EU's Tax-Centered State Aid Campaign May Have Peaked

By Joyce Beebe (August 19, 2020, 5:20 PM EDT)

Last month, the European Union's General Court overturned the European Commission's decision that required Apple Inc. to pay $15 billion of taxes back to Ireland. The EC claimed that Ireland's tax rulings granted selective advantages to Apple, which distorted competition and constituted illegal state aid.\[1\]

Although many are debating whether the EC will appeal the case to the European Court of Justice — and whether the EC's decision will be based on fundamental merits of the case or political considerations — it is equally intriguing to note several factors that may point to a potential slowdown of the EC's state aid probe of member states' tax conduct.

Recent State Aid Investigations of Tax Rulings

Since the EC began its tax-focused state aid initiative in 2013, several U.S. companies — including Starbucks Corp. in a case involving the Netherlands, Apple Inc. in a case involving Ireland, Amazon.com Inc. in a case involving Luxembourg, McDonald's Corp. in a case involving Luxembourg and Nike Inc. in a case involving the Netherlands — have been under formal investigation. These cases are in different stages of development.

Specifically, the EC concluded that Luxembourg did not give McDonald's selective tax benefits and closed the case in 2018. The Starbucks and Apple cases went through to the General Court, and the court annulled the EC's decisions on both, concluding that the Netherlands and Ireland, respectively, did not provide unlawful advantages.

Amazon appealed the EC's 2017 decision regarding the tax rulings granted by Luxembourg and argued the case in front of the General Court in March 2020; a decision is expected in the next few months. Finally, the investigation involving Nike was initiated in 2019 and is ongoing.

Simply seeing the number of cases and their progression may lead one to conclude the EC is at full throttle with tax-related state aid investigations and new cases will constantly be added to the pipeline. However, the following considerations may provide a different perspective.

First, although there were numerous developments in these cases over the last 18 months, it is important to bear in mind that the EC investigation is generally a lengthy process sometimes involving tax rulings issued decades ago. The duration is even longer when a case enters the court system.

For instance, Ireland initially issued the subject tax rulings to Apple in 1991 and 2007, but the EC didn't accuse Apple of receiving unlawful state aid until 2016. It took another four years for the General Court to reach its decision.

Starbucks received its tax ruling from the Netherlands in 2008, the EC announced its
decision in 2015 and the court ruled in favor of the company in 2019.

Similarly, Amazon obtained its rulings from Luxembourg in 2003 and 2011, the EC concluded its state aid investigation in 2017 and the case is currently pending in the General Court.

In the meantime, significant changes in international tax rules and practices have occurred. In fact, several jurisdictions modified their tax systems, closed loopholes and tightened their tax ruling issuance standards in the past few years. Multinational corporations responded by sharpening their pencils for tax planning and ditching their questionable tax structures, which relied on old rules.

Ireland has been under EC pressure to revise its tax laws. In 2015, the country changed its tax residence rules, essentially invalidating the popular "double Irish" tax planning structure. Existing structures were given until the end of 2020 to unwind.

At the same time, Ireland is eager to avoid the tax haven image and maintain its tax reputation. In the Apple case, Ireland was dedicated to defending the integrity of its tax rulings even if this meant turning away $15 billion in tax revenue.

Other jurisdictions also made significant changes in their tax rules. Luxembourg made its permanent establishment recognition rules more stringent, whereas the Netherlands tightened the criteria for issuing international tax rulings and implemented a conditional withholding tax for interest and royalty payments.[2]

In reaction to these changes, Google Inc. announced it will shut down its double Irish structure[3] and Amazon changed the way it operates in Europe; the new structure is not within the scope of the EC's current investigation.

Second, digital companies experienced rapid global growth over the last decade. Such expansions have not only disrupted existing business models, but have also pressured regulatory environments in multiple dimensions, creating challenges for tax, privacy, data protection and antitrust issues. Therefore, the EC's competition-based investigations have been branching into nontax fields.

The four U.S. tech giants — Google, Amazon, Facebook Inc. and Apple — have either been under investigation, fined or forced to change their operations in the EU on antitrust matters. As the EC focuses more on digital companies' overall conduct, resources dedicated to tax-based state aid investigations are likely to decline.

Such redeployment may be a more effective use of resources for the EC, because the court's state aid decisions involve wide discretion and the disputes can be highly political. Practitioners indicate it is intrinsically difficult to distinguish between what is acceptable and what constitutes illegal state aid, as there is often not a clear line between the two.

As existing state aid cases continue to enter the appeal process, the parties involved theoretically have more legal precedents to gain clarity about the elements the court values. However, the EC's statement that it treats combating state aid as a political commitment complicates the picture.[4]

Both the Trump and Obama administrations indicated that they strongly disagreed with the EC's position and stood firmly behind U.S. tech companies on tax issues. As a result, when the EC, the company or the member state is deciding whether to bring a case to court, it is
unclear if the parties are following the merits or making a political statement.

