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Consequences Of EU's Belgium Tax Scheme Decision

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On Jan. 11, 2016, the European Commission declared that Belgium's "excess profits" tax regime and rulings issued thereunder are illegal state aid that violates the European Union's competition laws — in particular Article 107 of the Treaty on the Functioning of the European Union (TFEU).[1] As a result of this decision, Belgium is now required to recover approximately €700 million in foregone taxes from over 35 multinationals. The Belgian government is however considering appealing this decision and multinationals benefiting from the scheme might consider doing it too.

Background

Since 2013, the commission has been reviewing the tax ruling programs of various EU member countries under EU competition laws. More specifically, it has been reviewing whether individual EU countries' tax ruling practices grant selective tax benefits to specific companies in a manner that constitutes illegal state aid. In 2014, the commission opened investigations into tax rulings that Luxembourg had granted to Amazon and Fiat Finance, Ireland to Apple, and The Netherlands to Starbucks. In October 2015, the commission declared that some of these tax rulings violated the EU rules on state aid and continues to investigate the other two cases (Amazon and Apple). See "Likely Impact Of The EU's Fiat, Starbucks Tax Rulings" (Oct. 23, 2015).

On Dec. 3, 2015, the commission opened a new formal probe into Luxembourg's tax rulings, this time affecting McDonald's. As in the previous cases, the commission considered that the advantageous tax treatment granted to McDonald's by Luxembourg was in breach of EU competition laws. The commission's position in these cases relied in part on a finding that the tax rulings issued by these EU member states did not apply Organization for Economic Cooperation and Development transfer pricing guidelines in a principled manner.

In February 2015, the commission announced that it was investigating Belgium's "excess profits" tax regime and related tax rulings, without naming particular companies. The commission's Jan. 11 decision confirms the commission's finding that the Belgian regime violates EU competition laws. The commission is charged with enforcing the prohibition on selective state aid under Article 107 of the Treaty on the Functioning of the European Union (TFEU). Under the TFEU, no member state may offer state aid to companies that creates an advantage over competitors and thereby distorts the economy. "State aid" is any advantage, regardless of its form, that is granted on a selective basis to companies or associations by a government authority. Subsidies to individuals, and those granted companies on a nonselective basis, are allowed.

Why Does the Commission Say That the Belgian Tax Rulings are Illegal?

The commission's tax investigations focus on the potential for the tax rulings to grant selective advantages to recipients of the rulings. It is not challenging the more traditional practice under which tax authorities provide guidance on the application of generally applicable tax laws to a specific transaction or situation. Accordingly, the tax rulings issued by EU member states per se should not be called into question under the commission's actions.

According to the commission, however, the Belgian rulings granted under its excess profits tax scheme are distortive. Its position is that Belgium, with its "Only in Belgium" program, has used rulings to reduce the corporate tax base of certain multinational companies by between 50 and 90 percent by excluding from the tax base "excess profits" attributable to the companies' membership in multinational groups. The commission holds that rulings granted to companies under the Belgian excess profits regime were illegal state aid under Article 107 of the TFEU.

Under Belgian law, companies operating in Belgium are liable to tax on income from activities in Belgium. Under the Belgian excess profits regime, however, a company can apply for a ruling that excludes from the tax base "excess profits" attributable to the company being part of a multinational group. The rulings reportedly compare the company's reportable profits from activities carried on in Belgium to a hypothetical, lower level of income that the company would have earned as a stand-alone Belgian business. The difference between the actual income and the hypothetical stand-alone income is deemed to be "excess profits" and deducted from the company's Belgian income. The theory is that this excess profit is attributable to being part of a multinational group that has synergies, economies of scale, reputation, client and supplier networks, and market access. According to the commission, the Belgian tax authorities granted companies rulings under the excess profits regime that reduced taxable income by 50-90 percent.

The commission claims that Belgium's rulings granted more than 35 companies "a preferential, selective subsidy" in the form of a tax advantage. More specifically, multinational companies receiving rulings were permitted a significant reduction in tax as compared to stand-alone companies operating in Belgium.

In addition, the commission argues that the Belgian tax rulings violate international transfer pricing norms. Thus, the commission asserts that under the arm's-length principle, profits attributable to a multinational's synergies, economies of scale, reputation and similar attributes "would be shared between group companies in a way that reflects economic reality, and then taxed where they arise." This assertion represents a questionable interpretation of how the arm's-length principle applies to a multinational's synergistic income. For example, the determination of an arm's-length price for a transaction between members of a multinational enterprise may not take into account that a

multinational enterprise enjoys synergistic savings that would be unavailable to two independent businesses engaging in a similar transaction.

