

McDonald's Fiscal State Aid Clearance: Questions Still Pending

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Following three years of investigation, McDonald's has been cleared from the charge that it received fiscal state aid from Luxembourg, by virtue of the European Commission's concluding decision of 19 September 2018. Thus, the Commission seems to have closed one of the various fronts opened in the fiscal state aid area in the last five years, including cases like [Apple](#), [Starbucks](#) and [Engie](#). Yet, the war is much ampler and critical questions remain still pending.

From a business perspective, the ongoing fierce debate entails important implications and requires close monitoring. On the one hand, taxpayers need to ensure their timely intervention in cases concerning tax measures from which they themselves or their competitors have potentially benefitted. On the other hand, major part of the Commission's recent investigations focuses on tax rulings, questioning their validity as an instrument to obtain tax certainty. The outcome of the debate shall determine the expectations taxpayers can place on the tax rulings they have or request from EU Member States and subsequently their alternatives to ascertain their tax liability in the Single Market.

In fact, the [McDonald's story](#) is about tax rulings as well. The investigation centered on two tax rulings issued by the Luxembourg tax authorities in 2009 following request by the local subsidiary of the US fast food corporation. In essence, the tax rulings affirmed that royalties received by the local subsidiary fell under the scope of the tax treaty with the U.S (the "Bilateral Treaty") and were not taxable in Luxembourg, i.e. at the hands of this subsidiary. Such application of the Bilateral Treaty was concluded following its interpretation on the basis of local Luxembourg law. Such interpretation and application implied that:

1. the local subsidiary had a permanent establishment (PE) in the U.S.;
2. where the royalties received should be allocated (since the U.S. PE had the relevant franchise rights); and
3. since the royalties were taxable at PE level according to the Bilateral Treaty, they were not taxable at the level of the subsidiary in Luxembourg – regardless of the effective exercise of the U.S. taxing right at PE level.

What the Luxembourg tax authorities did not take into account was that the U.S. was not able to exercise its taxing right under the Bilateral Treaty because U.S. law did not permit the recognition of a U.S. PE in the case of the McDonald's Luxembourg subsidiary. This was what the European Commission challenged in its opening decision of the case. It argued that in principle effective taxation of the royalties by the U.S. is not relevant to determine Luxembourg's taxing right. However, the fact that the U.S. was precluded from exercising its right under the Bilateral Treaty due to its domestic law could be a game-changer. In such case, Luxembourg should not consider itself precluded from taxing the royalties. In other words, Luxembourg tax authorities should take into account the provisions of the U.S. law in order to interpret and apply the Bilateral Treaty; considering Luxembourg law alone was not sufficient to give a correct interpretation.

In its closing decision, as arises from the relevant [press release](#), the Commission took a different view, endorsing Luxembourg's interpretation of the Bilateral Treaty in light of Luxembourg domestic law. The lack of effective taxation of the royalties received by McDonald's Luxembourg subsidiary was the result of a mismatch between U.S. and Luxembourg law. Yet, double non-taxation does not necessarily imply fiscal state aid, since the latter requires that a Member State grants a selective tax advantage. Where the Member State applies its law consistently to all taxpayers, there is no selectivity in the conduct of the Member State (even if there might be an advantage for certain taxpayers due to the interaction of the domestic law with a specific foreign law).

From the above, it follows also that Member States do not need to take into account foreign tax law for the application of their domestic tax law. Such conclusion is also in line with established case law of the Court of Justice of the EU ([Columbus Container, C-298/05](#)). In any case, it may be deemed rather unreasonable to demand from Member States to change the application of domestic law in light of the relevant foreign law and subsequently to closely monitor the changes of all foreign laws.

The McDonald's story had clearly a happy end, not only for the food company but also for Member States' power to legislate and apply their domestic law as well as for the business environment in the Single Market in general. But even if this battle was won, there is still war in the EU fiscal state aid front.

Tax certainty in the Single Market is at stake.

Firstly, the length of the investigations of fiscal state aid cases risks to compromise the investment potential and the development of business in the EU. By way of an example, the McDonald's case took almost three years to be concluded, despite the fact that it did not involve e.g. transfer pricing evaluations. For three years the company had to provide for the management of the relevant tax risk, abstaining from potential development initiatives, as well as to suffer the relevant reputational damage.

Secondly, the extended challenge of Member States' tax rulings practices questions their efficiency as a tool to enhance tax certainty. However, amidst the overhaul of the international tax framework through the BEPS Project and the global debate on the taxation of digital economy, the need for tax certainty is increasingly pressing. Lack of such certainty could then be a disincentive for investment and entrepreneurship.

Concluding, the closing of the McDonald's state aid case constitutes a positive step ahead in the clarification of the EU fiscal state aid framework. Nevertheless, a number of question-marks still remaining prejudice tax certainty in the Single Market. Clear-cut responses are urgently needed; hopefully they will come soon from the Court of Justice, where a series of fiscal state aid cases are awaiting final judgement.