

COMMISSION

COMMISSION DECISION

of 16 October 2002

on the State aid scheme C 49/2001 (ex NN 46/2000) — Coordination Centres — implemented by Luxembourg

(notified under document number C(2002) 3740)

(Only the French text is authentic)

(Text with EEA relevance)

(2003/501/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) In 1997 the Ecofin Council adopted a code of conduct on direct business taxation with a view to putting a stop to unfair practices in this area ⁽²⁾. Further to the undertaking contained in the code, the Commission in 1998 published a notice on the application of the State aid rules to measures relating to direct business taxation ⁽³⁾ (hereinafter referred to as 'the notice'), in which it reaffirmed its determination to apply those rules rigorously and in accordance with the principle of equality of treatment. This procedure is covered by that notice.

(2) By letter of 12 February 1999 (D/50716), the Commission asked Luxembourg for information concerning the Luxembourg scheme for coordination centres. By letter

of 26 March 1999 (A/32604), the Luxembourg authorities informed the Commission that the scheme had been withdrawn on 20 February 1996.

(3) By letter of 25 April 2000 (D/51738), the Commission asked for further information in view of the fact that, although it had been withdrawn, the scheme might have produced effects and/or still be producing effects. The information was supplied to the Commission by letter from the Luxembourg authorities dated 10 May 2000 (A/34012).

(4) By letter SG (2001) D/289761 of 11 July 2001, the Commission informed Luxembourg that it had decided to initiate the formal investigation procedure laid down in Article 88(2) of the EC Treaty in respect of the tax scheme for coordination centres. By letter of 14 September 2001 (A/37236), Luxembourg submitted its comments concerning the Commission's decision.

(5) The Commission decision to initiate the procedure was published in the *Official Journal of the European Communities* ⁽⁴⁾. The Commission invited interested parties to submit their comments on the measure. It received no comments from interested parties.

(6) By letter of 25 March 2002 (D/51316), the Commission asked Luxembourg for further information, which was provided by letter of 17 April 2002 (A/32897).

⁽¹⁾ OJ C 304, 30.10.2001, p. 10.

⁽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

- (7) The status of coordination centres is governed by Circular LIR No 119 of 12 June 1989 (hereinafter referred to as 'Circular 119' or 'the Circular'). The Circular was repealed by Circular LIR No 1119 of 20 February 1996. A total of five companies were approved as coordination centres, of which four became operational.
- (8) A coordination centre is a resident limited company which is multinational in nature and has as its sole purpose the provision of services exclusively to companies or enterprises in the same foreign international group. Within the meaning of the Circular, a foreign international group refers to companies that are financially linked and incorporated in at least two countries other than Luxembourg and whose parent company is not a resident taxpayer and is subject in another country to a tax corresponding to Luxembourg corporation tax (*impôt sur le revenu des collectivités*).
- (9) Coordination-centre status was granted by prior administrative approval. Approval was, in principle, limited to four tax years.
- (10) The administrative services provided by coordination centres to other companies within the group are as follows:
- organisational and secretariat services,
 - advertising,
 - marketing and market research,
 - the supply, gathering and processing of technical or administrative information,
 - relations with national or international authorities,
 - centralisation of accounting, administrative/financial, IT and legal expertise services, and provision of assistance and services directly and indirectly relating to the activities in question.
- (11) The Circular states that, for corporation tax purposes, the provision of intra-group services must generate an appropriate trading profit in line with the normal behaviour of a prudent manager in his relations with independent third parties. To that end, taxable profit is determined according to the cost-plus pricing method. This method involves applying a flat-rate mark-up to all deductible expenditure linked to the services provided to other companies within the group.
- (12) However, if expenditure and charges to be taken into consideration do not exceed LUF 30 000 000 (approximately EUR 750 000), the trading profit is fixed at a flat rate of LUF 1 500 000 (approximately EUR 37 500).
- (13) If the coordination centre pursues activities involving the payment of invoices in different currencies, the trading profit is not determined according to the cost-plus pricing method but on the basis of an appropriate consideration generally payable under conditions of full

competition for the exchange risk borne by a third party. The consideration must be at least equal to 1 % of all invoices to be taken into account and must be in proportion to the exchange risk.

