II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 13 May 2003

on the aid scheme implemented by France for headquarters and logistics centres

(notified under document number C(2003) 1483)

(Only the French text is authentic)

(Text with EEA relevance)

(2004/76/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 called on interested parties to submit their comments pursuant to the provision cited above [1], and having regard to those comments,

Whereas:

I. PROCEDURE

(1) In 1997 the Ecofin Council adopted a Code of conduct for business taxation [2], with a view to tackling harmful tax competition. In line with the undertaking it gave in connection with that Code, the Commission published in 1998 a Notice on the application of the State aid rules to measures relating to direct business taxation [3] (hereinafter called the Notice), restating its determination to apply the rules strictly and in accordance with the principle of equality of treatment. The present procedure has to be viewed in this context.

(2) The present procedure is concerned exclusively with the scheme of taxation of headquarters and logistics centres (hereinafter called the scheme) and hence does not cover the scheme of expatriation allowances paid to members of staff of headquarters and logistics centres posted temporarily to France from abroad by other units of the group concerned.

(3) By letter dated 12 February 1999 (D/50716), the Commission sent a request for information on the scheme to the French authorities. The latter furnished the requested information by letter dated 7 May 1999 (A/33525).

(4) The Commission's decision to initiate the procedure was published in the *Official Journal of the European Communities* [4], inviting interested parties to submit their comments.

(5) By letter dated 9 October 2001 (A/37896), the Commission received comments from France in reply to the letter initiating the formal investigation procedure.

(6) The Commission received comments from the American Chamber of Commerce in France (A/39294). By letter dated 14 January 2002, it forwarded them to France (D/50110) to give it the opportunity to react. The Commission has not received any other comments on the subject, whether from France or from any other interested party.

[1] OJ C 302, 27.10.2001, p. 2.
[2] OJ C 2, 6.1.1998, p. 1.
[3] OJ C 384, 10.12.1998, p. 3.
[4] See footnote 1.

II. **DESCRIPTION OF THE MEASURE**

Introduction ([5])

(7) The scheme entered into force in 1974 and was not notified under Article 88(3) of the Treaty. A circular of the Directorate-General of Taxes dated 21 January 1997 set out all the administrative arrangements relating to the scheme and stated that headquarters already approved by the tax authorities could avail themselves of the circular. The circular forms the legal basis for all rules relating to the scheme. A second circular of the Directorate-General of Taxes dated 11 October 2002 ([6]), taking effect as from the financial year beginning on 1 January 2003, amended the 1997 circular in such a way as to enable the tax authorities' approvals of headquarters and logistics centres to be systematically reviewed every three to five years at the latest. According to the circular dated 21 January 1997, the scheme is intended to resolve the difficulties inherent in determining transfer prices in the context of commercial relations between headquarters and logistics centres in France and other group companies abroad. Such pricing is often difficult in practice because it depends on the practical application by taxpayers and the tax authorities of the arm's length principle laid down by the OECD. The arm's length principle is the international standard agreed by OECD member countries to determine transfer prices for tax purposes with a view to avoiding, firstly, double taxation of taxable income and, secondly, tax evasion involving the same income.

(8) The scheme makes it possible to determine profits subject to corporation tax in an alternative manner, using the 'cost-plus' method. This method consists in determining taxable profits by applying a mark-up to the operating expenditure of the headquarters or logistics centre. This mark-up is determined by the tax authorities at the taxpayer's request. The method used forms part of the traditional methods, based on a comparison with similar transactions with non-associated enterprises, as recommended by the OECD in its report on transfer pricing (hereinafter called the OECD report) ([7]). Compared with other transaction methods, which involve a direct comparison between the price charged in a transaction between associated enterprises and that charged in a transaction between non-associated enterprises, the cost-plus method is based on an indirect determination of the arm's length price. The method involves setting a mark-up on a case-by-case basis by analogy with the mark-ups actually charged in comparable situations between non-associated enterprises in the light of the functions performed, the assets used, the risks assumed and the market conditions. These factors may result in adjustments being made to the mark-up actually charged in comparable uncontrolled situations to make it better suited to the peculiarities of the intra-group transactions concerned. This mark-up is then applied to the costs actually incurred by the same supplier of goods or services whose taxable profits are to be calculated. The result obtained after applying the mark-up to the above costs is considered equivalent to the arm's length price of these transactions between associated enterprises.

(9) The OECD report also mentions the possibility for associated enterprises to draw up prior transfer pricing agreements with the tax authorities concerned. This type of agreement makes it possible to determine, in advance of transactions between associated enterprises, a series of appropriate criteria (including the method to be used, the factors of comparison and the adjustments to be made thereto) with a view to determining the transfer price applicable to those transactions during a given period. According to the OECD nomenclature, a prior transfer pricing agreement may be unilateral, involving one tax authority and one taxpayer, or multilateral, involving two or more tax authorities. The agreement provides beneficiaries with an assurance that the amount of taxable profits determined using the procedure will not be called into question by the authority or authorities concerned during the lifetime of the agreement, subject, however, to the situation of the enterprise and the circumstances recognised by the agreement remaining unchanged.

