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- The Attack on Principal Companies Richard Syratt, Taxand UK; Luis
   Manuel Viñuales, Taxand Spain and Anne Harvey, Taxand Ireland

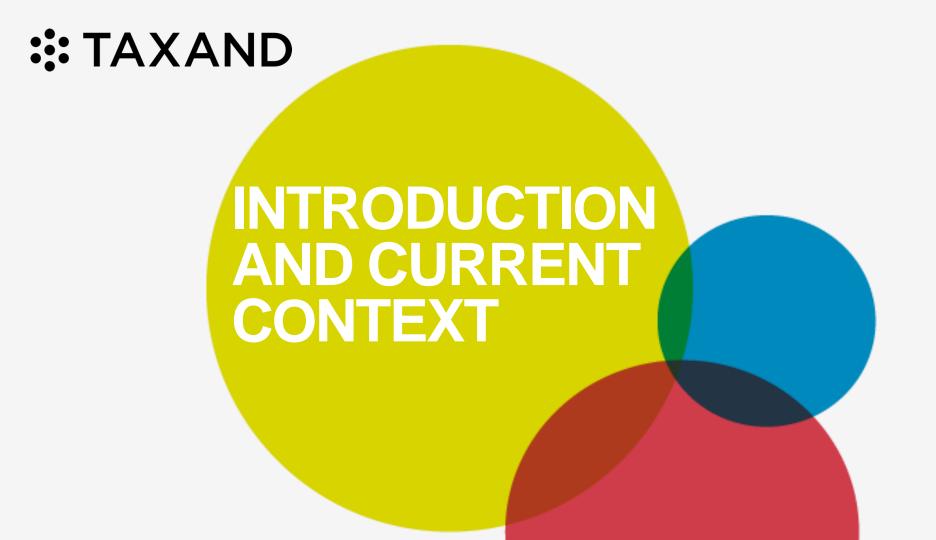
### **:::** TAXAND



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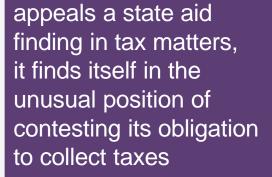


# **STATE AID: MAIN FEATURES**



State aid is a competition law matter, not a tax law matter

Proceedings take place between the EU Commission and the Member State, meaning the taxpayer that can end up footing the bill is not fully represented



When a Member State









# STATE AID: BUILDING BLOCKS



A measure is illegal state aid if:

- 1. It is **granted by state** resources
- 2. It confers an advantage to undertakings
- 3. It is selective 1 and
- 4. It affects trade between Member States and distorts or threatens to distort competition



Image credit: taxadvisermagazine.com/Stockphoto/Gajus



# **STATE AID: PROCEDURE**



### Worst case scenario

- 1. Negative COM decision + formal illegality (new aid granted without notification)
- 2. Recovery decision against
  Member State: from each
  beneficiary (+ interest)
- 3. Retroactive for (at least) 10 years, overriding domestic statutory limitations



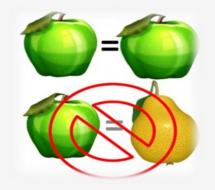


# **ADVANTAGE AND SELECTIVITY**

- Both are based on comparisons but of a different kind
- 'Advantage' requires a comparison...
  - ... with normal treatment (often market terms)
  - not really with the treatment of other companies
- "Selectivity" requires a comparison...
  - ... with the actual treatment that the Member State grant to the rest of the companies established in its territory...
  - ... provided that they are in a comparable legal and factual situation







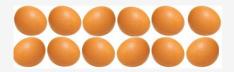
# INDIVIDUAL AID VS. AID SCHEMES



- Two families of fiscal aid cases:
  - Tax rules based on selective criteria: tax advantages that only benefit certain undertakings/activities/behaviours (as compared to others), e.g.:
    - The Spanish goodwill deduction in the acquisition of foreign entities;
    - The excess profits ruling system in Belgium;
    - The group financing exception to CFC rules in the UK (investigation phase); etc.
  - Discretionary decisions by tax authorities, e.g. the so-called "tax rulings" cases









### A LONG STORY

# Financial goodwill in the Spanish CIT Law

Only in the acquisition of foreign holdings... by any Spanish taxpayer

#### **EC Decision #1**

State Aid in intra-EU acquisitions

### **EC Decision #2**

State Aid in non-EU acquisitions

2001

2007

2009

2010

### **State Aid investigation**

Following several complaints

# Appeals before the GC and Recovery orders

Not affecting pre-2007 acquisitions (but DT claims full recovery)

# Appeals before the GC and Recovery orders

Not affecting pre-2007 acquisitions and some other particular cases

### A LONG STORY

#### EC Decision #3

State Aid in the acquisition of holding entities (?)
But no recovery, since...

