Euro Tax Flash from KPMG's EU Tax Centre

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European Commission decision in Luxembourg fiscal state aid case

Fiscal State Aid – Tax Rulings – Tax Treaty Law – Permanent Establishment – Double Non-Taxation – Mismatch - Luxembourg – US

On September 19, 2018 the European Commission issued its final decision in the State aid investigation into two tax rulings obtained from Luxembourg by McDonald's (see the European Commission's press release). The Commission concluded that the tax rulings issued by the Luxembourg Tax Administration to McDonald's do not constitute State aid within the meaning of EU law.

Background

Under EU law, the Commission is obliged to review whether Member States give selected companies a preferential treatment, incompatible with applicable State aid rules. Tax rulings have increasingly become a center of attention as their investigation became part of what the Commission refers to as a wider strategy towards tax transparency and fair taxation. This has led to inquiries into the compatibility of the tax ruling practices of certain Member States with EU law, starting in June 2013. In December 2014, the Commission extended the information inquiry into tax rulings issued by all Member States since January 1, 2010, and in June 2015 requested 15 Member States to provide detailed information on some of their rulings. Following a series of in-depth investigations, the Commission concluded that Belgium (see ETF 271), Luxembourg and the Netherlands (see ETF 262), and more recently Ireland (see ETF 300 and ETF 307) and Luxembourg (see ETF 339 and ETF 372) have granted selective tax advantages that are illegal under EU state aid rules.

The decision in the McDonald's case follows an in-depth investigation launched by the European Commission further to the announcement of its preliminary conclusions in December 2015 (see ETF 264 and ETF 288).

The EU Commission's decision

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.

The European Commission concluded that the tax rulings granted by the Luxembourg Tax Administration did not constitute state aid. Although the interpretation given to the double tax treaty between Luxembourg and the United States resulted in the double non-taxation of the royalty income attributed to the US branch, the European Commission found that the treaty had not been misapplied. This is because the US based branch did fulfill all the conditions of a permanent establishment under Luxembourg tax law, even if it did not qualify as such under the US tax law.

Next steps

This decision forms part of the standard state aid investigation procedure. The non-confidential parts of the decision are expected to be published in the next few months.

On June 19, 2018, the Luxembourg government issued draft legislation, amending the domestic definition of a permanent establishment, in cases where the latter is located in a treaty country. According to the proposed bill, the treaty definition will in general prevail and a permanent establishment will be recognized if the taxpayer is engaged in an independent economic activity in the other country. In this context, the Luxembourg tax authorities will have the right to request a certificate from the foreign tax authorities with regard to the recognition of the foreign permanent establishment. This certificate will have to be provided if the tax treaty does not include any provision that would allow Luxembourg to refuse the exemption of the branch income or wealth where the other contracting state uses another provision of the tax treaty to exempt such income or wealth (so-called 'switch-over clause').

If adopted by the Luxembourg parliament, it is expected that the new provision would close existing cases of double non-taxation similar to the McDonald's case for about seventy companies, according to the European Commission.

EU Tax Centre comment

As expected in December 2015, it was questionable whether the measure could be deemed selective State aid under Article 107(1) TFEU to the extent that the Luxembourg Tax Administration had consistently applied its interpretation of the US-Luxembourg double tax treaty and similar tax treaties to all taxpayers. The European Commission has now confirmed that the double non-taxation in this case results from a mismatch between Luxembourg and US tax laws, and therefore does not constitute illegal State aid.

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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