

ABA Tax Section | 2015 Annual Meeting | Foreign Lawyers Forum

# Lux Tax Leaks Become EU Tax Leaks: 2016 Automatic Exchange of Tax Rulings in the EU

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# Agenda

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- **Background**
- **State Aid Update**
- **LuxLeaks, EU Exchange and CbC**
- **Implications and Outlook**



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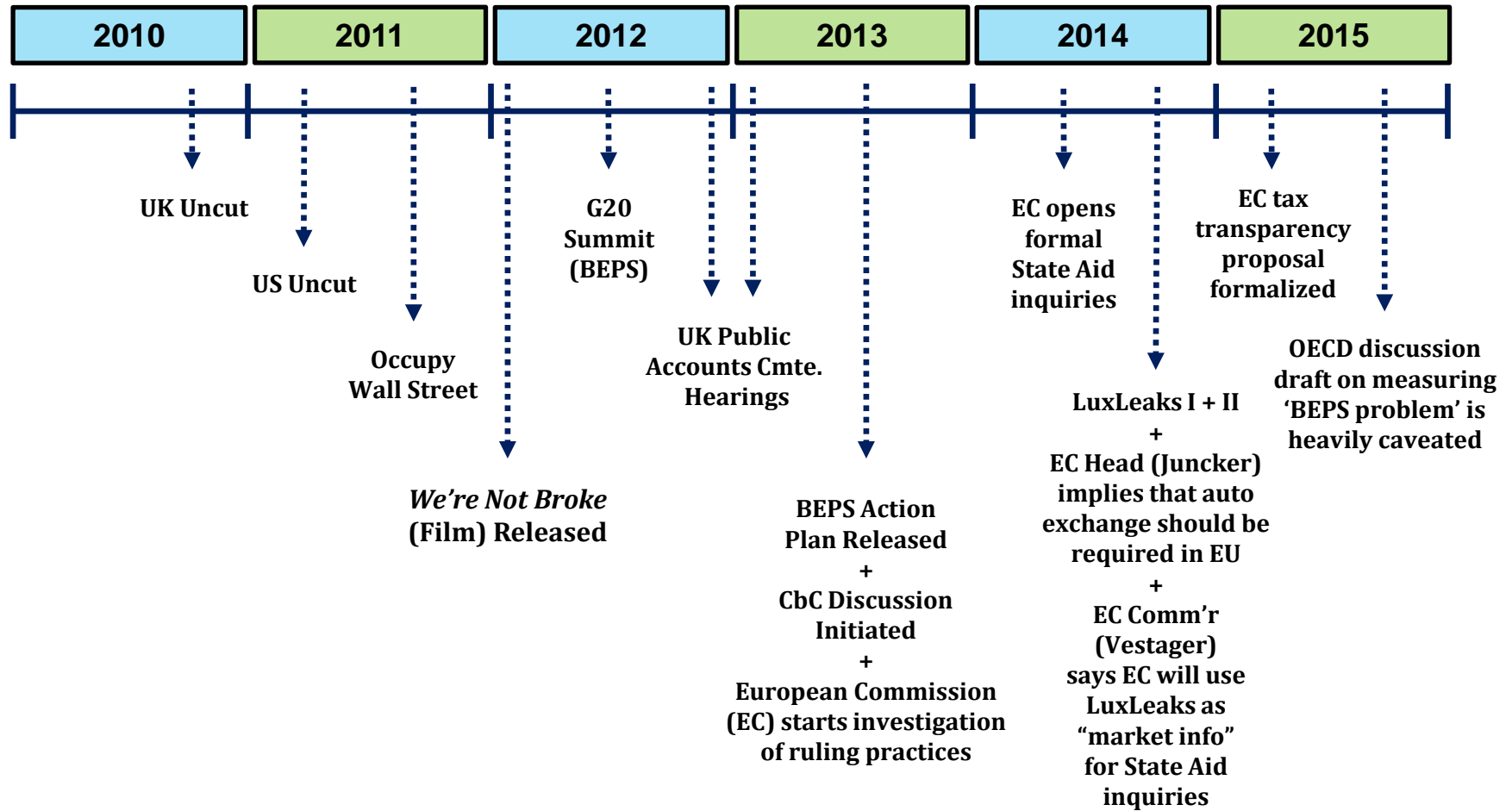


