# When Is a Favorable Tax Ruling Impermissible State Aid Under EU Law?


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# State aid docket

- The European Commission has recently opened at least 8 **in-depth investigations on State aid tax issues**:
  - Two cases against Luxembourg (Fiat Finance and Trade; Amazon); in Fiat, the European Commission has issued a final decision that the arrangements (ruling re calculation of taxable profits) constitute State aid; Fiat is on appeal to the EU General Court. The Amazon case (deduction for royalty paid to affiliate) is awaiting a final decision by the EC.
  - One case against Ireland (Apple) (ruling that profits are attributable to “head office”); recently, the EC has issued a final decision that the arrangement constitute State aid; appeal expected.
  - One case against The Netherlands (Starbucks) (ruling re royalty and price for green coffee beans); the European Commission has issued a final decision that the arrangements constitute State aid; case on appeal to the EU General Court.
  - Two cases against Belgium and France regarding corporate tax exemptions related to ports.
  - One case against Belgium for “excess profits” rulings; the EU has issued a final decision that the arrangements constitute State aid; case on appeal to the EU General Court
  - One case against Luxembourg (rulings issued to GDF Suez (Engie) that allegedly allow dual treatment as debt and equity)

# The Problem of the Favorable Tax Ruling

- While presumably an application of the law to the taxpayer's particular facts, a favorable tax ruling
  - Can eliminate legal or factual uncertainty
  - Can characterize facts in a favorable way
  - Can apply the law to the facts in a favorable way
  - Can announce a legal principle that previously had no support

# Under US tax principles

- A favorable private letter ruling or the equivalent is nonprecedential.
- In other words, no other taxpayer can rely on it.
- In some circumstances, a competitor may be able to obtain a similar ruling under IBM v. United States, 343 F.2d 914 (Ct. Cl. 1965). (The IRS has nonacquiesced.)
- Note that, in the state and local arena, tax competition is not constrained by the Commerce Clause, after DaimlerChrysler Corp. v. Cuno, 547 U.S. 332 (2006) (based on standing doctrine).

# Under EU law

EU law prohibits:

- An advantage in any form whatsoever conferred on a selective basis by public authorities
- That distorts or threatens to distort competition and has a negative effect on trade between EU Member States
- Subsidies granted to individuals or general measures open to all enterprises are not covered by this prohibition and do not constitute State aid

- Rationale: prevent EU Member States from interfering in the economy by granting **distortive aid**, in any form, to companies operating in the EU market. The subsidy need not benefit local businesses at the expense of nonlocal businesses.

**EU State aid law is part of EU Competition Law**

# The State aid prohibition must also address tax measures

- “The role of EU state aid control is to ensure Member States do not give selected companies a better tax treatment than others, via tax rulings or otherwise.” From EC press release re Apple case (August 30, 2016).
- If that were not the case, a Member State could obviously provide a subsidy to a favored company through the tax system.

Article 107(1) TFEU: a state measure is considered to be **<u>incompatible</u>** with the internal market when the following four conditions are met:

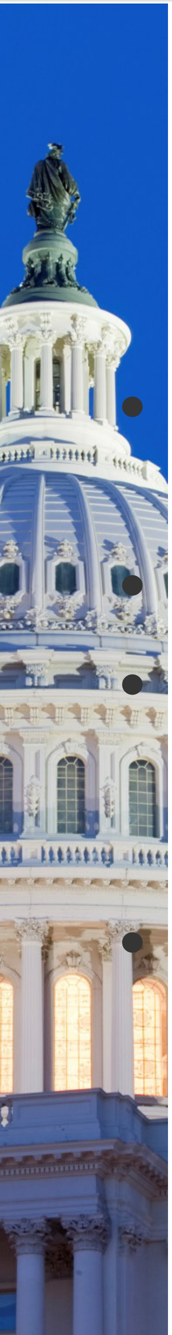
- the measure **is imputable to the State** (i.e. enacted by the State itself or an agency) and **financed through State resources**;
- the measure confers an economic **advantage** to the company or group of companies to which it is directed;
- the advantage is **selective**, that is, only available to that specific company or group of companies to which it is directed; and
- the measure distorts or threatens to **distort competition** and has a **negative effect on trade** between EU Member States.

# Selectivity is a requirement

- Members States presumably can compete with each other by lowering generally applicable tax rates.
- In Ireland, the corporate tax rate for trading income is 12.5%.
- Because selectivity arguments are harder to make for generally applicable legislation, the EU has focused on tax rulings.

# Key questions

- What is the baseline? Is it the tax law of the Member State or does EU law play a role?
- Does it matter that other taxpayers could have gotten a similar ruling?
- Does it matter that such rulings were "available" only to multinationals?



# Consequences if a Member State's tax ruling is found to be impermissible State aid

- The Member State is required to collect the back taxes with interest, notwithstanding its tax law.
- The look-back period is ten years
- In many cases, the taxpayer will seek a foreign tax credit in the United States. If there is a credit, the real aggrieved party is the U.S. Treasury.
- Will Treasury allow the credit for such large amounts? Or will Treasury look for reasons why the credit does not apply.

# Policy and Politics

- Growing interest of **other EU Institutions**, most notably the European Parliament and the Council of the European Union, as part of broader discussions on tax policy
  - Political action
  - Legislative measures
- Possible changes to EU taxation law to limit the Member States' ability to grant tax rulings on transfer pricing
- While the State aid cases are raised under competition law, the effect is to change EU tax policy. Arguably, tax policy can more effectively be set by tax professionals.

# Policy and Politics

- Interesting to note that many of the in-depth investigations target large US companies
- The US Treasury Department this summer released a white paper that is highly critical of these State aid cases (The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings (August 24, 2016))
- Among other criticisms, Treasury objected to the retroactive application of what it perceived to be a new EU tax policy
- So there is a strong political aspect to these cases