Euro Tax Flash

Issue 288 – June 13, 2016

Euro Tax Flash
from KPMG's EU Tax Centre

EU Commission publishes opening decision in McDonald’s case

Fiscal State aid – Tax rulings – Tax treaty law

On June 6, 2016 the European Commission published a non-confidential version of its decision to open a State aid investigation into a tax ruling obtained from Luxembourg by McDonald's (available in the State aid register). The decision was originally announced on December 3, 2015, when the Commission took the preliminary view that the tax ruling issued by the Luxembourg Tax Administration to McD Europe Franchising S.à.r.l. may constitute State aid within the meaning of Article 107(1) TFEU.

For more information, also see the European Commission's Press Release of December 2015.

Background

The case concerns a Luxembourg company with a US branch to which royalties received by the company were allocated. The Luxembourg Tax Administration issued a tax ruling in 2009, according to which the royalty income of the US branch was – based on the double tax treaty with the United States - exempt from tax in Luxembourg even if this income was not subject to tax in the United States. A previous ruling had reached the same conclusion, but on the assumption that the income was subject to tax in the United States.

Under EU law, the Commission is obliged to review State aid granted by EU Member States. Tax rulings have increasingly become a center of attention as their investigation is one of three relevant EU initiatives in the areas of tax transparency (see ETF 247) and tackling harmful tax competition between Member States and tax avoidance (see ETF 253). The investigation into the McDonald's tax ruling is one of a series of State aid investigations launched by the Commission and the third one focusing on Luxembourg.

The EU Commission's decision

Referring to well-established case law, the EU Commission applied the three-step analysis to determine whether a tax measure constitute a selective advantage. Firstly, identifying the so-called "reference system". Secondly, determining whether the tax measure in question constitutes a derogation from that system in so far as it differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. Lastly, by assessing whether an established derogation may nevertheless be justified by the nature or the general scheme of the reference system.

The EU Commission considers that the Luxembourg corporate income tax system constitutes the reference system against which the tax ruling in question should be examined. In this respect, the Luxembourg tax corporate tax system was also considered to include the double tax treaties to which Luxembourg is a party. Furthermore, the tax ruling was considered a selective derogation from this system. In the view of the EU Commission, the Luxembourg Tax Administration misapplied the tax treaty, as there was no possibility that the United States would tax the income attributed to the US branch. The Luxembourg Tax Administration should therefore not have issued the ruling and therefore the ruling represents a preferential treatment of the taxpayer. Finally, the EU Commission held that it had not identified any justification for this preferential treatment.

EU Tax Centre comment

The emphasis in the decision is on the double non-taxation of the US branch due to the Tax Administration's interpretation and application of the US-Luxembourg double tax treaty. Opinions are likely differ on the correct interpretation of the treaty. Moreover, to the extent that the Luxembourg Tax Administration has consistently applied its interpretation of the US-Luxembourg double tax treaty and similar tax treaties to all taxpayers, it is questionable whether the measure should be deemed selective State aid under Article 107(1) TFEU.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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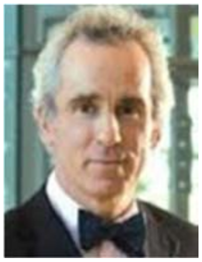

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