# **BACKGROUND**



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# Timeline



# Opening Perspectives

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- **Multiple touch points of change**
  - OECD vs. UN economies, and BRICS
  - Business model paradigm shifts (*e.g.*, digital economy)
  - Globalized economy / mobile workforces
- **Budget deficit crisis**
  - “Fair share” narrative – from UK Uncut to European Commission
  - Politically-expedient targeting – mobile income/assets, wealth and MNEs
  - Linguistic / semantic shift – from debate of experts to newspaper front pages
  - Adequacy of substantiation?
- **Instability of rules (BEPS), aggressive audits and double-tax risks**
  - In-depth reform of international tax rules vs. defensive reactions?
  - Multilateral vs. unilateral actions

# Reference Paradigms

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- **Paradigm 1 – Inbound to Europe**
  - US MNE inbound into Europe through typical deferral structure and/or hybrid instruments
- **Paradigm 2 – Outbound within Europe**
  - European MNE outbound from its Member State to other Member States (*e.g.*, UK company with holding structure, outbound to other Member State)
- **Paradigm 3 – Outbound from Europe**
  - European MNE outbound from Europe (*e.g.*, UK company with Dutch or Lux structure, going outbound to India)

# EU Tax Leaks – Drivers / Considerations

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- **Players**
- **“Fair share” concept**
  - What is “fair” per country?
  - B2B or B2C
  - Examples – Ireland, France, China
- **Privacy**
  - General vs. public at large
  - Commercial secrets (*e.g.*, margins)



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# **STATE AID**



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# What is State Aid?

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- **An advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities**
- **Subsidies granted to individuals or general measures open to all enterprises are not covered by this prohibition and do not constitute State Aid (examples include: general taxation measures or employment legislation)**
- **To be State Aid, a measure needs to have certain features:**
  1. An intervention by the State or through State resources, which can take a variety of forms (*e.g.*, grants, interest and tax reliefs, guarantees, government holdings of all or a part of a company, or providing goods and services on preferential terms, etc.)
  2. The intervention gives the recipient an advantage on a selective basis – for example, to specific companies or industry sectors, or to companies located in specific regions
  3. Competition has been or may be distorted
  4. The interventions is likely to affect trade between Member States

## **What is State Aid? (cont.)**

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- **The Treaty generally prohibits State Aid, unless it is justified by reasons of general economic development**
- **To ensure that this prohibition is respected and exemptions are applied equally across the EU, the European Commission is in charge of ensuring that State Aid complies with EU rules**
- **A finding of State Aid results in the recipient having to reimburse the aid (including interest)**
- **Other parties that benefitted have to make similar reimbursements**

# State Aid Investigations

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- **Ongoing investigations**
  - 14 June 2014 – Commission announces opening of State Aid investigations in Ireland, Luxembourg and the Netherlands
    - Ireland – Apple
    - Luxembourg – Fiat and Amazon
    - Netherlands – Starbucks
  - EU's Competition Commissioner expected to present rulings on these investigations by May 2015
- **LuxLeaks**

# Ireland | Apple

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- **Inquiry – relates to the Irish branches of two Apple entities**
- **EC investigating two rulings issued by the Irish tax authorities in 1991 and 2007, regarding the calculation of the taxable profits allocated to the Irish branches**
- **Ireland Revenue-sanctioned tax arrangements saw Apple avoid € 850m in Irish tax between 2004-08 alone**
- **EC questions whether the Irish tax authorities adhered to the “arm’s-length” principle (Ireland did not have transfer pricing rules at the time)**
- **The EC has requested information on Ireland Revenue’s administrative practices in relation to the provision of advance opinions and details of the types of opinions provided to up to five multinationals by Ireland Revenue**

## Ireland | Apple (cont.)

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- **OECD guidelines on transfer pricing methods**
- **Commission alleges:**
  - Cost-plus basis was unsuitable
  - Rulings were open-ended
- **Government has hired senior UK tax Queens Counsel to spearhead defense**
- **Preparing to take the Commission to the ECJ if Apple's tax arrangements are found to be illegal State Aid**
- **Minister for Finance statements:**
  - *"[It is] more likely that that investigation will be dropped rather than there will be further investigations"* (Nov. 2014)
  - *"My legal advice is that the Irish authorities will win the case quite easily and that there isn't a very strong case by the Commission."*