- (14) Operations covered by the activities authorised by the Circular and carried out through the intermediary of a permanent establishment in Luxembourg of a foreign international group or by a resident company, other than a coordination centre, forming part of a foreign international group may also qualify for this method of calculating taxable profit.

III GROUNDS FOR INITIATING THE PROCEDURE

- (15) In its evaluation of the information supplied by the Luxembourg authorities, the Commission examined whether the method of determining the mark-up rate, the exclusion of certain expenditure from the calculation of the tax base and the exercise of possible discretionary power by the administration might confer an advantage on coordination centres. It also took the view that such an advantage might have been granted from State resources, might affect competition and trade between Member States, and might be selective. Finally, it felt that none of the exceptions to the general principle that State aid is prohibited seemed to be applicable. These doubts led the Commission to initiate the formal investigation procedure in this case.

IV COMMENTS FROM LUXEMBOURG

- (16) The comments submitted by the Luxembourg authorities may be summarised as follows.
- (17) Since the scheme had been withdrawn, it was no longer producing any effects other than in respect of enterprises to which the provisions of Circular 119 applied up to the end of 2001. The Luxembourg authorities also pointed to the problems posed by transfer prices⁽⁵⁾ and defended the solution adopted. Finally, they did not consider the measure as constituting aid within the meaning of Article 87 of the Treaty.

Transfer prices

- (18) The links which exist between two enterprises within a particular group enable them (at least in theory) to determine conditions for supplying goods and services between them which differ from those which would have applied if the two parties had acted as independent enterprises operating on free markets. Enterprises may thus be tempted to allocate their profits within the group in such a way as to minimise the total tax burden on the group as a whole. In the case of multinational groups, allocating profits in this way often results in the tax base being increased in one country and reduced in another. This explains the concern of governments to ensure that transfer prices within a group are as close as possible to market prices.

⁽⁵⁾ Transfer prices are the prices at which a company invoices goods or services to associated companies.

- (19) Within the OECD, to which the Member States belong, the principle of full competition was adopted to eliminate the impact of special conditions on the level of profits. This principle, set out in Article 9 of the OECD Model Tax Convention, serves a dual objective: to ensure that tax is correctly assigned to each country and, as far as possible, to avoid double taxation. It also enables multinational enterprises and independent enterprises to be treated as equally as possible. The methods used to determine transfer prices include the 'comparable prices on the free market' method and the cost-plus pricing method.
- (20) Referring to the need to prevent tax avoidance and to the principle of full competition, the Luxembourg authorities point out that Article 164 of the Law of 4 December 1967 on income tax constitutes the legislative basis for transfer prices. It was in this context that Circular 119 was adopted to facilitate the taxation of certain types of activity. The Luxembourg administration normally tries to compare prices charged within the same group with prices charged for comparable transactions between independent enterprises. This is not always possible, however, because the relevant comparative data are not available.
- (21) Consequently, the Luxembourg administration opted in this case for the cost-plus pricing method with a view to determining transfer prices for the intra-group services provided by coordination centres. On the basis of a uniform method such as that recommended by the OECD, the minimum threshold of 5 %, a rate comparable to that which can be obtained on the free market, was deemed reasonable for this type of services. Nevertheless, a higher rate could always be applied if the tax administration received information indicating that a higher profit margin had been achieved.

Circular 119 did not involve State aid within the meaning of Article 87 of the Treaty

The measure must give rise to an advantage

- (22) The measure did not set out to lighten the tax burden normally borne by coordination centres but solely to determine as accurately as possible a market price for intra-group services by applying the cost-plus pricing method. Luxembourg points out that, in paragraph 13 of its notice, the Commission stressed that tax measures of a purely technical nature, such as provisions to prevent double taxation or tax avoidance, do not constitute State aid. Given that Circular 119 was a general measure designed to prevent tax avoidance and to produce an appropriate and fair trading profit for coordination centres, it did not constitute State aid.
- (23) The requirement that coordination centres belong to a large international group and the imposition of a minimum profit of LUF 1 500 000 (approximately

EUR 37 500) were such as to ensure a sufficient volume of activity in Luxembourg. Otherwise, profits would have been so insignificant from a tax point of view that the application of Circular 119 would not have been justified.

