

EUROPEAN STATE AID AND W.T.O. SUBSIDIES

Authors

Fanny Karaman
Stanley C. Ruchelman
Astrid Champion

Tags

E.U.
State Aid
Subsidy
World Trade Organization

INTRODUCTION

Recent European Commission (“Commission”) rulings involving Apple and Starbucks¹ and a World Trade Organization (“W.T.O.”) ruling involving E.U. subsidies to Airbus² are viewed by some as evidence of a not-so *sub rosa* trade war between the U.S. and the European Union (“E.U.”). The stated view in the E.U. is that these are two separate developments that should not be linked because one relates simply to fundamental harmony within the internal market of the E.U. and the other regards provisions in global trade agreements designed to settle disputes relating to export subsidies.

This article seeks to explain the basic internal procedures within the E.U. determining and outlawing State Aid. It also explains the global trade agreement embodied in the W.T.O. in connection with export subsidies and other actions designed to promote internal business in one country that harms competitors in other countries. This article concludes by evaluating the European position that State Aid within the E.U. and actionable or prohibited distortion of trade within the context of the W.T.O. are simply separate and distinct actions and that a discriminatory act under the latter cannot be compared with an illegal act under the former.

STATE AID TO STARBUCKS AND APPLE

In the past few years, the Commission has investigated many tax rulings between various companies and E.U. Member States to determine whether the agreements breached E.U. State Aid rules.

Starbucks in The Netherlands

The 2015 *Starbucks* decision addressed a Dutch advance pricing agreement obtained by the Netherlands-based entity Starbucks Manufacturing EMEA BV (“Starbucks Manufacturing”), the only wholly controlled Starbucks group entity (outside the U.S.) that roasts coffee. Starbucks Manufacturing supplied affiliates with roasted coffee. These were identified as controlled transactions for income tax purposes.

To obtain certainty regarding Dutch tax, a ruling was obtained allowing for a margin of between 9% and 12% over total production costs incurred to produce the roasted

¹ Beate Erwin, “Treasury Attacks European Commission on State Aid – What Next?” *Insights* 8 (2016).

² *Id.*; Peggy Hollinger, Shawn Donnan, and Arthur Beesley, “W.T.O. Gives Boeing Lift with Airbus Ruling,” *The Financial Times*, September 22, 2016; Jason Lange, “U.S. Accuses E.U. of Grabbing Tax Revenue with Apple Decision,” *Reuters*, August 31, 2016.

coffee that was sold to affiliates. Because reported profits for financial statement purposes exceeded cost plus 12%, the Dutch tax authority agreed to allow a deduction in the form of a floating royalty payment to another group entity, Alki LP.

Alki LP then reduced its income through payments to the U.S. group under a cost sharing agreement. Alki LP made buy-in payments and annual payments reimbursing the U.S. group for the development of intangible property. Under U.S. practice, Alki LP could use the intangible property without payment of a royalty to the U.S. group. The cost sharing payments simply reduced net costs incurred by the group.

In the view of the Commission, this arrangement was not available to all and distorted the internal market because of the advantage received by Starbucks Manufacturing and Alki LP.

Apple in Ireland

In its most recent *Apple* decision, the Commission ordered Ireland to collect a record €13 billion (\$14.6 billion) in unpaid taxes from Apple, holding that certain Irish tax rulings artificially lowered the tax paid in this country since 1991.³ Apple Ireland recorded most of the profit for Apple's European operations. In turn, Apple Ireland allocated the bulk of its profits (and hence the European profits) to a fictitious "head office" that had no substance, thus essentially allowing Apple to be taxed "nowhere."

SUBSIDIES TO AIRBUS

In its recent *Airbus* ruling, the W.T.O.'s compliance panel report (the "Panel Report") confirms its 2011 Dispute Settlement Board Report (the "D.S.B. Report").⁴ As a result, and in relevant part, several measures provided to Airbus by the European Communities, France, Germany, Spain, and the U.K. were characterized as specific subsidies⁵ causing serious prejudice to the interests of the U.S.

