MULTINATIONAL TAX AVOIDANCE VS. EUROPEAN COMMISSION[1]

Kristína Považanová, Hana Kováčiková
Comenius University in Bratislava, Faculty of Law

Abstract: This paper deals with recent actions of the Commission with respect to EU State Aid rules. The Commission is looking at the compliance with EU State Aid rules of certain tax practices in some Member States in the context of aggressive tax planning by multinationals, with a view to ensure a level playing field. A number of multinational companies are using tax planning strategies to reduce their global tax burden, by taking advantage of the technicalities of tax systems, and substantially reducing their tax liabilities. This aggressive tax planning practice erodes the tax bases of Member States, which are already financially constrained.

Key words: the Commission, State Aid, tax planning, tax ruling, investigation

1 EU COMPETITION LEGAL FRAMEWORK

In order to ensure fair competition, functioning market and competitive economy with the common market, the European Union (hereinafter "EU") developed the competition policy. Competition puts businesses under constant pressure to offer the best possible range of goods at the best possible prices, because if they don't, consumers have the choice to buy elsewhere. In a free market, business should be a competitive game with consumers as the beneficiaries.

Sometimes companies try to limit competition in order to gain the advantages compared to their competitors. To preserve well-functioning product markets, authorities like the European Commission (hereinafter "Commission") or national competition authorities (hereinafter "NCA") must prevent or correct anti-competitive behaviour. To achieve this, based on the powers granted by the EU legislation, the Commission monitors agreements between companies that restrict competition[2] – agreements between undertakings, decisions by associations of undertakings and concerted practices in which companies agree to avoid competing with each other and try to set their own rules; abuse of a dominant position[3] – where a major player tries to squeeze competitors out of the market; mergers[4] (and other formal agreements whereby companies join forces permanently or temporarily) – legitimate provided they expand markets and benefit consumers, as well as efforts to open markets up to competition (liberalisation) – in areas such as transport, energy, postal services and telecommunications. Many of these sectors used to be controlled by state-run monopolies and it is essential to ensure that liberalisation is done in a way that does not give an unfair advantage to these old monopolies. Moreover, the

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[2] Article 101 TFEU.

[3] Article 102 TFEU.

[4] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings.

Commission monitors financial support (State Aid) for companies from national governments and cooperation with national competition authorities in EU countries (who are also responsible for enforcing aspects of EU competition law) – to ensure that EU competition law is applied in the same way across the EU.[5]

Given the topic of this paper, the text will only focus on the application of EU State Aid rules. According to Article 107 (1) Treaty on the Functioning of the European Union (hereinafter "TFEU"): *"Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."*[6] Based on the above mentioned, it can be concluded that prohibited State Aid exists, if four cumulative conditions are fulfilled: Firstly, the measure confers an advantage on its recipients which relieves them from charges that are normally borne from their budget. Secondly, the advantage is granted by the state or through state resources by national public authorities. Thirdly, the measure affects competition and trade between Member States. Last but not least, the advantage conferred is specific or selective in that it favours certain undertakings or the production of certain goods.[7]

2 DEVELOPMENT OF APPLICATION OF THE PROHIBITION OF STATE AID IN TAX MATTERS

Application of EU State Aid rules should serve a double purpose, and thus preventing waste of public resources via inefficient subsidies, therefore helping Member States to manage their budgets more wisely[8] and preventing the crowding out of efficient private investments[9] by preserving competitive and open internal market.[10] As of 1998 the Commission applies the prohibition of State Aid to tax reliefs, which is accompanied by an extensive campaign, aiming to gain the support of Member States.[11] The campaign itself focuses on the use of "soft law" instruments such as notices, communications and other non-binding documents that depict the application of EU State Aid prohibition to direct business taxation as being required in order to promote good governance, tackle harmful tax competition, combat avoidance of taxation. The following text will provide brief overview of key milestones of this effort:

The Code of Conduct for business taxation was set out in the conclusions of the Council of Economics and Finance Ministers (ECOFIN) of 1 December 1997. The Code is not a legally binding instrument but it clearly does have political force. By adopting this Code of Conduct, the Member States have undertaken to roll back existing tax measures that constitute harmful tax competition and

5 http://ec.europa.eu/competition/consumers/what_en.html (online; accessed 1/11/2016).