Scope

(10) According to the circular of 21 January 1997 (hereinafter called the circular), headquarters and logistics centres may take the legal form either of companies having their registered office in France or of permanent establishments of foreign companies. In addition, headquarters may take the form of a department attached to an industrial or commercial branch of activity of an existing enterprise or to a holding company (holding foreign or French investments). On the other hand, logistics centres may not be attached to an industrial or commercial branch

([5]) Official Tax Bulletin 13 G-1-97 No 21 of 30 January 1997.
([6]) Official Tax Bulletin 4 C-5-02 No 175 of 11 October 2002.
([7]) 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations', OECD, 1995.

of activity of an existing enterprise lest there be any risk of confusion between their own activities and those of the principal enterprise. Lastly, logistics centres constituting a branch of activity may not be attached to a holding company, but they may be attached to a headquarters.

(11) The circular stipulates that headquarters and logistics centres must be entities liable to corporation tax in France. Under ordinary tax law, economic entities are liable to corporation tax where they take the form of companies established in France or of permanent establishments in France of foreign companies, but they are not separately liable to tax where they are simply branches of activity of domestic companies.

(12) The activities of headquarters and logistics centres must depend on an international group controlled from France or from abroad. The circular points out that the scheme is reserved exclusively for functions performed on behalf of enterprises within the group. If headquarters or logistics centres supply services to enterprises outside the group, the corresponding profits must be determined in accordance with ordinary law. The circular states that French or foreign companies placed under the same French or foreign control are to be considered as belonging to one and the same group in accordance with the conditions of ordinary tax law.

(13) Apart from this restriction concerning the international character of the group, the scheme is not limited to certain specific sectors of the economy or to certain areas of France. The circular indicates that headquarters and logistics centres must supply services predominantly to companies whose registered office is outside France or to establishments of companies within the group situated outside France. It states that this condition is met where the total amount of current operating expenditure corresponding to services supplied by the headquarters or logistics centre to companies or permanent establishments within the group situated abroad accounts for more than half of the total amount of current operating expenditure.

(14) As regards eligible activities, both headquarters and logistics centres may carry on a wide range of activities, which are listed non-exhaustively in the circular. In general, although it is only activities on which it is difficult to place a commercial value owing to their group-specific nature that are eligible, these activities consist in the supply of services being in the nature of economic activities for the associated beneficiaries, and correspond to:

— administrative functions such as management or control functions, and

— the supply of services being essentially of a preparatory or ancillary nature and not constituting directly productive functions.

(15) As regards headquarters, the circular refers, *inter alia*, to administrative services and data processing services relating to the internal administration of the group; human resource services such as personnel management, training and the development of pay or pay management systems; and communication or public relations services.

(16) As regards logistics centres, the circular refers, *inter alia*, to the functions of storage, packaging, labelling or distribution of raw materials, supplies, finished products or goods; the administrative activities linked to these functions; warehousing and management of the packaging of raw materials, supplies, finished products or goods; and the transport and delivery of these goods to companies within the group.

(17) The circular states that, in view of the nature of the services supplied and the status of the recipients of those services, being entities not taxable in France but belonging to the same group, headquarters and logistics centres may obtain from the tax authorities an assurance that the amount of their profits liable to corporation tax will not be called into question if they determine it on the basis of one profit margin for all the activities that are covered by the functions of a headquarters and logistics centre.

Method of calculating taxable profit

(18) The amount of taxable profit is calculated by applying the mark-up to the amount of current operating expenditure in accordance with the cost-plus method. Inasmuch as the calculation method used is based on the relevant OECD recommendations, France considers that it makes it possible to ensure compliance with the arm's length principle which normally prevails between independent economic entities and that it is justified by the nature of the rules governing the international taxation of cross-border profits.

(19) In fact, according to the circular, the tax base determined by the cost-plus method is considered to

reflect the profit likely to be earned under arm's length conditions, and consequently the authorities' approval is subject to the condition that headquarters and logistics centres invoice their services on the basis of cost plus the profit margin set. The circular goes on to state that any over-invoicing will result in a finding of an additional result subject to corporation tax in accordance with ordinary tax law. Any under-invoicing will constitute a hidden advantage for headquarters and logistics centres and a presumed distribution of income to the beneficiaries which would lead to the application of distribution tax. Otherwise, the method of fixing the taxable profit applied by the scheme has no impact on the taxation of financial products not involving pursuit of the activities of headquarters and logistics centres, such as the income from securities and the capital gains or losses resulting from the sale of fixed assets.

(20) According to the circular, the mark-up will be set on a case-by-case basis separately for headquarters and for logistics centres and in the light of the characteristics of the particular activity and of the context in which it is pursued, at the level which best corresponds to the profit which would have been achieved by an independent enterprise under arm's length conditions. In particular, the mark-up will be low if the activities carried on are purely administrative and higher if the activities are strategic in nature. The tax authorities can take account, in setting the mark-up, of the nature of the jobs needed to perform the tasks of headquarters and logistics centres. The employment of highly skilled staff will give rise to the application of a higher mark-up than the employment of low-skilled staff.

(21) The mark-up set is not cast in stone for the lifetime of headquarters and logistics centres but may be modified in the light of changes in the nature or context of the activities which the beneficiary is required to declare to the tax authorities as from the financial year in which the changes occur. According to the circular of 11 October 2002, and as from 1 January 2003, the mark-up must be determined afresh as part of a systematic review of the approval every three to five years.

