EU's financial transaction tax: where are we now?

The wrong track or the wrong tax?

Comments from the Austrian finance minister, Hartwig Loeger, in an interview with Bloomberg on 4 September 2018, highlight the lack of progress made by the group of member states seeking to take forward the EU financial transaction tax (FTT). We have grown accustomed to disparaging statements from many quarters on the FTT proposal and Mr Loeger's statements only reiterate the continuing challenges facing the project.

For Mr Loeger, the abandonment of the principles included in the European Commission's original proposal for a union-wide FTT is troubling. The proposal, initially published on 28 September 2011, included plans to harmonise the tax base and set minimum rates for all transactions in financial instruments and derivatives carried out over-the-counter or on organised financial markets between financial institutions where at least one party is established or deemed to be established in the EU. In Mr Loeger's opinion, following years of seemingly unsuccessful meetings between the finance ministers of the countries still pursuing the FTT, there is 'precious little meat left for a financial transaction tax'.

The proposed scope of the FTT has been a point of contention since its inception. The extra-territorial provisions of the FTT have been a central battleground; as witnessed, for example, in the UK government's legal challenge to the decision of the EU Council of 22 January 2013 (Case C-209/13), authorising the use of the 'enhanced cooperation' procedure in relation to the FTT. Both the 'issuance principle' (which brings within the scope of the FTT financial instruments issued in the FTT-zone regardless of where they are traded or where the parties to the transaction are established so long as a financial institution is party to the transaction), and the 'residence principle' (which brings within the scope of the FTT any financial institution that transacts with an entity which has a legal or physical presence in the FTT-zone or that has authority to operate there), are clear examples of the extra-territorial effect of the FTT.

To date it remains unclear whether derivative transactions in particular will be taxed in accordance with the controversial 'issuance' and 'residence' principles which, given derivatives account for more than half of the projected revenue from the FTT, represents a fundamental obstacle to the progression of the FTT project.

Linked to the extra-territorial effect of the FTT, concerns remain in relation to the enforcement of the tax, particularly where financial institutions are outside of the FTT-zone. It is not clear how enforcement of the FTT would work in relation to the UK in the case of a 'hard' Brexit. There is also some anxiety about the risk of double taxation where the FTT could operate alongside unharmonised tax regimes in other jurisdictions (e.g. UK stamp duty).

It is clear from recent meetings of the participating member states that there is discord on the fundamental principles of the FTT. In February 2017, reports emerged suggesting that support amongst the remaining participants was waning and that conflicting approaches to the treatment of pension funds under the proposed tax could not be resolved.

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Mr Loeger is right to be concerned about the ability of the group to agree a future for the FTT and the political landscape will play its part. Press reports coming out of the informal meeting of finance ministers in Estonia on 16 September 2017 suggested that member states expressed concerns over the potential impact of the FTT on their efforts to attract London-based banks and other financial institutions post-Brexit.

The simplified Franco-German FTT proposal in the joint 'Economic road map' is, according to Mr Loeger, a possible alternative to the Commission's proposal. This form of FTT would be based on the existing French financial transaction tax and would focus on taxing transactions of domestically issued equity (and possibly equity derivatives), which, according to the road map, 'has not led to evasive shifts to other financial products or disruptions on financial markets'. As yet, there is no detail about how this type of tax would work on an EU-wide basis.

For now, the FTT continues to flounder and there appears to be much disagreement and little appetite for compromise between the participating member states. ■

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Luxembourg did not provide state aid to McDonald's

A recent decision shows the limits to claims of illegal state aid in tax cases.

On 19 September 2018, the European Commission announced that, in its view, Luxembourg did not grant any unlawful state aid to McDonald's. This conclusion is in line with our earlier views (see *Tax Journal*, 15 June 2016).

In December 2015, the European Commission had initiated a state aid investigation into tax rulings granted by the Luxembourg tax authorities to McDonald's in 2009.

Under the terms of the first ruling, royalties received by the US branch of McD Europe Franshising S.à.r.l., a Luxembourg tax resident company (McDonald's), were exempt from Luxembourg taxation, under both domestic tax rules and the double tax treaty between Luxembourg and the US ('the tax treaty'), in particular, based on article 7 (business profits) and article 25 (elimination of double taxation) of such treaty, and provided that such profits were subject to tax in the US.

The second tax ruling (amending the first one), confirmed that even though there was no permanent establishment (PE) from a US perspective and consequently, in practice, the US did not tax such royalties, such royalties should nevertheless be exempt in Luxembourg.

In relation to tax measures, the CJEU has defined a three-step analysis to determine if state aid exists (see *Paint Graphos* (joined Cases C-78/08 to C-80/08)):

1. identify a 'reference system', as the common or 'normal' tax regime applied in the member state;
2. assess if the measure is 'selective', in the sense that it operates as a derogation from the 'reference system' inasmuch as it differentiates between taxpayers (economic operators) who or which, considering the objective of the tax system, are in a comparable factual and legal situation; and
3. evaluate if there is any 'justification' for such 'selective' treatment by reference to the nature or the general scheme of the reference system.

Applying this test, the Commission initially considered that:

- the Luxembourg corporate income tax regime (including double tax treaties, specifically the tax treaty) was the 'reference system'; and
- the rulings granted by the Luxembourg tax authorities had a 'selective' character.