6 Article 107 (1) Treaty on the Functioning of the European Union.

7 LANG, M. – PISTONE, P. – SCHUCH, J. – STARINGER, C.: Introduction to European Tax Law on Direct Taxation. 4th edition. Vienna: Linde Verlag GmbH, 2016, p. 97.

8 ALMUNIA, J.: The State Aid Modernization Initiative. Brussels. 7 June 2012 (Speech/12/424), p. 8

9 Ibid., p. 3

10 Communication from the Commission and the Committee of the Regions – EU State Aid Modernisation (SAM), Brussel. 8 May 2012, COM (2012) 209 final, para. 5

11 LANG, M. – PISTONE, P. – SCHUCH, J. – STARINGER, C.: Introduction to European Tax Law on Direct Taxation, p. 98.

refrain from introducing any such measures in the future ("standstill").[12] The Council, when adopting the Code of Conduct, acknowledged the positive effects of fair competition, which can indeed be beneficial. Mindful of this, the Code of Conduct was specifically designed to detect only such measures which unduly affect the location of business activity in the EU by being targeted merely at non-residents and by providing them with a more favourable tax treatment than that which is generally available in the Member State concerned. For the purpose of identifying such harmful measures the Code of Conduct sets out the criteria against which any potentially harmful measures are to be tested.[13] The Code of Conduct has also anticipated the establishment of a group to assess tax measures of Member States that may fall within its scope and to oversee the provision of information on those measures.[14] The Code of Conduct Group (Business Taxation) was established at a Council meeting on 9 March 1998. Since then, the Code of Conduct Group has been monitoring standstill and the implementation of rollback and reported regularly to the Council. Currently, the Code of Conduct Group is mainly working on anti-abuse rules, exchange of information and transparency in the area of transfer pricing, administrative practices and promotion of its rules in third countries (non-EU countries).[15]

On the occasion of adoption of the Code of Conduct, the Commission undertook to draw up guidelines on the application of Articles 92 and 93 of the EC Treaty (Article 107 and 108 TFEU) to measures relating to direct business taxation and committed itself 'to the strict application of the State Aid rules concerned'. Since the Code of Conduct aims to improve transparency in the tax area through a system of information exchanges between Member States and of assessment of any tax measures that may be covered by it, the Commission claimed that for their part, EU State Aid rules will also contribute through their own mechanism to the objective of tackling harmful tax competition. The Commission's undertaking regarding State Aid in the form of tax measures forms part of the wider objective of clarifying and reinforcing the application of the State Aid rules in order to reduce distortions of competition in the single market.[16]

Generally, it has to be concluded that between harmful tax competition as interpreted in the Code of Conduct and the scope of the prohibition on State Aid as implemented to direct business taxation measures there is a gap which is not disputed by the Commission. With respect to the mentioned, the Commission notice on the application of the State Aid rules to measures relating to direct business taxation (hereinafter "Commission Notice") provides: *"The qualification of a tax measure as harmful under the code of conduct does not affect its possible qualification as a State aid. However the assessment of the compatibility of fiscal aid with the common market will have to be made, taking into account, inter alia, the effects of aid that are brought to light in the application of the code of conduct."*[17] According to Kronthaler and Tzubery some decisions of the Court of Justice of the European Union (hereinafter "CJEU") and the Commission[18] can be understood as attempts to bridge the gap between application of prohibition of State Aid in the area of direct taxation and the Code of Conduct.[19]

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12 http://ec.europa.eu/taxation_customs/business/company-tax/harmful-tax-competition_en (online; accessed 2/11/2016).

13 http://ec.europa.eu/taxation_customs/business/company-tax/harmful-tax-competition_en (online; accessed 2/11/2016).

14 Code of Conduct, OJ C 2/2 of 6 January 1998, pp. 2-5, para. H.

15 LANG, M. – PISTONE, P. – SCHUCH, J. – STARINGER, C.: Introduction to European Tax Law on Direct Taxation, p. 100.

16 Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384 od 10 December 1998, pp. 3-9, para. 1-2.

17 Ibid., para. 30.

18 E.g. Case C-143/99 Adria-Wien Pipeline, Joined cases C-106/09 P and C-107/09 P Commission v Gibraltar.

19 LANG, M. – PISTONE, P. – SCHUCH, J. – STARINGER, C.: Introduction to European Tax Law on Direct Taxation,

The further development is connected with the adoption of another "soft law" instrument and thus Communication on promoting good governance in tax matter.[20] Among the measures of existing tax cooperation designed to promote better governance within the EU, the Communication highlights the Code of Conduct and the State Aid prohibition.

