Tax rulings and fiscal state aid in the EU

Current developments

Dr. Bertold Bär-Bouyssièrè, Partner, DLA Piper – Brussels
Ortwin Carron, Partner, DLA Piper – Brussels
Michael Hardgrove, Partner, DLA Piper – Boston

The audio portion is available via conference call. It is not broadcast through your computer, please make sure you have called the teleconference number on your invitation.

* This presentation is offered for informational purposes only, and the content should not be construed as legal advice on any matter.
What is going on?

- The EU Treaty subjects national subsidies (state aid) to EU control

- National subsidies can take any form, including tax relief

- Recently, the European Commission started a sweeping crusade against tax rulings, alleging that companies have received state aid in form of tax relief through tax rulings

- Coincidentally, all companies targeted thus far are US-based
“The main reason behind our state aid action is the realization that governments can distort competition in the Single Market not only by granting subsidies but also by offering sweetheart tax deals. In particular, the deals we have identified benefit only a handful of large multinationals that can put enticing investments and job opportunities on the negotiating table. Smaller companies cannot wield the same bargaining power”

“EU tax authorities are responsible to ensure a level playing field, instead of offering different treatments to companies with comparable legal standings and operations”

Excerpts from speech Comm. Almunia, AmCham EU's 31st annual Competition Policy Conference, Brussels October 14, 2014
“Too much state aid is still badly designed and hinders growth. By preventing inefficient companies from leaving the market or awarding tax breaks to multinationals, it disadvantages the young, innovative companies that could revolutionize our economy. […]”

“I will take swift and decisive action against breaches of the rules, as in the case of the EU-wide investigation on tax rulings that I have announced. And I will expect member states to follow up effectively and in a timely manner whenever the Commission orders recovery of state aid paid contrary to the rules.”

Excerpts of speech of Com. Vestager, High-level Forum of Member States, December 18, 2014
"We have four open cases [...] We have to find out what the precise decisions were in these individual cases and learn from them. But tax agreements are not per definition illegal"

Commissioner Vestager
EU Parliament
November 11, 2014
Timeline

- **June 2014**
  - Commission opened 3 proceedings:
    - Ireland – SA. 38373
    - The Netherlands – SA.38374
    - Luxembourg – SA.38375

- **October 2014**
  - Commission opened proceedings against Luxembourg – SA.38944

- **November 2014**
  - LuxLeaks

- **December 17-18, 2014**
  - Commission announces EU-wide investigation
  - Luxembourg surrenders to information injunctions
Timeline

Q1/2015

EU directive on the automatic exchange of information amended to include ruling transparency/decision on creation of EU data base of tax rulings

February 3, 2015: EU Commission starts proceeding against Belgium's excess profit ruling system

February 5, 2015: As patent box regimes have now received broad multi-lateral support, the EU Commission has announced that it will not pursue these investigations any further

February 25, 2015: "Unhappy Meal" report – EU/US trade unions call for action from EU Commission
Timeline

Q2/2015

May 5, 2015: Commission announces postponement of Decision in 4 current individual case investigations: “We will not meet the first deadline to be done by end of the second quarter, but we will do our best…. We will not sacrifice the rule of law or quality of work to speed up the process. … “Fast is always better than slow. But best of all is being just.”

May 26, 2015: Amazon introduced a new tax structure in the UK, Germany, Italy and Spain. The Commission said it "will consider changes to the group tax structure, but these changes going forward don’t affect any advantages the company may have received in the past.”
The state aid game

- **Who?**
  - EU Commission
  - Member state
  - Beneficiary
  - Complainant

- **Why?**
  - Avoid subsidy race between EU member states
  - Ensure EU-wide competitive level-playing field

- **What / Where?**
  - Admin. proceed before the Commission
  - Appeal before the Court of Justice / Interim injunction
  - National court case

- **What?**
  - Must be “state aid”
  - Must be approved by EU
  - Standard: compatibility with the internal market
  - If not: mandatory recovery
Preliminary Examination and Formal Procedure

- (1) No aid
- (2) Compatible aid
- (3) Doubts -> FP

- Financial advantage?
- Granted by the State + via State resources?
- Selectivity
- Affectation of Trade between member states/competition

How much: Amount payable under normal tax rules – tax paid + interests
Limitation period: 10 years since grant

EU Commission (DG COMP) / member state
Procedure – recovery and appeal

**PE**
- (1) No aid
- (2) Compatible aid
- (3) Doubts -> FP

**FP**
- (1) No aid (amendments?)
- (2) Compatible aid (positive or (3) conditional decision)
- (4) Incompatible aid (Negative decision)

**Recovery**
- Commission Decision: indications
- Enforced by Member State
- (Before national Courts)
- Against beneficiary

**EU Commission (DG COMP) / Member state**
- Tribunal
- Court of Justice

**Appeal**
- Member state/ Beneficiary v. Commission

Legitimate expectations are irrelevant
Assessment of tax rulings

- **Selectivity** (as opposed to general measure) is key issue

- 3-step analysis
  - *What is the commonly applicable tax reference system?*
    - A consistent set of rules that generally apply – on the basis of objective criteria – to all undertakings falling within its scope as defined by its objective, e.g. regarding the tax base, the taxable persons, the taxable event and the tax rates
    