# Luxembourg | Amazon

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- **Tax ruling dates back to 2003 and applies to Amazon's Luxembourg subsidiary (Amazon EU Sarl)**
- **The subsidiary pays a tax deductible royalty to a Luxembourg LLP which is not subject to corporate tax**
- **Commission claims:**
  - Most European profits of Amazon being recorded in Luxembourg but not taxed there
  - Royalty paid by the subsidiary is not in line with market conditions (license fee does not reflect value of the IP concerned)
  - The ruling underestimates taxable profits of the subsidiary thereby granting an economic advantage
  - The advance tax ruling is excessively old

## Luxembourg | Fiat

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- **Fiat Finance and Trade (FTT) provides treasury services and financing to Fiat group companies in Europe mainly and manages several cash pool structures**
- **Commission investigations into the tax treatment of FTT by Luxembourg**
- **Involves a tax ruling validating an advance pricing agreement (APA)**
- **Commission claims the APA gave an advantage to Fiat and did not respect the EU's principles of full competition**

# Netherlands | Starbucks

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- Investigating an advance pricing agreement (APA) involving Starbucks Dutch manufacturing arm
- Commission claims the APA tolerates questionable adjustments, allowing the Dutch entity to lower the resulting corporate income tax basis in the Netherlands
- Commission also questioning royalty payments made to a UK LP that doesn't pay Dutch corporate tax:
  - The royalty paid to the UK LP “does not reflect the value of the IP” since it “fluctuates from year-to-year and is not in line with sales”
- **Government response:** *“Considering that the transfer prices of [Starbucks BV] are set in line with OECD principles and the national legislation which is based on those, there is no question of selective advantage for Starbucks.”*

# Belgium | “Excess Profit” Rulings

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- **EC opened investigation 3 Feb 2015**
  - **Focus is on Belgian law that permits a reduction of corporate tax liability for “excess profits” in registered accounts of Belgian entity**
    - “Excess profits” – profits associated with advantage of belonging to MNE group (*e.g.*, intra-group synergies, economies of scale)
    - Tax ruling required to secure deduction
  - **EC believes scheme appears only benefits MNE groups with Belgian operations but not stand-alone Belgian companies (*e.g.*, operating only in Belgium)**
  - **EC notes that the rulings often granted to companies that have relocated a substantial part of activities to, or made significant investments in, Belgium**
  - **EC implies that rulings may vastly overstate actual benefits – deductions due to excess profits amounting to > 50% of profits covered by tax ruling (up to 90%)**
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# **LUXLEAKS, EU EXCHANGE AND CBC**

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# LuxLeaks

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- **November 2014** – the International Consortium of Investigative Journalists (ICIJ) revealed rulings that had been granted between 2002 and 2010 by Luxembourg tax authorities
  - 500+ rulings / approx. 340 MNEs / 100s of billions (US\$)
- **Massive media campaign in a special political context**
- **Leaks derived from a theft of documents**
  - Under criminal prosecution
  - No secret deal, but taxpayer-protected information
- **Immediate political reaction**

*“It is legal but immoral”*

*“Other countries are used for more aggressive planning – don’t name and shame Luxembourg”*

*“This media campaign does not bring any information that was unknown to tax authorities worldwide”*

# EU Exchange | Background

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- LuxLeaks leads to focused attention on EU Exchange concept (December 2014)
- EC formally proposes EU Exchange on 18 March 2015
- EU exchange prior to March 2015

## 1. WG Code of Conduct for Business Taxation

- Identified the types of cross-border rulings on which information should be spontaneously exchanged
- Developed a Model Instruction that could be used as a reference for internal application



However: Model Instruction is not binding

## 2. Administrative Cooperation Directive – see next page

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# EU Exchange | Current Directive

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- **Administrative Cooperation Directive – EU Directive 2011/16/EU (15 Feb. 2011)**
  - **Exchange of information on request**
  - **Spontaneous exchange of information** – in cases where a competent authority of one Member State has grounds for supposing that there may be a loss of tax in another Member State (article 9) – thus, may already apply to tax rulings
    - ➔ **However, inefficiency issue** – the efficiency of the exchange depends on discretion given to the issuing Member State (to decide which other Member States should be informed)

