Collected Writings on State Aid

By Professor Itai Grinberg

Preparation for Presentation on December 7, 2016

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The retroactive nature of the levy violates international economic law, writes Itai Grinberg

The €13bn tax bill handed down to Apple by Brussels is the latest in a series of novel and unprecedented decisions by the European Commission against multinational corporations. In one fell swoop the commission’s actions have upended tax certainty for businesses and EU governments, and may well provoke a nasty, and unnecessary, transatlantic dispute.

For business, the commission’s approach means, as Margrethe Vestager, competition commissioner, said on Tuesday, that “if you want legal certainty, then you need a commission decision”. Since commission decisions are very hard to come by, a greater recipe for uncertainty is hard to imagine.
The Apple case follows a recent commission announcement that it could also challenge corporate tax audit settlements under its “state aid” rules. This asserted ability to reverse both tax rulings and audit settlements, under principles Brussels is inventing as it goes, undermines the authority of national tax offices in EU member states.

The retroactive component of these decisions is particularly unjust. EU state aid rules arose in the 1950s to remedy misbehaviour by member states subsidising domestic champions to the detriment of the single market. Now the commission is using state aid rules to set aside tax rulings for foreign companies, and retroactively assess higher levies.

From the perspective of US law — where such retroactive charges can be credited against a company’s tax bill — this could effectively see billions transferred from American taxpayers to EU member states. This may just be the beginning. The commission appears to be on the verge of overturning rulings held by Amazon and McDonald’s. Senior commission officials have said that they are examining cases involving 50 to 60 further companies.

More important is the basic rule of law. The issue is not whether Apple and others should in future pay higher taxes to European states: they clearly will. The retroactive aspect of the decisions violates ideas of fundamental fairness as well as international economic law. The commission’s actions could result in violations of World Trade Organisation rules and investment treaties.

The positions adopted by the commission in unwinding the Apple ruling also seem to disregard longstanding international rules for determining the location of profits, either as they stood historically or as recently modified by the “Base Erosion and Profit Shifting” project, a global effort that the commission itself endorsed and approved in its capacity as a G20 member.

Indeed, recognising this flaw in its analysis, the commission has recently claimed that the standard it is applying in these cases is not the one it agreed to internationally, but one that it now says arises out of the EU treaties. The commission, perhaps seeing an opportunity to take advantage of US companies and taxpayers, is asserting the existence of a separate EU treaty standard for determining the location of profits for the first time in the almost 60-year period during which the relevant European treaty language has been in effect.

Last week, the US Treasury warned the commission of the dangers of its approach and wrote that Washington was considering potential responses should Brussels continue its present course. Unless the commission desists from further proceedings, and the European Court of Justice overturns the decisions, one should expect the US to act to defend its rights and understandings resulting from various international agreements and multilateral projects. There is strong bipartisan support in the US for action, and a variety of options are available to policymakers. In an environment where free trade, and much else in the liberal order, is under assault from both the left and the right on both sides of the Atlantic, it is unfortunate that the commission has led us all to this point.

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RELATED TOPICS United States of America, European Union, European Commission, Apple Inc, Tax Evasion and Avoidance
Chairman Brady, Ranking Member Levin, and distinguished members of the Ways and Means Committee, good morning. My name is Itai Grinberg, and I am an Associate Professor of Law at Georgetown University Law Center. It is a pleasure to appear before you today to discuss the global tax environment and its implications for international tax reform. My testimony will focus on the European Commission’s state aid investigations with respect to tax ruling practices and the implications for US international tax policy.

The international tax environment around the world is becoming both less stable and less favorable to American business. The Base Erosion and Profit Shifting (BEPS) Project at the Organisation for Economic Co-operation and Development (OECD) was justified as an attempt to prevent the old framework for international taxation from falling apart and being replaced by unilateral actions, double taxation of cross-border business, and what the OECD termed “global tax chaos.” Unfortunately, the post-BEPS environment already shows signs of becoming characterized by much of the global tax chaos the BEPS Project was supposed to prevent. We are seeing an increase in unilateral actions, growing disregard for long-standing international tax norms, and more double tax disputes, especially in the transfer pricing area. The European Union (EU) state aid investigations with respect to tax ruling practices represent an extreme example of the emerging challenges in this new international tax environment.