- (24) Circular 119 required the parent company to be subject abroad to a tax corresponding to Luxembourg corporation tax. In this way, transferring excessive deductible tax to a foreign country seems to have been ruled out. If it considered the Luxembourg tax arrangements to be too favourable, the foreign country in which the parent company of the coordination centre originated could either refuse to apply the provisions of the 'parent company-subsidiary' Directive⁽⁶⁾ in respect of distributions of dividends by the Luxembourg coordination centre or apply measures to prevent tax avoidance.
- (25) Luxembourg notes that the Commission is merely questioning the way in which the principle of full competition is complied with, claiming that this objective is not being met under the scheme and asserting that, where the authorities have some margin of discretion, this is liable to favour certain enterprises or groups.
- (26) The Luxembourg authorities consider that the Commission is criticising two aspects of the advantage enjoyed by coordination centres: on the one hand, the practical application of the cost-plus pricing method as compared with the use of the transfer prices actually paid and, on the other, the fact that non-deductible expenditure is not included in the tax base.
- (27) As far as the first aspect is concerned, Luxembourg stresses that it was only where the transfer prices charged by the enterprise were higher than those resulting from the application of the cost-plus pricing method that the use of that method could have led to an advantage for the enterprise as a result of a smaller tax base being applied to it. The Luxembourg authorities admit that Circular 119 did not contain any explicit reference to the principle of linking the tax balance sheet to the commercial balance sheet and that they could not rule out the possibility that a taxpayer might have sought to take advantage of this loophole in order to overcharge in Luxembourg for services performed for other companies in the group. Nevertheless, Luxembourg considers that third countries had the means to check whether such overcharging was taking place. Should the Commission conclude that the application of Circular 119 in such cases constituted unlawful State aid and demand its recovery, the enterprises concerned would have to be identified and an individual calculation made for each enterprise on the basis of the real transfer prices.

⁽⁶⁾ Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ L 225, 20.8.1990, p. 6).

(28) Luxembourg would point out that the Commission accepts the use of methods such as the cost-plus pricing method and that there would not be any advantage if using such alternative methods resulted in taxation equal or at least comparable to that which could have been arrived at between two independent operators applying the traditional method whereby taxable profit is calculated on the basis of the difference between the enterprise's income and charges. According to Luxembourg, the Commission considers that an advantage should be deemed to exist where the result of applying the cost-plus pricing method is not sufficiently comparable to that which would have been obtained by means of the traditional method. However, the Commission is not concerned with the extent of any such advantage, and Luxembourg considers that the cost-plus pricing method does not in any case give rise to any advantage to the point where the taxable income would no longer be comparable to that which could have been obtained between two independent operators by means of the traditional method.

(29) As for the second aspect, Luxembourg considers that the Commission seems to be claiming that, by not including in the tax base expenditure which is not deductible pursuant to Article 168 of the Law on corporation tax, an advantage might be conferred on coordination centres. However, the Luxembourg authorities consider such exclusions to be justified. As regards the exemption of dividends from corporation tax and wealth tax, they note that dividends are allocations based on the trading result and are not genuine expenditure, and so the question of their deductibility does not arise. As for bonuses, attendance fees and donations to cultural, charitable or general-interest institutions, their exclusion from the basis for determining cost-plus prices can be explained by the need to avoid double taxation. Bonuses are an allocation from reserves formed on the basis of the net result.

(30) Luxembourg takes the view that all of these non-deductible expenses are already added to the coordination centre's tax result. In other words, they form in any case part of the tax base. If they had been included in the basis for determining cost-plus prices, they would have been taxed twice. Luxembourg also points out that Circular 119 is applied in its entirety and must therefore confer an advantage in its entirety without it being possible to single out any one of its aspects.

The advantage must be granted from State resources

(31) Luxembourg acknowledges that, if any advantage was conferred by Circular 119, it came from State resources.

The measure must be selective

(32) As for the alleged selectivity stemming from the application of a discretionary practice, the Luxembourg authorities confirm that the administration does not have any

discretion to grant or refuse application of the scheme for coordination centres. On the contrary, although such selectivity results from a legislative or administrative exception to the tax provisions, they assert that the State aid rules have never been applied to a situation comparable to this case. The Commission has not cited any precedent.

