Euro Tax Flash from KPMG's EU Tax Centre

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European Commission investigation into Luxembourg tax rulings on interest-free loans

Fiscal State Aid – Tax Rulings – Luxembourg – Ireland - Interest-Free Loans – Fictitious deductions

On March 7, 2019 the European Commission launched an investigation to evaluate whether the tax rulings granted to a Finnish food and drink packaging group by Luxembourg constitute State aid within the meaning of EU law. (See the European Commission's press release).

Background

Under EU law, the Commission is obliged to review whether Member States give companies preferential treatment incompatible with applicable State aid rules. Tax rulings have increasingly drawn public 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), Luxembourg (see ETF 339 and ETF 372) and Gibraltar (ETF 390) have granted selective tax advantages that are illegal under EU State aid rules. As regards the current investigation, it follows from the press release that the Commission opened the preliminary investigation following the disclosure of one of the three rulings under scrutiny as part of the 'Luxleaks' investigation.

Preliminary Findings

The European Commission's concerns relate to a Luxembourg resident company that is part of a Finnish group and which carries out intra-group financing activities. More specifically, the European Commission is concerned that certain elements of the three tax rulings issued by the Luxembourg tax authorities between 2009 and 2013 may have provided a selective advantage in comparison to other stand-alone or group companies subject to the same national taxation rules.

The taxpayer is part of a group headquartered in Finland and carries out intra-group financing activities. The Luxembourg entity receives interest-free loans from another group company based in Ireland. These funds are then used to finance other group companies through interest-bearing loans.

Under the tax rulings, the Luxembourg company was allowed to deduct from its taxable base fictitious interest payments on the interest-free loans it receives from another company of the group located in Ireland. According to the Commission, this unilateral downward adjustment may grant the Luxembourg company a selective advantage. During the in-depth investigation the Commission will assess whether this allowed the Finnish group to pay less tax than other stand-alone or group companies whose transactions are priced in accordance with market terms. If confirmed, this would amount to illegal state aid according to the Commission.

Next steps

As part of the standard procedure in State aid investigations, the European Commission will publish a non-confidential version of their preliminary decision in the Official Journal. The opening of an in-depth investigation gives interested third parties and the Member States concerned one month from the publication date to submit comments. It does not prejudge the outcome of the investigation. There is no legal deadline for completing an in-depth investigation and its actual duration depends on many factors, including the complexity of the case, the information provided and the level of cooperation from the Member State concerned. The European Commission will reach a final decision at the end of the formal investigation.

EU Tax Centre comment

In a press release, the Luxembourg government confirmed its position that Luxembourg did not grant illegal state aid and noted the significant tax reform implemented by the Grand Duchy in line with the EU Anti-tax Avoidance Directive and the country's commitments under the OECD BEPS project. It further argued during the investigation that the deduction of deemed interest granted to the Luxembourg debtor in fact corresponds to arm's length payments.

It is unclear on which exact line of reasoning the European Commission is basing its analysis and more information will become available when the non-confidential version of this preliminary decision is published. However, this investigation is likely to further spark discussion on other forms of notional and deemed deductions, in particular in light of the recent review by the EU Code of Conduct of notional interest deduction regimes implemented by several EU Member States.

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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