In effect, the Commission's initial view was that such rulings were contrary to the 'reference system'. Indeed, according to the Commission, the fundamental condition in article 25 of the tax treaty that the profits of the PE 'may be taxed' by the US, was clearly not met and the Luxembourg tax authorities were aware of this fact. In relation to the third step of the CJEU's analysis, the Commission considered there was no justification for such tax treatment.

However, in their 2018 decision, the Commission has finally concluded that the existence of a double exemption was simply a consequence of a 'mismatch' between both applicable tax regimes in Luxembourg and the US, without any misapplication of the tax treaty or domestic tax rules in Luxembourg. Hence, Luxembourg did not infringe EU state aid rules. Indeed, the business activities carried out by the US branch of McDonald's met all the conditions to qualify as a PE under Luxembourg law.

For the Commission, it is still regrettable that this tax treatment contravenes the concept of 'tax fairness', but it acknowledges that Luxembourg is taking the appropriate legislative steps to ensure this type of practice does not continue.

The mere fact that a large multinational has benefited from a favourable tax ruling in a member state does not automatically lead to a conclusion there has been state aid

In particular, the Commission referred to recent Luxembourg legislative changes to address this type of situation, including a BEPS-related change to the Luxembourg domestic PE definition under which, in order to recognise the existence of a PE from a Luxembourg perspective, taxpayers may need to provide evidence of the recognition of the existence of the PE in the other state (included in the draft law 7318 of 18 June 2018), making the existence of such a mismatch virtually impossible in the future.

This decision is the first of the recent collection of state aid cases on tax rulings (including the Starbucks, Apple and Amazon cases) in which an EU member state has been found not to have granted state aid to a worldwide multinational.

The decision is, therefore, potentially significant in showing the limits of state aid case law in the tax arena. The mere fact that a large multinational has benefited from a favourable tax ruling in a member state does not automatically lead to a conclusion there has been state aid. Where the operation of the tax rules in that member state have not been overstepped, and those rules themselves do not infringe EU law, then the favourable treatment will not be illegal state aid. Accordingly, it will be of particular importance to review the full non-confidential version of the decision once it has been made available. ■

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Fife Resources: jurisdiction of the Scottish FTT

When is a tax case not a tax case? The Scottish Tribunal finds it has no jurisdiction to determine an appeal made prematurely.

On 9 August 2018, the First-tier for Scotland Tax Chamber issued its most recent decision in the case of *Fife Resources Solutions LLP v Revenue Scotland* [2018] FTSTC 1. This case is of interest due to the procedural matters that it discussed.

The sequence of events is as follows. Two assessment notices were issued to the appellant in January 2017 covering two Scottish landfill tax (SLfT) quarters: April-June and July-September 2015. The appellant asked for these assessments to be reviewed under s 234 of the Revenue Scotland and Tax Powers Act (RSTPA) 2014.

Section 239 of that Act requires a review to be completed within 45 days or such other period as may be agreed, which was the case here where a longer period was initially agreed. Nevertheless, the appellant lodged an appeal before the review was completed, and Revenue Scotland subsequently withdrew and then cancelled the assessments due to an error in them. Following this, a closure notice was issued by Revenue Scotland in relation to the second SLfT period but the enquiry for April-June remained open. In due course, further closure, assessment and penalty notices for the April-June quarter were issued which, at the time of this decision, were the subject of a review request.

The appellant wanted their original appeal to the tribunal to continue (in particular to address the issue of all their costs incurred being paid by Revenue Scotland) and, after a number of tribunal instructions and questions being issued, both sides put in their submissions, and the case was heard as a paper case.

What issues had to be decided?

This case did not address any Scottish landfill tax matters because a number of procedural questions arose:

- Was there an appealable decision – or could the assessment not be appealed until the review was completed, i.e. can there be an appeal made when there are ongoing matters?
- If there was an appealable decision, but Revenue Scotland then withdrew the assessment did that mean there was no longer an appealable decision? and
- Did the tribunal have the jurisdiction to hear the case?

In addressing these questions, it was held that a decision may not be appealed when the taxpayer has asked for a review and it has not been concluded or treated as concluded (RSTPA 2014 s 241(4)). The legislation is clear on this. The decision also discusses the second point, whether an appeal could be heard when the underlying assessment had been withdrawn. The discussion draws a comparison between this case and both *Rasam Gayatri Silks Ltd v HMRC* [2010] UKFTT 50 (TC) and *GE International Inc v HMRC* [2010] UKFTT 343 (TC). This is a reminder that UK jurisprudence may be relevant in Scottish devolved tax cases. The judge noted that these cases are not binding on the Scottish tribunal (and FTT decisions are not binding), in this case they were nonetheless instructive because of the structural similarity of some of the rules of procedure vis a vis the tribunal rules.

This is a reminder that UK jurisprudence may be relevant in Scottish devolved tax cases

The tribunal found it did not have the jurisdiction to determine the appeal because it was made prematurely. The decision also notes that if the appeal had not been premature, the question of whether the tribunal could have jurisdiction remains live where the disputed decision is withdrawn after the appeal is initiated. The question of quantum of costs remained outstanding but the tribunal did not consider that it should make an order on this. The case suggests some frustrations amongst the parties but also provides useful guidance on the procedures required by the RSTPA 2014. ■

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