



# **Managing Tax Audits and Appeals 2015**

**October 8-9, 2015  
San Francisco, CA**

**LuxLeaks – The EU State Aid  
Investigations into Multinationals’  
Tax Rulings in Ireland, Luxembourg,  
Netherlands and  
Belgium**

# Overview

- I. Introduction
- II. State Aid and Tax Measures
- III. The Current Investigations into Tax Rulings
- IV. Tax Policy Implications
- V. The Way Ahead





# I. INTRODUCTION

# What is LuxLeaks?

November 5, 2014 – The International Consortium of Investigative Journalists (‘ICIJ’) uncovered ‘tax rulings’ between the State of Luxembourg and almost 350 multinational companies



Luxembourg **LEAKS**



Search the documents

# A Commission's Priority

- Investigations into tax rulings already started with Commissioner Almunia in June 2014
- With the current EU Commissioner for Competition Policy Margrethe Vestager (and Commission President Juncker), they have become an **enforcement priority**

*“We need to take action – and are taking action - to ensure companies pay their fair share of tax. I am committed to taking a structured and informed approach to address **distortions of competition** in the EU through unfair and selective tax advantages.”*(Commissioner Vestager, Public Statement, December 18, 2014)

*“I am strongly committed to using the state aid tool against any tax that seriously distorts competition and, of course, I will not hesitate to take appropriate actions when a company receives a benefit, an advantage that is not deserved and will **distort competition.**”*  
(Commissioner Vestager, Financial Times, September 17, 2015)

# A Tax Issue? A Competition Issue?

Initially not a tax matter - Investigations dealt with under **EU Competition Law**

 EU State aid law

But now, a tax and political issue as well



## II. STATE AID AND TAX MEASURES

# What is EU State Aid law

- EU State aid law is **part of EU Competition Law** (Arts 107-109 TFEU)
- EU State aid law **prohibits**:
  - An advantage / in any form whatsoever / conferred on a selective basis to undertakings / 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**:
  - Preserve the Internal Market
  - Prevent EU Member States from interfering in the economy by granting **distortive aid**, in any form, to companies operating in the EU market

## The Legal Basis

- **Primary law:** Articles 107, 108, 109 TFEU
- **Secondary Law:**
  - Procedural rules (Regulation No. 659/1999)
  - Horizontal rules (e.g. Block exemption Regulation 651/2014; rescue and restructuring aid, R/D and innovation aid, etc)
  - Sector specific rules (e.g. coal industry; transport; steel)
- **Soft law:** 1998 European Commission Notice on Direct Business Taxation (the ‘1998 Notice’)

## The Main Players

- **European Commission** is the main and sole enforcer (monitors, investigates, adopts Decisions)
- **EU Member States** are the subject of the investigation and the addressees of the Decisions
- Legal recourse to the **European Courts** (appeal to the General Court and to the Court of Justice of the European Union on legal grounds)
- Companies – can be **beneficiaries** or **complainants**  
– to carefully assess the legality of the aid granted

# The Prohibition

Article 107(1) TFEU: a **measure** is considered to be **incompatible** when the following four conditions are met:

- the measure **is imputable to the State** (i.e. enacted by the State itself or by 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.

The measure can take any form – including tax measures

## State Aid and Tax Measures

- In principle, Member States are **free to choose the tax system** and tax measures they consider appropriate (Case C-78/76 *Steinike*)
- **But** there is a limit - Two broad situations in which a tax measure will fall **within** the scope of State aid rules:
  - (1) the tax is the method of financing a measure that confers State aid and the tax is an integral part of that measure
  - (2) the tax measure gives rise to a difference in treatment that favors certain companies



*(1) The tax measure is the method of financing a measure that confers State aid and the tax is an integral part of that measure*

- Where a Member State imposes a tax on certain persons who receive the proceeds of the tax, then the **conferral of that benefit** constitutes State aid, and hence the tax itself
- The tax might be caught under the prohibition in Article 107(1) TFEU on the basis that “**it is an integral part of the overall aid measure**” (see C-206/06 *Essent*)



*(2) Tax measures favor certain companies or sectors by relieving them of the tax liability which they normally would have to bear*

- Differential taxation, such as:
  - Tax exemptions
  - Special deductions
  - Lower rate social security contributions
  - Special tax regimes
  - Accelerated depreciation arrangements
  - Deferral or cancellation of tax debts
- Advantage must be “**funded by State resources**”:
  - a loss of tax revenue is treated as equivalent to consumption of State resources in the form of fiscal expenditure (see 1998 Notice, para. 10)