Lastly, in the 2014, the affair well known as "Luxembourg Leaks" contributed to the recent development of EU State Aid prohibition in relation to tax matters. Hundreds of tax ruling of the Luxembourg tax authorities were made available for public. According to these rulings, the Luxembourg tax authorities helped multinational companies to avoid payment of taxes in other jurisdictions by granting beneficial tax treatments. According to Commission press releases this could constitute a prohibited State Aid.[21] However, being aware of the sensitivity of the Member Stater to their tax revenues, the Commission chose to depict its actions as an effort to combat corporate tax avoidance that exploits disparities in the tax policies of the Member States.[22]

3 COMMISSION'S INVESTIGATION OF TRANSFER PRICING ARRANGEMENTS ON CORPORATE TAXATION

The Commission's actions in late 2014 confirmed that the application of EU State Aid rules to Member States' tax ruling practices will be a priority for the new Commission. On 20 November 2014, Margrethe Vestager, who replaced Joaquin Almunia as competition commissioner indicated that by the second quarter of 2015 the Commission aims to conclude investigations aimed at four companies: Amazon, Apple, Fiat Finance and Trade, and Starbucks.[23]

On the 11 June 2014, the European Commission opened three in-depth investigations to examine whether decisions by tax authorities in Ireland, the Netherlands and Luxembourg with regard to the corporate income tax to be paid by Apple, Starbucks and Fiat Finance and Trade, comply with the EU rules on State Aid. Moreover, on the 7 October 2014, the Commission has opened an in-depth investigation to examine whether the decision by Luxembourg's tax authorities with regard to the corporate income tax to be paid by Amazon in Luxembourg complies with the EU State Aid rules.[24]

All four cases concern tax rulings dealing with transfer pricing arrangements between entities of the same corporate group, which the Commission believes may involve illegal State Aid.

Former competition commissioner stated in this respect: "In the current context of tight public

p. 101.

20 Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee – Promoting Good Governance in Tax Matters. Brussels. 28 April 2009, COM (2009) 201 final, p. 4.

21 http://europa.eu/rapid/press-release_IP-14-663_sk.htm (online; accessed 2/11/2016).

22 LANG, M. – PISTONE, P. – SCHUCH, J. – STARINGER, C.: Introduction to European Tax Law on Direct Taxation, p. 102.

23 https://www.euractiv.com/section/competition/news/vestager-says-will-use-luxleaks-documents-in-eu-tax-probe/ (online; accessed 3/11/2016).

24 The latest case in this respect concerns McDonald's. On the 3 December 2015, the Commission has opened a formal probe into Luxembourg's tax treatment of McDonald's. Its preliminary view is that a tax ruling granted by Luxembourg may have granted McDonald's an advantageous tax treatment in breach of EU State aid rules, In particular, the Commission would like to assess whether Luxembourg authorities selectively derogated from the provisions of their national tax law and the Luxembourg-US Double Taxation Treaty and thereby gave McDonald's an advantage not available to other companies in a comparable factual and legal situation.

budgets, it is particularly important that large multinationals pay their fair share of taxes. Under the EU State Aid rules, national authorities cannot take measures allowing certain companies to pay less tax than they should if the tax rules of the Member State were applied in a fair and non-discriminatory way."[25]

It has to be highlighted that the Commission has no direct authority over national tax systems. However, it is authorized to investigate whether certain fiscal regimes, including the form of tax rulings, could constitute "unjustifiable" State Aid to companies on a selective basis. As stated in the first part of this paper, the EU State Aid rules are set out in TFEU and constitute part of the TFEU provisions on competition law. Generally, Member States are prohibited from granting financial support in a way that distorts competition, unless measure concerned has been notified to and authorized by the Commission. The prohibition applies to any form of financial aid, including in the form of tax rulings. "Although not problematic in themselves, tax rulings may amount to unlawful State Aid if they provide selective advantages to a specific company or group of companies that are not approved under EU State Aid rules." [26]

Article 108(3) TFEU requires Member States to notify non-exempted State Aid measures, including in the form of tax measures, to the Commission before their implementation, and to await the Commission's approval before implementing such measures (the so-called "standstill obligation").[27] If either of those obligations is not fulfilled, the State aid measure is considered to be unlawful.