(33) Luxembourg points out that, in point 20 of the notice, the Commission explains that some tax benefits are on occasion restricted to certain types of undertaking, to some of their functions or to the production of certain goods and may therefore constitute State aid. However, Luxembourg indicates that there is no example of a decision or judgment of the Court of Justice of the European Communities in which a measure has been deemed to be selective because it applied only to some types of undertaking or to some of their functions.

(34) According to Luxembourg, the specificity criterion is not met because Circular 119 stems from the normal application of the Luxembourg tax rules. The Circular applies to all international groups of a sufficient size and forms part of efforts to combat abnormally low transfer prices. The only conditions imposed relate to the size of the group and to its establishments in several countries. Such limitations are necessary in order to guarantee that serious operations are managed from Luxembourg in a volume which is sufficient to give rise to difficulties in determining the transfer prices of the enterprises concerned. The principles to be applied in determining the taxable result of a coordination centre, as proposed in the Circular, are based on the rules for transfer prices set out by the OECD, which are general in scope and applicable to all taxpayers encountering intra-group invoicing. The Circular does not involve the application of a lower tax rate to coordination centres but, at most, lays down how the tax base is to be calculated, taking account of the specific characteristics of multinational companies. It is therefore a tax measure of a purely technical nature, which, according to the Commission, does not constitute State aid.

(35) If, because of a loophole in the wording, the Circular had been used to obtain lower taxation, it would be an abusive extension of the concept of State aid to consider the exploitation of a loophole by a taxpayer as aid.

(36) As an ancillary argument, Luxembourg takes the view that, even if the arrangements for coordination centres were considered by the Commission to be a derogation from the normal arrangements, they are justified by the nature and general scheme of the system. The Luxembourg authorities wanted to reconcile the principle of legal certainty with that of full competition. For the reasons outlined above, they chose the cost-plus pricing method in order to give the taxpayers concerned a point of reference by laying down a minimum threshold for declaring profits earned on internal operations.

The measure distorts competition and affects trade between Member States

- (37) Since the rules on transfer prices are designed to prevent disguised transfers of profits abroad by means of inappropriate invoicing methods, Circular 119 was addressed to international groups. The aim was not to permit an overall reduction of taxable profits within international groups but to prevent tax avoidance. Therefore, according to Luxembourg, the Circular cannot be considered to confer an advantage which improves the competitive position of the enterprises making up such groups within the common market.

The principle of legitimate expectations

- (38) In Luxembourg's view, the taxpayers to which Circular 119 was applicable had legitimate expectations which militate against the repayment of any State aid resulting from application of the Circular. There is no precedent for applying the State aid rules to the choice of methods for calculating the tax base. Applying them in this way would involve a radical and unforeseeable extension of the current scope of Article 88 of the Treaty.
- (39) Moreover, the Commission considered at the time that rules governing the taxation of European headquarters of multinational groups did not fall within the scope of the Treaty's provisions on State aid⁽⁷⁾. Likewise, the Commission had not raised any objection concerning the taxation of coordination centres in Belgium. Consequently, Luxembourg had legitimate grounds for believing that the Circular was legal.
- (40) Moreover, until publication of the notice in 1998, Community policy on State aid was unclear. Recovery could at most extend to the advantages obtained after the date on which the notice was published.

The principle of non-retroactivity of tax laws

- (41) Luxembourg takes the view that a request for recovery of the alleged aid would be tantamount to a retroactive amendment of the ordinary tax rules that would run counter to the basic constitutional principle of non-retroactivity of tax laws. The Commission cannot reasonably impose recovery where aid results from a general tax scheme contested after the event by the Commission.

Impossibility of recovering the alleged aid

- (42) Luxembourg considers that there is consistent case law to the effect that, where it is in fact impossible to recover illegal aid, a Member State may not be required to recover it. This is the situation in which Luxembourg

finds itself in this case. A figure cannot be put on the amount of the aid because it would not be possible to establish the real transfer prices which should have been charged by coordination centres or to envisage using any other of the methods described by the OECD.

