Fiscal aid - a potential time bomb

Tax Update

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The European Commission has - once again - launched a new crusade against what it calls "aggressive tax planning". This time it is about "fiscal State aid", i.e. subsidies in the form of national tax advantages. Unhappy about the lack of fiscal harmonization at Member State level, the Commission uses its State aid powers to increase the pressure - at the expense of the thousands of companies that have in good faith entered into tax rulings with tax authorities all over Europe. In a number of cases targeting different companies in different Member States (Luxemburg, Ireland, the Netherlands), the Commission contests in particular transfer price arrangements. The threat: reimbursement of "undue" tax savings - speak: billions of Euros in some cases.

In at least two particular cases, the Commission considers that the company's internal profit allocation scheme is not in line with the OECD's Transfer Pricing Guidelines for Multinational Companies[1] and does not conform to any of the OECD-proposed methods to establish that the "arm's length" principle is respected. The Commission considers that "a prudent independent operator acting under normal market conditions" would not have accepted this profit allocation scheme; the ruling might thus constitute an economic advantage to that company by allowing the group to which the company belongs to pay less tax than other companies whose profits are allocated in line with market terms.

In another case the Commission takes the view that a 10 year-old transfer pricing ruling which allows the company to lower its taxable income through the payment of a royalty to a foreign sister company, lacks an objective basis, because the royalty is not calculated based on true market terms.

In a third case, the Government of Gibraltar clashed with the Commission over the assessment of an entire tax scheme that allegedly provides unjustified exemptions for certain categories of "passive income" such as interests or dividends. The Commission found that the exemption differentiates between companies in similar conditions and deviates from the general reference system in a way which is not objectively justified (in particular not by the need to keep the tax system simple and effective).

Companies having entered into tax rulings should check whether any of the following is present:

- The ruling is based on a scheme deviating from the OECD recommendations or similar soft law;
- The taxable basis has been freely negotiated with the tax authorities without any reference to other comparable transactions;
- The tax authorities merely accepted the proposals of the company seeking the ruling;
- Internal documents (e-mails) reflect that the cost have been reverse engineered to obtain a certain taxable income;
- The financial parameters of the ruling lack motivation in economic terms and are not substantiated by any generally accepted methodology;

- The ruling is open-ended in time;
- The profit allocation factors are not consistent throughout the company's organization.

1. http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-guidelines.htm.↩

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