The measures at issue constituted over 300 different allegations of illegal subsidies by the European Communities and the four W.T.O. member states participating in Airbus over a period of approximately 40 years. These measures enabled Airbus to develop and produce large civil aircraft that were sold globally. The principal subsidies can be summarized as follows:

- Launch aid/member state financing provided by France, Germany, Spain, and the U.K. for the development of certain large civil aircraft projects
- Certain equity infusions provided by France and Germany to companies that were part of the Airbus group
- Certain infrastructure measures provided to Airbus (e.g., the lease of land in Germany, the right to exclusive use of an extended runway at a German airport, regional grants by German authorities and government, and regional grants in Spain)

³ See Beate Erwin, "[Apple in Europe – The Uphill Battle Continues.](#)" *Insights 2* (2016), pp. 9-15.

⁴ See organizational chart of the W.T.O. below.

⁵ See below for a definition.



When compared to the aforementioned E.U. State Aid cases, the differences in the type of considered measures are substantial. The E.U. State Aid decisions fight fictitious tax arrangements allowed by certain Member States to specific taxpayers through the grant of a favorable ruling. The W.T.O. ruling condemns measures taken by a government that cause specific damage to another government.

E.U. STATE AID CONTROVERSY

One of the key concepts of the E.U. is its internal single market. The European Single Market seeks to treat the E.U. territories as one territory without any internal borders or other regulatory obstacles that may impede four fundamental principles:⁶

- The free movement of goods
- The free movement of services
- The free movement of capital
- The free movement of persons

The main objective of the European Single Market is to stimulate competition and trade, raise quality, and help cut prices.

In order to create and maintain this single market, the various E.U. Member States, relinquished national sovereignty, in part, to the E.U. This relinquishment was effected principally through the ratification of the Treaty on the Functioning of the European Union (“T.F.E.U.”). While Member States relinquished the four freedoms, mentioned above, other aspects of national sovereignty were retained. Thus, the E.U., through its institutions, may only act within the limits of the grants of authority conferred to it by the Member States.

To further the achievement of the European Single Market, the E.U. State Aid rules were included in the T.F.E.U. These rules are designed to ensure fair and equal market conditions for commercial enterprises active within the various countries that comprise the European Single Market. Article 107 of the T.F.E.U. provides in relevant part that:

Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

The article further provides a list of deemed compatible aids and potential compatible aids.

In a 1998 Notice, the Commission further expanded the definition of State Aid.⁷ It provides the following criteria upon which a measure by a Member State may be viewed to constitute State Aid:

⁶ Article 26 of the T.F.E.U.

⁷ “Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation,” *Official Journal C 384* (1998), pp. 3-9.

“As the Commission is responsible for enforcing the E.U. State Aid rules, it may, on its own initiative, examine information regarding alleged unlawful aid from any source.”

- The recipient of the measure is granted an advantage relieving it of certain charges it may otherwise incur. This advantage may reduce the taxpayer’s tax burden in several ways, including
 - a tax base reduction (such as a special deduction, a special or accelerated depreciation arrangement, or the entering of reserves on the balance sheet),
 - a total or partial reduction in the amount of tax (such as an exemption or a tax credit), and
 - a deferment, cancellation, or even special rescheduling of tax debt
- The advantage must be granted either by the Member State (including its regional or local bodies) or through its resources. Whether that measure is provided for in a given Member State’s tax laws or through the practice of its tax authorities is irrelevant. A loss of tax revenue is equivalent to consumption of Member State resources in the form of fiscal expenditure.
- The measure must affect competition and trade between Member States.
- The measure must be specific or selective in that it favours “certain undertakings or the production of certain goods.”

Article 108(1) of the T.F.E.U. states that “the Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States.” Such review extends to tax measures because Article 107 applies to measures in any form whatsoever.⁸ Thus, although the Member States retain sovereignty in terms of direct taxes, their direct tax systems must be compliant with the E.U. State Aid rules.⁹ As the Commission is responsible for enforcing the E.U. State Aid rules, it may, on its own initiative, examine information regarding alleged unlawful aid from any source.¹⁰

In this area, the Commission operates in several steps. It begins by opening a preliminary investigation. If questions regarding the compatibility of the measure persist, the Commission then carries out an in-depth investigation.¹¹ The decision to initiate the formal investigation procedure is sent to the relevant Member State.