## III. CURRENT TAX RULING CASES

# Overview of the current tax rulings cases

Investigated Country	Company (Country)	Initiation of the Case (Year)	Conduct
Ireland	Apple (US)	June 2014	Tax rulings on transfer pricing
The Netherlands	Starbucks (US)	June 2014	Tax rulings on transfer pricing
Luxembourg	Fiat Finance and Trade (Italy)	June 2014	Tax rulings on transfer pricing
Luxembourg	Amazon (US)	October 2014	Tax rulings on transfer pricing
Belgium	No company specified	February 2015	Tax Rulings on Excess Profits

# Why an Investigation now?

According to the Commission,

*“through favorable tax rulings on transfer pricing, international companies are able to allocate great amounts of profits in low-tax rates jurisdictions, thereby obtaining an unfair advantage vis-à-vis other companies in similar legal and factual situation”*

European Commissioner Margrethe Vestager, November 2014

# What is the problem?

- The European Commission does not question the **validity per se** of tax rulings (“perfectly legal instrument to grant certainty to companies”)
- But these tax rulings “**could**” constitute illegal State aid because the **four cumulative conditions of Article 107(1) TFEU** appear to exist
- Therefore, Commission opened **formal investigation** into tax rulings given to four companies in Luxembourg, The Netherlands and Ireland – but many others likely to follow (after LuxLeaks and RFIs)
- Investigation is **ongoing**

## *(1) Tax rulings create an advantage*

- The tax rulings validated company-specific financing arrangement that resulted in a **very low effective tax rate** in the country granting the ruling (e.g. 3%)
- The tax rulings created an **incentive** to employ transfer pricing strategies **to shift** risks, activities, and ultimately **profits** to the country that grants the ruling

## *(2) Measure is Imputable to the State*

- The rulings were granted by the State and were thus **imputable** to the State
- The advantage were **financed through State resources** because of the loss of tax revenue



### *(3) Effect on intra-EU trade*

- Since the companies to which the rulings were granted operate in various EU Member States, the rulings **distort or threaten to distort intra-Community trade**

## *(4) The advantage was selective*

- The tax rulings provided certain companies with “*a more favorable treatment as compared to other companies which are in a similar factual and legal situation*”,
- in particular, non-multinational companies and multinational companies that employ transfer pricing in compliance with the arm’s length principle.
- An advantage is “selective” when the transfer pricing arrangement does **not** comply with the internationally recognized ‘arm’s length principle’ established by Article 9 of the OECD Model Tax convention

## ***(4) The advantage was selective (cont.)***

- An advantage is “selective” when the transfer pricing arrangement does not comply with the internationally recognized ‘arm’s length principle’:
  - when accepting a calculation of the taxable profits proposed by a company, the authorities should compare that method “*with the behavior of a prudent hypothetical market operator, which would require a market conform remuneration of a subsidiary or branch, which reflect normal conditions of competition*”

# Selectivity – the key legal issue

- The key legal issue appears to be **selectivity** – are the contested measure only available to certain categories of companies?
  - The European Commission seems to suggest that the measures benefit **exclusively multinational companies**
  - They are able to **artificially allocate their profits to subsidiaries in low tax jurisdictions** through tax rulings

## ... But not a clear issue

- In two recent cases (T-399/11 *Banco Santander*; and T-219/20 *Autogrill Espana*), the CJEU considered tax breaks for shareholdings in foreign companies **not** to be selective and hence not to break EU state aid rules
  - The selectivity of a measure must be based, inter alia, on a "*difference of treatment between categories of undertakings under the legislation of the same Member State,*
  - *not a difference in treatment between companies of a member State and those of other member States."*



## IV. TAX POLICY IMPLICATIONS

## Tax Ruling Cases to have Wider Implications

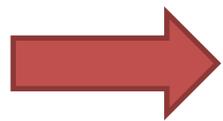
- Growing interest of **other EU Institutions**, most notably the European Parliament and the Council of the European Union, as part of **broader discussions on tax policy**
- **February 26, 2015:** European Parliament created the “Special Committee on Tax Rulings”
  - ➔ to analyze tax ruling practices and to propose possible reform

## More Tax Transparency

- Fight against tax evasion and corporate tax avoidance is a political priority of the Commission (President Juncker)
- **March 18, 2015:** Commission to present the new **Tax Transparency Package**
  - Amendment of Directive 2011/16/EU is the cornerstone of Tax Transparency Package