The EC filed a cassation appeal before the ECJ

The case is back to the General Court to discuss #1, #2, #3, the DT appeal...

—— 2014 ——→

2015

2016

2017

2018

The General Court annulled Decisions #1 & #2

T-219/10 *Autogrill* T-220/10 Santander

The ECJ annuls the GC judgments C-20/15P and C-21/15P World Duty Free (ex-Autogrill)/Santander

THE END ???

# **SELECTIVITY LESSONS**

Can a formal exception to the tax system, materially available (*de iure* and *de facto*) to all undertakings be selective?

- "Of course not!", the GC said the rule is open to all companies and do not benefit a particular category of undertakings/buyers
- **"Why not?"**, the ECJ said:
  - Selectivity does not require identifying a category of undertakings
  - Measures favouring certain behaviours may be selective
  - So, even a measure open to all undertakings may be selective if treats
    differently two situations (e.g. domestic vs. foreign acquisitions) that are
    legally and factually comparable

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# **SELECTIVITY LESSONS**

- But now the cases are referred back to the GC
  - Did the EC prove that foreign and domestic acquisitions were in a similar situation?
  - Did it consider other tax provisions offering the same treatment to domestic acquisitions?
- The real problem with this ECJ judgement is rather for the State aid system:
  - Now, even tax measures open to all undertakings may be considered selective
  - Institutional balance/tax sovereignty seriously in question
  - Need of a much more realistic definition of the 'reference system'

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# **SOME CONCLUSIONS**

- According to the current EC's (and ECJ's) trend, open-to-all tax measures benefiting certain activities are in principle selective, so Member States must be ready to:
  - Prove that the tax exception is justified; or
  - Notify the (supposed) aid to the EC and get a clearance in advance (so avoiding recovery issues).
- Does this make sense?
- SA is not an instrument for EU harmonisation

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## THE EC VIEW

Rulings give companies certainty and clarity as to how their tax will be calculated and are "perfectly legal"

However, rulings will be regarded as providing a selective advantage if they have the effect of "granting the undertakings concerned lower taxation than other undertakings in a similar legal and factual situation"



**Commissioner Vestager** 



# THE US REACTION

"The Commission's actions could threaten to undermine foreign investment, the business climate in Europe, and the important spirit of economic partnership between the US and the EU."

US Treasury

"The Commission has got itself now in a position where it's a bunch of plumbers doing electrical work......The Commission has probably bitten off more than it can chew."

Robert Stack (former senior official at US Treasury)





# **EC RULINGS CASES: A TIMELINE**



DG Comp "Task Force Tax Planning Practices" requests overview of tax rulings from 7 Member States (Bel, Cyp, Irl, Lux, Malta, NL, UK)

#### LuxLeaks

548 tax rulings obtained by MNCs in Lux from 2002 to 2010 leaked in the press EC opens investigation into Belgium's excess profit ruling scheme

June **2013** 

June-Oct 2014 Nov 2014 Dec 2014 Feb

Oct

2015 2015

EC opens investigations into Irl (Apple), Lux (Fiat & Amazon), Netherlands (Starbucks)

EC requests info from all Member States issued from 2010-2013

EC issues negative decision against Lux (Fiat) and NL (Starbucks)



# **EC RULINGS CASES: A TIMELINE**



EC opens investigation into rulings issued by **Lux** to **McDonalds** 

**Panama Papers** 

40 years of data leaked from law firm Mossack Fonseca

EC issues negative decision against Lux (Amazon)

Dec 2015 Jan 2016 April 2016

Aug-Sept 2016 Oct

Nov

2017

2017

EC issues negative decision against Belgium's excess profit ruling scheme

EC issues negative decision against Irl (Apple)

EC opens investigation into rulings issued by **Lux to Engie** 

Paradise Papers

13.4 million documents leaked. The majority came from law firm Appleby



## **OVERVIEW OF EC RULINGS CASES**

- Targeted high profile, "media-friendly" companies
- Majority involve method of applying transfer pricing rules / allocation of profits to branches
- EC focus on whether the arm's length principle was adequately applied
- Proving selectivity EC using best practice in international standards vs Member State's national legal system
- EC concerned with cases which may give rise to double non-taxation
- Amounts to be recovered range from €20m to €13bn (plus interest)