**Background on State Aid**

EU law generally prohibits so-called “state aid” that threatens to distort competition within the European Union by favoring certain businesses. The Directorate General for Competition of the European Commission effectively has plenary authority regarding what countries, companies, or practices to investigate or not investigate under these rules. When it finds illegal state aid, it can demand assessments that claw back that aid, including what it views as underpaid taxes, going back ten years with interest.

The state aid rules date to the late 1950s and were originally designed to prevent EU member states from subsidizing domestic “national champion” companies in ways that

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2 Consolidated Version of the TFEU, art. 107(1), May 9, 2008, 2008 O.J. (C 115) 91-92.
would undermine a competitive marketplace within Europe. In a series of decisions reaching back fifty years, the European Commission (Commission) has found specific cases of state aid to violate EU rules and required the offending member state to recover that aid from the affected company. The history and scholarship surrounding state aid law suggest that this regime has been an important political tool of the Commission in many contexts.

State aid decisions focusing on indirect subsidies provided through tax benefits are not new as a general matter. The first tax-related state aid case dates to the 1970s. In the late 1990s the Commission issued a notice on the application of state aid rules to business taxation.

Until recently, state aid cases in the tax area generally involved statutory rules that selectively favored domestically headquartered companies in a given EU member state or regimes that provided tax benefits to only a very narrow group of taxpayers. Then, just as press exposés and high-profile legislative hearings abroad concentrated the attention of the European public on legal tax planning undertaken by US multinationals—often simply to achieve effective tax rates that were comparable to their global competitors—the Commission decided to take its state aid work in a new direction. In the cases against Amazon, Apple, Fiat Chrysler, Starbucks, and McDonald’s, the Commission is claiming that EU member states provided illegal state aid to foreign-headquartered companies merely by providing them legal certainty through tax rulings that clarified how generally applicable national law would apply to those companies’ facts.

These tax rulings do not appear to meet the Commission’s own requirements for finding state aid in that they do not seem to be “selective.” Similar rulings were broadly available from the tax administrations of those same EU governments that issued the rulings being challenged by the Commission. Moreover, the relevant national governments strenuously assert that those rulings were consistent with the general income tax systems of the relevant countries. Finally, the new state aid cases largely relate to transfer pricing matters, which present notoriously difficult fact-specific determinations that are ill-suited to a state aid analysis. For all of these reasons, the current EU state aid tax investigations are novel and unprecedented.

Given the importance of state aid as a political tool of the Commission, the current investigations should perhaps be considered in the context of the Commission’s broader regulatory agenda. The President and others have suggested that, at least in the technology sector, that agenda has often amounted to a protectionist attack on US

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companies, driven by frustration at European companies’ inability to compete in that area.\textsuperscript{4}

The new state aid investigations can be understood as part of that broader trend. All but one of the company-specific investigations and almost the entire potential amount in controversy involves US multinationals. This remains true even when the more general investigation launched by the Commission into Belgium’s excess profits regime is taken into account. The enforcement reality that almost all the revenue at stake comes from US multinationals contrasts with the simple fact that tax rulings of the type that the Commission has recently decided to examine were also routinely procured by European-headquartered multinationals.

Moreover, the remedy that state aid law imposes against member states that provide illegal state aid is deeply inappropriate when applied to a foreign firm instead of the domestic “national champion” firms for which the state aid regime was originally intended when it was created in the 1950s. When the Commission finds that a member state has provided illegal state aid to a foreign firm, the remedy is to require that member state to collect a revenue windfall from the foreign-headquartered company. That does seem to make for great politics: when the Commission reprimands a member state for violating EU law, that member state wins.\textsuperscript{5}

**Concerns the State Aid Investigations Raise for US International Tax Policy**

The state aid investigations raise basic rule of law issues in attempting to tax American business retrospectively rather than prospectively. The legal positions taken by the Commission also disregard international tax norms as they stood during the period the Commission is investigating. Importantly, the investigations could give rise to US multinationals paying EU member states amounts that may be creditable taxes under our law. Thus, the Commission’s decisions may in effect amount to demanding a multi-billion dollar transfer from US taxpayers to the EU member states the Commission claims acted illegally.

