

**EU STATE AID REVIEW OF TAX RULINGS: WHAT MULTINATIONAL CORPORATIONS CAN DO NOW**

Multinational corporations (MNCs) who are substantially relying on tax rulings in the EU should be aware of the potential challenges under EU State aid rules. This memo summarizes some actions MNCs can take to mitigate financial risks and reduce legal uncertainty.

**I. BACKGROUND**

Tax measures that selectively favour MNCs have been actively challenged under EU State aid rules for more than 15 years. Since 2013, the European Commission is closely monitoring individual tax rulings, in particular rulings relating to transfer pricing (advance pricing agreements).

In addition to the six formal investigations opened in 2014 and early 2015 against measures applied by Ireland, Luxembourg and the Netherlands in favour of individual MNCs, by Belgium under its excess profit ruling system and by Gibraltar as part of its territorial corporate tax system<sup>1</sup>, the Commission is further examining the ruling practices of many EU Member States<sup>2</sup> and has indicated that new formal investigations may be opened shortly.

Furthermore, the Economic and Financial Affairs Council (Ecofin) has on June 19 discussed a proposal under which Member States will be required to automatically transmit cross-border tax rulings and advance pricing arrangements to other Member States and to the European Commission. This exchange obligation would extend to rulings that have been issued during a period (possibly ten years) before the introduction of the new rules. The proposal may be adopted before the end of 2015.

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<sup>1</sup> Commission Decision of 11 June 2014 in Case SA.38373 (Apple), OJ C 369, 17.10.2014, p. 22; Commission Decision of 11 June 2014 in Case SA.38375 (FTT), OJ C 369, 17.10.2014, p. 37; Commission Decision of 11 June 2014 in Case SA.38374 (Starbucks), OJ C 460, 19.12.2014; Commission Decision of 7 October 2014 in Case SA.38944 (Amazon), OJ C 44, 6.2.2015; Commission Decision of 1 October 2014 to extend proceedings in Case SA.34914 (Gibraltar offshore companies), not yet published; Commission Decision of 3 February 2015 in Case SA.37667 (Belgian excess profit rulings), OJ C 188, 5.6.2015.

<sup>2</sup> See the European Commission's press releases IP/14/2742 of 17 December 2014 and IP/15/5140 of 8 June 2015.

## II. WHAT IS AT STAKE?

Under Articles 107 and 108 TFEU, any State aid granted by Member States to undertakings is prohibited unless such aid has been authorized, prior to its implementation, by the European Commission. Tax measures favouring individual companies or sectors may be considered as State aid.

Against this background, a successful challenge of a tax ruling under EU State aid rules may have severe financial consequences. In addition to a prohibition to continue the concerned ruling, the Member State that granted the ruling will normally be required to recover the fiscal State aid granted over the past ten years, increased with interest<sup>3</sup>.

With its current EU State aid investigations into individual tax rulings, the European Commission is clearly testing the scope of EU State aid rules. Certain arguments underlying the Commission's current reasoning are questionable and untested before the European Courts.

With limited precedents and guidance available, some MNCs have criticized the current lack of legal certainty. However, actions can be taken to mitigate the financial risks and reduce legal uncertainty.

## III. WHAT CAN MNCs DO NOW?

### A. **Identify problematic tax rulings**

MNCs should review all tax rulings granted to their group by tax authorities in the European Union.

***What should be the focus of the review?*** Obviously, not all tax rulings are problematic from a State aid perspective. Tax rulings that merely confirm or interpret the law in accordance with general tax principles or case law do not constitute State aid.

The focus of the review should be on tax rulings that confirm the application of open norms or very factual circumstances and on tax rulings which were adopted after detailed negotiations. The review seeks to confirm that the tax ruling upholds a reasonable appreciation of the facts and a defensible interpretation of tax rules. If this cannot be confirmed, the tax ruling may be problematic from a State aid perspective.

***Are only transfer pricing rulings concerned?*** No. Most of the current Commission investigations relate to transfer pricing but other tax arrangements may

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<sup>3</sup> For more information on the application of State aid rules to tax rulings, see our [Alert Memorandum dated 17 September 2013](#).

equally be scrutinized under EU State aid rules, including tax rulings that do not have a cross-border dimension.

Tax rulings regarding open tax norms and rules requiring factual appreciation are most likely to be challenged. Examples include tax rulings which confirm that general or specific anti-abuse rules will not be applied to a certain transaction, tax rulings confirming the absence of a taxable permanent establishment, tax rulings confirming that certain income items are outside the scope of a territorial tax regime, etc.

Tax rulings regarding qualification issues, such as with respect to hybrid instruments (qualification as debt or equity), hybrid entities (qualification as tax transparent or opaque) and similar tax mismatch arrangements are concerned too.

***Should only currently applicable tax rulings be reviewed?*** Since State aid can be recovered retroactively, any tax rulings on which the company relied during the past ten years are relevant. This being said, given the high number of tax rulings potentially coming within the scope of State aid review, it can be expected that the European Commission will prioritize and focus on incompatible tax rulings on which MNCs continue to rely today.