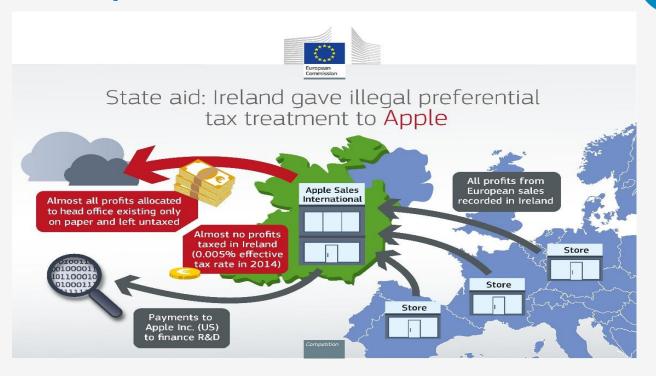


# **SUMMARY OF SIGNIFICANT CASES**

STARBUCKS	FIAT	Excess Profit Rulings	Apple	Amazon	McDonalds
Netherlands	Luxembourg	Belgium	Ireland	Luxembourg	Luxembourg
Transfer pricing	Transfer pricing	General scheme of rulings granted to MNCs	Profit allocation methods	Transfer Pricing	Exemption for royalties attributed to US branch
Negative decision issued	Negative decision issued	Negative decision issued	Negative decision issued	Negative decision issued	Final decision pending
€20-30m	€20-30m	€700m	€13bn	€250m	€TBC
Under appeal to General Court	Under appeal to General Court	Under appeal to General Court	Under appeal to General Court	Under appeal to General Court	



# APPLE CASE: PRESENTATION BY THE EC (IP/16/2913)





# THE APPLE CASE

### Negative decision issued August 2016

- Choice of allocation method unacceptable: based on attribution of Apple IP licences to stateless head offices which exercise no relevant activities
- Method used did not have any factual or economic justification
- 'Reverse engineering' to reach a particular amount of taxable income
- Method agreed in 1991 ruling applied for over 15 years without revision
- Amount to be recovered may be reduced if other countries impose tax or if US authorities require subsidiaries to pay more to US parent for R&D



# THE APPLE CASE

### Reaction from Apple

- EU's decision is "seriously flawed" and implies Apple products are designed in Ireland, rather than the US
- "Since virtually all of our research and development takes place in the United States, according to the law, we pay the majority of our taxes in the US...The Commission's ruling is contrary to the tax principles that other countries around the world have adhered to for decades."

### Reaction from Irish State

- Disagrees profoundly with the Commission's analysis. "Ireland does not do deals with taxpayers"
- Tax rules from which Apple benefited available to all and did not violate EU or Irish law



# IMPACT OF APPLE CASE ON IRELAND

- Revenue increasingly reluctant to issue client specific rulings on technical issues
- Revenue unwilling to provide guidance on hypothetical fact patterns
- Revenue focused on ensuring that administrative practices which are of importance to corporates and multinationals are up to date and aligned with BEPS
- Greater awareness among businesses operating in Ireland of the need to comply with State Aid law



# ADVICE FOR CURRENT & FUTURE RULINGS

- Time to review all rulings obtained in EU in order to determine your risk profile
- Lessons learnt from the current state aid procedures for future and current APAs in order to reduce the risk:
  - Prepare robust transfer pricing documentation
  - Substantiate the choice of TP method & why it fits the activities
  - If the profit is in any way capped, explain why
  - Substantiate the outcome
  - Substantiate choices made in the benchmark more thoroughly
  - Bilateral APA is preferable
- Reduce term of the ruling to five years
- If it's too good to be true, then...

