. While the Commission does not deny that tax administrations are entitled, and must be in a position, to guarantee legal certainty for taxpayers, this should not result in a reduction in the tax base. By setting an upper limit for the mark-up, the Order assured the taxpayer that, in cases where a retrospective check showed the need for a mark-up higher than 10 % to reflect the economic reality of the transfer price, the tax authorities would agree to a 10 % mark-up. This automatic acceptance of an undervalued mark-up corresponds to an artificial reduction in the tax base for the control and coordination centre which cannot be justified by the need for legal certainty.

(24) If legal certainty is to be ensured, it must be in relation to the elements that will be taken into consideration for taxation and not in relation to the maximum mark-up rate that will be applied. The existence of an upper limit cannot be justified in terms of administrative simplification, since control and coordination centres are, in any event, subject to retrospective checks by the tax administration.

(25) In addition, as Germany pointed out in its comments of 11 September 2001 ([1]), in at least one case the margin for the control and coordination centre was determined without any retrospective check being carried out and was therefore left to the discretion of the tax authorities. This clearly shows that the application of the scheme, even if it was not intended to, gave rise at least once to use by the tax administration of its discretionary power possibly to grant an advantage to a control and coordination centre.

(26) In the area of transfer pricing, the internationally agreed standard is the arm's length principle as set out in Article 9 of the OECD Model Tax Convention on income and on capital and further elaborated on in the 1995 OECD transfer pricing guidelines. This principle provides that taxable profits on cross-border activities between associated enterprises should be calculated as if the transaction had been carried out between unrelated parties under market conditions. The OECD guidelines do not recommend the use of minimum or maximum mark-ups as in the present case (also known as 'safe harbours') since these may not reflect the nature of the transactions at issue.

(27) Moreover, according to the information available, the tax administration has used its discretionary power to grant an advantage in at least one case, which is in contradiction with the arm's length principle. The Commission cannot rule out the possibility that there may have been other, comparable cases before 1996, i.e. at a time for which Germany has provided no information but which, pursuant to Article 15 of Regulation (EC) No 659/1999, is covered by this examination.

([1]) See paragraph 16.

(28) The Commission therefore considers that both the existence of an upper limit for the mark-up and the use by the tax administration of its discretionary power confer an advantage on the relevant undertakings and to the groups to which they belong within the meaning of Article 87(1) of the EC Treaty.

(29) Secondly, the advantage must be granted through State resources in any form whatsoever. According to point 10 of Commission notice 98/C 384/03, the loss of tax revenue deriving from the reduction in the tax base is equivalent to consumption of State resources in the form of fiscal expenditure. As confirmed by the Court of Justice of the European Communities [1], this principle also applies to aid granted by regional or local bodies in Member States.

(30) Thirdly, the aid must distort or threaten to distort competition. The Court of Justice has consistently ruled [2] that intra-Community trade is to be deemed to be affected from the moment the beneficiary firm carries out an economic activity which is the subject of trade between Member States.

(31) The Commission takes the view that the scheme in question is capable of affecting competition and trade between Member States since it is open to all sectors of the economy. In addition, control and coordination centres belong to multinational groups which may be active in other Member States. This criterion is therefore fulfilled.

(32) Fourthly, the aid must favour certain undertakings or the production of certain goods. Germany considers that there is no selectivity since all sectors of the economy qualify for the aid. The Commission cannot share this view because the benefit of the scheme is, in fact, limited to companies belonging to groups with foreign headquarters. German resident companies were explicitly excluded from the benefit of the scheme. Furthermore, in the present case, the benefit of the scheme was limited to intra-group activities and could not, as Commission notice 98/C 384/03 requires, be justified by the logic of the tax system. Germany has not provided the Commission with any such justification as required by point 23 of the notice.

(33) Finally, Germany claims that the small number of cases found shows that taxable persons have not viewed the scheme as a tax concession comparable to State aid, especially in the case of the control and coordination centre which ceased its activities in the first quarter of 1996, despite the fact that the mark-up was at the low threshold rate of 5 %. On this point, the Commission considers that neither the small number of beneficiaries nor the level of the advantage is relevant in the context of the assessment of the aid character of a scheme.

(34) The Order therefore satisfies the criteria equating it to an aid scheme in two respects. Firstly, it confers on the tax authorities a discretionary power to accept a mark-up without carrying out any retrospective check and, secondly, it prevents them from demanding the application of the real mark-up where this is higher than 10 %. The Commission has therefore to examine whether the aid can be considered compatible with the common market under the exceptions laid down in Article 87(2) and (3) of the EC Treaty.