V ASSESSMENT OF THE MEASURE

- (43) After considering the comments submitted by the Luxembourg authorities, the Commission would confirm its initial position as set out in its letter to Luxembourg of 11 July 2001⁽⁸⁾ initiating the formal investigation procedure laid down in Article 88(2) of the Treaty. It takes the view that the comments submitted by Luxembourg have not enabled the doubts it expressed in that letter to be dispelled and, consequently, that the tax scheme under review constitutes State aid within the meaning of Article 87(1) of the Treaty. Moreover, it deems the aid in question to be illegal and to constitute operating aid which cannot be declared compatible with the common market. Nevertheless, it considers that, in this case, Luxembourg and the recipient enterprises were justified in having legitimate expectations and that the aid need not therefore be recovered.
- (44) To begin with, the Commission is able to accept Luxembourg's comments concerning the problems posed by transfer prices in an international context. There is nothing to prevent tax administrations from using a cost-plus pricing method to determine the tax base for intra-group services provided by coordination centres. This system can be likened to a tax measure of a technical nature, as referred to in the second indent of paragraph 13 of the notice. Nevertheless, some of the rules for applying the method in this case suggest that the possible granting of aid cannot be ruled out.
- (45) In order to be regarded as aid within the meaning of Article 87(1) of the Treaty, a measure must meet all of the four criteria set out below.

Advantage

- (46) Firstly, the measure must confer on recipients an advantage which relieves them of charges that are normally borne from their budgets. The objective of using alternative methods of determining taxable income in order to prevent certain transactions from hiding undue advantages or donations with the sole purpose of avoiding taxation must normally be to achieve taxation comparable to that which could have been arrived at between independent operators on the basis of the traditional method, whereby the taxable profit is calculated on the basis of the difference between the enterprise's income and charges. This complies with the principle of full competition. In the area of transfer prices, this international principle is set out in Article 9 of the OECD Model Tax Convention (and, in more detail, in the 1995 OECD Transfer Pricing Guidelines). Since an analysis requires individual facts and circumstances to be taken into account, the OECD Guidelines do not recommend the use of 'safe harbours' (such as fixed margins).

⁽⁷⁾ Written question No 1735/90 (OJ C 63, 11.3.1991, p. 37).

⁽⁸⁾ See footnote 1.

(47) The Luxembourg authorities have not provided any information on how the mark-ups used to establish the tax base for coordination centres under the cost-plus pricing method are determined in practice. While the Commission can accept the argument that the administration did not have any discretionary power to grant or refuse the application of the scheme for coordination centres, it is clear from the answers given by Luxembourg that the administration did have such power when it came to determining the mark-ups to be applied. Circular 119 fixed a minimum mark-up of 5 %. Nevertheless, it did not lay down any rules or guidelines on how to determine mark-ups in practice. Indeed, the Luxembourg authorities expressly indicated that only the 5 % mark-up recommended in the Circular was applied. The Commission thus concludes that coordination centres and the groups to which they belong were able to derive an advantage by dint of the fact that, in practice, Luxembourg systematically granted the minimum rate of 5 % without checking whether it corresponded to the economic reality of the underlying services. It transpires that the Luxembourg authorities failed, at least in some cases, to ensure that coordination centres were subject to taxation comparable to that which generally applied to enterprises liable for tax in Luxembourg.

(48) It is irrelevant that Circular 119 required the parent company to be subject abroad to a tax corresponding to Luxembourg corporation tax or that the foreign country in which the parent company originated could apply measures to prevent tax avoidance because these aspects do not demonstrate that the Luxembourg scheme for coordination centres did not confer any advantage or that any advantage which might have been conferred would have been justified. The conduct of other Member States, and in particular the possibility that they might take account of the advantage conferred by a Member State in an attempt to reduce or cancel its effects, does not in any way detract from the reality of that advantage. In any case, the method applied by Luxembourg in taxing cross-border intra-group services, which is based on cost-plus pricing, might not tally with the method used in other Member States whereby the taxable profit is calculated on the basis of the difference between the enterprise's income and charges. If this is the case, there is a risk that overcharging might give rise to a reduction in the tax burden in another Member State which would not be offset by an increase in the tax burden in Luxembourg. In this case, the advantage obtained in Luxembourg would come on top of the advantage obtained in another Member State and would not be in any way offset.