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RECOVERY AND PROCEDURAL ISSUES: OTHER PRACTICAL ASPECTS

# **RECOVERY ISSUES**

- A Spanish tax advantage not available in e.g. Germany, is not State Aid by itself (only if discriminates other Spanish taxpayers) but can give rise to a State Aid complaint by e.g. a German competitor
- The Member State that granted the aid is normally compelled to defend it (not always, Spain did not appeal against Decisions #1 and #2) but, at the same time, will benefit for the recovery. Spain is now recovering Decision #3, which has not even heard by the GC
- Unless legitimate expectations, recovery can go back to 10 years of aid (deductions) plus interest
- Recovery is not suspended by the court appeals, unless very exceptional circumstances arise. No chances to defer payment (by providing guarantees) in Spain. Suspension is probably easier for the State than for the companies



# **RECOVERY ISSUES**

- Recovery is a matter for the State
  - State should use the most effective measures available in their national legal systems to recover the aid
- Do amounts recovered constitute a "tax"? EC has said it may. Some jurisdictions expressly provide such amounts are "tax"
- **Can recovery of state aid give rise to foreign tax credits?** Depends on jurisdiction:
  - Whether recovered aid is recognised as a "tax"
  - Whether voluntary taxes (i.e. tax paid as part of a settlement) are creditable
- Taxpayer should get agreement from tax authority that a tax assessment will be made if the court finally determines it has been in receipt of state aid
- If MS fails to seek recovery (or delays) EC can initiate infringement proceedings

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# **IMPACT ON M & A**

- Company which has received aid and sold at an arm's length price aid recovered from seller (Banks [Case C-390/98]) but if shares sold at less than market value recovery may be sought from purchaser (Commission v Germany [case C-277/00])
- Risk allocation point focus for particular sectors
- Due diligence on prior rulings and concessions issued to the Target Group
- General warranty that target has not been in receipt of state aid
- **Cover under general tax warranties/ tax indemnity?** 
  - Do amounts payable in respect of state aid constitute "Tax" for purposes of warranties/indemnities?
  - Subject to normal limitations (financial cap and time limits for claims)
  - 10 year look back is problematic

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# **CLIENT CONSIDERATIONS**

- **::** Consult your tax advisor if in doubt
- Reduce reliance on historic rulings that may have been issued by tax authorities as these could potentially be open to challenge
- Option of asking tax authority to submit ruling to EU on whether specific arrangement constitutes state aid most likely a costly and lengthy exercise
- "Nice to have" rulings a thing of the past, replaced by opinions
- In the absence of rulings or opinions, may need to accept the fact that there may be less certainty in areas of non-legislative tax law
- "Necessary" rulings still available
- Rulings now mandatorily exchanged (Council Directive 2011/16/EU on administrative cooperation in the field of taxation)
- If subject to state aid proceedings, seek agreement from tax authority that a tax assessment will be issued in the case of a negative court decision- to ensure credit will be available



# SPEAKER PROFILE





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### **CONTENTS**

- 1. Towards a definitive regime for intra-EU trade
- 2. Transitional Provisions ("quick fixes")
- Other Proposals already published
- 4. Proposals pending publication







### **BACKGROUND**

- The Green paper on the future of VAT
- \* A definitive regime based on the principle of taxation at origin is abandoned
  - The need to tackle fraud and, particularly, carousel fraud
  - The need to simplify the application of the rules, formal obligations...
  - So as to avoid making it more difficult to trade within the EU than with third territories (legal certainty, harmonisation) or domestically
  - Towards a simpler, more efficient and neutral, robust and fraud-proof system



### **BACKGROUND**

- Consultation process with stakeholders: 12 different alternatives to tax intra-EU transactions are considered
- Four final options:
  - Physical flow of goods + tax charged by supplier
  - Physical flow of goods + tax reverse charged
  - Contractual route + tax charged by supplier
  - Contractual route + reverse charge
- Plus keeping the current rules with some adjustments to improve the system (proposal by the GFV)
- Report on the different options



## **EXPECTED PROPOSAL (ACTION PLAN 2016)**

- Elimination of the double taxable event for a single transaction (zero-rated supply + intra-EU acquisition of goods)
- System based on the physical movement of the goods
- By which the supplier will have to charge VAT to the recipient
- VAT accrues in the country of destination of the goods
- Declaration and payment through the OSS
- Reverse charge by Certified Taxable Persons ("CTP")
- Proposal expected in 2018 with a view of its provisions being applicable in 2022
- # Future extension to services







## "QUICK FIXES" COM (2017) 569

- In the meantime, several improvements to the current arrangements need to be introduced
- These affect to:
  - Chain transactions
  - Proof of intra-EU dispatch
  - Consignment stock (call-off stock) transactions
  - Substantive requirements for intra-EU zero-rated supplies (VAT Number, ESL)
- Certified Taxable Persons ("CTP")