Despite the political nature of the issue and the court's discretionary power, the General Court delivered a consistent message in both the Apple and Starbucks rulings. Although the court was asked to decide a state aid case that could have economic impacts across multiple jurisdictions, it respects a member state's fiscal authority to set its own tax rules. As such, the court's guiding principle is the member state's corporate tax regime and it examines whether the tax rulings properly comply with the member state's tax law.

In other words, the court affirms that the EC is not a supra tax authority for member states. Although the EC can rely on overarching economic principles in its analysis — such as the arm's-length standard — even if they have not been specified in member state tax rules, the EC needs to explicitly prove the rulings would have changed the profits attributable to the member state instead of simply pointing to noncompliance with technical or methodological requirements.

Running parallel to the proliferation of the digital economy and the changing international tax landscape is the Organization for Economic Cooperation and Development's, ongoing digital tax overhaul. After years of effort and a pandemic-inflicted hiatus, the OECD is set to release key policy features and digital tax implementation plans between October and year-end.

Although the OECD's final recommendations are not immediately binding until adopted by local laws, it is in a better position than the EC to handle global tax matters. This is partly because it has been taking a dialogue-based approach, allowing all participants to provide input. The EC has also been advocating for a digital service tax, which is generally perceived as an inferior alternative to a coordinated global framework.

Third, the COVID-19 pandemic has changed the EC's perspective on state aid, or at least its rhetoric. This is likely due to the fact that almost all EU countries have provided financial relief to domestic businesses over the last few months. The EC has also relaxed its rules as to what constitutes state aid, although the updated rules include safeguards meant to avoid excessive government interventions and undue market distortions.

For instance, government funds can only be used to restore the viability of companies impacted by COVID-19 instead of helping those already in trouble before the pandemic. Additionally, publicly traded companies must release government funds within six years — seven years for other types of entities.[5]

However, the rules can still be vague at the implementation level, and whether or not the relationship between business and government will return to prepandemic status is also uncertain.

Besides, not all companies welcome such subsidies. Ryanair Holdings PLC, based in Ireland, argues that the German government's €9 billion (approximately $10.69 billion) bailout to Deutsche Lufthansa AG constitutes illegal state aid and is a clear breach of EU competition rules.[6]

Ryanair claims the German government used taxpayer funded bailouts to push smaller rivals out of the EU market and threatens to bring the case to the General Court. The EC disagrees, indicating that such measures are necessary to keep the EU economy intact and that the money repairs economic damage induced by COVID-19.[7] Although there is no doubt that the pandemic imposes unprecedented economic challenges, the line between
emergency relief and illegal state aid is becoming increasingly blurry.

**The New Direction**

The EC has reiterated that it will not stop combating tax-related state aid. However, several considerations indicate that the EC is reprioritizing its anti-competitive initiatives from tax-related state aid to broader issues, focusing on tech companies.

Today's international tax landscape is different from that of several years ago as a result of countries revising domestic tax rules and companies changing tax structures. The operational structures of multinational corporations, which could withstand tax-related examination when they were put in place, may no longer be able to stand up to the pressure today.

As a result, various corporations have been scrapping these problematic arrangements and member countries are being more selective when issuing tax rulings. Although there will still be tax-related probes, the new cases are more likely to enter the caseload in a more moderate manner.

Government authorities around the world are paying close attention to the rise of Google, Amazon, Facebook and Apple and the pressure they put on existing regulatory environments. The EC is also expanding its scope of investigation on competition distortion. Instead of focusing on member states that provide selective tax advantages to companies in any industry, the EC is highlighting antitrust issues involving tech giants.

Moving away from examining narrow, tax-focused cases may generate more meaningful results for the EC, as the General Court has been hesitant to interfere with the authority of member countries to set their own tax rules. In addition, with the OECD spearheading the digital tax overhaul, it is advantageous for the EC to focus on digital companies' nontax issues.

Finally, EU member countries have been providing fiscal relief to domestic companies affected by the pandemic. These measures are funded by taxpayers and could be noncomprehensive in nature.

Although the pandemic has caused unprecedented disruption to the economy, companies that do not receive comparable benefits, either because their governments do not provide the funds or because they have been operating conservatively instead of overleveraging, may view these funds as selective state aid. Whether the funds technically constitute state aid in the context of COVID-19 may be secondary to how the issue is perceived by the public and stakeholders and companies that do not receive aid will continue to oppose such asymmetric treatment.

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[1] Court of Justice of the European Union, Case Law: Judgment of the General Court,