    The boundaries of the system of reference may not be designed in a clearly arbitrary or biased way, so as to favor certain undertakings which are in a comparable situation with regard to the underlying logic of the system in question. (*Gibraltar* case – favoring off-shore companies)

- *Does the measure constitute an exception to the reference system?*

- *Is this deviation justified by the nature/general scheme of the reference system?*
  - The measure results directly from the basis or guiding principles of its tax system: e.g. progressive nature of tax justified by redistributive considerations
1998 Commission's notice regarding state aid and direct business taxation, para 21:

"The discretionary practices of some tax authorities may also give rise to measures that are caught by Article [107]. The Court of Justice acknowledges that treating economic agents on a discretionary basis may mean that the individual application of a general measure takes on the features of a selective measure, in particular where exercise of the discretionary power goes beyond the simple management of tax revenue by reference to objective criteria."
Discretion = selectivity

- 1998 Commission's notice regarding state aid and direct business taxation, para 22

"If in daily practice tax rules need to be interpreted, they cannot leave room for a discretionary treatment of undertakings.

Every decision of the administration that departs from the general tax rules to the benefit of individual undertakings in principle leads to a presumption of state aid and must be analyzed in detail.

As far as administrative rulings merely contain an interpretation of general rules, they do not give rise to a presumption of aid.

However, the opacity of the decisions taken by the authorities and the room for maneuver which they sometimes enjoy, support the presumption that such is at any rate their effect in some instances."

NOTE: Opacity can be validly motivated by commercial sensitivity of information contained in certain rulings (i.e. pricing, IP etc...)
Deviation from OECD transfer pricing recommendations can be selectivity

- What is the Commission looking at?
  - The accepted scheme **deviates from the OECD arm's length principle** in determining net profit allocation of a given entity
  - The **taxable basis** has been freely negotiated with the tax authorities **without any reference to other comparable transactions**
  - The tax authorities **merely accepted the proposals** of the company seeking the ruling
  - **Employment considerations** strongly motivated the tax authorities
  - The financial parameters of the ruling **lack motivation in economic terms** and are not substantiated by any generally accepted methodology
    - Similar to previous *Belgian coordination centres* and *US sales corporations* cases
  - **Costs** attributable to a given entity **do not have any economic** basis but are the result of reverse engineering calculations
  - The ruling is **open-ended** in time
  - The **profit allocation factors are not consistent** throughout the company's organization
Recovery: a real risk?

- Recovery up to 10 years back is the rule

- The Commission *may* find that *legitimate expectations and legal certainty* may oppose a recovery

- However, according to ECJ case law, this requires that the beneficiaries *could not possibly doubt* that the measure was not compliant (very high standard)

- There may also be room for a political compromise at the Commission level, … but this would not limit the role of national court
What next?

- **4 test decisions in currently open cases**
  - Strong stance on tax rulings/exchange of information/EU data base
  - Appeals before ECJ
  - Political controversy around recovery – incentives of member states

- **Actions by competitors before national courts**
  - EU Commission has only limited resources; complainants can seize national courts to take "temporary" measures (including recovery) pending a final Commission decision
  - Actions can be based on precedent value of pilot cases (i.e. when competitor benefits from similar sweetheart tax deal as the one classified by the EU Commission as state aid

- **Harmonization proposals**
  - Pressure on Commission Juncker
  - Adjustments/exchanges between soft law (OECD guidelines), EU state aid law and national tax law, BEPS
  - Political consensus?
What to do?

- If you have a problematic ruling, try to go clear

- If you want legal certainty, ask tax authorities to submit ruling to EU

- What if tax authorities refuse to grant a ruling?

- A word on the AmChamEU initiative
Reporting obligations – auditors position

- Should companies involved in 5 test cases refer to state aid examination is annual accounts /SEC filings?
- Should companies involved in 5 test cases make state aid recovery provisions?
- How should companies, not being involved yet but with similar tax rulings, act/react?
Dr. Bertold Bär-Bouyssière is one of the leading practitioners of competition law in Brussels and Germany. Bertold has more than 20 years of experience in the field. A partner with DLA Piper’s Brussels and German offices, Bertold is a Fulbright alumnus and admitted to the New York, German and Brussels bars. Bertold currently heads the EU Competition team in Brussels and also has responsibilities as an Elected Member of DLA Piper's International Board. As Vice-Chair of the AmChamEU Competition Policy Committee, Bertold is Rapporteur for its "Fiscal aid" initiative, which involves exchanges with the leading Commission Officials in charge of this campaign.
Ortwin Carron has over 20 years of experience as a Belgian corporate and tax practitioner.

He focuses on transactional work, acquisition structuring and post-acquisition restructuring. He has extensive experience in negotiating tax rulings for multinational corporations and in multinational tax planning, including transfer pricing. His clients are primarily multinational companies and private equity funds.
**Michael Hardgrove** has provided international consulting, structuring and intangible transaction services to numerous public and private companies with operations throughout the world.

Michael focuses his practice on international taxation, concentrating in particular on global business structuring (GBS), a process of assessing international tax and operating cost exposures and then designing strategies for management of cost efficiency and key value drivers. Primary objectives of this process are to reduce the after-tax cost of capital and to lower the effective tax rate on profits from foreign activities.