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10 Steps to Mitigate EU State Aid Exposure on Tax Arrangements

As the European Commission reviews whether tax arrangements conform with State aid rules, companies active in Europe should ensure their fiscal regimes comply with EU law.

In recent years, the European Commission (the Commission) has focused its attention on State aid issues in the context of Member States' tax treatment of multinational companies (and in particular with respect to certain tax rulings issued by Member States to such companies). Although the Commission has previously looked into competition distortions arising at the national level from tax measures, the latest wave of State aid cases is notable in terms of investigations being conducted in parallel across several Member States.

State aid is a European law concept that essentially prohibits Member States from providing a selective advantage to companies (for example, in the form of preferential tax treatment or preferential benefits). Accordingly, fiscal measures of a general nature that apply to all companies without distinction do not constitute State aid. While it will be the case that a great many tax rulings granted to companies fall outside the scope of State aid (and indeed have the tangible benefit of providing legal certainty to taxpayers undertaking complex transactions and to the tax authority), the Commission has looked more closely at some tax rulings that are alleged to have given preferential treatment to individual companies.

Since 2013, the Commission has been examining more than 1,000 tax rulings involving numerous companies across the 28 EU Member States.[1] As a result of this broad review, the Commission has opened in-depth State aid investigations into tax rulings granted by fiscal authorities in Ireland, Luxembourg, the Netherlands and Belgium. Four of these investigations have resulted in the Commission ordering the recovery of past State aid for an unprecedented total amount of around €14 billion. Given the amounts at stake, these decisions are likely to be appealed (either by the Member State in question, or by the relevant company), though the Commission's State Aid investigations remain ongoing.

In light of the above, companies active in the EU should take steps to consider whether their tax rulings, advance pricing agreements, or other tax arrangements are compliant with EU law. This *Client Alert* identifies 10 precautions that companies should bear in mind to better ensure compliance with State aid and other EU rules.

1. Think EU State aid law, not just tax planning

The current Commission investigations are groundbreaking in the corporate income tax area as, for the first time, the Commission is using its powers of State aid control to address national corporate income tax practices on an EU-wide scale. The investigations also have significant financial implications for the

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parties concerned, as they potentially result in an obligation to repay several years of “tax savings” with interest. It is clear that, in addition to reviewing tax rulings from a pure tax law perspective, companies should assess any ruling validating a specific tax arrangement in Europe in light of State aid law and, if necessary, obtain adequate State aid advice.

2. Understand the notion of what may constitute State aid and its consequences

Article 107 of the EU Treaty defines State aid as an advantage, in any form whatsoever, granted by a public authority or through public resources to one or more undertakings on a selective basis. The EU Treaty requires Member States to notify the Commission of all new State aid measures, and wait for approval before putting the measure into effect. Failure to do so may trigger not only a negative Commission decision, but also scrutiny by any national court asked to consider the issue, typically by a competitor. In either case, EU procedural rules allow the recovery of the illegal State aid with a 10-year limitation period that runs from the Commission’s first enquiry into the ruling.

The application of State aid rules to tax measures rests upon the concept that a reduced tax bill may constitute an advantage that a Member State provides to the relevant company. The State aid analysis asks whether the measure provides a selective advantage to some companies, *i.e.,* a fiscal position that discriminates between taxpayers, and whether this selective advantage is in line with the “nature and economy” of the overall tax system. In other words, fiscal measures of a general nature that apply to all companies without distinction do not qualify as State aid.

3. Consider what type of fiscal arrangement you benefit from

A tax ruling is a fiscal authority’s decision providing a taxpayer with clarity on their tax position. The ruling may also clarify the interpretation of particular tax provisions. Tax rulings provide legal certainty for taxpayers, often by confirming the future tax treatment of complex commercial transactions. The Commission accepts that such rulings can be perfectly legal and legitimate in principle. However, the Commission considers that a ruling may involve State aid if it provides a selective advantage to the relevant taxpayer that does not correspond to economic reality.