(22) According to the circular, the operating expenditure that is taken into account in calculating the taxable profit is determined in accordance with the ordinary law rules on corporation tax. This expenditure corresponds to the miscellaneous expenses incurred during the financial year as registered on the debit side of the taxpayer's revenue and expenditure accounts, and includes interest payments and amortisation. However, operating expenditure does not include:

— disbursements which are reimbursed to headquarters and logistics centres under the conditions laid down by the ordinary law scheme provided for in Article 267 II-2 of the General Tax Code. Such disbursements must be occasional and incidental in nature and must not come within the traditional area of activity of headquarters and logistics centres. They are regarded as incidental if the amount does not exceed 10 % of current operating expenditure excluding disbursements. Above this percentage, disbursements are included in expenditure,

— subcontracted activities, provided that the expenditure in respect of these activities represents less than half of the operating expenditure excluding subcontracting. From an example given in the circular, the Commission has learnt that, where this exclusion from the tax base is applicable, that part of the subcontracting expenditure which does not exceed half of the operating expenditure excluding subcontracting is deducted from the base subject to application of the mark-up. The inclusion of subcontracting expenditure in the basis for calculating taxable profits is therefore limited to the part exceeding 50 % of current operating expenditure excluding subcontracting.

Annual flat-rate tax

(23) As regards the annual flat-rate tax (imposition forfaitaire annuelle — IFA), headquarters and logistics centres are taxable only on the amount laid down for the first bracket of the IFA scale fixed by Article 223 septies of the General Tax Code. The amount of the IFA depends on the amount of turnover plus financial income. The first tax bracket is EUR 750 and relates to turnover plus financial income between EUR 76 000 and EUR 150 000. The last IFA tax bracket is EUR 30 000 and relates to turnover plus financial income greater than EUR 75 million. The IFA tax brackets between EUR 750 and EUR 30 000 are not applicable to beneficiaries under the scheme.

(24) The IFA must be paid to the State by 15 March of the financial year in question. The payment is therefore only a part payment towards one of the payments subsequently due for the current year or the following two years ([8]). Consequently, an exemption from the IFA which is not set against corporation tax for the three consecutive years is equivalent to total exemption from the tax. Exemption from payment of the IFA for a

([8]) If, for example, a company paid the IFA on 15 March 2003, it may set this sum against one of the part payments or the balance due in either 2003, 2004 or 2005. After that date, the tax becomes definitively due to the Treasury.

shorter period, because the tax due during the three-year period exceeds the IFA part payment, constitutes a mere tax deferral.

III. GROUNDS FOR INITIATING THE PROCEDURE

(25) In opening the formal investigation procedure ([9]), the Commission considered that the measure might constitute State aid as it seemed to meet the four cumulative criteria under Article 87(1) of the Treaty. In particular, the Commission identified the following three potential aid elements:

— firstly, certain costs borne by headquarters and logistics centres are not taken into account in calculating taxable profit according to the cost-plus method,

— secondly, the partial exemption from the IFA from which headquarters and logistics centres benefit seems to result in lower taxation than under the ordinary law,

— thirdly, the authorities' room for manoeuvre in setting the mark-up applicable in the cost-plus method may favour certain enterprises or groups.

(26) Lastly, as part of its preliminary assessment, the Commission considered that none of the derogations in Article 87(2) and (3) of the Treaty applied to the scheme.

IV. COMMENTS FROM INTERESTED PARTIES

(27) The American Chamber of Commerce in France (hereinafter called the American Chamber of Commerce) considers that the scheme does not confer any financial advantage on beneficiaries and that, for the following reasons, it cannot constitute aid:

(28) firstly, the American Chamber of Commerce considers that the only advantage that the scheme confers on beneficiaries is that of enabling them to have prior knowledge of the method for determining the applicable taxable income. Consequently, the scheme is akin to a unilateral prior transfer pricing agreement between the taxpayer and the tax authorities, constituting an administrative practice encouraged by the OECD;

(29) secondly, the fact that the costs relating to disbursements and subcontracting expenditure are partially taken into account in the basis for applying the cost-plus method is in keeping with the strictest application of the OECD rules on transfer pricing, which requires even the total exclusion of such costs, notably where the international intra-group transactions concerned take the form of supplies of services. As far as subcontracting expenditure is concerned, the American Chamber of Commerce considers that the inclusion of such expenditure in the basis for applying the cost-plus margin does not correspond to economic reality for an intermediary in France. Such inclusion would give rise to problems of tax deductibility for the group company benefiting from the service in view of the unjustified application of a margin to the subcontracting expenditure potentially deductible by the latter;

(30) thirdly, the American Chamber of Commerce considers that the IFA is not a definitive tax as it is credited towards the corporation tax due during the two years following application of the IFA. Where this latter tax base, once the 33 1/3 % corporation tax rate is applied, determines a result greater than EUR 750, an entity benefiting from the scheme is obliged to pay the higher definitive tax and hence this IFA ceiling will have no impact. The IFA ceiling provided by the scheme does not therefore have a decisive impact as an advantage;

(31) lastly, the American Chamber of Commerce considers that the French tax authorities are particularly rigorous and strict when it comes to negotiating and determining the mark-up applicable to operations carried out by headquarters and logistics centres and that, consequently, no advantage lies in the methods of setting the mark-up involved in applying the cost-plus method. In particular, the American Chamber of Commerce confirms the application of paragraph 36 of the circular, according to which 'the mark-up shall be set on a case-by-case basis in the light of the characteristics of the headquarter's activity and of the context in which it is pursued, at the level which best corresponds to the profit that would have been achieved by an independent enterprise under arm's length conditions'.