(49) As for Luxembourg's claim that Circular 119 did not contain any explicit reference to the principle of linking the tax balance sheet to the commercial balance sheet, the Commission has no criticism to make. It should be noted that, in the case of cross-border intra-group services, it is not necessary to compare the cost-plus pricing system with real transfer prices but to ensure that the system results in taxation which is comparable to what would have been obtained by means of the

traditional method. The extent of the advantage derived from the system need not be determined at this stage of the analysis but only for the purposes of recovering the aid, if this proves necessary: the Commission notes that the 5 % minimum mark-up was systematically applied in this case. Luxembourg has not provided any indication of the existence of checks to ensure that the application of the minimum rate tallied with the level of taxation which would have resulted from the application of the traditional method. Consequently, the Commission takes the view that the conduct of the tax administration had the effect of conferring an advantage.

(50) With regard to the claim that non-deductible expenditure is not included in the base to which the mark-up rate is applied under the cost-plus pricing method, the Commission is able to accept some of the arguments put forward by Luxembourg. The logic behind this clearly stems from a comparison with the traditional method of taxation. Tax does not form part of genuine business expenditure but is a payment based on its trading result. The exclusion of donations seems to follow the same logic in that they do not represent genuine business costs. In other words, such non-deductible expenditure is not likely to contribute to the realisation of a taxable result. Since the existence of an advantage has been established as a result of the systematic application of a 5 % rate, it is not necessary to determine whether the same considerations apply to bonuses and attendance fees since they represent distributions of net profits.

Competition and trade between Member States are affected

(51) This criterion is met in that coordination centres were supposed to provide services predominantly to companies situated outside Luxembourg. Moreover, in accordance with the case law of the Court of Justice ⁽⁹⁾ and as stressed in paragraph 11 of the notice, the mere fact that a measure strengthens a firm's position compared with other firms competing in intra-Community trade is enough for it to be concluded that trade has been affected. In this particular case, coordination centres or enterprises in the groups to which they belong might have found their position to have been strengthened as a result of the reduced tax burden of their centre in Luxembourg. Assuming this to be the case, and taking account of the possibility that the groups in question are active in sectors characterised by the existence of trade between Member States, the Commission takes the view that the measure is liable to affect such trade.

(52) Even if, as the Luxembourg authorities claim, the main objective of Circular 119 was not to allow an overall reduction in taxable profit but rather to prevent disguised transfers, a measure must be assessed according to its effects and not according to its objectives. As consistently confirmed by case law ⁽¹⁰⁾, the objective pursued by the scheme in question cannot prevent it from being classified as State aid within the meaning of Article 87(1) of the Treaty.

⁽⁹⁾ Case 730/79 *Philip Morris v Commission* [1980] ECR 2671.

⁽¹⁰⁾ Case C-75/97 *Belgium v Commission* [1999] ECR I-3671, paragraph 25.

Selectivity

- (53) Given that the tax provisions in question concerned only coordination centres belonging to multinational groups present in at least two countries other than Luxembourg and having their headquarters outside Luxembourg, only some enterprises had access to the advantages described above. Moreover, as stated in point 20 of the notice, some tax advantages are on occasion restricted to certain functions, such as intra-group services. This also holds for the Luxembourg scheme for coordination centres. The criterion of selectivity is thus met.
- (54) Another aspect of selectivity stems from the fact that, if the coordination centre's total expenditure does not exceed LUF 30 000 000 (approximately EUR 750 000), the trading profit is fixed at a flat rate of LUF 1 500 000 (approximately EUR 37 500). This implies selectivity in favour of large groups in so far as groups which had been unable to achieve the minimum expenditure threshold would have been excluded from equal treatment under the cost-plus pricing method. The Luxembourg authorities themselves admit that the requirement that coordination centres belong to a large international group and the imposition of a minimum profit were such as to ensure a sufficient volume of activity in Luxembourg.
- (55) The Commission considers these aspects of selectivity to be unjustified by the nature or general scheme of the Luxembourg tax system. In particular, it does not consider such limitations to be necessary to ensure that serious operations are managed from Luxembourg in a volume sufficient to give rise to difficulties in determining the transfer prices of the enterprises concerned⁽¹¹⁾. The difficulties linked to the determination of transfer prices apply in principle to all services or goods supplied between associated companies. While the international nature of such supplies is likely to increase those difficulties, they are faced not only by companies belonging to a large-scale multinational group with its headquarters outside Luxembourg. In any case, the difficulties in question are not relevant since the Luxembourg authorities systematically applied a 5 % rate to calculate cost-plus prices.
- (56) As regards Luxembourg's comment to the effect that there is no precedent in the form of a Court decision or judgment, the Commission would merely point out that such precedents are not necessary. Classification of the scheme for coordination centres as State aid stems directly from Article 87(1) of the Treaty. However, it should be noted that, according to recent case-law, tax measures are selective and constitute State aid where