2. **Compatibility of the aid measure with the EC Treaty**

(35) Measures caught by Article 87(1) of the EC Treaty are incompatible with the common market unless they qualify for one of the exceptions in Article 87(2) or (3).

(36) As far as Article 87(2) is concerned, the Commission considers that, inasmuch as it is not aimed at the objectives listed there, the aid measure contained in the tax scheme does not fall under that provision.

(37) Nor can the measure be considered compatible with the common market pursuant to Article 87(3).

(38) There are no indications that the conditions of Article 87(3)(a), (b), (d) and (e) are fulfilled. According to Article 87(3)(c), aid may be authorised if it serves to facilitate the development of certain economic activities or of certain economic areas. The Commission has acknowledged in several Community frameworks that the conditions for such an exemption may be fulfilled if the aid serves to pursue a certain objective.

(39) However, the tax provision in question serves to promote neither investment nor employment nor any other recognised Community objective. The aid cannot therefore be authorised under the Treaty provisions.

(40) The Commission finds that the measure thus constitutes incompatible aid.

3. **Legitimate expectations**

(41) In its letter of 11 July 2001, the Commission invited Germany and interested parties to submit comments on possible legitimate expectations of the sort that would present an obstacle to the recovery of the aid in the event of its being classified as illegal and incompatible with the common market.

[1] Case 248/84 *Germany* v *Commission* [1987] ECR 4013, paragraph 17.

[2] Case 730/79 *Philip Morris* v *Commission* [1980] ECR 2671 and Case 142/87 *Belgium* v *Commission* [1990] ECR I-959.

(42) In its answer, Germany argued that recovery cannot take place because a tax assessment becomes definitive one month after it has been issued. In such cases it is impossible to reassess the tax retrospectively. Therefore, the German tax authorities would be unable to recover taxes in the one (and only) case established where the rules contained in the Order were applied without examining the individual case and where, therefore, it is theoretically possible that the tax had been set too low. The Commission does not share this view. According to the case law of the Court of Justice [1], the existence of a time limit laid down under national law in the interests of legal certainty does not constitute an insuperable obstacle to the recovery of aid.

(43) In the present case the Commission notes, however, that the German Order has some features in common with the scheme introduced in Belgium by Royal Decree No 187 of 30 December 1982 concerning the tax treatment of coordination centres. Both measures concern intra-group activities and both use cost-plus methods that lead to a reduced tax base. In its decision of 2 May 1984, the Commission came to the conclusion that the Belgian scheme did not constitute aid within the meaning of Article 87(1) of the EC Treaty. Although this decision was not published, it was stated in the 14th Competition Report and in an answer to a parliamentary question [2] that the Commission had no objections. In this context, it can be argued that this 1984 Commission Decision on the Belgian scheme, which was adopted before the entry into force of the German Order, conferred a legitimate expectation on Germany and on the aid beneficiaries, who could consider, on the basis of the Commission Decision, that the Order did not constitute State aid. Moreover, in the answer to the abovementioned parliamentary question, the scheme under examination was referred to and classified as not falling under Articles 92 and 93 (now 87 and 88) of the EC Treaty. Accordingly, Germany and the beneficiaries can be considered to have legitimate expectations, with the result that, in accordance with Article 14(1) of Regulation (EC) No 659/1999, recovery of the aid would be contrary to a general principle of Community law.

VI. **CONCLUSION**

(44) In the light of the information provided by Germany, the Commission concludes that Germany has implemented the Order in breach of Article 88(3) of the EC Treaty. It also finds that the measure favours control and coordination centres and does not satisfy any of the conditions in Article 87(2) and (3). The measure is therefore incompatible with the common market. However, since it has been established that both Germany and the beneficiaries under the scheme have had legitimate expectations, recovery of the aid will not be effected,

HAS ADOPTED THIS DECISION:

Article 1

The aid which Germany has granted under the Administrative Order for the treatment of control and coordination centres of foreign companies in accordance with German Double Taxation Treaties (Verwaltungsanweisung für die Behandlung von Kontroll- und Koordinierungsstellen ausländischer Konzerne nach den deutschen Doppelbesteuerungsabkommen) (see letter of the Federal Finance Minister dated 24 August 1984) is incompatible with the common market.

Article 2

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 5 September 2002.

For the Commission

Mario MONTI

Member of the Commission

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[1] See, *inter alia*, Case C-24/95 *Land Rheinland Pfalz* v *Alcan Deutschland GmbH* [1997] ECR I-1591.

[2] Written Question No 1735/90 (OJ C 63, 11.3.1991).