(32) At all events, the American Chamber of Commerce points to the legitimate expectation of its members, who have benefited from the scheme in the certain knowledge that the transfer prices charged corresponded to arm's length prices.

V. COMMENTS FROM FRANCE

(33) In its comments, France challenges the categorisation of the headquarters and logistics centres scheme as aid, arguing that it fulfils none of the four criteria in Article 87(1) of the Treaty.

([9]) See footnote 1.

Absence of an advantage

(34) France considers that the correspondence between the taxation applied to headquarters and logistics centres and that applicable to entities acting entirely independently excludes the presence of any advantage. It must be borne in mind that the arm's length principle has to be applied in situations involving international transactions between associated enterprises, and that it is therefore this principle that is the general rule for determining whether the taxable profits of a firm acting in the intra-group context are calculated more advantageously. France considers that the method applied for determining the taxable profits of headquarters and logistics centres corresponds to that which, according to the OECD, makes it possible to obtain the arm's length price. Moreover, the OECD considers the cost-plus method to be the most appropriate where the controlled transactions taken into account are supplies of services.

(35) As regards the exclusion of disbursements and subcontracting expenditure from the basis for calculating taxable profits, France observes that, in order to be excluded from this basis, such costs must be occasional and incidental in nature, i.e. wholly independent of the exercise of the normal functions of a headquarters or logistics centre. The difference in threshold for subcontracting expenditure (50 % of current operating expenditure excluding subcontracting) compared with disbursements (10 % of operating expenditure excluding disbursements) is justified by the need to make the scheme reflect economic reality as closely as possible and to distinguish between the activities of headquarters or logistics centres and those of agents (disbursements) or intermediaries (subcontracting). With regard more particularly to subcontracting expenditure, France considers that, if the scheme had followed the OECD's recommendations on application of the cost-plus method to the activities of agent or intermediary, it might have been more advantageous. The OECD advocates either the exclusion, without any ceiling, of subcontracting expenditure from the tax base, or the application of a lower rate to such expenditure and to that part of the current operating expenditure which is related thereto. According to France, the solution adopted by the circular is less favourable than that advocated by the OECD in its determination of the arm's length price, and therefore the French measure cannot constitute an advantage.

(36) As regards the setting of the mark-up permitting application of the cost-plus method, according to France it is effectively determined on a case-by-case basis and is adjustable every three to five years at the most. However, the authorities do not enjoy any room for manoeuvre capable of favouring certain enterprises owing to the fact that the setting of the rate is actually carried out in general on a case-by-case basis in the light of changes in the nature or context of the pursuit of the activities and as from the financial year in which those changes occur. Moreover, as a result of the mark-up being set on a case-by-case basis, the taxation of headquarters and logistics centres in fact more closely resembles that deriving from the application of the arm's length principle, which is the standard applicable to all intra-group transactions.

(37) As regards the limitation of the IFA to the first bracket of the scale fixed by Article 223 septies of the General Tax Code, France considers that this limitation confers no advantage as the IFA is no more than an advance on the corporation tax owed by beneficiaries and is ultimately borne by enterprises only if they are in deficit, a situation which would not arise in the case of headquarters and logistics centres. These are in principle always subject to corporation tax through the application of the cost-plus method, which makes it possible to determine their taxable profits as a surplus on top of their gross operating expenditure. Application of the advances system constituted by the IFA represents at the most an advance payment which, for ordinary companies, is larger than for headquarters and logistics centres. In view of the fact that the maximum amount of the IFA is EUR 30 000, any cash flow advantage stemming from exemption from the IFA is negligible.

(38) As regards the fact that application of the cost-plus method enables taxpayers to know in advance how much tax they owe and to avoid any disputes with the tax authorities, this cannot, in France's opinion, be considered an advantage because disputes are avoided only if the conditions of the cost-plus method are met and hence if the tax base of headquarters and logistics centres is determined in accordance with the arm's length principle. Therefore, according to France, if the application of this principle constitutes an advantage compared with the analytical determination of the tax base as provided for under the ordinary law, that advantage is justified by the nature and general scheme of the French tax system, complying as it does with the OECD's recommendations regarding the taxation of supplies of services between controlled enterprises. In fact, the scheme promotes the removal of uncertainty in the application of corporation tax in an international intra-group context in accordance with the OECD's recommendations on the conclusion of prior transfer pricing agreements.

Absence of State resources

(39) According to France, the scheme merely safeguards the resources of the State as the alternative method which is

applied makes it possible to effectively tax activities which would otherwise be completely missed by corporation tax in France. It is thanks to this scheme that France obtains tax revenues from certain activities which, in France's view, are not normally likely to give rise to marketing to third parties and hence are not determinable in any way.

Absence of effect on competition and trade

(40) In France's view, the scheme is not likely to affect competition and intra-Community trade as the services which benefit from the measure are, by definition, 'non-externalisable' and hence extra-market. With regard more particularly to logistics centres, France considers that their activities do not add any value to the products they serve.

Absence of selectivity

(41) Lastly, in France's view, the scheme is not selective as it is a general tax policy measure open to all economic sectors and all international groups controlled from both France and abroad. The fact that the scheme is directed exclusively at international operations is justified because these operations alone are faced with the problem of transfer prices and the risk of double taxation. In fact, the measure is not selective because the special determination of prices between associated enterprises covered by the scheme has no fiscal impact for other enterprises which do not do business at the international level.

