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European Commission State aid decision on Gibraltar's corporate tax exemption regime for interest and royalties

State Aid – Gibraltar – Corporate income tax – Exemption regime for Interest and Royalties – Tax rulings

On December 19, 2018, the European Commission announced its final decision on the State aid investigations into Gibraltar's corporate tax regime (see the EU Commission's [press release](#)). The decision confirms the Commission's preliminary view that Gibraltar's tax exemption scheme for interest and royalties, as well as five tax rulings, constitute State aid incompatible with the internal market. As a result, Gibraltar must recover the aid from the beneficiaries. It is now open to both Gibraltar and the companies concerned to appeal the decisions before the General Court (and possibly later the Court of Justice of the European Union (CJEU)).

Background

The decision follows an in-depth investigation launched by the European Commission further to its preliminary conclusions in October 2013 and October 2014 that Gibraltar's corporate tax regime may constitute illegal State aid. The review of Gibraltar's corporate tax regime is also part of what the Commission refers to as a wider strategy towards tax transparency and fair taxation, which has led to inquiries into the compatibility of the tax ruling practices of all Member States with EU law.

In 2011, Gibraltar introduced a new Income Tax Act that confirmed the territorial principle of taxation for companies, whilst certain types of passive income (i.e. dividends, royalties and certain types of interest) were not subject to tax in Gibraltar. At this time, there was already a tax rulings practice in Gibraltar, allowing companies to request confirmation of the tax treatment applicable based on specific circumstances. Following a complaint filed by Spain in June 2012, the European Commission launched in October 2013 a first in-depth investigation

into whether the tax exemption for interest (mainly arising from intra-group loans) and royalty income might grant a selective advantage to the companies that generate this type of income. In July 2013, Gibraltar amended the Income Tax Act so that inter-company loan interest became subject to tax and subsequently for royalties in January 2014.

In October 2014, the European Commission decided to extend its inquiry into 165 tax rulings issued by the Gibraltar tax authorities between 2011 and 2013. At the time, the European Commission had expressed concerns that such rulings were granted without an adequate review of whether the tax-exempt income had been derived from outside Gibraltar, therefore departing from the general corporate tax system.

Under EU law, the European Commission is obliged to review State aid granted by EU Member States. If it finds that the aid is incompatible with EU law, it is further compelled to require the Member States concerned to abolish or alter such aid within a prescribed time period, as well as force them to recover the aid from the taxpayers that have benefited. Broadly speaking, aid is incompatible with EU law if it distorts competition by, for example, favoring certain undertakings and thus affecting trade between Member States. However, certain aid is specifically considered compatible with EU law, such as certain regional aid granted to promote economic development.

The Decision

According to the European Commission, Gibraltar's tax exemption scheme for interest and royalties gave a significant advantage to certain companies that are members of multinational groups and perform specific functions, such as intra-group financing or the holding of intellectual property rights. This selective tax treatment unduly favored a set of multinational companies between 2011 and 2013 (before the Income Tax Act was changed), in breach of EU State aid rules.

In addition, the European Commission concluded that five individual rulings granted by the Gibraltar tax authorities out of the 165 reviewed involved illegal State aid. These five rulings concerned the tax treatment of income generated by Dutch limited partnerships. Both Gibraltar and the Netherlands provide that profits realised by a limited partnership in the Netherlands should be taxed where its partners are resident for tax purposes, i.e. in Gibraltar. However, the companies were not taxed on the royalty or interest income at the level of the Dutch partnership contrary to other companies in receipt of other type of income. According to the Commission, this tax treatment constituted a selective tax advantage that continued even after the changes to the Income Tax Act.

Gibraltar must now recover the aid from the companies that benefitted from Gibraltar's corporate tax exemption regime for interest and royalties between 2011 and 2013 and from the five individual companies that were granted the contested rulings. Based on the European Commission's estimates, the amounts to be recovered could be up to EUR 100 million in total.

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. It is now open to both Gibraltar and the companies concerned to appeal the decisions before the General Court (and possibly later the CJEU).

EU Tax Centre Comment

The European Commission had already examined the compatibility of Gibraltar's corporate tax regime with EU State aid rules in 2001 and 2002. That investigation focused on the tax treatment of offshore companies. After a new investigation was launched in 2011, Gibraltar took a number of steps to bring its legislation in line with EU law, which were welcomed by the European Commission. The tax exemptions available for inter-company loan interest and for royalties were thus repealed as of July 1, 2013 and January 1, 2014 respectively. In 2018, Gibraltar further approved legislative amendments to improve its tax ruling procedure, applicable transfer pricing rules, and generally increase compliance requirements and transparency on its territorial system of taxation with guidance notes issued by the Gibraltar's tax authorities.

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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