### **CERTIFIED TAXABLE PERSON "CTP"**

- Status for reliable taxable persons so as to have access to certain simplifications particularly in fraud-sensitive areas:
  - Definitive regime reverse charge
  - Chain supplies
  - Call-off stock
- Similarities with AEO
- Criteria to grant the status:
  - Track record: absence of serious infringements
  - High level of control of operations and flow of goods
  - Financial solvency
- Integration in the VIES





### "QUICK FIXES". CHAIN TRANSACTIONS



- How to allocate the transport to a specific supply where there are subsequent sales with a single transportation (A-B-C)
- Discrepancies in the application of this criterion uncertainty
- The proposal concerns the cases in which the middleman takes care of the transport (which is the case in which controversies may arise)
  - If B (taking care of the transport) is identified in a different MS other than the one
    of the supply and communicates the MS to which the goods will be dispatched to
    his supplier transport ascribed to the first transaction
  - Otherwise, transport ascribed to the second supply
  - A and B must be CTPs



### "QUICK FIXES". CALL-OFF STOCK

- Transfers of goods to another MS for their subsequent supply to an already known buyer (as opposed to consignment stock)
- Direct intra-EU supply (and when) or deemed intra-EU transaction + local supply?
- Proposed solution:
  - Intra-EU supply / intra-EU acquisition (no transfer of own goods)
  - When transfer of title takes place
  - If both parties are CTPs
  - Specific VAT accounting obligations + ESL



# "QUICK FIXES". PROOF OF INTRA-EU DISPATCH – COM (2017) 568



- Amendment to Implementing Regulation 282/2011
- Need for harmonisation and legal certainty
- List of documents that may support the transport to another EU MS so that:
  - If the transport is made by the supplier (or on his behalf) and he is a CTP, a
    rebuttable presumption applies by which the transport has taken place if he holds
    two non-contradictory documents of the list
  - If transport by acquirer (also if CTP), the supplier would need a declaration by the acquirer that the goods have been dispatched, plus two non-contradictory documents of the list



## "QUICK FIXES". FORMAL REQUIREMENTS BECOMING MATERIAL



- Request from the MS
- As per EU Case Law, the VAT number of the recipient is not a material (substantive) requirement for the exemption to be applicable in an intra-EU supplies
- Non-compliance with formal requirements does not generally impact the rights granted by the Directive
- \* As a reaction to this, MS suggested (and the Commission Proposal includes) that:
  - VAT number of the recipient granted by another EU MS -becomes a substantive requirement for the zero-rate to apply
  - The transaction has to be properly reported by the supplier in the ESL also as a substantive requirement







### GENERALISED REVERSE CHARGE

- Temporary measure requested by some MS (until 30 June 2022)
- **#** Applicable to:
  - All transactions over a 10,000 Euro threshold
  - If VAT Gap of at least 5 percentage points above average
  - Provided carousel fraud represents more than 25% of the VAT gap
  - Other measures not effective
- May be extended to countries with a common border with a risk to the fraud shifting to their territories
- Electronic reporting obligations
- Subject to authorisation and monitoring by the Commission







## CROSS-BORDER B2C E-COMMERCE AND RATES ON E-BOOKS

- Changes in the taxation of distance selling:
  - Transactions to be taxed where the customer is located
  - Extension of the MOSS to these sales
  - 10,000 Euro threshold
- ## Elimination of the exemption for the import of small consignments
- Applicable to non-EU suppliers (generally through intermediaries)
- Other minor adjustments in connection with electronically supplied services
- Option for MS to apply the same rates to books and e-books







## **EXPECTED PROPOSALS (CALENDAR)**



- \*\* VAT regime applicable to SMEs (expected November 2017)
- ⇒ Proposal on rates, modernising the system on the basis of the principle of taxation at destination (expected November 2017)
- ➡ Definitive regime (intra-EU trade) expected in Spring 2018







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As well as providing VAT advisory services in relation to land and property, manufacturing, and the services industry, she specialises in mergers and acquisitions, business restructurings and insolvencies across all industry sectors.



