King & Spalding

# Client Alert

Tax Practice Group

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## The EC Challenge on Tax Rulings. Why it's Important that Your Business Acts Now in Relation to EU Challenges to Tax Rulings

### Summary

21 October 2015: Following state aid investigations, the European Commission has ordered Luxembourg and the Netherlands to recover unpaid taxes of €20-30m from each of Fiat and Starbucks. The Commission has confirmed that certain Tax Rulings historically provided by the Netherlands and by Luxembourg gave each company a selective tax advantage and, therefore, constituted unlawful state aid. The recovery is being required to remove the unfair competitive advantage. Further investigations will be announced shortly.

### The Issues

Certain Tax Rulings granted to Member State businesses are subject to European Commission (EC) unlawful state aid investigations.

- Where unlawful state aid has been provided to a taxpayer, the Member State granting that aid must require it to be repaid (with relevant interest and penalties).

- Some investigations will eventually result in payment of substantial tax settlements by affected taxpayers.

- From the businesses' perspective, the investigations are time consuming and expensive in terms of required management focus and adviser involvement.

- Auditors are requiring many businesses with Tax Rulings to confirm the financial consequences for the business were the Ruling to constitute unlawful state aid. In the absence of appropriate comfort, the accounts of the business may be provisioned.

- Providing the appropriate comfort will often require a full review of the Tax Ruling to determine its status for state aid purposes.

- The increasingly aggressive climate (which has become more prominent in recent months) means that it should be assumed that ALL Tax Rulings will head towards the microscope.

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- Other announced investigations include Starbucks (Luxembourg), MacDonald's (Luxembourg), Amazon (Ireland), and Apple (Ireland). Further announcements will follow shortly.

**When does a Tax Ruling constitute unlawful state aid**

EU law prohibits Member States from providing state aid in a way that distorts competition. This includes Tax Rulings that meet certain conditions:

- The Ruling grants an 'economic advantage';
- This advantage must be financed through State resources;
- The Ruling must distort, or threaten to distort, trade and/or competition between Member States; and
- The Tax Ruling must be specific or 'selective' by benefitting certain undertakings or the production of certain goods.

'*Selective' tax advantage*: The EC is concerned that Member States are using Tax Rulings to provide 'selective' tax advantages that do not comply with the arm's length principle and OECD transfer pricing guidelines.

Transfer pricing agreements/Rulings: Rulings provided to businesses in relation to their transfer pricing policies are of particular focus in EC investigations.

**The Starbucks and Fiat decisions**

In the case of Starbucks, the EC concluded that a Tax Ruling issued by the Dutch authorities in 2008 to a Starbuck Dutch subsidiary (Starbucks Manufacturing) gave it a selective advantage, and reduced its tax burden by €20-30m. In particular, according to the EC, the 2008 ruling artificially lowered taxes paid in two ways:

- Starbucks Manufacturing pays a very substantial royalty to Alki (a UK-based company in the Starbucks group) for coffee-roasting know-how.
- It also pays an inflated price for green coffee beans to Switzerland-based Starbucks Coffee Trading SARL.

Starbucks says it intends to appeal.

In the case of Fiat, the EC states that a tax ruling issued by the Luxembourg authorities in 2012 gave a selective advantage to Fiat's financial subsidiary, Fiat Finance and Trade, which has unduly reduced its tax burden since 2012 by €20-30m. It states that the 2012 Tax Ruling "endorses an artificial and extremely complex methodology that is not appropriate for the calculation of taxable profits reflecting market conditions. In particular, the EC concluded it artificially lowered taxes paid by Fiat Finance and Trade in two ways:

- Due to a number of economically unjustifiable assumptions and down-ward adjustments, the capital base approximated by the Tax Ruling is much lower than the company's actual capital.
- The estimated remuneration applied to this already much lower capital for tax purposes is also much lower compared to market rates.

**In light of current EC challenges, what actions should your business consider**

The increasingly aggressive climate means that it should be assumed that ALL Tax Rulings are likely to be reviewed by the EC and/or by auditors. Actions:

- Review, with relevant business stakeholders, whether your business is party to Tax Rulings granted by an EU Member State.

- Businesses with Tax Rulings in certain jurisdictions should carefully assess those Rulings; EC investigations are currently, particularly, focused on Luxembourg, Ireland, the Netherlands and Luxembourg. This focus will broaden.

- EC investigations are likely, eventually, to cause contagion with regard to non-EU jurisdictions within Europe (e.g. Switzerland) / globally.

- Simultaneously:

    - Assess, preferably with independent counsel, the detailed terms of Rulings to determine whether they involve, or may involve, the provision of unlawful state aid; and

    - Discuss with your auditors what level of 'comfort' they may require in view of existing Tax Rulings in assessing any potential provisioning in the business' financial statements.

- Understand the scope of the investigation so you can gather the correct evidence in order to present the most compelling and constructive arguments and to manage resulting risks.

- To the extent state aid risk exists, consider protective measures or defences available to mitigate the impact of a potential future challenge.

- Throughout, manage the many stakeholders (internally and externally) within the process who must be collaborated with to ensure the case is navigated to a prompt (and successful) outcome.

- Create appropriate budgets within the business to ensure that all actions are appropriately funded.

**How can King & Spalding help you**

We are a pre-eminent global law firm with legal practitioners of the highest quality and reputation. Our tax and anti-trust teams are highly experienced and respected, with the ability to manage an effective and speedy investigation. We will provide strategy and thought leadership at all stages in the process based on our substantial experience.

Working closely alongside you, we provide the highest standard of comprehensive analysis to ensure your case proceeds as promptly as possible to resolution.

We help you and your business to:

- Navigate the highly complex area of state aid;

- Work constructively and objectively with the auditors;

- Maximise engagement with the authorities throughout;

- Defend challenges from the EC and/or other interested third parties;

- Conduct any resulting judicial or other proceedings; and

- Mitigate or eliminate any resulting liabilities.