# The New Transparency Package

- Under current version of Directive 2011/16/EU, a Member State can voluntarily disclose tax rulings to another Member States when it considers that these impact the latter's tax bases



in practice mechanism is not frequently used

- Amendment sets out the scope and conditions for the mandatory automatic exchange of information on types of cross-border tax rulings and transfer pricing arrangements

# The Transparency Package (con't)

- A tax ruling is considered to be ‘**cross border**’ when:
  - not all the parties to the transaction or series of transactions are resident for tax purposes in the Member State giving the advance cross-border ruling, or;
  - any of the parties to the transaction or series of transactions is simultaneously resident for tax purposes in more than one jurisdiction, or;
  - one of the parties to the transaction or series of transactions carries on business in another Member State through a permanent establishment and the transaction or series of transactions forms part or the whole of the business of the permanent establishment
- Retrospective element – 10 years back

# The Transparency Package (con't)

- Proposal outlines the **standard information** that Member States would have to include in **quarterly reports** on their tax rulings:
  - Name of taxpayer and group (where this applies)
  - A description of the issues addressed in the tax ruling
  - A description of the criteria used to determine an advance pricing arrangement
  - Identification of the Member State(s) most likely to be affected;
  - Identification of any other taxpayer likely to be affected (apart from natural persons)

# The Transparency Package (con't)

- Objective - Increased tax transparency:
  - makes it easier for Member States to identify tax avoidance by multinational companies and take actions against them. If a Member State believes that it needs more information on a particular ruling, it can request more details or the full ruling
  - will exert peer pressure on Member States to avoid the issuance of tax rulings that result in tax avoidance
- Amendment must be adopted **unanimously** by the Council (previous consent given by the European Parliament). Negotiations might be concluded before the end of the year



## V. THE WAY AHEAD

# State Aid Investigations

- Commission investigation carried out by the newly created “**Task Force** on Tax Planning Practices” (within DG COMP)
- Formal investigations accompanied by **RFIs**:
  - **December 17, 2014**: the Commission requested information on **tax rulings** from all 28 EU Member States. Member States had to provide a list of all the companies that have received tax rulings from 2010 to 2013
  - **June 8, 2015**: Commission asked 15 Member States to provide a substantial number of individual tax rulings
- **September 17, 2015**: Commissioner for Competition Vestager announced that the Commission will issue **guidance** for Member States and companies on the application of State aid rules to tax rulings next year

## Final Decisions on the Cases?

- Not clear when the cases will be decided:
  - No legal deadline to complete an in-depth investigation
  - Decisions were initially foreseen for June 2015
  - In an interview released in mid-September, Commissioner Vestager stated that the investigations will “be completed soon but quality should come before speed”
  - Possible decisions before the end of the year?

## Impact on EU-US Relations?

- Interesting to note that **3 out of 5** in-depth investigations concern large US companies
- Impact on bilateral tax treaties that the US has negotiated with individual EU Member States
- Many other US companies included in the LuxLeaks list and also favoring from tax ruling in other EU countries
- More cases to be opened?

# What are the Implications for Companies?

- **Legal risks of current investigations**
  - Reputational issues
  - Long and complex legal procedures
  - Third party actions
  - Recovery
- **Multinational corporations with affiliates in EU jurisdictions that have received a tax ruling that reduces their effective tax rate**
  - To seek legal advice to **verify the compatibility** of their own tax ruling under EU State aid law and
  - To assess any **legal risks**, including potential third party actions
  - To **engage** with the pertinent Government

# Questions / Comments?

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# APPENDIX

# Exceptions to the Prohibition of State Aid

- **Article 107(2)** : certain categories of aid **shall be considered** to be compatible with the internal market, including:
  - aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned
  - aid to make good the damage caused by natural disasters or exceptional occurrences
- **Article 107(3)** : certain categories **may be considered** to be compatible with the internal market:
  - aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation
  - aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State
  - aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest
  - aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest
  - such other categories of aid as may be specified by decision of the Council on a proposal from the Commission

# Procedure in EU State Aid Cases

## Article 108 TFEU:

- Member States need to **notify** and obtain the Commission's **approval** before implementing any aid measure
- If the aid is implemented without such a notification or before having obtained the Commission's approval, the aid measure is considered to be **unlawful** and the Commission will open an investigation
- If after the investigation, the Commission comes to the conclusion that the aid is not compatible with the internal market, it will issue a **negative decision**
- If a negative decision is issued, the pertinent Member State will have to **recover the aid from the company to which it was granted**, including the applicable interest from the time the aid was at the disposal of the beneficiary until the date of its recovery