(42) Lastly, the measure is open to all economic operators supplying, in whatever legal form, international intra-group services ancillary to production and marketing activities and is therefore not selective.

VI. ASSESSMENT OF THE MEASURE

Introduction

(43) After considering the comments from France and from the interested parties, the Commission adheres to the position it took in its letter of 11 July 2001 ([10]) opening the formal investigation procedure. It considers that the observations submitted by France and the other interested parties have not removed the doubts expressed. It accordingly takes the view that certain aspects of the tax scheme scrutinised constitute unlawful operating aid which is incompatible with the common market.

Advantage

(44) France and the interested parties invoke the absence of any advantage linked to recourse to a flat-rate taxation method based on determination of the taxable profit in accordance with the arm's length principle. Where, in a multinational context characterised by differences in the actual level of taxation between the various countries concerned, associated enterprises carry out transactions with one another, their commercial relations and hence their accruing profits are theoretically liable to manipulation by the taxpayer because they involve the same economic interest. Consequently, the national tax authorities concerned may unilaterally correct the taxable profits of these taxpayers and hence determine a heavier taxation or a double taxation of the relevant transactions. In France's view, inasmuch as the aim of having recourse to the cost-plus method is to eliminate double taxation, the scheme does not confer any advantage.

(45) It should be pointed out first of all that the French tax system does in fact comply with the arm's length principle as regards the determination of taxable profits in international transactions between controlled enterprises, both at the level of domestic law, under Article 57 of the General Tax Code, and at that of the bilateral double taxation treaties concluded by France with its partner countries. In particular, Article 57 of the General Tax Code provides for a tax adjustment procedure 'to establish the income tax payable by enterprises which are dependent on or which control enterprises situated outside France' with regard to 'profits indirectly transferred to the latter, either by increasing or by reducing purchase or selling prices or by any other means'. In this case, profits which do not comply with the arm's length principle 'shall be included in the results as shown in the accounts' of the French enterprises concerned. Article 57 also specifies that, in the absence of specific evidence to support such adjustment, 'taxable profits shall be determined by comparison with those of similar, normally operated enterprises'. The double taxation treaties concluded by France make it possible, for their part, to make comparable adjustments as regards the profits accruing in commercial relations between related enterprises established in the contracting States, in accordance with the arm's length principle set forth in Article 9 of the

([10]) See footnote 1.

OECD Model Convention. The Commission would point out in this connection that the cost-plus method used to determine the taxable profits of headquarters and logistics centres forms part of the traditional methods listed by the OECD in its report on transfer pricing.

(46) The Commission considers that the nature of the services supplied by headquarters and logistics centres makes it difficult to determine directly their taxable profits in France and that the application of an indirect method of determining taxable profits is therefore justified. This method takes the form of an estimate involving the setting of the gross profit margin which one of the parties to a transaction between associated enterprises has sought by way of payment and which the other party has considered acceptable under arm's length conditions for the performance of comparable functions. Moreover, the determination of the mark-up within the framework of the application of the cost-plus method, via a prior agreement valid for a whole series of indeterminate economic transactions, constitutes a method of applying the arm's length principle strongly encouraged by the OECD. In conclusion, the Commission confirms its position according to which it has no objections of principle either to the cost-plus method or to the prior agreements for the setting of the mark-up relating to intra-group transactions used by France in the scheme under scrutiny.

(47) The Commission notes, moreover, that neither France nor the other interested parties contest the fact that the taxable profits accruing to headquarters and logistics centres are not actual but simply estimated. Lastly, the possibility of obtaining prior approval from the authorities covering the rate of return on an indefinite and potentially large number of transactions constitutes special treatment compared with the analytical determination of profits. It is therefore necessary to examine in detail the specific application by France of this method of taxation.

Setting of the mark-up

(48) As regards the setting of the mark-up, it should be pointed out that, according to the circular, the scheme concerns only 'activities on which it is in practice extremely difficult to place a commercial value owing to their group-specific nature' ([11]). In fact, the activities to which the circular refers concern functions which are 'essentially of a preparatory or ancillary character and which do not therefore constitute directly productive functions' ([12]). On the other hand, the Commission considers that the activities to which the circular refers are very varied and may well have a fairly considerable commercial value. By way of example, reference may be made to 'strategic services' or 'research and development services', as mentioned in the circular. In particular, it should be pointed out that these services constitute not only economic activities but also commercial activities which potentially account for a significant fraction of the overall added value produced by a multinational group. Lastly, the fact that certain activities of headquarters and logistics centres may be subcontracted bears witness to the commercial nature of those operations.

(49) The Commission considers that the application of the cost-plus method and the prior setting of the rate of return for all the activities carried on by a headquarters responsible for these strategic or research and development services for a period of three-five years may give rise to a different calculation from that resulting from an analytical determination. It takes the view, that, for want of other methods, this differential treatment is necessary in order to determine the transfer price for transactions between associated enterprises where a direct estimation of the price compared with that charged in similar transactions between independent enterprises would be inappropriate. This method is therefore justified by the nature of the French tax system within the meaning of point 23 of the Notice.