they apply solely to undertakings which carry out investments exceeding a certain amount or create a certain number of jobs⁽¹²⁾. The Commission takes the view that the same reasoning must be applied in this case.

- (57) When it comes to reconciling the principle of legal certainty with that of full competition and providing taxpayers with a point of reference, there is nothing to prevent tax administrations from opting for the cost-plus pricing formula. The Commission is not criticising the use of that system as a means of facilitating the determination of transfer prices for transactions between associated entities. Nevertheless, in the case at issue, the systematic application of the 5 % minimum rate must be regarded as a derogation from the correct use of the cost-plus pricing method which is liable to have conferred an advantage on some enterprises without being justified by the nature or general scheme of the system.

State resources

- (58) In this case, the reduction in the amount of tax resulting from the application of Circular 119 involves a reduction in tax revenues, which constitute State resources.

Compatibility

- (59) The Luxembourg authorities have not challenged the preliminary assessment of the compatibility of the scheme for coordination centres, which is set out in the decision to initiate the formal investigation procedure⁽¹³⁾ and which the Commission hereby confirms. That assessment may be summarised as follows:
- (60) The derogations provided for in Article 87(2) of the Treaty regarding aid having 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 regions of the Federal Republic of Germany are not applicable in this case.
- (61) The derogation provided for in Article 87(3)(a) regarding aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment is also not applicable.
- (62) Likewise, the scheme for coordination centres does not fall within the category of important projects of common European interest eligible for the derogation provided for in Article 87(3)(b) and, given that it is not designed to promote culture and heritage conservation, cannot qualify for the derogation provided for in Article 87(3)(d).

⁽¹²⁾ Joined Cases T-127/99, T-129/99 and T-148/99 *Territorio Histórico de Álava - Diputación Foral de Álava and others v Commission*, paragraph 157, and Joined Cases T-92/00 and T-103/00, paragraphs 39 and 40 and 49 and 50, not yet published.

⁽¹³⁾ See footnote 1.

⁽¹¹⁾ See paragraph (32): argument put forward by Luxembourg.

(63) It should also be examined whether the scheme is eligible for the derogation provided for in Article 87(3)(c), which authorises aid to facilitate the development of certain economic activities or of certain economic areas in cases where such aid does not adversely affect trading conditions to an extent contrary to the common interest. The tax advantages granted under the scheme are not linked to investment, job creation or specific projects. They merely constitute ongoing tax relief and must consequently be classified as operating aid. The Commission thus takes the view that the aid in question is liable to adversely affect trading conditions to an extent contrary to the common interest.

Recovery

(64) The measures in question may not be regarded as existing aid within the meaning of Article 88(1) of the Treaty and Article 1(b) of Council Regulation (EC) No 659/99 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty⁽¹⁴⁾ (now Article 88 of the EC Treaty). This is because they were implemented after the entry into force of the Treaty, have never been notified to the Commission as required by Article 88(3) of the Treaty, are not covered by a limitation period and constituted aid from the moment they were put into effect. They therefore constitute new aid. Where State aid granted illegally is found to be incompatible with the common market, the natural consequence is that the aid must be recovered from the recipients in accordance with Article 14 of Regulation (EC) No 659/99. The purpose of recovery is to restore as far as possible the competitive situation which existed before the aid was granted. Neither the absence of precedent for applying the State aid rules to choices concerning methods of calculating the tax base nor the alleged lack of clarity of Community State aid policy would justify an exemption from this basic principle.