Pursuant to the formal investigation, a final decision is taken. There is no legal deadline to complete an in-depth investigation, and its actual length depends on many factors, including the complexity of the case, the quality of the information provided, and the level of cooperation by the Member State concerned.¹²

Three possible outcomes exist:

- The Commission reaches a favorable decision regarding the measure at issue. The measure is considered not to be aid or the aid is considered to be compatible with the internal market.

⁸ *Id.*

⁹ *Italy v. Commission*, Case 173/73, EU:C:1974:71.

¹⁰ Council Regulation 2015/1589, Article 12.

¹¹ “Competition: State Aid Procedures.” European Commission.

¹² *Id.*

“The main purpose of the W.T.O. is to allow ‘open, fair and undistorted competition’ with regard to goods, services, and intellectual property, to the extent possible.”

- The Commission reaches a conditional decision. The measure at issue is found compatible, but its implementation is subject to conditions stated in the decision.
- The Commission reaches a negative decision. The measure is incompatible with Article 107 of the T.F.E.U. and must be withdrawn retroactively. The Commission, in principle, orders the Member State to recover the State Aid that has already been paid out to the beneficiaries.

The Commission can order the retroactive recovery of unlawful State Aid for a period of up to ten years preceding the Commission’s first action taken with regard to the unlawful aid.¹³ The aim of recovery is to remove the undue advantage granted to a company and to restore the market to its state before illegal State Aid was granted. A Member State is deemed to comply with the recovery decision when the aid (plus compound interest) has been fully recovered.¹⁴ If the relevant Member State does not comply with the decision in due time, the Commission may refer it to the C.J.E.U.¹⁵

W.T.O. PROHIBITION REGARDING SUBSIDIES

The W.T.O. was established on January 1, 1995, as a result of the Uruguay Round of the General Agreement on Tariffs and Trades (“G.A.T.T.”). It is composed of 164 member states as of July 29, 2016.¹⁶ The main purpose of the W.T.O. is to allow “open, fair and undistorted competition” with regard to goods, services, and intellectual property, to the extent possible.¹⁷

The W.T.O. also provides a forum for the settlement of disputes. The W.T.O. settlement procedures are directed at government actions that distort trade. The decisions of the W.T.O. are binding on the governments that are parties to the dispute.

Typical areas of dispute include

- dumping practices, occurring when a company exports a product at a price that is lower than the price it normally charges on its own home market;
- export subsidies; and
- emergency measures that temporarily limit imports to protect domestic industries.

The following organizational chart facilitates the understanding of the W.T.O.’s work:¹⁸

¹³ Regulation 2015/1589, Article 17.