# EU Exchange | Tax Transparency Proposal

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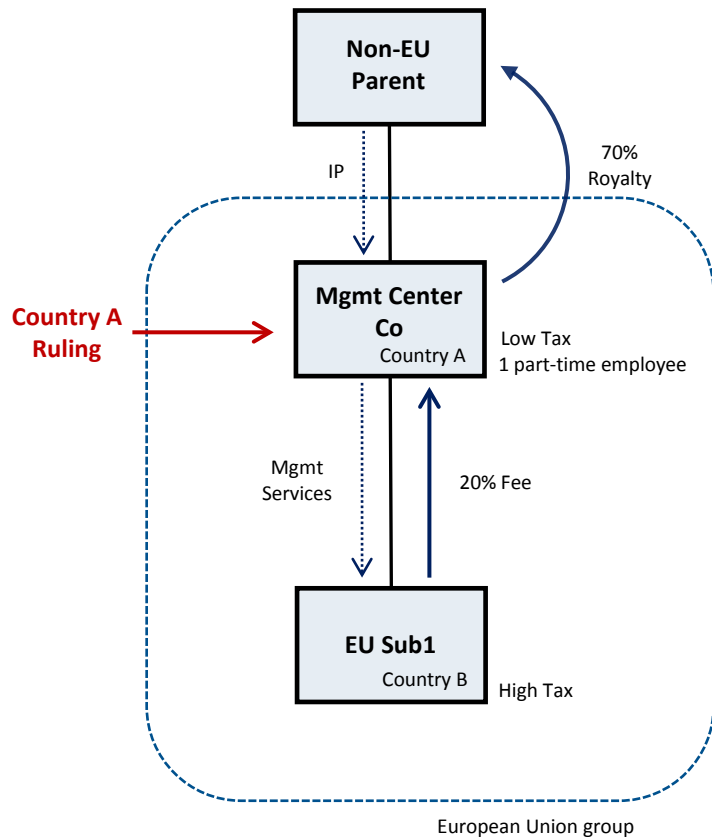
- **Tax Transparency Package (18 March 2015)** – proposal to amend Directive
  - Intended to be effective as of 1 January 2016
  - Retroactive coverage – targets all live rulings issued after 2005
- **Why?**
  - To ensure that Member States are equipped with the information they need to protect their tax bases and effectively target companies that try to escape paying their “fair share” of taxes
  - New Article 8a will amend Directive 2011/16/EU: Scope and conditions of mandatory automatic exchange of information on ***advance cross-border rulings*** and ***advance pricing arrangements***
- **Mismatch in information or mismatch in tax systems?**
  - Disparities in tax ruling practices and approaches within the EU

# EU Exchange | Tax Transparency Proposal (cont.)

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- **What is a ruling?**
  - Any agreement, communication, or any other instrument or action with similar effects given in advance by, or on behalf of, the government or the tax authority of a Member State concerning the interpretation or application of a legal or administrative provision
- **Who has access to information?**
  - 2-step process
    - *FIRST*: All Member States and the European Commission have access to information sent by the Member State issuing or amending an advance cross-border ruling or an advance pricing agreement
    - *SECOND*: Member States may request additional information
- **What if ruling is merely a confirmation of law?**
- **What if a ruling is not required?**

# EU Exchange | EC Justification Ex. #1



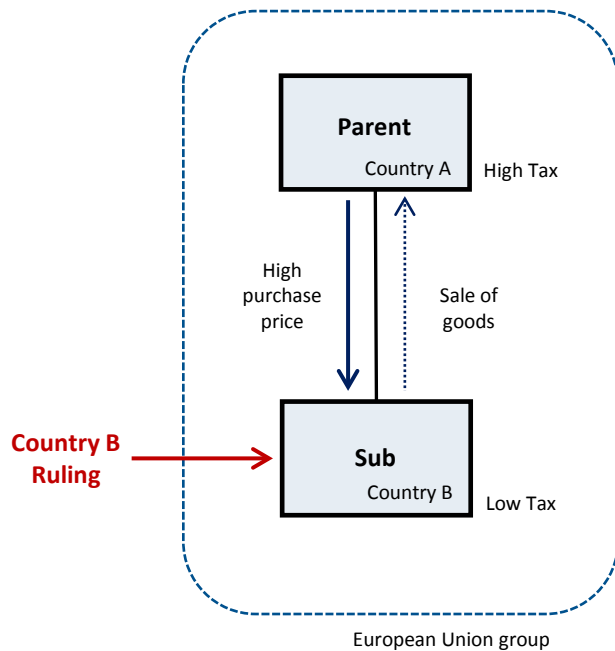
## Facts

- Royalty is 70% of Mgmt Center Co's turnover
- Country A ruling confirms only 30% of profits taxed
- "Management services" provided to other EU subs (e.g., EU Sub1) in exchange for 20% of turnover

