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Competition – State Aid

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European Commission probes into national tax rulings on transfer pricing

The European Commission ("EC") has long sought to eliminate so-called harmful tax competition, which it sees as undermining the integrity of the internal market, fair competition and the fiscal sustainability of the Member States. Although the EU Member States remain sovereign in this area, over the years there have been numerous initiatives to tackle this problem at the EU level, such as attempts to introduce a 'Common Consolidated Corporate Tax Base', or the 'Code of Conduct on Business Taxation', under which Member States commit to eliminate regimes deemed to be harmful.

Following a number of media reports into significant tax reductions granted to some multinational companies, the EC has recently stepped up its efforts, this time using EU State aid rules. It has taken the exceptional step of creating within its Competition Directorate-General a 'task-force' dedicated to investigating national tax rulings which validate advantageous calculations of the taxable basis, based on transfer pricing arrangements. Competition Commissioner Almunia has made it clear that he means business:

"Because aggressive tax planning is contrary to the principles of the Single Market, even under the present distribution of competences between the EU and its Member States. A limited number of companies actually manage to avoid paying their proper share of taxes by reaching out to certain countries and shifting their profits there. In those cases where national laws or tax-administration decisions permit or encourage these practices, there might be a State aid component involved and I intend to go to the bottom of it".[1]

The focus of the task force's investigation became clearer on 11 June 2014,[2] when it announced the opening of 'formal investigations' in three cases involving the treatment of individual companies by the tax authorities of Ireland, the Netherlands and Luxembourg. In these cases, the EC has expressed doubts that the calculations used to determine the taxable basis could underestimate the taxable profit, and thereby grant an advantage to the companies in question by allowing them to pay less tax. Specifically, the EC is investigating:

- Ireland/Apple: the tax rulings issued by the Irish tax authorities on the calculation of the taxable profit allocated to the Irish branches of Apple Sales International and of Apple Operations Europe;
- Netherlands/Starbucks: the tax ruling issued by the Dutch tax authorities on the calculation of the taxable basis in the Netherlands for manufacturing activities of Starbucks Manufacturing EMEA BV; and

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1 Speech of Joaquin Almunia on 11 February 2014, SPEECH/14/119.

2 EC Press Release of 11 June 2014 IP 14/663.

- Luxembourg/Fiat Finance and Trade: the tax ruling issued by the Luxembourgish tax authorities on the calculation of the taxable basis in Luxembourg for the financing activities of Fiat Finance and Trade.

National tax practices are caught by EU State aid rules when these are deemed to confer an economic advantage, granted from State resources, to certain undertakings or sectors, affecting intra-EU trade and threatening to distort competition. The key question in tax cases – which is likely to be strongly contested here – is whether the measure is 'selective', or whether it forms part of the general regime.

If the EC concludes that any of the measures do indeed constitute State aid, the consequences could potentially be dramatic. In principle, State aid is prohibited unless the EC deems it 'compatible with the internal market'. Compatibility is assessed according to detailed rules and guidance documents, depending on the sector or objective pursued, but it is not clear which would apply in the present cases. Any incompatible State aid which has already been granted should in principle be recovered by the Member State, with interest. Exceptionally, the EC may waive the recovery obligation in order to protect a company's legitimate expectations, but such cases are rare.

The prospect of these companies having to repay any tax advantages received is, for the moment, still a distant possibility. The opening of the EC formal investigation does not prejudge the outcome. The Member States concerned, the companies in question and other interested third parties will all have an opportunity to submit comments to the EC. On the basis of these, the EC will conclude whether or not the measures involve (compatible) State aid. The EC aims to conclude formal investigations within 18 months, but this can take longer in complex cases. Another delaying factor is the refusal by the Luxembourgish authorities to provide certain details to the EC, invoking fiscal secrecy rules. The EC has referred the matter to the European Court of Justice,[3] which could delay at least the investigation concerning the Luxembourg measure.

These three investigations will probably be test cases, with other cases likely to follow. The EC has already stated that it is, in parallel, continuing its inquiry into the tax practices of these, and other, Member States.

Companies which have benefited from tax rulings which confirm transfer pricing arrangements would be advised to follow these developments closely, and, where appropriate, liaise with the relevant national authorities, as these may ultimately have to defend their practices before the EC.

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3 EC Press Release of 24 March 2014, IP/14/309.