Building blocks

Large Corporate | Management of taxes



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Bill Dodwell considers the application of state aid rules in recent incident

One of the fundamental building blocks of the European Treaties is the concept of state aid. The principle is that a country should not use state resources to offer selective benefits – thereby potentially depriving other member states of business investment. There are exceptions to this principle: for example, the creative industries tax reliefs are ‘approved’ state aid, on the basis that cultural support is a good thing. Responsibility for enforcing the state aid rules rests with the Commission, which has extremely wide powers to investigate cases, including obtaining information from third parties and member states. It’s important to recognise, though, that whilst the Commission initiates cases and delivers its ruling, there are rights of appeal to the European courts. The first appeal goes to the lower level General Court which has jurisdiction over matters of fact. Dissatisfied parties

may then appeal to the Court of Justice (the CJEU) for a final ruling on a point of law.

There's a real furore over the Commission's investigations into rulings granted by Member States. Some forget that tax issues have been investigated for decades; for example, twenty-five years ago the UK was ordered to recover about £44 million from British Aerospace in relation to a ruling on using losses from Rover Group. More recently, Spain has not been impressed by the Commission's ruling against its regime allowing companies making acquisitions outside Spain to deduct consolidation goodwill against Spanish income. Affected companies have won appeals before the General court. We now await the final ruling from the CJEU – and Advocate General Melchior Wachelet has just delivered his opinion. The goodwill case covers a point which is also at the heart of a number of the recent cases against Belgium, Ireland, Luxembourg and The Netherlands. How should selectivity be defined? What is the reference system? The Commission argues that an advantage open to multinationals but not to wholly domestic companies is selective – even if it is potentially available to all multinationals. This raises a difficult conceptual question: are a multinational's potential advantages simply because it operates in a number of countries, or could it be receiving favourable treatment to encourage activities in a particular country?

Advocate General Wachelet argues that the CJEU's existing jurisprudence takes a wide view 'a tax measure which derogates from the general tax regime and differentiates between undertakings performing similar operations is selective, unless the differentiation created by the measure is justified by the nature or general scheme of the system of which it is a part.' Even if all multinationals may benefit, in his view a measure is selective where wholly domestic companies cannot achieve similar benefits.

Into this mix comes the Commission's decision in relation to rulings granted by Ireland to Apple. All we have is the short press release, where the Commission declares that all the trading profits of the relevant companies should be taxed in Ireland. The Commission suggests that if in fact it turns out that some of those profits should be taxed in the United States, as payments for research & development, or taxed in other locations globally, then only the residual should be taxed in the Emerald Isle. Ireland's Cabinet has approved an appeal – no doubt because the Irish authorities consider they had already taxed the right amount of profits based on the actual Irish activities. The case highlights both political and legal issues. The United States – and many others – argues that the political solution

to dissatisfaction with international corporate tax regimes is the changes in national law and treaties resulting from the BEPS project.

However, the question whether there was unlawful state aid is now a legal question. The Commission says that the companies concerned were managed in the United States and under Irish law they were treated as non-resident companies with Irish branches. The Commission asserts in its press release that there were no activities in the United States and thus all the trading profit should be allocated to Ireland. The Irish tax authorities appeared to have assessed taxable profits based on what the Irish branches actually did. Clearly the CJEU will be asked to adjudicate on which approach is correct. The economic point, made by some in the press, is that the Irish activities of the company did not justify so much profit being allocated to them by the Commission in its state aid determination.

The overarching problem for the EU, some of its member states, and many businesses, is that state aid inquiries are a poor way to raise questions about tax systems. Whilst there is public concern in Europe at untaxed profits, state aid inquiries shouldn’t lead to taxing profits left low-taxed or untaxed by other countries. Quite how the wide range of Commission enquiries conclude in this, and all the other cases, is very unclear. The judgment of the CJEU in the Spanish goodwill deduction cases will probably come out in early 2017 – and may give some limited guidance. However, it will no doubt be at least five years before the recent crop of cases get to the CJEU and we start to understand whether the Commission’s new arguments have any legal basis.