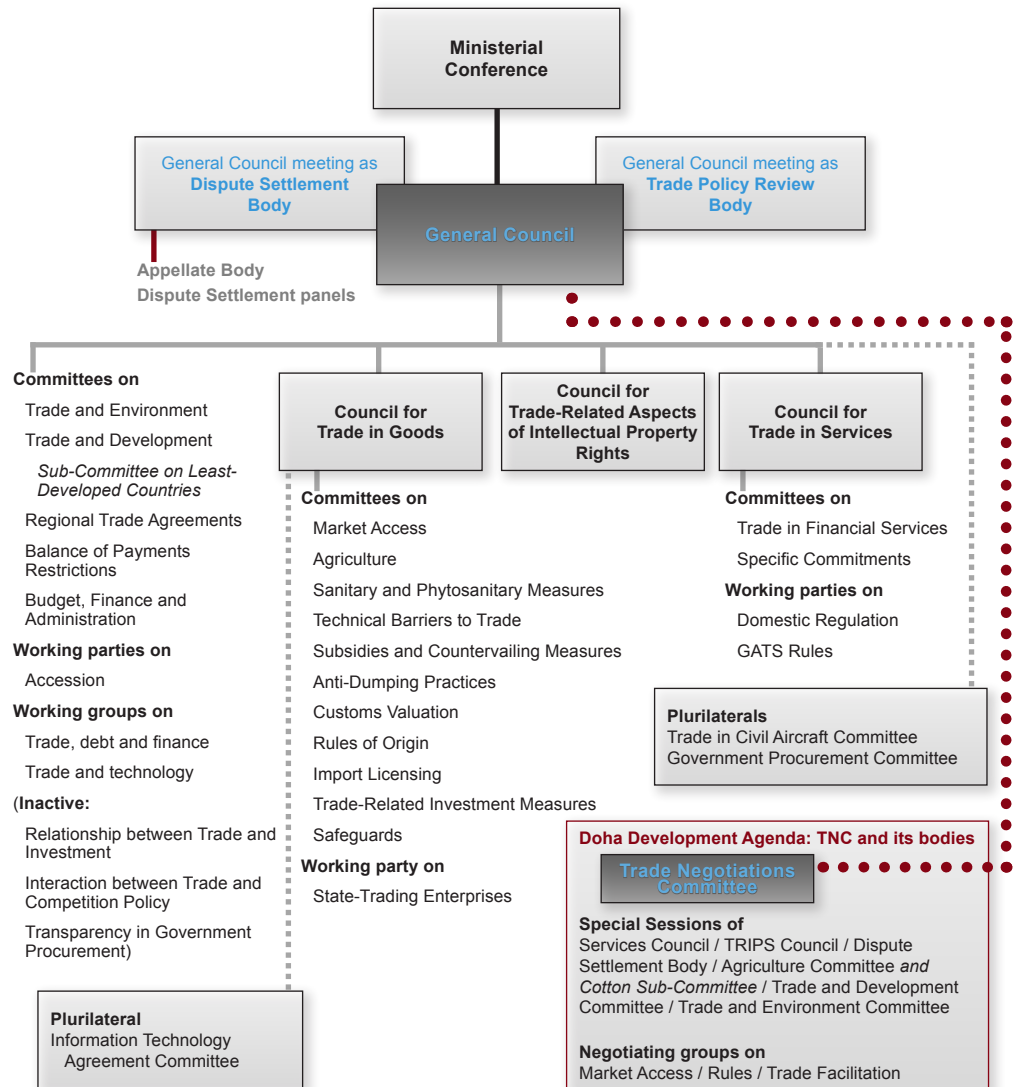
¹⁴ European Commission, “[State Aid: Recovery of Illegal State Aid Gets Faster as Commission Tightens Procedures.](#)” press release, February 18, 2011.

¹⁵ Article 258 of the T.F.E.U.

¹⁶ “[Understanding the WTO – Members.](#)” W.T.O.

¹⁷ *Understanding the WTO*, Fifth Edition, (Geneva: World Trade Organization Information and External Relations Division, 2015), pp. 10, 12, and 23.

¹⁸ “[Understanding the WTO – Organization Chart.](#)” W.T.O.



Of the three main areas of dispute, the balance of this article focuses on the regulation of subsidies and the dispute settlement procedure.

Among the various agreements between the members of the W.T.O. is the Agreement on Subsidies and Countervailing Measures (the “S.C.M. Agreement”), which contains a definition of the term “subsidy.” This definition is composed of three basic elements: (i) a financial contribution (ii) by a government or any public body within the territory of a W.T.O. member state (iii) that confers a benefit. All three of these elements must be satisfied in order for a subsidy to exist.

A financial contribution requires a charge on government funds. It can take the form of any of the following measures made directly or through payments to an intermediary:¹⁹

- A government practice involving a direct transfer of funds (e.g., grants, loans, and equity infusion) or a potential direct transfer of funds or liabilities (e.g., loan guarantees)

¹⁹ Article 1 of the S.C.M. Agreement and Article 16 of G.A.T.T. 1994.