## Commission Says

- Due to arrangement, "large amounts of the group's revenue is shifted to [Country A], which applies a low tax rate to just 30% of these profits. The rest of the profits are shifted to the [Non-EU Parent] in the non EU-country and remain untaxed"
- Apparently other EU member states (e.g., Country B) are not aware of Country A's ruling, and do not have enough information "to challenge the high price that the tiny management centre" is charging
- With automatic exchange, Country B will know of the tax ruling and that only 30% of the management centre's profits are taxed by Country A, allowing Country B to request more information if it thinks that the ruling and the company's set up was impacting its taxing rights or eroding its base

# EU Exchange | EC Justification Ex. #2



## Facts

- Sub charges very high prices for goods sold to Parent
- Country B ruling confirms the sales price
- Sub later dividends the profits to Parent, which is tax-free under EU Parent/Subsidiary Directive

## Commission Says

- With automatic exchange, Country A “would find out about the artificially high prices that the subsidiary is charging to the parent company.”
- With automatic exchange, Country A “may be able to apply the anti-abuse element of the [P/S Directive], and deny the company the usual tax exemption for dividends.”

# EU Exchange | Related EC Proposals

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- **Review Code of Conduct regarding tax matters**
  - Criteria are not relevant anymore to tackle tax-planning mechanisms
- **Repeal Savings Directive**
  - **Why?** The co-existence of the Savings Directive and the revised Administrative Cooperation Directive creates overlaps; thus, it otherwise would be contrary to clarity and legal certainty
  - **How?** Coordinate the repeal of the Savings Directive with the execution of the revised Administrative Cooperation Directive

# EU Exchange | Compatibility with European Law

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- **Principle of legal certainty**

- When adopting acts of general application and individual decisions, EU institutions must respect the principle of legal certainty – *i.e.*, the law must be clear, precise and predictable in its effects in order to protect individuals

➡ Directive imposes obligations on *Member States*, not on individuals

- **Principle of no-retroactivity**

- A measure is not retroactive when it applies immediately to the future effects of a past situation

➡ Even though the exchange of information concerns past rulings, the obligation to exchange is forward-looking; in this sense, the directive applies immediately to future effects of a past situation

# EU Exchange | Compatibility with European Law (cont.)

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- **Principle of proportionality**

- When intervening in the sphere of private activities of any person, the public authorities must respect the principle of proportionality – *i.e.*, measures cannot exceed the limits of what is appropriate and necessary to attain the objectives

➡ Is a 10-year retroactivity proportionate to the objective of tackling tax avoidance, tax fraud and tax evasion?

- **Misuse of powers**

- The EC, while adopting measures against a tax avoidance, tax fraud and tax evasion, seems to seize the opportunity to obtain information concerning another phenomenon that can distort internal market competition: State Aid

➡ 10-years corresponds to the limitation period concerning the recovery of illegal aid? A fishing expedition?

# Exchanges Outside the EU

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- **EU Exchange of information and BEPS**
  - BEPS Action Plan supported by EU
  - BEPS Action 12 – transparency requirements on aggressive tax planning arrangements are covered, requiring taxpayers to disclose their aggressive tax planning arrangements
  - The EC will assess the opportunity of increasing transparency in order to limit profit-shifting outside the EU
- **BEPS Action 13 – TP documentation / CbC reporting**



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# **POTENTIAL IMPLICATIONS**



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# Potential Implications

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- **Retroactive effect**
- **What will greater awareness achieve?**
  - Enhanced knowledge by tax authorities?
  - Increased public discussion in local jurisdictions?
  - CCCTB revival?
- **Future of rulings?**
  - Will countries make policy and avoid need for rulings?
  - Will companies seek rulings if disclosure unavoidable?
- **Implications for MNE planning?**
  - Will it deter involvement in EU?
  - US MNE-specific considerations

## Potential Implications (cont.)

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- **Dispute resolution issues?**
  - MAP implications?
  - Multilateral instrument?
  - Resources / sophistication of CAs?
- **Is this solving a problem or creating more issues?**



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**QUESTIONS?**



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**THANK YOU**



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