(50) The Commission must also verify whether the methods of determining the margin are such as to leave the tax authorities a degree of discretion. In the light of the comments submitted by France and the interested parties, it would appear that the mark-up is effectively set on a case-by-case basis by reference to the characteristics of the activities actually carried on by the taxpayer and of the context in which they are carried on. The evidence in the Commission's possession does not therefore support a finding that the authorities' room for manoeuvre in setting the mark-up usable in the cost-plus method may have been used to favour certain enterprises or groups. Lastly, the Commission takes note of the amendment to the circular, introduced after the formal investigation procedure was opened, providing for a systematic review, at the latest every three to five years, of agreements in the light of changes in the conditions under which the activities of headquarters and logistics centres are carried on. It must therefore be concluded that the determination of the mark-up under the scheme does not confer any advantage on headquarters and logistics centres or on the groups to which they belong.

([11]) See paragraph 13 of the circular.

([12]) See paragraph 56 of the circular.

Disbursements and subcontracted activities

(51) With regard to the non-inclusion of disbursements in the cost-plus method, the Commission considers that, while these activities may in fact be of an occasional and ancillary nature, they are nevertheless significant owing to the fact that the ceiling of 10 % of current operating expenditure excluding disbursements may correspond to substantial amounts. It takes the view, however, that the decisive factor when it comes to eliminating any supposition of advantage is the fact that, in order to be excluded from the expenditure base for the cost-plus method, and hence from the tax base, disbursements must fulfil the common conditions set out in Article 267 II-2 of the General Tax Code. That article excludes from the tax base for corporation tax purposes 'sums reimbursed to intermediaries … who carry out expenditure in the name and on behalf of their principals in so far as those intermediaries are answerable to their principals, enter the expenditure in suspense accounts and provide the tax authorities with proof of the nature and exact amount of the expenditure'. The fact that the scheme under scrutiny and the ordinary law rule are the same makes it possible to rule out the existence of an advantage over the arrangements for the analytical determination of taxable profits. In the latter case, activities relating to disbursements would not give rise to any taxable profits.

(52) With regard to the exclusion of subcontracted activities from the method for calculating taxable profits under the conditions referred to above, it should be pointed out that the OECD transfer pricing principles advocate, in such cases involving application of the cost-plus method, either applying a margin only to the costs inherent in the exercise of the function of agent or intermediary or reducing the mark-up to be applied to all the costs of the services. Although in this connection the OECD report gives an example whereby it is considered appropriate for an associated enterprise which bears costs on behalf of another associated enterprise to pass on these costs to the latter without applying a margin, this example does not prevent the Commission from remarking that, in such situations, it must be ensured that all the advantages enjoyed by the beneficiary are correctly taken into account so as to make the determination of the taxable profit comply with the arm's length principle.

(53) It must be concluded that France applies systematically the exclusion of expenditure relating to subcontracting activities without evaluating on a case-by-case basis whether it might not be appropriate to apply a specific mark-up to the activity of intermediary or whether an alternative solution involving reducing the mark-up for all the activities might be envisaged. If, on the one hand, reducing the mark-up determines lower taxable profits, on the other hand, extending the basis for applying the mark-up produces a larger taxable profit. The Commission finds that the exclusion of subcontracting expenditure cannot be justified in so far as, beyond the limit of 50 % of the total excluding subcontracting expenditure, subcontracting activities are again taken into consideration in the calculation of the tax base. Lastly, the Commission considers that the ceiling of 50 % of total expenditure excluding subcontracting may represent a considerable amount of revenue which systematically escapes taxation.

(54) As indicated in point 9 of the Notice, the advantage may be provided through a reduction in the tax burden. The Commission would observe that not all costs borne by headquarters and logistics centres are taken into account in calculating taxable profit according to the cost-plus method. This exclusion is liable to constitute a reduction in the tax burden within the meaning of point 9 of the Notice.

IFA

(55) With regard to the exemption from the annual flat-rate tax (IFA) forming part of the scheme, the Commission agrees with France's argument that any advantage would be limited to situations in which headquarters and logistics centres do not generate tax amounting to more than EUR 30 000. Although it is difficult to assess the impact of the limited application of the IFA (exclusively to its first bracket) in a system such as that of the scheme under scrutiny, which fixes tax revenue presumptively, this does not prevent the Commission from observing that beneficiaries' turnover can be determined autonomously and objectively in relation to the eligible expenditure of headquarters and logistics centres. The partial exemption from the IFA granted by the scheme therefore constitutes, as France acknowledges, an advantage which may take the form of a tax deferment. The IFA paid is deductible from corporation tax and headquarters and logistics centres are still liable for that tax as use of the cost-plus method still implies the existence of a taxable profit. However, where the IFA avoided under the scheme is higher than the amount paid by way of corporation tax, this difference during the course of a tax year involves a tax deferment. In addition, and as already indicated in recital 23, the Commission cannot rule out that the partial exemption from the IFA may constitute a definitive tax exemption where such tax deferment is repeated during three consecutive years.

(56) The fact that the amounts in question are modest does not suffice to rule out the existence of an advantage within the meaning of Article 87(1) of the Treaty. France has not furnished any evidence to show that the conditions of application of the *de minimis* rule as laid down by Commission Regulation (EC) No 69/2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid ([13]) are complied with in the present case, notably as regards the sectors excluded from that rule and the limits on cumulation.

Conclusions on the advantage

(57) It must be concluded from the above that both the non-inclusion of subcontracting expenditure and the exemption from the IFA constitute advantages for beneficiary enterprises and the groups to which they belong.