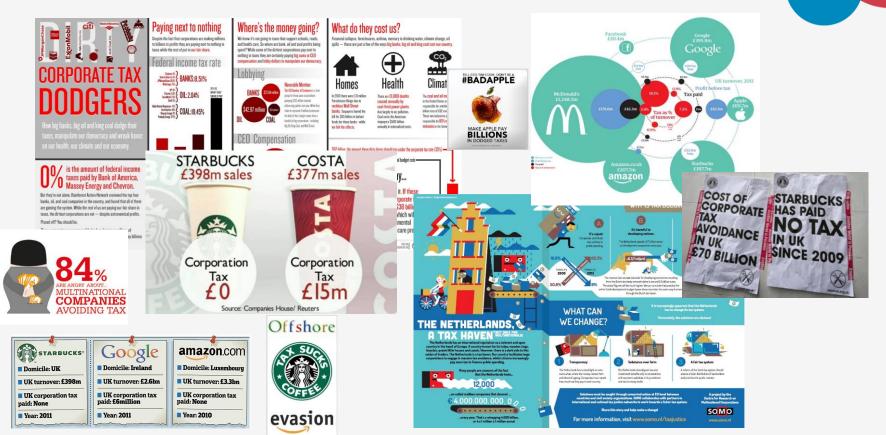


## **AGENDA**

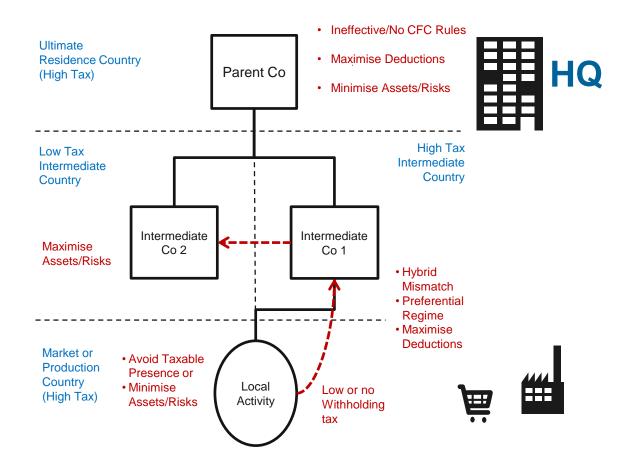
- Background to non-State Aid approach
- **BEPS** measures aimed at principal companies
- Unilateral measures
- **Experience** with tax authority approaches
- How multinationals have reacted



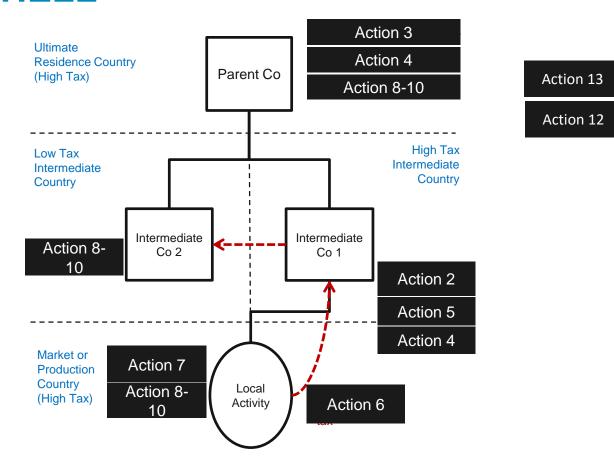
## THE MORALITY ARGUMENT – IN LAYMAN'S TERMS



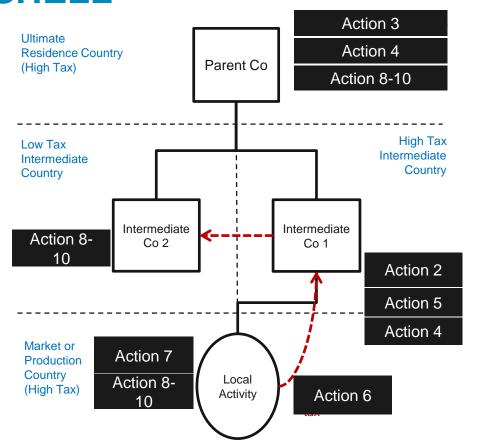
#### **EXPECTED IMPACT ON BEPS ... IN A NUTSHELL**



