



# EUROFISCUS NEWSLETTER

Newsletter by Eurofiscus Transfer Pricing Consultants

## Amazon's State Aid problems

In May 2021, the General Court (the "Court") ruled on Amazon's appeal against the European Commission's (the "Commission") decision that Amazon had been granted undue tax benefits worth around €250 million Euros as a result of a tax ruling provided by Luxembourg. These tax benefits were considered to be State Aid by the Commission.

### Amazon's Structure

Amazon's Structure involved two companies, both incorporated in Luxembourg and fully owned by their American parent company:

1. **Amazon Europe Holding Technologies SSC:** the holding company ("SSC") acts as an intermediary between the operating company and Amazon in the US, licensing the Group's Intellectual Property to Amazon EU and receiving remuneration in the form of royalty payments in return. SSC was also in a cost-sharing agreement with its parent company for the purpose of further developing the IP.
2. **Amazon EU Sàrl:** the operating company (the "OpCo"), responsible for running Amazon's retail business in Europe. Amazon set up their sale operations in Europe in such a way that customers buying on any of their websites in Europe were considered to buy from the OpCo, thereby allowing Amazon to consolidate all of its European profits in Luxembourg.

The tax ruling in question was provided by Luxembourg to Amazon in 2003 and prolonged in 2011. It endorsed the application of the transactional net margin method ("TNMM") to determine the level of OpCo's annual royalty to be paid to SCS in return, using OpCo as the tested party. Under Luxembourg's tax laws, the operating company was subject to corporate taxation in Luxembourg, while the holding company was not. Instead, only the shareholders located in America were liable to tax, which they were able to defer indefinitely. According to the Commission, this tax ruling meant Luxembourg had provided Amazon with State Aid, as the same benefits derived thereunder were not available to other companies.

*pictured below: the Amazon Structure as portrayed by the European Commission*



### The Commission's Argument

The crux of the Commission's argument was largely based on the premise that Amazon and Luxembourg had chosen the wrong transfer pricing method / misapplied the transfer pricing method chosen.

Specifically, the Commission presented the following arguments:

1. That according to their own functional analysis:
  - a. The tested party should have been SSC rather than the OpCo, as SSC was the least complicated party. According to the Commission, SSC was merely a 'passive holder' of the intangibles - a term uniquely drawn from the 2017 OECD Guidelines - and further justifying this conclusion with an analysis of the DEMPE functions performed by SSC - a concept also introduced in the 2017 OECD Guidelines.
  - b. The remuneration SSC received should have been significantly lower, as SSC only had the right to a recharge of the pass-through costs it bore in relation to the Intellectual Property, plus a markup of 5% on a cost-base consisting solely of the costs incurred for the external services acquired to maintain its legal ownership of the IP.
2. That the correct transfer pricing method was the Profit Split Method, rather than the Transactional Net Margin Method - as the Profit Split Method would have led to a more accurate remuneration given OpCo's unique and valuable contributions.
3. That the profit level indicator should have been based on total costs, as it was used in the 2003 Transfer Pricing Report prepared by Amazon, rather than on the Berry ratio (gross profit divided by operating expenses) used in the Tax Ruling. According to the Commission, by basing it on the Berry ratio, it led to lower taxable income.
4. That installing a tax ceiling on the remuneration OpCo could receive on its annual sales was not economically justified and conferred a clear tax advantage to Amazon.

## The Court's Ruling

The Court made a number of notable decisions in its ruling.

**First, that the Commission had, in its use of the 2017 OECD Guidelines, relied on concepts that did not apply retroactively.** Aside from its use of then non-existent terms such as DEMPE and passive holdership, the Commission's functional analysis was also flawed in its application of the tested party concept, as the 1995 OECD Guidelines indicate that the party owning unique and valuable assets should not be used as the tested party for applying the TNMM. Since the Commission did not prove that there were comparables for SSC, the intangibles owned by the holding company were by definition unique and valuable. Nor did the Commission prove that it was easier to find comparables for SSC than it was to find comparables for the OpCo. As such, the Court ruled that Luxembourg was right to accept OpCo as the tested party.

**Second, that the Commission had not adequately justified that the methodological errors it had encountered would actually lead to non-arm's length price.** To do so, the Commission would not only have to prove that there was a difference in remuneration caused by Amazon's choice of transfer pricing method and profit level indicator, but actually calculate the impact that choice had on Amazon's tax burden.