Such a notification usually triggers a preliminary investigation by the Commission. The Commission can also investigate unnotified State Aid that has already been granted on its own initiative or following a complaint from the third party. If, following an in-depth investigation, the Commission finds that a measure constitutes unjustified State Aid, the Commission requires the Member State to recover the financial support from the beneficiary (unless such recovery would be contrary to a general principle of EU law). In the case of tax measures, the amount to be covered is calculated on the basis of a comparison between the tax actually paid and the amount that should have been paid if the generally applicable rule had been applied. Interest is added to this basic amount. Recovery of past benefits can be ordered for up to ten years.

Measures taken to exempt a company from an obligation to pay taxes can amount to unlawful State Aid if the following conditions are met:

Firstly, the tax measure must grant a financial advantage. In the case of tax rulings, an advantage would in principle exist where the tax payable under the tax ruling is lower than the tax that would otherwise have to be paid under the normally applicable tax system. The general rule is that the allocation of profit between companies of the same corporate group must comply with the "arm's length principle" as set in Article 9 of the OECD Model Tax convention. In the case of transfer pricing agreements, this means that arrangements between companies of the same corporate group must not depart from arrangements that a prudent independent operator acting under normal market conditions would have accepted. The CJEU has confirmed that if the method of taxation for intra-group transfers does not comply with the arm's-length principle and leads to a lower taxable base than would result from a correct implementation of that principle, it provides a selective advantage to the company concerned.[28]

[25] http://europa.eu/rapid/press-release_IP-14-663_sk.htm (online; 3/11/2016).

[26] http://www.nortonrosefulbright.com/knowledge/publications/120029/tax-rulings-on-transfer-pricing-may-violate-eu-state-aid-rules#autofootnote6 (online; 4/11/2016).

[27] Article 108 (3) Treaty on the Functioning of the European Union.

[28] Joined cases C-182/03 and C-217/03 Belgium and Forum 187 v Commission.

Secondly the financial advantage must be financed through State resources. In cases where a tax authority lowers the effective tax rate that would otherwise be payable, the resulting loss of revenue for the State is equivalent to the use of State resources.[29]

Thirdly, the tax measure must distort or threaten to distort trade and competition between Member States. Where the beneficiary carries out an economic activity in the EU, this criterion is easily met.

Last but not least, the tax measure must be specific or selective in that it benefits "certain undertakings or the production of certain goods". According to the Commission, "every decision of the administration that departs from the general tax rules to the benefit of individual undertakings in principle leads to a presumption of State Aid and must be analysed in detail."[30] Thus, a tax ruling that merely interprets general tax rules or manages tax revenue based on objective criteria will generally not constitute State Aid, while a ruling that applies the authorities' discretion to apply a lower effective tax rate than would otherwise apply may amount to State Aid. In the case of transfer pricing agreements, a tax ruling that deviates from the arm's-length principle is likely to be considered as specific and hence qualify as State Aid under EU law.[31]

If tax authorities' measures in question constitute State Aid, they could be in principle justified and benefit from an exemption under TFEU, but generally such exemption apply to tax reliefs granted for specific purpose, such as promoting cultural and heritage conservation. However, the Commission has stated several times that at this stage of the investigations, it has no indication that the contested rulings can benefit from an exemption under the TFEU.

4 PRELIMINARY CONCLUSIONS OF THE COMMISSION'S INVESTGATION IN STARBUCKS AND FIAT

Following in-depth investigations that were initiated in June 2014, the Commission has concluded that Luxembourg has granted selective tax advantages to Fiat's financing company[32] and the Netherlands to Starbucks' coffee roasting company.[33] In each case, a tax ruling delivered by the national tax authority allowed the companies concerned to artificially lower the tax paid in the respective country.

In is necessary to state that tax rulings as such are perfectly legal. They are proper decisions issued by national tax authorities to give a company guidance and clarity on how its corporate tax will be calculated or on the use of special tax provisions. However, these two tax rulings subject to the Commission's investigation endorsed artificial and complex methods to establish taxable profits for the companies. According to the Commission, they do not reflect economic reality.[34] *"This is done,*

[29] See more: http://www.nortonrosefulbright.com/knowledge/publications/120029/tax-rulings-on-transfer-pricing-may-violate-eu-state-aid-rules#autofootnote6 (online; 4/11/2016).

