

CLIENT MEMORANDUM

Luxleaks: Tax Rulings and State Aid Law

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AUTHORS

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On November 5, 2014, the International Consortium of Investigative Journalists (ICIJ) disclosed online multiple favorable tax rulings that had been granted by the Luxembourg tax administration to approximately 340 multinational companies. The so-called “Luxleaks” case was widely covered in the press. It raises complex political and legal issues in the field of tax harmonization and State aid law.

The issue of tax rulings is well known by the European Commission (the “Commission”), which is currently conducting in-depth investigations as to the legality, under State aid rules, of favorable tax rulings granted by the Luxembourg tax administration to Amazon and Fiat. Similar investigations were also opened regarding rulings granted by Ireland (to Apple) and the Netherlands (to Starbucks).

The new European Commissioner for Competition, Margrethe Vestager, indicated on November 6 that the General Directory for Competition already contacted Luxembourg, as well as other countries, on this issue and added: “*we will be vigilant to enforce state aid control in fair and justified manner.*” Thus, it cannot be ruled out that the Commission may open other investigations on various tax rulings. Actually, the Competition Commissioner recently declared that Directorate-General (DG) for Competition may well open up new cases after the four ongoing investigations are concluded, possibly next spring.

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THE QUALIFICATION AS STATE AID OF TAX RULINGS BY THE EUROPEAN COMMISSION

The Commission is inclined to consider favorable tax rulings as State aid. In particular, as regards the Luxembourg regime of transfer prices, the Commission seems to conclude that such rulings create an advantage for the company concerned to the extent the tax base is calculated using a transfer price that is not a market price.

This position is in line with the Commission's usual decisional practice, according to which tax regimes that leave a certain margin of discretion to the tax administration are considered to be State aid to the extent that they deviate from the general tax system.

THE CONSEQUENCES OF STATE AID QUALIFICATION

The stakes are important for the companies affected by these rulings. Indeed, if the Commission considers that those companies have received State aid that is incompatible with the internal market, it could order the recovery of the advantage received, *i.e.*, the difference between the taxes the company should have paid under Luxembourg general tax law and the taxes it has actually paid by virtue of the tax ruling, including interest. Also, the benefit of those tax rulings would cease to apply going forward.

SEVERAL OUTSTANDING QUESTIONS

Several complex legal issues could be raised during these investigations.

First, the conditions under which these rulings were granted should be examined with great care. The legal analysis would not be the same if the rulings were granted on a discretionary basis or, rather, on the basis of objective criteria binding the tax administration. In the latter case, the existence of a "selective" advantage, a necessary condition for the qualification as State aid, would not be met.

Moreover, the fact that such rulings imply the use of "state resources" (another condition for the qualification as State aid) is also debatable. Indeed, if it appears that the tax rulings were a condition for the companies concerned for establishing themselves in Luxembourg, it would imply that in the absence of these rulings, the Luxembourg State would have received no tax revenue.

The distortion of competition (another condition for the qualification as State aid) can also be debated since competitors of the beneficiaries of these rulings may also be able to benefit from favorable tax regimes.

At the end of the day, State aid law seems ill-suited to deal with the complex issue of tax competition among States, which goes far beyond the borders of the European Union. International companies again risk being the victims of the critical lack of international harmonization in this area, impeding the creation of a level playing field for global markets.

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