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The European Commission finds no illegal State aid was provided by Luxembourg's non-taxation of McDonald's

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On 19 September 2018, the European Commission ("Commission") issued a press release declaring that Luxembourg did not provide illegal State aid to McDonald's with regards to two tax rulings that resulted in double non-taxation of franchise profits in Luxembourg. The Commission's three-year-long in-depth investigation established that Luxembourg had merely acted in compliance with its national tax laws and that the double non-taxation was the result of a mismatch between Luxembourg and US tax law, as opposed to a more favourable treatment given to McDonald's compared to other companies in Luxembourg.

The Commission's initial concerns

In December 2015, the Commission launched an investigation into McDonald's Europe Franchising ("MEF"), a EU subsidiary of the US-based McDonald's Corporation. At issue were two tax rulings regarding MEF, a tax resident of Luxembourg with one Swiss branch and one US branch, that received franchisee royalties from outlets in Europe, Ukraine and Russia.

Under the first tax ruling, the authorities in Luxembourg exempted MEF from having to pay corporate tax by reference to the Luxembourg-US Double Taxation Treaty (the "Treaty"). The Treaty states that company profits cannot be taxed by Luxembourg if the company may be taxed in the US by virtue of it having a "permanent establishment" there, from which permanent establishment business is carried out, as well as a taxable presence. Using the Luxembourg definition of "permanent establishment", the US branch of MEF may have been subject to taxation in the US and therefore exempted from corporate tax in Luxembourg. Despite this, MEF was still required to provide the Luxembourg authorities with annual proof that royalties transferred to the US via Switzerland were declared and subject to taxation.

Under the second tax ruling, McDonald's subsequently highlighted a discrepancy between the US and Luxembourg jurisdictions. It claimed that, although MEF's US branch could be considered a "permanent establishment" under Luxembourg tax law, it could not be classified as such under US tax law. On this basis, it argued that (i) the royalty income should be exempt from corporate tax in Luxembourg, under the interpretation given of "permanent establishment" by Luxembourg national tax law, and that (ii) MEF did not have to prove that the royalty income was subject to tax in the US. The authorities in Luxembourg agreed with these points and issued a second tax ruling.

As a consequence, both Luxembourg tax rulings resulted in a double non-taxation as MEF's royalty income would be taxable neither under Luxembourg nor US tax law.

The Commission's findings

In its examination, the Commission concluded that the Luxembourg authorities had not misapplied the Treaty in exempting the income of the US branch of MEF from Luxembourg corporate taxation. In particular, the Commission could not establish that the interpretation given by the second tax ruling to the Treaty was incorrect, even if it resulted in a double non-taxation of the royalties awarded to MEF's US branch. Therefore, no special, more favourable treatment had been provided to McDonald's that would have constituted illegal State aid.

However, Commissioner Vestager expressed concerns from a tax fairness point of view and emphasized that "*the fact remains that McDonald's did not pay any taxes on these profits – and this is not how it should be from a tax fairness point of view*". Consequently, the Commission welcomed actions taken by the Luxembourg government to combat situations of double non-taxation including the presentation of draft legislation that aims to:

- strengthen the conditions required to determine the existence of a permanent establishment under Luxembourg law; and
- require companies, under certain conditions, to provide confirmation that they are subject to the taxation in another country, where such a claim is made.

Conclusion

The Commission has investigated individual tax rulings of Member States under EU State aid rules since June 2013, with this being the first investigation which has not resulted in a finding by the Commission of illegal State aid. To companies under investigation the decision offers hope, by illustrating that there are situations where the specificities of the national tax laws are recognised, even if they may result in special treatment. However, the decision also demonstrates the influence the Commission has and that it can successfully urge Member States to make legislative amendments to change the current situation even if this situation is legally accepted. This can also prevent future situations of non-taxation, even if the Commission did not find the current situation to result in illegal State aid.

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