# EXPECTED IMPACT ON BEPS ... IN A NUTSHELL



# EXPECTED IMPACT ON BEPS ... IN A NUTSHELL

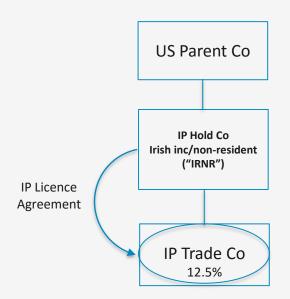


Action 13

Action 12

### IRELAND - OFFSHORE IP STRUCTURE

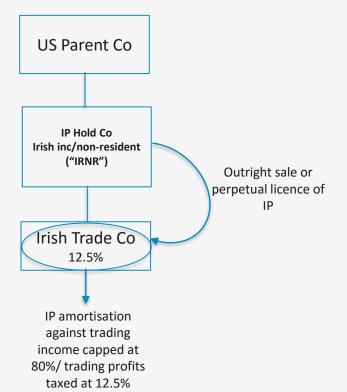




- IRNR holds intangibles and licenses the right to exploit
   IP to Irish Trade Co
- Deductible royalty payments to IRNR
- Irish trade Co taxed on trading profits at 12.5%
- Low ETR
- Pressure to change Irish tax residence rules
- Changes from 1 January 2015 (existing structures grandfathered until 31 December 2020)
- Actions 8-10 pressure on quantum of royalty,
   allocation of profits in IP Trade Co
- State aid similar fact pattern to Amazon case?



### IRELAND - ONSHORE IP STRUCTURE



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- Irish Trade Co acquires IP from IRNR via an outright sale or an exclusive, perpetual licence
- Irish TradeCo carries on its trading activities as before.
   Claims IP amortisation allowances against its trading income, either based on accounts or through an elective 15 year write down.
- Finance Bill 2017 announced an annual limitation of 80% of Irish Trade Co's profits for IP acquired after 10 October 2017
- Significant levels of onshoring of IP since 2015
- MNCs aligning substance and IP ownership
- Impact of EU proposals on the taxation of the Digital Economy

### IRELAND - TAX AUTHORITY REACTION

- Ireland only introduced transfer pricing for accounting periods commencing after 1 January 2011
- Irish tax authorities are increasing TP resources
  - Increased TP audits
  - Growing Competent authority team
  - Defence of overseas challenges
- Consultation re. broadening of scope of TP legislation
- Formal Bilateral APA Programme from 1 July 2016
- New guidelines issued in July 2017 for requesting MAP assistance in Ireland
- Directive on Tax Dispute Resolution





### **UK UNILATERAL MEASURES**



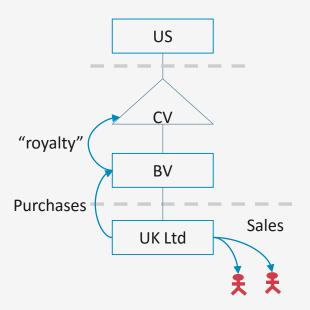
- Three recent unilateral measures:
  - Diverted Profits Tax
  - Wider royalty definition for withholding tax purposes
  - Disapplication of treaties to royalty payments in tax avoidance situations