(65) As for the claim that it would be impossible to recover the aid and the principle of the non-retroactivity of tax laws, the relevant case law indicates that, even if recovery of a tax credit presents difficulties from an administrative point of view, that fact is not such as to enable recovery to be deemed to be technically impossible⁽¹⁵⁾. Moreover, as consistently confirmed by case law, a Member State may not plead provisions, practices or circumstances existing in its internal legal system in order to justify a failure to comply with its obligations under Community law. In particular, a provision laying down a time limit for the revocation of an administrative act must, like all the relevant provisions of national law, be applied in such a way that the recovery required by

Community law is not rendered practically impossible and the interests of the Community are taken fully into consideration⁽¹⁶⁾. If this were not the case, Member States could escape effective monitoring of State aid by not complying with their obligation under Article 88(3) of the Treaty to notify in advance plans to grant aid.

Legitimate expectations

(66) Nevertheless, Article 14(1) of Regulation (EC) No 659/1999 lays down that 'the Commission shall not require 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 practice in previous decisions have established that recovery would be contrary to a general principle of Community law if, following the Commission's action, the recipient had legitimate expectations that the aid was granted in accordance with Community law.

(67) In *Van den Bergh and Jurgens*⁽¹⁷⁾, the Court stated that:

'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 the 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.'

(68) In Commission Decision 2001/168/ECSC of 31 October 2000 on Spain's corporation tax laws⁽¹⁸⁾, the Commission noted the similarities between the Spanish system and a French system it had approved on the basis that it did not constitute aid within the meaning of Article 92(1) of the EEC Treaty (now Article 87(1) of the EC Treaty). In the present case, it notes that the Luxembourg scheme for coordination centres closely resembles the scheme introduced in Belgium by Royal Decree No 187 of 30 December 1982 on the taxation of coordination centres. Both schemes relate to intra-group activities and use the cost-plus pricing method to determine the tax base. In its decision of 2 May 1984, the Commission took the view that the scheme did not involve State aid within the meaning of Article 92(1) of the EEC Treaty. Even though that decision was not published, the fact that the Commission did not raise any objection to the Belgian scheme was made public at the time in the XIVth Report on Competition Policy and in an answer to a Parliamentary question⁽¹⁹⁾.

⁽¹⁴⁾ OJ L 83, 27.3.1999, p. 1.

⁽¹⁵⁾ Case C-280/95 *Commission v Italy* [1998] ECR I-259, paragraph 23, and Case 378/98 *Commission v Belgium* [2001] ECR I-5107, paragraph 42.

⁽¹⁶⁾ Case C-5/89 *Commission v Germany* [1990] ECR I-3437, paragraphs 18 and 19.

⁽¹⁷⁾ Case C-265/85 *Van de Bergh and Jurgens and others v Commission* [1987] ECR 1155, paragraph 44.

⁽¹⁸⁾ OJ L 60, 1.3.2001, p. 57.

⁽¹⁹⁾ See footnote 7.

(69) In this connection, the Commission notes that its decision on the Belgian scheme was adopted before the entry into force of the Luxembourg scheme. It also notes that all the beneficiaries of the scheme were approved as coordination centres before the Commission's decision of 11 July 2001 to initiate the formal investigation procedure. It would further point out that Circular 119 was repealed on 20 February 1996 and that it has not applied to the beneficiaries since 31 December 2001. Consequently, the Commission accepts the arguments put forward by Luxembourg concerning the beneficiaries' legitimate expectations and waives recovery of the aid granted.

VI CONCLUSION

The Community finds that the Luxembourg scheme for coordination centres constitutes State aid within the meaning of Article 87(1) of the Treaty and that none of the derogations provided for in Article 87(2) or (3) are applicable. It also finds that Luxembourg unlawfully implemented the system in question in breach of Article 88(3) of the Treaty. Nevertheless, it notes that the system was withdrawn on 20 February 1996 and that the tax advantages granted to beneficiaries ceased on 31 December 2001. Lastly, it acknowledges that the beneficiaries had legitimate expectations such as to rule out recovery of

the State aid found to be incompatible with the common market. Consequently, it is not requiring that the aid be recovered,

HAS ADOPTED THIS DECISION:

Article 1

The tax scheme for coordination centres implemented by the Grand Duchy of Luxembourg by means of Circular LIR No 119 of 12 June 1989 constitutes State aid which is incompatible with the common market.

Article 2

This Decision is addressed to the Grand Duchy of Luxembourg.

Done at Brussels, 16 October 2002.

For the Commission

Mario MONTI

Member of the Commission