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

Mr. Miguel Troncoso-Ferrer
Partner
mtroncoso@gomezacebo-pombo.com

In the Commission’s preliminary view two tax rulings granted by Luxembourg to the US company McDonald’s in 2009 may have granted an advantageous treatment in breach of EU State aid rules. Therefore, the Commission has opened a formal investigation in order to assess whether the Luxembourgish authorities selectively derogated certain national tax law provisions and the Luxembourg-US Double Taxation Treaty granting the company an advantage not available to other companies in comparable factual and legal conditions.

On the basis of these tax rulings, McDonald’s Europe Franchising, a company incorporated in Luxembourg, paid no corporate tax in Luxembourg for the profits derived from royalties paid by franchisees in Europe and Russia in return of the right to use the McDonald’s brand and associated services, despite recording large profits (more than €250 million in 2013).

McDonald’s Europe Franchising has (i) an office in Luxembourg, in charge of McDonald’s strategic decision-making, (ii) a branch in Switzerland with limited activity in franchising rights, and (iii) another one in the US, with no real activities. The royalties received by the Luxembourgish branch were transferred internally to the US branch. Under the first tax ruling, the Luxembourgish branch was not obliged to pay corporate tax since the profits were to be subject to tax in the US on the basis of the Luxembourg-US Double Taxation Treaty. McDonald’s was required to justify every year that the royalties transferred to the US via Switzerland were declared and subject to taxation in these two countries. However, the profits were not subject to tax in the US, so the condition required by Luxembourg to benefit from a tax exemption in Luxembourg under the ruling was not fulfilled.

Therefore, McDonald’s requested for a second ruling, and insisted that Luxembourg should nevertheless exempt the profits not taxed in the US from taxation in Luxembourg. McDonald’s argued that the US branch of McDonald’s Europe Franchising constituted a “permanent
establishment” under Luxembourg law, because it had sufficient activities to constitute a real US presence. By contrast, McDonald’s argued in the US simultaneously that its US-based branch was not a “permanent establishment” under US law because, from the perspective of the US tax authorities, its US branch did not undertake sufficient business or trade in the US.

Consequently, the Luxembourg authorities recognised the McDonald’s Europe Franchising’s US branch as the place where most of their profits should be taxed, while at the same time US tax authorities did not recognise it. While knowing that the profits were not subject to tax in the US, the Luxembourg authorities exempted the profits from taxation in Luxembourg.