The EU state aid rules mean that companies cannot rely on advantageous tax schemes – multi-billion EUR claims against Apple

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It is not unusual that large corporate groups choose carefully where the company's profit is to be taxed for the purpose of reducing the group's total taxation. However, this norm has been challenged by the European Commission (the "Commission"), which in recent years has investigated how the Member States choose to tax multinational company groups from the perspective of state aid law. This may result in that the companies have to pay previously unpaid taxes. Partner Elisabeth Eklund and associate Angelica Ström report on the risks for Member States and companies, respectively.

Introduction

The EU state aid rules aim at ensuring that competition between companies in corresponding situations is not distorted by public bodies such as the state, municipalities or county councils providing aid (in the form of subsidies, favourable loans or warranties etc.) that creates a competitive advantage. In Sweden, aid to regional airports and sub-market pricing on the sale of land from municipalities have been the primary subject of state aid proceedings, both by the Commission and before the national courts. In a couple of cases, Swedish companies have been found liable to repay, with interest, the advantage that the company had obtained. However, in recent years tax schemes have been in focus in the state aid area, resulting in significantly greater economic risks for companies than before.

State aid and tax regulations

The Commission, which is the EU's supervisory authority for the compliance of state aid rules, has in recent years started to review and apply the state aid rules in the tax area. Thus, the Commission has, indirectly, questioned how the Member States choose to impose tax on companies. This may seem surprising since the European Union does not have any authority to directly affect the Member States' national taxation systems. The Commission justifies its investigations by stating that the tax schemes may negatively affect the competition on the EU's internal market. The investigations that have been initiated have primarily been aimed at large companies and company groups with an international presence. This has resulted in the Commission rejecting both transfer pricing schemes and tax agreements.

What are the state aid requirements and how has the Commission's interpretation changed?

There are four criteria that must be met for a state aid to be deemed to exist. There must be an economic advantage (which also includes subsidies of a cost which otherwise would be incurred by the company) that must be related to the state (which includes e.g. the state, municipalities and county councils and companies or organizations owned by them). In addition, the measure must distort competition (e.g. by giving one company an unfair advantage) and selectively favour certain companies or one specific company. It may be bared in mind that all state aid (with some exceptions) that has not been reported to, and approved by, the Commission constitutes illegal state aid – i.e. all state aid must be reported to, and approved by, the Commission *before* it is given to a company, even if the Commission in a later assessment would consider the state aid to comply with EU law.

When reviewing the tax ruling practices of Member States', the Commission has focused on the aforementioned selectivity criterion. In general this is determined in relation to other companies in an equivalent situation and industry. The Commission's opinion is that individual group members of a multi-national company group must be taxed on the basis that they act at arm's length in their dealings with each other. There is no doubt that the arm's length principle is well-established in the area of tax law, but the principle can be applied in several different ways, and herein lays a big question mark. In summary, the Commission's most recent decisions have not focused on whether a company has received advantages in relation to other companies in the same industry, but instead have focused on how the taxation would have been for the company group in question, if it had consisted of separate companies.

What are the consequences of illegal state aid?

Where the Commission finds that a measure has constituted illegal state aid, the Commission can order recovery of illegal state aid for a ten-year period preceding the Commission's first request for information from the company. In addition, repayment is to be made with interest and as a result a company may have to repay significant amounts. Further, there is also a bad-will aspect associated with illegal state aid and in addition, companies that have incurred losses due to illegal state aid may be entitled to damages.

What measures has the Commission taken in the tax area so far?

The Commission started to review Member States' taxation systems under the former Commissioner for Competition, Joaquín Almunia and has continued under the current Commissioner, Margrethe Vestager. Until now, the Commission has, *inter alia*, pursued a case concerning the taxation system of Gibraltar, which was tried by the European Court of Justice (the "ECJ") in 2011. In Gibraltar, a new corporate tax had been introduced with the effect that off-shore companies did not have to pay any tax since tax was calculated on the basis of the number of employees. The proposed system was deemed to be selective, even though it applied to all comparable companies, due to the fact that it in practice only applied to off-shore companies because of the special characteristics of these companies.

Further, the Commission has in recent years reviewed set-ups in several Member States where tax agreements have been made between company groups and tax authorities. The Commission's investigations on tax agreements were facilitated by *LuxLeak* in November of 2014, when over 340 multinational companies' tax agreements were published in the same way as *WikiLeaks*.

On 30 August 2016, the Commission announced that through an in-depth state aid investigation of Apple it had concluded that Ireland had granted Apple, under two tax rulings, undue tax benefits of up to EUR 13 billion. The Commission concluded that the tax rulings substantially and artificially lowered the tax paid by Apple in Ireland. As a result of the allocation method endorsed in the tax rulings, Apple paid an effective corporate tax rate that declined from 1% in 2003 to 0.005% in 2014, and the Commission has now ordered Ireland to recover unpaid taxes from Apple for the years from 2003 to 2014 of up to EUR 13 billion, plus interest. If other countries require Apple to pay more taxes on profits during the same period, this would reduce the repayable amount. In October 2015 the Commission also demanded that the Netherlands and Luxembourg should recover unpaid taxes from Starbucks and Fiat due to transfer pricing arrangements, of up to EUR 20-30 million per company. In addition, there are ongoing investigations of Amazon and McDonalds. Many of the companies that have been in focus of the Commission's investigations have been large American groups of companies, a fact that has made the American Secretary of Commerce write a letter to the chairman of the Commission in which he criticizes, what he sees as a witch hunt of American companies carried out by the Commission. Further, the US Treasury Department has criticized the Commission's decision regarding Apple's repayment obligation and has added that the decision could threaten to "undermine foreign investment and the business climate".

What happens next?

The Commission's decisions regarding repayment obligations for Starbucks and Fiat have been appealed and both Ireland and Apple are expected to appeal the Commission's decision regarding the repayment obligation for Apple. Pending a final decision, Ireland must, in accordance with the Commission's decision, recover the illegal state aid but can until further notice place the recovered amount in an escrow account. Due to the uncertainty regarding what the Tribunal and the ECJ will find in their judgments, companies that have received illegal state aid based on a tax ruling from a national tax authority, risk having to repay substantial amounts.

Through the Commission's proposals on tax transparency, the Member States reached in 2015 a political agreement on automatic exchange of information on tax rulings. The Commission's investigations, together with an increased exchange of information between Member States, can continuously be expected to result in the EU state aid rules indirectly affecting national tax systems also in the future. Even if it is difficult to assess exactly how the Commission's agenda may affect other Member States' tax systems, or companies that have not yet been investigated, our point of view is that the Commission's investigations will have a great influence on how countries choose to impose tax on companies and, more specifically, how transfer pricing will be applied to company groups and how advantageous tax reliefs will be given. If the ECJ upholds the Commission's decision, it will cost the companies in question dearly. In addition, the Member States themselves risk claims for damages from companies that have incurred losses due to the state aid at hand.