The commission also rejects Belgium's argument that the excess profits regime and the reductions in taxable income were necessary to avoid double taxation of the income of multinationals. The commission notes that Belgium granted the companies unilateral relief without requiring the companies receiving rulings to show that other countries were attempting to tax the same income. The commission observed: "In reality, it resulted in double non-taxation."

Legal Consequences of the Commission Decision

The commission's decision requires Belgium to recover the taxes that Belgium did not collect in prior years from the companies that received rulings under the excess profit scheme irrespective of any litigation that might follow. The commission states,

[T]o remove the unfair advantage the beneficiaries of the scheme have enjoyed and to restore fair competition, Belgium now has to recover the full unpaid tax from the at least 35 multinational companies that have benefitted from the illegal scheme. Which companies have in fact benefitted from the illegal tax scheme and the precise amounts of tax to be recovered from each company must now be determined by the Belgian tax authorities. The Commission estimates that it amounts to around €700 million in total.

The Jan. 11 decision confirms the commission's finding that the Belgian regime violates EU competition laws. Belgium may now appeal the commission's finding to the General Court of the European Union in Luxembourg. Further appeals could go to the Court of Justice of the European Union. Any affected multinationals may join the Belgian government's appeal as interveners or also start their own appeals against the commission decision on the basis of Article 263(4) TFEU.

The commission emphasized that it continues to investigate the tax rulings that Ireland granted to Apple and Luxembourg granted to Amazon and McDonalds. In 2015, the commission used new investigative tools introduced by Regulation 734/2013 to obtain further information throughout the EU. It sent out requests for information (or RFIs) to the 28 EU member states seeking information on the tax rulings granted to companies between 2010 and 2013. Based on the widespread use of tax rulings for transfer pricing across the EU, the commission may well open new investigations of tax ruling practices by EU member states. Companies benefiting from tax rulings should seek legal advice to identify possible risks and limit the scope of potential liabilities.

The commission mentioned that the EU state aid probes into tax rulings are part of a broader tax transparency initiative launched by the commission in March 2015. In this context, on Oct. 6, 2015, EU member states agreed on new legislation to provide for the automatic exchange of information on cross-border tax rulings. The new rules are intended to foster greater cooperation between member states on tax matters and deter the use of tax rulings as an instrument for competition among member states.

Commission's Investigations Attract Attention of the Treasury and Congress

The commission's state aid investigations have attracted the attention of U.S. government officials and Congress, who have raised concerns about retroactive taxation of U.S. companies, the potential impact on U.S. tax revenues, and the EU operating outside the tax treaty network among the various EU

member states and the United States. On Dec. 1, 2015, the Treasury's deputy assistant secretary for international tax affairs, Robert Stack, testified before Congress regarding the European Commission's state aid investigations.[2] Stack raised the following concerns:

- The commission, according to Stack, appears to be disproportionately targeting U.S. companies.

- The commission "is substituting its own tax determinations for that of the Member States," calling into question the United States' bilateral relationships with individual EU member states through the U.S. tax treaty network. In this regard, Stack stated that "the United States has interest in understanding with clarity the precise nature of income tax enforcement in the EU."

- The commission's decisions would effectively impose retroactive taxation going back up to 10 years. Stack argued that any remedy should be prospective only.

- Additional taxes imposed under the commission's decisions could give rise to U.S. foreign tax credits, costing the United States tax revenue. (Stack emphasized that the IRS has not yet analyzed the novel foreign tax credit issues presented by these cases).

On Jan. 15, 2016, the chairman of the U.S. Senate's Finance Committee, along with several other senators, sent a letter urging the Treasury "to intensify its efforts to caution the EU Commission not to reach retroactive results that are inconsistent with internationally accepted standards and that the United States views such results as a direct threat to its interests." The letter also asks the Treasury to consider whether taxes resulting from the Commission's decisions would constitute discriminatory or extraterritorial taxes within the meaning of Internal Revenue Code Section 891, which authorizes the president to impose retaliatory taxes against citizens and companies of the offending country.[3] Although action under Section 891 appears very unlikely, the senators' mention of the provision highlights the level of their concern about the commissions investigations.

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[1] See European Commission Press Release, "State aid: Commission concludes Belgian ‘Excess Profits' tax scheme illegal; around €700 million to be recovered from 35 multinational companies" (Jan. 11, 2016: see http://europa.eu/rapid/press-release_IP-16-42_en.htm. The public version of this decision is not yet available.)

[2] See A. Parker and K. Bell, "Treasury Official: EU State Aid Cases Raise Questions for U.S." (Dec. 1, 2015).

[3] See Letter of U.S. Senate Committee on Finance to Secretary of the Treasury (Jan 15, 2016).

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