State resources

(58) In the present case, the reduction in the amount of tax, whether it stems from a reduction in the tax base or from a reduction in the amount of the IFA, leads to a reduction in tax revenue, which is a State resource.

(59) France's argument that tax revenue is increased as a result of the scheme is immaterial as, in its assessment, the Commission must refer exclusively to the resources from which the State would benefit if the taxation of headquarters and logistics centres were determined under the conditions of ordinary law.

Effect on competition and trade between Member States

(60) Since the scheme is a scheme of direct taxation which is in principle open to all sectors of activity connected with production and commerce, the Commission cannot rule out that some beneficiary enterprises and the groups to which they belong may be active in sectors where intra-Community trade is intense. The possibility of an effect on trade through the application of this flat-rate tax scheme cannot be excluded.

(61) Secondly, in accordance with the case-law of the Court of Justice of the European Communities ([14]) and as stated in point 11 of the Notice, 'The mere fact that the aid strengthens the firm's position compared with that of other firms which are competitors in intra-Community trade is enough to allow the conclusion to be drawn that intra-Community trade is affected'.

(62) Lastly, the fact that the scheme in question applies in a multinational context is a strong indication that it may influence inter-State economic activities and therefore distort competition at European level.

Selectivity and justification by the nature or general scheme of the system

(63) According to France, the scheme is not selective as it is a general tax policy measure open to all economic sectors, all geographic areas and all legal forms.

(64) The Commission does not dispute that the scheme is open to all sectors of the economy irrespective of their geographic location or legal form, but it considers none the less that this does not suffice to rule out the selective character of the measure.

(65) Firstly, the measure is limited to supplies of services which correspond to the functions of management, administration, coordination or control and to activities preparatory or ancillary to productive or commercial functions performed in the context of an international group. Directly productive or commercial activities and activities not taking place in the context of an international group are therefore excluded. Only the former activities are therefore capable of benefiting from the advantages identified.

(66) Secondly, the benefit of the scheme is limited exclusively to headquarters and logistics centres which provide their services predominantly to associated companies situated outside France. The Commission would observe that entities which do not provide their services predominantly to associated companies located outside France are excluded from the benefit of the measure. This predominance condition must be viewed in the light of the ratio between the total amount of current operating expenditure corresponding to services supplied by the entities in question to group companies whose registered office is situated outside France or to permanent establishments of group companies situated outside France and the total amount of current operating expenditure corresponding to all services

([13]) OJ L 10, 13.1.2001, p. 30.
([14]) Case 730/79 Philip Morris Holland BV v Commission [1980] ECR 2671.

supplied to all beneficiaries whether established or not in France. Thus, entities established in France but not satisfying the predominance condition cannot benefit from the advantages of the scheme despite the fact that in their transactions with associated companies or branches situated abroad they must face the same difficulties as headquarters and logistics centres in determining their taxable profits.

(67) Lastly, the fact that logistics centres constituting a department attached to an industrial or commercial branch of activity of an existing enterprise or to a holding company are excluded from the scheme strengthens the selectivity of the measure. France has not presented any arguments in this connection in the course of the procedure. The circular states that this limitation is motivated by the need to avoid any confusion with other activities of the group. However, it is not stated why this limitation does not apply to headquarters.

(68) As regards the possible justification for the differential nature of the scheme, the French authorities have not furnished, as required by point 23 of the Notice, any information explaining to what extent operations carried out by headquarters and logistics centres deserve more favourable tax treatment than entities carrying out the same operations but not satisfying the abovementioned predominance criterion or than logistics centres not attached to an enterprise in France or to a holding company. In the present case, it does not appear that the economic rationale of the measure makes it necessary to the functioning and effectiveness of the tax system ([15]). The measure must therefore be deemed not to be justified by the nature or general scheme of the system, and the Commission confirms its preliminary position on the selective character of the measure.

(69) The Commission would point out, lastly, that subcontracting activities receive different tax treatment above a certain ceiling, which confers a selective character on this differentiated treatment.

Conclusions on the existence of aid

(70) It must be concluded that the measure in question constitutes aid within the meaning of Article 87(1) of the Treaty as the advantages represented by the exclusion of certain expenditure from the basis for calculating taxable profits and the partial exemption from the IFA scheme are not justified by the nature or general scheme of the French tax system.

Compatibility

(71) As stated in the decision to open the formal investigation procedure, the scheme in question does not seem *prima facie* to qualify for any of the derogations laid down in Article 87(2) and (3) of the Treaty. In the course of the procedure, neither the French authorities nor the interested third parties presented any arguments as to a possible compatibility of the scheme with the common market. The Commission's doubts have therefore been confirmed.

(72) The derogations in Article 87(2) of the Treaty, which concern aid of a social character granted to individual consumers, aid to make good the damage caused by natural disasters or exceptional occurrences and aid granted to certain areas of the Federal Republic of Germany, do not apply in this case.

(73) Nor does the derogation in Article 87(3)(a) of the Treaty, which provides for the authorisation of aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, apply, as the scheme in question has unlimited territorial scope.

(74) Similarly, the scheme does not fall into the category of projects of common European interest eligible for the derogation in Article 87(3)(b) of the Treaty, and in so far as it does not seek to promote culture and heritage conservation it cannot qualify for the derogation in Article 87(3)(d) of the Treaty.