- The relinquishment of government revenue or the failure to collect revenue (as would be the case with a credit or an exemption from tax generally due on domestic sales)
- The provision of goods or services other than general infrastructure by a government or the purchase of goods by a government
- Any form of income or price support that operates, directly or indirectly, to increase exports of any product from or reduce imports of any product to its territory

A subsidy is subject to the terms of the S.C.M. Agreement only if it has been specifically provided to an enterprise or industry or group of enterprises or industries so that it is not broadly available within a given economy. The basic principle is that a subsidy that distorts the allocation of resources within an economy violates the S.C.M. Agreement. In comparison, a subsidy that is widely available within an economy does not distort resources and for that reason is not subject to the S.C.M. Agreement.

Article 2 provides that the following fact patterns involve subsidies that violate the S.C.M. Agreement because benefits are directed to certain enterprises:

- Access to the subsidy is explicitly limited to certain enterprises either by law or by administrative practice.
- The law or the administrative practice for granting the subsidiary does not provide objective criteria for eligibility, or if such criteria exists, the subsidy is not automatic or the administrative practice is not strictly followed.
- There is reason to believe that the subsidy may be specific, based on other factors, such as
 - the subsidy program is used by a limited number of enterprises;
 - the subsidy program is predominantly used by a limited number of enterprises; or
 - the way in which discretion has been exercised by the granting authority.

A subsidy also is subject to the S.C.M. Agreement if it is limited to certain enterprises located within a designated geographical region, or if it targets export goods or goods using domestic inputs.

Once a subsidy subject to the S.C.M. Agreement exists, a determination must be made whether the subsidy is prohibited or actionable. Prohibited subsidies are those that promote exports and those that have local content requirements. Actionable subsidies are subsidies that cause adverse effects to the interests of another member of the W.T.O. Most subsidies fall in this category.

There are three types of adverse effects. First, there is injury to a domestic industry caused by subsidized goods that are imported into the territory of the complaining member state. Second, there is serious prejudice, which usually arises because of adverse effects of the subsidy on the market of the complaining member state or a third country. Third, there is nullification or impairment of benefits accruing under

G.A.T.T., meaning an impairment of market access is presumed to flow from a tariff reduction as a result of the subsidy.²⁰

CONCLUSION

As to procedure, Commission decisions regarding illegal State Aid of an E.U. Member State differs from W.T.O. rulings as to trade disputes that impair global trade.

- The Commission’s rulings on State Aid are binding on the relevant Member State, which then must recover up to ten years in back taxes and interest.
- The W.T.O.’s rulings are based on good faith participation by the W.T.O. member states. Every member will then carefully consider whether a countermeasure, such as the implementation of an import duty, would be the appropriate remedy. No retroactive effect is given to a W.T.O. ruling.

However the goals of Article 107 of the T.F.E.U. to stop actions that distort free trade and those of Article 2 of the S.C.M. Agreement appear to be identical.

PROVISIONS THAT MAY CONSTITUTE STATE AID	PURPOSE OF W.T.O. AGREEMENT; ACTIONABLE & PROHIBITED ACTS
The recipient of the measure is granted an advantage relieving it of certain charges it may otherwise incur.	A benefit conferred by a government or any public body within the territory of a member in the form of a financial contribution.
This advantage may reduce the taxpayer’s tax, which amounts to a loss of tax revenue.	The foregoing of or absence of collection of revenue, for instance tax incentives such as tax credits.
The measure must affect competition and trade between Member States.	Government actions contrary to open, fair and undistorted competition.
The measure must be specific or selective in that it favors certain undertaking.	Access to a subsidy that is explicitly limited to a certain enterprise.

There may be many ways to look at the foregoing similarities between the Commission actions against Apple and Starbucks, and the W.T.O. decision in the *Airbus* case. However, the quantum of similarities in the goals of E.U. principles and W.T.O. principles leads one to question the judgment of the Commission to attack Member States and U.S. companies on the basis of illegal distortion to internal trade, while at the same time turning a blind eye on subsidies granted to European enterprises in a way that distorts a global market.

²⁰ Article 5 of the S.C.M. Agreement.