***Is it just the text of the tax ruling that must be reviewed?*** The actual text of the tax ruling is the starting point but it is not the end. In order to assess whether the ruling may constitute State aid, the underlying fact pattern including the contractual documentation should be reviewed in detail.

The position of the European Commission is that tax authorities should not merely rely on the information and factual description provided by the taxpayer. They should instead review all information and underlying contractual documentation, challenge the statements made by the taxpayers and question the alleged business motives of envisaged transactions. A tax ruling that would have been “normal” had the facts presented by the taxpayer been correct (e.g. the fact that a taxpayer is a mere toll manufacturer) may still be problematic if those facts turn out to be wrong (e.g. the taxpayer in reality bears the risks and exercises the functions of a full-fledged manufacturer). This problem arises in particular where rulings have been granted by “passive” tax authorities without thorough review of the ruling request.

***Are only official tax rulings concerned?*** State aid can be granted through formal tax rulings but also by more indirect means. Informal agreements with local tax inspectors or even a position taken in a tax return that is not being challenged by the tax authorities, may also be at risk.

**B. Assess the associated risk**

Once problematic tax rulings have been identified, the potential risk should be assessed.

This may not always be evident and raises several unsettled legal issues.

For instance, in the event that a tax ruling allocating certain profits to an MNC's local manufacturing or distribution activities would be considered as a selective advantage, one would have to determine the actual tax revenue foregone by the Member State pursuant to that ruling. Determining the "normal" profit to be allocated to the MNC's local manufacturing and distribution activities will typically require (i) a functional analysis and review of contractual documentation in order to determine the functions performed, resources employed (including IP) and significant risks assumed by these activities, (ii) the identification of an appropriate pricing methodology and (iii) the preparation and interpretation of a benchmark study. As transfer pricing is not an exact science, experts may have diverging opinions on a number of these elements.

In principle, these assessments have to be made in the light of factual elements and normal transfer pricing practice at the time the contested rulings were granted (possibly with regular intervals, if those rulings were granted for unreasonably long periods). In practice however, some Commission statements show that the assessment may be impacted by subsequent evidence (such as actual sales figures realized by the taxpayers) and more recent policy developments such as the increased focus on substance and value creation in the BEPS project<sup>4</sup>.

In other cases the advantage may be more easy to assess. For instance, the Belgian excess profit rulings are usually implemented through an annual downward "tax" correction of the Belgian taxpayer's accounting profits. This makes an assessment of the granted benefit relatively straightforward, should it be concluded that these excess profit rulings constitute State aid as a whole.

**C. Possibly, amend or renew tax rulings**

MNCs that are heavily relying on tax rulings in the EU should consider asking a renewal of their tax rulings. There may be various good reasons to do so.

Firstly, as indicated above, the European Commission is more likely to prioritize the review of tax rulings that continue to be relied on by MNCs. MNCs who apply for new, EU-compatible tax rulings may be able to reduce their risk exposure for the past.

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<sup>4</sup> Base erosion and profit shifting. For more background on this OECD project initiated in 2012, see <http://www.oecd.org/ctp/beps.htm>.

Secondly, a new tax ruling may be notified to the European Commission in order to avoid any later discussion on EU compatibility. This may be appropriate in some cases where a new tax ruling turns out to be particularly favourable for the taxpayer even though it is believed that such benefit results from a normal application of the general tax system. Only the Member State, not the taxpayer, can make such notification.

Thirdly, even if an existing tax ruling is not considered problematic as such, in that it confirms the application of general tax rules in line with established principles and case law, it may have been granted in the past through a deficient ruling procedure, *i.e.*, a ruling procedure that does not meet certain requirements in terms of quality (rulings without expiry date or very long duration, rulings granted without a thorough examination by the ruling authority, *etc.*) and transparency. According to the European Commission such rulings create a presumption of State aid and are thus more likely to trigger State aid scrutiny. Even if there is in substance nothing wrong with the tax ruling, MNCs will want to avoid that this EU compatibility can only be established after State aid proceedings, given the cost, waste of management time and reputational damage that such proceedings inevitably entail.

#### **D. Defend your case?**

A State aid investigation is a bilateral procedure between the European Commission and the Member State concerned.

However, taxpayers who are affected by a State aid review of tax rulings, be it as recipient of the tax ruling, as recipient of similar aid, as competitor (not benefiting from similar aid), or otherwise, may wish to defend their case.

While not formally a party to the proceedings, any interested person is entitled to submit comments to the Commission within one month following the publication of the Commission's decision to open a formal investigation procedure. In the Commission investigations into tax rulings, the one-month period has expired with respect to the opening decisions in Apple, Starbucks, FTT and Amazon and is currently running (until 6 July 2015) with respect to the Belgian excess profit ruling case. The period is not yet running with respect to the extension to individual tax rulings of the investigation into Gibraltar's corporate income tax. Any late comments can be rejected, although the Commission may consider them for background information.

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If you have any questions with respect to the issues addressed herein, please contact any of your regular contacts listed at <http://www.cgsh.com/>.

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