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THE EUROPEAN COMMISSION GETS TOUGH ON PREFERENTIAL TAX RULINGS

A decision by the European Commission that Starbucks and Fiat should pay back 'illegal' State aid has serious consequences for a company's tax structures.

A summary

On 21 October 2015, the European Commission announced that tax rulings granted to Starbucks and Fiat by the tax authorities of the Netherlands and Luxembourg constitute illegal State aid. Starbucks and Fiat will now be required to pay back between €20 and €30 million each, the total benefit they are said to have received under the tax rulings.

These landmark decisions signal the Commission's determination to clamp down on tax avoidance by private businesses as part of its action plan for fair and effective taxation, adopted in the wake of the 'Lux Leaks scandal'. The decision is likely to lead to a number of further challenges to historical tax rulings issued by the tax authorities of Member States.

What is State aid?

State aid rules are one of the pillars of competition law. They are designed to ensure that the State does not intervene in the market in a way that leads to distortion of competition. State aid rules make it illegal for public bodies to provide a selective advantage to an individual business or businesses, apart from in defined circumstances. For State aid to exist the following factors need to be present:

- There must be an advantage – if the State acts towards a business as a rational market operator would, for instance by granting a business a loan at a standard market rate, then the business will not receive 'aid'.
- The advantage must be granted through State resources – this includes situations where the State loses revenue it would otherwise receive, for example where land is sold at an undervalue.

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- The advantage must favour certain business or certain types of goods – if a scheme applies equally to all businesses in a Member State, there is no State aid.
- The advantage distorts or threatens to distort competition, and distorts trade between Member States – the Commission routinely finds this condition to be met if the other three conditions have been met.

State aid rules have been applied to a wide range of situations, including loans granted by the State on favourable terms, State guarantees against losses, and sales of land or equipment at an undervalue.

Why were the deals illegal?

Starbucks and Fiat were issued individual tax rulings by the Dutch and Luxembourg tax authorities respectively. These tax rulings date back to 2008 for Starbucks and 2012 for Fiat. The decision is not an attack on companies receiving individual tax rulings, with the Commission stating *"Tax rulings as such are perfectly legal."*

Instead, the decision is an attack on companies receiving individual tax rulings that allow them to pay a lower rate of tax in one country than can be economically justified. The Commission has stated that in both cases the tax calculation had been made using *"artificial and complex methods"* which *"do not reflect economic reality"*. This had been done by setting prices for goods and services sold in the group (transfer prices) that did not correspond to market conditions. Whilst the text of the final decisions had not been released at the date of publication of this bulletin, the press release indicates that:

- In the case of Fiat Finance and Trade, the way in which the company calculated its taxable profit was not in line with market standards and should not have been accepted by the Luxembourg tax authority.
- In the case of Starbucks, the way in which the company had structured its tax affairs meant that much of the revenue derived from Starbucks' coffee roasting operations in the Netherlands had been moved outside the Netherlands through payments to other group companies. These transactions were not in line with market reality, as they were not at 'arms-length', and should not have been accepted by the Dutch tax authority.

The most interesting feature of the decision is that it focuses not on the behaviour of the public authorities, but on the behaviour of private businesses in how they have structured their tax affairs. Whilst State aid decisions would normally focus on whether a public authority has acted in line with economic reality, the decisions appear to focus on whether the tax affairs of private businesses were structured in line with economic reality - with the fault of the public bodies being in not challenging these structures.

What are the consequences of the decision?

The immediate consequence of the decision is that both companies will be required to pay back between €20 million and €30 million plus interest, even if there is an appeal against the decision. Similar decisions against Apple in Ireland and Amazon in Luxembourg may be issued, and it is expected that the Commission will open similar investigations against previous tax decisions in the near future.

The Commission's decision will have a significant impact on the way companies structure their tax affairs. The tax authorities of Member States will have to make more detailed investigations into such structures, and may be less likely to make tax rulings for companies without first consulting the Commission to check their compatibility with State aid. Intra-group transfers of capital or loans will come under particular scrutiny. Schemes that result in capital being distributed from an EU Member State to countries which have low tax regimes, whether inside or outside the EU, but where a company has little physical presence are likely to be targeted.

The decision is a clear signal that the Commission is prepared to enforce its aims, set out in its action plan for fair and effective taxation, to tackle tax avoidance and ensure that companies should pay a fair share of tax in the country where they make their profits.

What should companies do?

Companies that have received past rulings from the tax authorities of Member States should carefully review these rulings and the circumstances surrounding them. If the amount of tax payable under these rulings is based on intra-group transactions that do not reflect similar transactions on the open market, or if turnover, profit or capital calculations appear to differ from acceptable norms, legal advice should be sought.

Companies should always conduct due diligence in their dealings with public entities, including tax authorities, to ensure compliance with State aid rules. If concerns exist, companies should insist that the public authority makes a referral to the Commission, to ensure that the Commission declares a measure or transaction compatible with the rules before it is entered into.



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