



EU Direct Tax Newsalert

Non-confidential version of the EC's State aid opening decision in Inter IKEA

On 27 March 2018, the European Commission (EC) made publicly available its opening decision of 18 December 2017 in the formal investigation into the Netherlands' tax treatment of Inter IKEA Systems BV (Systems) as regards State aid. The EC explains the reasons for the initiation of the formal investigation and requests additional information from the Netherlands and potentially Systems or any other company of the Inter IKEA Group, in order to reach a final conclusion. This decision represents therefore the opening, not the outcome, of the EC's formal investigation into this matter.

The EC's opening decision focuses on two Advanced Pricing Agreements (APAs) granted by the Netherlands to Systems in 2006 and 2011, respectively.

The 2006 APA

The 2006 APA indirectly determined for tax purposes the annual licence fee which Systems paid to another group company, established in Luxembourg, I.I. Holding S.A. (Holding), for a set of proprietary rights (PRs) necessary for the exploitation of the franchising business of IKEA. As indicated in the 2006 APA, Holding was the owner of the PRs.

The EC considers at this stage that the 2006 APA may have granted an advantage to Systems since it results in a reduction of System's corporate income tax liability in the Netherlands which, in the EC's provisional view, does not seem to reflect a reliable approximation of a market-based outcome in line with the arm's length principle.

More specifically, the EC considers that when applying the Transfer Pricing method used, i.e. the transactional net margin method (TNMM), the 2006 APA may have improperly considered Systems as the less complex entity and therefore the tested party. Alternatively, even if Systems had been correctly identified as the tested party, the application of the TNMM appears to contain certain methodological "mistakes" which the EC presents in its opening decision.

The 2011 APA

Pursuant to a restructuring, in 2011, Systems signed a Sale and Purchase Agreement (SPA agreement) with a Liechtenstein foundation (foundation) by which it acquired the beneficial ownership of the PRs (formerly held by Holding). The acquisition took place through two transactions: the foundation contributed to Systems 40% of the beneficial interest in the PRs – representing an amount of EUR 3.6 billion – as share premium reserves. In addition, the foundation sold to Systems the remaining 60%

of the beneficial interest in the PRs for a purchase price of EUR 5.4 billion (the purchase price). The purchase price was then converted into a loan whose terms were defined in a loan agreement signed by the foundation and Systems (the loan agreement). Moreover, the SPA agreement contained a certain price adjustment mechanism.

The EC considers at this stage that the 2011 APA may have granted an advantage to Systems since it endorses a tax treatment that does not seem to reflect a reliable approximation of a market-based outcome in line with the arm's length principle. The EC's preliminary conclusion is based on several arguments concerning first, the value of the PRs and the terms of the loan agreement for the acquisition of such PRs and, second, the price adjustment mechanism.

More specifically, the EC considers at this stage that the EUR 9 billion value attributed by Inter IKEA to the PRs and accepted by the 2011 APA may not reflect the price that non-associated companies would have agreed to pay for these rights in the market. In addition, even if the value of the PRs as agreed in the APA correctly reflected their market value, the EC has doubts as to whether some of the terms of the loan agreement would have been agreed by independent undertakings negotiating under comparable circumstances at arm's length.

Moreover, the EC considers at this stage that the price adjustment mechanism may have not been agreed between independent undertakings. Finally, even if the price adjustment mechanism was to be considered at arm's length, the EC considers that the deduction of provisions for future interest related to the price adjustment mechanism may not be compliant with Dutch law.

The EC mentions in its opening decision that, as both APAs are individual measures, for which the EC's provisional conclusion is that they confer an economic advantage, it can be presumed that they are selective in nature. For the sake of completeness, however, it examines the potential selectivity of the APAs in light of the three-step selectivity analysis devised by the Court of Justice for aid schemes and concludes that both APAs are selective measures.

Takeaway

This is another decision of the EC in the area of transfer pricing. If the EC's approach is confirmed in its final decision, further litigation before the European Courts is likely.

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