(75) The tax advantages granted under the scheme do not qualify for the derogation in Article 87(3)(c) of the Treaty, which authorises aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent that is contrary to the common interest. They amount to operating aid which relieves the beneficiary companies or groups to which they belong of charges that should normally be borne by them.

(76) It must be concluded, therefore, that the scheme is incompatible with the common market.

([15]) See Commission Decision 96/369/EC of 13 March 1996 concerning fiscal aid given to German airlines in the form of a depreciation facility (OJ L 146, 20.6.1996, p. 42).

Recovery

(77) The measure in question has been implemented without ever having been notified to the Commission in accordance with Article 88(3) of the Treaty; it is not covered by prescription and it constituted aid as soon as it came into force. It therefore constitutes illegal aid.

(78) Where illegally granted State aid is found to be incompatible with the common market, the natural consequence of such a finding is that the aid should be recovered from the recipients in accordance with Article 14 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 ([16]). Through recovery of the aid, the competitive position that existed before the aid was granted is restored as far as is possible. Neither the lack of any precedent involving the application of the State aid rules in similar cases nor the alleged lack of clarity of Community policy on State aid justifies a departure from this basic principle.

(79) Nevertheless, Article 14(1) of Regulation (EC) No 659/1999 provides that 'the Commission shall not require the recovery of the aid if this would be contrary to a general principle of Community law'. The case-law of the Court of Justice and the Commission's own decision-making practice have established that where, as a result of the Commission's actions, a legitimate expectation exists on the part of the beneficiary of a measure that the aid has been granted in accordance with Community law, then an order to recover the aid would infringe a general principle of Community law.

(80) In its judgment in Van den Bergh en Jurgens ([17]), the Court ruled:

'The Court has consistently held that any trader in regard to whom an Institution has given rise to justified hopes may rely on the principle of protection of legitimate expectation. On the other hand, if a prudent and discriminating trader could have foreseen the adoption of a Community measure likely to affect his interests, he cannot plead that principle if the measure is adopted.'

France has invoked the existence of a legitimate expectation on the part of the beneficiaries of the scheme without submitting to the Commission any specific argument concerning this approach. However, it follows from the case-law of the Court of Justice ([18]) that the Commission must take into account exceptional circumstances justifying, in accordance with Article 14(1) of Regulation (EC) No 659/1999, non-recovery of aid illegally granted where recovery would be contrary to a general principle of Community law such as respect for the recipients' legitimate expectations.

(81) In the present case, the Commission notes that the French scheme presents certain similarities with the system introduced in Belgium by Royal Decree No 187 of 30 December 1982 concerning the taxation of coordination centres. The two schemes concern intra-group activities and lay down specific rules for determining the tax base. In its Decision SG(84) D/6421 of 16 May 1984, the Commission took the view that the scheme did not give rise to aid within the meaning of Article 92(1) of the Treaty. Even though the decision has not been published, the fact that the Commission did not raise any objection to the Belgian scheme for coordination centres was made public at the time in the Fourteenth Report on Competition Policy and in an answer to a Parliamentary question ([19]).

(82) Under the circumstances, the Commission notes that its decision on the Belgian scheme for coordination centres was adopted before the French scheme was adopted in its present form as set out in the circulars of 21 January 1997 and 11 October 2002. Accordingly, the Commission concludes that the beneficiaries under the scheme had a legitimate expectation that the aid would not be recovered and hence is not requiring recovery.

VII. **CONCLUSIONS**

(83) The Commission finds that certain aspects of the French scheme constitute State aid within the meaning of Article 87(1) of the Treaty and that France has unlawfully implemented the aid in breach of Article 88(3) of the Treaty.

(84) Nevertheless, the position that the Commission has taken in the past with regard to certain tax measures for multinationals may have given rise, on the part of the beneficiaries under the scheme, to the legitimate expectation that the scheme did not constitute State aid. The Commission finds that recovery of the aid would

([16]) OJ L 83, 27.3.1999, p. 1.
([17]) Case C-265/85 Van den Bergh en Jurgens BV v Commission [1987] ECR 1155, paragraph 44.
([18]) Case 223/85 RSV v Commission [1987] ECR 4617.
([19]) See answer to Written Question No 1735/90 (OJ C 63, 11.3.1991, p. 37).

run counter to the general principle of respect for legitimate expectation and, accordingly, has decided not to require recovery of the aid,

HAS ADOPTED THIS DECISION:

Article 1

The exclusion of subcontracting expenditure from the calculation of the tax base and the application limited to the first bracket of the scale of the annual flat-rate tax implemented by France within the framework of the circular of 21 January 1997 of the Directorate-General of Taxes concerning the headquarters and logistics centres scheme constitute State aid which is illegal and incompatible with the common market.

Article 2

France is required to abolish, with effect from the tax period following that under way on the date of notification of this Decision, the following aid elements governed by the circular referred to in Article 1:

(a) the arrangements for applying the cost-plus method as regards the exclusion of certain subcontracting expenditure from the basis for calculating taxable profit;

(b) the arrangements for partial exemption from the IFA.

Article 3

France shall inform the Commission, within two months of notification of this Decision, of the measures taken to comply with it.

Article 4

This Decision is addressed to the French Republic.

Done at Brussels, 13 May 2003.

For the Commission

Mario MONTI

Member of the Commission