For example, the Commission has found in recent negative decisions that certain tax rulings allowed the companies in question to adopt artificial and complex methods to quantify their taxable profits. Under those rulings, according to the Commission, these companies were able to set prices for intercompany sales and services that were not at “arm’s length” and/or did not correctly reflect the Organisation for Economic Co-operation and Development’s (OECD’s) transfer pricing principles. The Commission held that these rulings provided the companies a selective advantage amounting to unlawful State aid.

While transfer pricing has been an area of tax law traditionally subject to the scrutiny of national tax authorities, the Commission’s approach in recent cases suggests that it will make its own assessment of whether the arrangements are compatible with the OECD principles, and that assessment may provide a multijurisdictional overview.

4. Analyze consistency with State aid law

Any multinational group or corporation that has obtained a tax ruling from a Member State should reassess the legality of its position from a State aid law perspective. This implies several practical steps:

- Identify the current rulings, advance pricing agreements, and other formal or informal agreements with Member States and their legal basis under national law. Some individual rulings granted on the

basis of tax planning schemes, such as those colloquially referred to as "*Double Irish"* schemes, have already been found to be at odds with State aid law. If your company's tax returns are based on a ruling issued under such a scheme, ascertaining the risks under State aid law would be advisable.

- Gather all possible evidence to support that the Member State's actions were correct when granting the ruling, including evidence that the company presented to its advisers and to the tax authorities and evidence of the level of engagement of the relevant fiscal authority in the ruling process.
- Consider the extent to which the functional analysis and indicative arm's length prices presented to the tax authority may have been inaccurate.
- Gather all of the evidence related to how the agreement was monitored internally, both by your tax advisers and by the tax authority.
- If necessary, create — as far as possible — a functional and benchmarking analysis of the arrangements at the time of the agreement. Consider how this changed over time and the extent to which a revised agreement could have been appropriate.
- If relevant, evaluate the potential State aid advantage to calculate the possible financial exposure and consider what provision to make for this in the accounts.

5. Consider the complexity of the State aid legal issues …

State aid is a particularly complex area of EU law. It is often difficult to assess whether a measure may be viewed as constituting aid that should be notified to the Commission and approved prior to any implementation. Companies should bear in mind that the EU Treaty enables the Commission to maintain a constant review of existing aid.[2] The Commission may therefore ask a Member State at any time to abolish or alter aid which it considers incompatible with the EU single market.

6. … and engage as early as possible with the Commission

Taxpayers cannot rely on any general expectation or even explicit assurances that Member States abide by EU law.[3] In particular, taxpayers cannot assume that a fiscal measure they benefitted from is compatible with EU law if it has not been notified to, and approved by, the Commission, or if the measure has not been properly block-exempted.[4] When in doubt as to the State aid nature of a fiscal arrangement and its compatibility with EU law, companies should proactively engage in a dialogue with the Commission as early as possible, in addition to any discussion with national tax authorities.

7. In case of an investigation, be proactive

To the extent that a ruling or agreement is being investigated, companies should actively engage with the Commission to represent their position, help the Commission understand the national law and relevant facts and, to the extent possible, advocate for the correctness of the relevant Member State's actions.

When opening a State aid investigation, the Commission asks interested parties to provide input on a wide range of issues. In the recent tax ruling cases, these issues included actual transfer prices set for intragroup transactions, the reasons to consider unilateral downwards adjustments at arm's length, and the actual allocation of the profits exempted to the other entities of the group. Companies have scope to explain and justify their position to the Commission and should seize the opportunity to do so, rather than simply rely on the relevant Member State to defend the companies' position. Experience shows that the interests of the Member State and the relevant company do not always coincide. Furthermore, refraining

from participating in the investigation process could weaken a company's legal position in any subsequent action against the Member State or the Commission.