[30] Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384 od 10 December 1998, pp. 3-9, para. 22

[31] See more: http://www.nortonrosefulbright.com/knowledge/publications/120029/tax-rulings-on-transfer-pricing-may-violate-eu-state-aid-rules#autofootnote6 (online; 4/11/2016).

[32] Decision of the Commission - SA.38375 http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38375

[33] Decision of the Commission - SA.38374 http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38374

[34] http://europa.eu/rapid/press-release_IP-15-5880_en.htm (online; 5 November 2016).

in particular, by setting prices for goods and services sold between companies of the Fiat and Starbucks groups (so-called "transfer prices") that do not correspond to market conditions. As a result, most of the profits of Starbucks' coffee roasting company are shifted abroad, where they are also not taxed, and Fiat's financing company only paid taxes on underestimated profits."[35]

The Commission concluded that this is illegal under EU State Aid rules: Tax authorities when issuing tax rulings shall not use methodologies, no matter how complex, to establish transfer prices with no economic reason and which unduly shift profits to reduce the taxes paid by the company. With respect to EU State Aid rules, such tax rulings give companies an unfair competitive advantage over other companies that pay taxes from the tax base calculated in respect of their actual profits because they pay market prices for the goods and services they use.

Therefore, the Commission has ordered Luxembourg and the Netherlands to recover the unpaid tax from Fiat and Starbucks, respectively, in order to remove the unfair competitive advantage they have enjoyed and to restore equal treatment with other companies in similar situations. The amounts to recover are EUR 20 - 30 million for each company. It also means that the companies can no longer continue to benefit from the advantageous tax treatment granted by these tax rulings.[36]

Moreover, recently the Commission has concluded that Ireland granted undue tax benefits of up to EUR 13 billion to Apple. However, this case will be subject to specific paper.

Furthermore, the Commission continues to pursue its inquiries into tax rulings practices in all Member States. It cannot prejudicate the opening of other formal investigations into tax rulings if it has indications that EU State Aid rules are not being complied with. Its existing formal investigations into tax rulings in Belgium (McDonald's) and Luxembourg (Amazon) are ongoing.

5 CONCLUSIONS

While the Commission has not yet reached a final decision with regard to the tax rulings in favour of Amazon and McDonald's, the Commission's preliminary view is that these rulings are again likely to constitute unlawful State aid under EU law. If the in-depth investigations confirm this view, the companies concerned will have to repay the aid received, plus interest, as already ruled in cases of Fiat, Starbucks and Apple. The Commission's decision seems likely to turn on the question of whether the benefits provided were "selective," or whether the same principles were applied to all companies.

Before opening these specific investigations, the Commission was already conducting a wider inquiry into certain tax practices by several Member States, an inquiry that the Commission has now broadened to include all Member States.[37] Through its (so far) five in-depth investigations, however, the Commission has made clear that it will not wait for the conclusions of its broader inquiry to pursue potential violations involving specific companies.

35 Ibid.

36 http://europa.eu/rapid/press-release_IP-15-5880_en.htm or more in Decision of the Commission - SA.38375 http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38375
Decision of the Commission - SA.38374 http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38374

37 See more: http://www.nortonrosefulbright.com/knowledge/publications/120029/tax-rulings-on-transfer-pricing-may-violate-eu-state-aid-rules#autofootnote6 (online; 4/11/2016)

Companies that have benefited from these advantageous tax rulings or other special tax measures are advised to assess the possibility that tax benefits negotiated as part of their European tax planning may constitute unlawful State Aid. More generally, for the future, companies are reminded to take account not only of the applicable tax rules as part of their global tax planning and negotiation of tax rulings, but also of potential State Aid considerations.

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Decision of the Commission - SA.38374

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Contact Information:

Mgr. Kristína Považanová, PhD.
kristina.povazanova@flaw.uniba.sk
Comenius University in Bratislava, Faculty of Law
Šafárikovo nám. 6, P.O.BOX 313
810 00 Bratislava
Slovak Republic

JUDr. Hana Kováčiková, PhD.
hana.kovacikova@flaw.uniba.sk
Comenius University in Bratislava, Faculty of Law,
Department of the European Law
Šafárikovo nám. 6, P.O. BOX 313
810 00 Bratislava
Slovak Republic