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Newsalert
EU Direct Tax Group

European Commission opens formal State aid investigation into Luxembourg's tax treatment of McDonald's

EU Direct Tax Group

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On 3 December 2015 the European Commission announced, in a press release, its decision to open a formal investigation into tax rulings between McDonald's and the Luxembourg tax authorities. The press release elaborates the reason for this investigation, and specifies the additional information which the EC has requested from Luxembourg.

This decision represents the opening, not the outcome, of the Commission's formal investigation in this matter.

Background

The formal investigation pertains to the granting of two tax rulings concluded in March 2009 and September 2009 on the tax treatment of royalty income in Luxembourg received by a Luxembourg McDonald's entity, McDonald's Europe Franchising.

The European Commission believes that the combination of these two rulings leads to a situation where McDonald's does not pay corporate income tax in either Luxembourg or the United States (US) on royalty income it receives from franchisees operating restaurants in Europe and Russia for the right to use the McDonald's brand and associated services.

Key reason

The European Commission states that its key area of concern is the incidence of double non-taxation.

The European Commission appears to have doubts with regard to the differing qualifications of McDonald's Europe Franchising activities under the Double Tax Treaty between Luxembourg and the US.

From a Luxembourg tax perspective the US activities of McDonald's Europe Franchising are characterized as constituting a Permanent Establishment (PE) there. The result is that the income attributed to that PE from a Luxembourg tax perspective should not be taxed in Luxembourg. However, from a US perspective, the US activities of McDonald's Europe Franchising are not characterized as constituting a taxable presence there. In the view of the European Commission, this results in a situation of double non-taxation, since the royalty income is neither taxed in Luxembourg nor in the US.

Double non-taxation and EU Law

The European Commission asserts that the purpose of *"Double Taxation Treaties between countries is to avoid double taxation – not to justify double non-taxation."*

This is the first time that the European Commission has targeted double non-taxation resulting from the application of a Double Tax Treaty. If this approach is confirmed in the final decision, further litigation before the European Courts is likely.