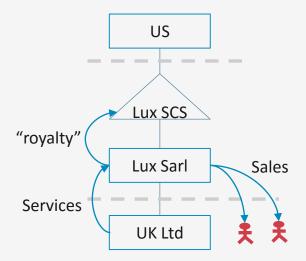
# UK DPT – PRE-BEPS TARGET STRUCTURES



Insufficient economic substance



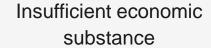
Avoided PE

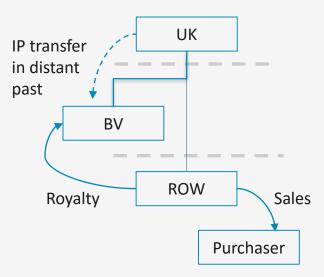




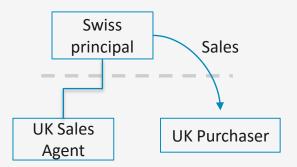
## UK DPT – ACTUAL STRUCTURES AFFECTED







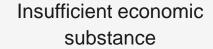
#### Avoided PE

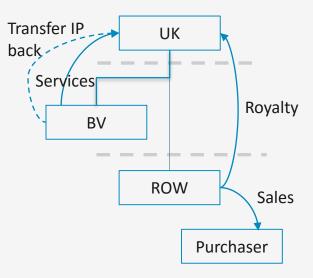




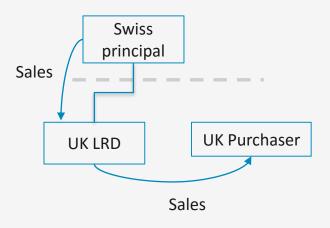
## **UK DPT – TAXPAYER RESPONSE**





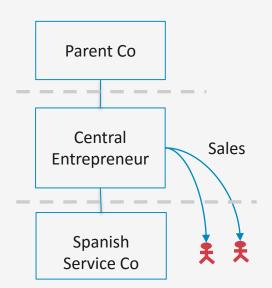


#### Avoided PE





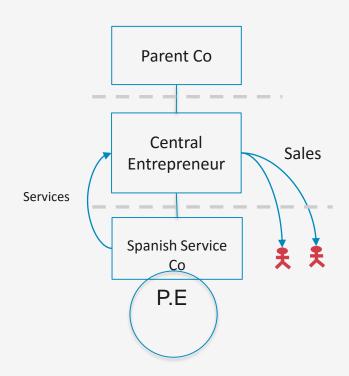
## SPAIN - P.E. CHALLENGE







## SPAIN - P.E. CHALLENGE 2

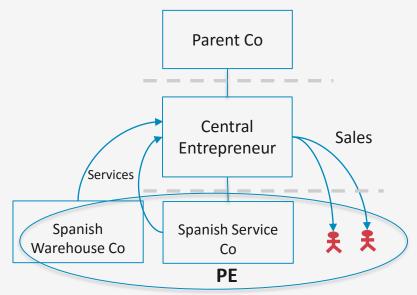






## **SPAIN – P.E. CHALLENGE 3**

### "Complex Operating Establishment"



Significant economic presence?





## THE SPANISH SUPREME COURT

- Roche: January 2012
  - Dependent agent / fixed place of business
- Borax: June 2014
  - Fixed place of business / complex operating establishment / dependent agent
- **:** Dell: June 2016
  - The Spanish subsidiary constitutes a PE of the parent company because this carried out its business through the premises of the former / dependent agent

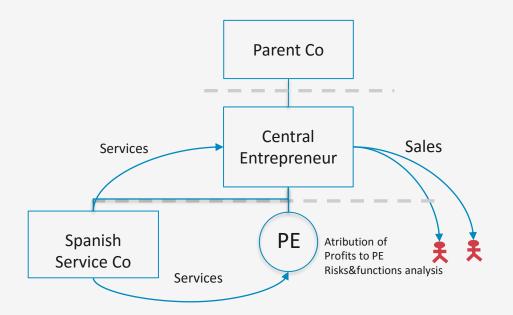


## THE BUSINESS REACTION

- Setting up of PE as a protective measure
- **APAs**
- \* Avoid litigation ... if possible



## SPAIN - P.E. RECOGNITION





## THE BUSINESS REALITY

- MNE usually opt to be present in foreign jurisdictions through Limited Liability Companies rather than through branches/PE
- ⇒ PE regularisations do not lead to a change in the MNE type of presence (i.e. no operations through a PE) but rather to a change of the TP policy
- ⇒ PE regularisations "should" require a thorough discussion on the attribution of profits to the PE
- By remunerating properly the risks and functions taken by the local subsidiary the outcome (re income taxes) should be similar to that of a PE assessment



## P.E. IN THE DIGITAL ECONOMY

- Is the PE discussion different from other industries?
  - Vertical reporting lines
  - Organised through business lines
  - Decisions and strategies set-out at HQ level
  - Business operation through local subsidiaries
- If risks & functions of local subsidiaries are properly remunerated

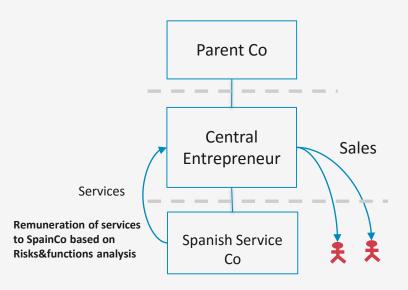
. . .

Why a PE?



## SPAIN – ALTERNATIVE TO P.E. CHALLENGE: TP APPROACH THROUGH APA











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Luis Vinuales is based in Taxand Spain where he joined Garrigues in 1992 (then, Arthur Andersen) and has been with the firm ever since. He worked in the Budapest office from 1996 to 1999 and in the New York office during 2004 and 2005.

He currently leads the International Tax Practice of Garrigues in Madrid.

He has gained broad experience working with multinational clients on their international acquisitions and restructuring projects and regularly advises foreign real estate groups investing in Spain and Spanish groups investing in real estate abroad.

In the last decade Luis has been specially focused on the digital economy industry, helping international clients in their discussions with the Spanish Tax Agency, both in APA processes and tax audits.