8. In case of a negative decision, consider bringing an appeal before the EU courts and, in any case, engage with national authorities

If the Commission hands down a negative decision imposing recovery of State aid, the company may seek to revise or nullify the decision by filing an application for annulment before the EU General Court. Although Member States granting aid routinely appeal negative decisions, the company's position and interest may differ from those of the Member State. Moreover, the beneficiary of an aid measure that forgoes its chance to challenge a Commission decision in front of the EU Courts can no longer raise arguments against the decision's substance in recovery-related litigation before national courts.[5]

Appealing a negative decision does not suspend the recovery of the State aid, which will be dealt with according to national procedural rules, under the Commission's supervision. The Commission's decision does not indicate the amount the Member State must recover, but only the methodology to calculate it. The taxpayer should therefore contact the relevant domestic fiscal authority to present its arguments concerning the determination of that amount. The taxpayer should seek local tax advice to ensure that its rights are preserved in the national proceedings implementing the Commission's decision, and should continue engaging with the Commission to carefully monitor the approval of the recovery measures.

9. Continue to monitor where the EC is focusing

In the absence of a unified EU corporate tax regime, the Commission has two basic options to reduce the negative effects of inconsistencies across Europe: tax harmonizing legislation (which requires unanimity in the European Council and is consequently difficult to adopt) or State aid control (for which the Commission has exclusive competence and very powerful tools — as we have seen in the recent Commission decisions).

Alongside its recent investigations into Member States' tax measures, the Commission has continued to propose tax harmonizing legislation, such as its recommendations on aggressive tax planning[6] and on minimum standards of good governance in tax matters.[7] The Commission also recently adopted the Anti-Tax Avoidance Package, which reflects the OECD's anti-Base Erosion and Profit Shifting project and introduces suggestions for "fairer, simpler and more effective" corporate taxation in the EU.[8] The Commission has also announced, for late 2016, a proposal to introduce a mandatory Common Consolidated Corporate Tax Base, *i.e.*, a common system for calculating the tax base of businesses operating in the EU.[9] These far-reaching initiatives provide strong political cover and are important background for the Commission's assessment of Member States' treatment of taxpayers.

Interested companies should consider participating in the ongoing political and academic debate at the EU level around State aid control and proposals for greater tax harmonization. Participation can include a strategy ensuring regular contacts with relevant European institutions, industry representations and consumers associations. Such contacts should be appropriately targeted and the content of the discussions approved by EU counsel.

10. Do not underestimate the impact of State aid rules on your company

While the Commission has previously used State aid rules to tackle individual Member State tax issues, recently it has relied more heavily on this instrument to address multinational tax practices that it perceives as harming the distribution of tax revenues between the Member States. Member States may perceive this development as highly invasive as it touches upon their fiscal autonomy and choice of

economic policy. The European Courts in Luxembourg will have to decide whether this course of action is appropriate and has been correctly implemented in these cases. However, clearly the Commission has found a way, at least in the short term, to review and control not only tax rulings, but more generally the fiscal arrangements of its Member States in relation to corporations resident in its territory.

The European Commissioner for Competition, Margrethe Vestager, has repeatedly affirmed that further enforcement in the State aid area is a priority of her mandate and that she will continue the enquiry into the corporate tax practices of all Member States. Other individual transfer pricing rulings and rulings relating to other kinds of tax issues (for example, taxation of intellectual property or deductibility of interest) may therefore be part of future State aid investigations. It is also highly likely that national judges will increasingly be asked to consider State aid issues.

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Endnotes

[1] See DG COMPETITION Working Paper on State Aid and Tax Ruling, para. 6.

[2] Article 108 of the Treaty on the Functioning of the European Union.

[3] Undertakings to which aid has been granted may not, in principle, entertain a legitimate expectation that the aid is lawful unless it has been granted in compliance with the procedure laid down in Article 108 of the Treaty on the Functioning of the European Union. See for example, Judgment of the EU Court of Justice of 20 March 1997 Land Rheinland-Pfalz v Alcan Deutschland, ECLI:EU:C:1997:163, para. 31.

[4] See Commission Regulation (EU) N°651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0651&from=EN).

[5] Case C-188/92, TWD Textilwerke Deggendorf v Germany, [1994] ECR I-833, paragraphs 17, 25 and 26.

[6] Commission Recommendation of 6.12.2012 on aggressive tax planning, COM(2012) 8806, final.

[7] Commission Recommendation of 6.12.2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters, COM(2012) 8805, final.

[8] See Commission Press Release of 28 January 2016, (available at: http://europa.eu/rapid/pressrelease_IP-16-159_en.htm).