These issues were articulated in testimony given to this committee and the Senate Finance Committee by Treasury Deputy Assistant Secretary Bob Stack, as well as in a letter from the Senate to Secretary Lew.\textsuperscript{5} In addition to the concerns articulated in those

\textsuperscript{4} See, e.g., Murad Ahmed, Duncan Robinson, & Richard Waters, Obama Attacks Europe over Technology Protectionism, FIN TIMES (Feb. 16, 2015), http://www.ft.com/intl/cms/s/0/41d968d6-b5d2-11e4-b58d-00144feab7de.html#axzz3uIoMQQ8b.

\textsuperscript{5} See Michael J. Graetz, Behind the European Raid on McDonald’s, WALL ST. J. (Dec. 3, 2015), http://www.wsj.com/articles/behind-the-european-raid-on-mcdonalds-1449187952.

settings, I believe it is important to consider whether these investigations rise to the level of discrimination against American business under section 891 of the Code, what these investigations tell us about whether the United States will be able to continue treating EU member states as sovereigns for tax purposes, and what the existence of these investigations tells us about the international climate the United States faces as it considers international tax reform.

**Discrimination Against Corporations of the United States Under Section 891 of the Code**

The state aid investigations raise serious questions about whether the European Union is discriminating against American business. After all, the Commission has requested a list of all companies that have received tax rulings from all member states, and it is clear that European-headquartered multinationals hold many such rulings. Yet all but one of the named investigations involve American companies. Section 891—a rarely mentioned provision dating to the 1930s—seems to have been enacted precisely to address the kinds of concerns raised by this type of fact pattern.

Section 891 provides:

> Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by sections 1, 3, 11, 801, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country. . . .

Difficult technical questions arise under section 891 when considered in connection with the state aid investigations. One of these regards the circumstances under which a foreign tax measure should be viewed as rising to the level of being discriminatory. On this issue, the legislative history of section 891 does seem to suggest that the analysis should focus on the impact of the foreign rule as applied. Thus, the fact that rulings are broadly available to multinationals across the globe, but that almost all the revenue at stake is coming from US multinationals, would appear to be highly relevant. Another issue relates to the relationship between section 891 and US tax treaties concluded with EU member states after the date of enactment of section 891. This is a highly challenging issue, but in my view section 891 may be made operative, at least in part, to the extent that discriminatory taxation by a foreign country violates the terms of a tax treaty of the United States. Separately, it is worth noting that for purposes of section 891, the European Union itself may be a “foreign country.”

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7 Revenue Act of 1934 § 103, 48 Stat. 680, 703 (current version at 26 I.R.C. § 891 (2015)).

8 The issues discussed in this paragraph as well as other issues of statutory interpretation of Section 891 are covered in greater depth in Itai Grinberg, *A Constructive U.S. Counter to EU State Aid Cases*, TAX NOTES INT’L, Jan. 11, 2016, at 167.

Of course, actually applying section 891 would be unprecedented—but no more so than the Commission’s decision to use its “competition law” to engage in retroactive tax takings from American businesses and attempt to alter EU member states’ tax policies at the same time. Thus, although numerous practical obstacles and technical questions must be addressed, studying the issues that arise under section 891 in the context of the EU state aid investigations is an important policy step the US government can take.

How the United States Relates to the European Union in Tax Matters

Every EU member state has held itself out to the international community as sovereign for tax purposes, regardless of its membership in the European Union. The United States has conducted its international tax affairs in good faith based on that representation. The EU state aid investigations, however, suggest that member states of the European Union cannot uphold their bargains in the way one expects of a sovereign. Rather, we are learning that the EU state aid rules impose a stringent set of constraints on tax policy and administration in EU member states, and that these rules trump tax treaties reached by EU member states. For example, when the positions taken by the Commission with respect to the application of the arm’s length standard under EU law are inconsistent with the understandings reached in tax treaties, the Commission appears to consider itself empowered to disregard the meaning of the arm’s length standard intended by the relevant tax treaty.

The state aid investigations therefore bring into doubt the United States’ ability to continue treating EU member states as sovereign for tax purposes. If the present EU state aid investigations continue and are upheld by the European Court of Justice, it could in effect amount to abrogating EU member states’ tax treaties. The eventual result may be that the United States will need to formalize that decision by terminating its tax treaties with European sovereigns and negotiating a tax treaty with the European Union. Importantly, many EU member states, both large and small, would disfavor this outcome. That the Commission is undermining an element of sovereignty that member states tend to vigorously defend is further evidence that in these investigations the Commission has likely overstepped its bounds. Nevertheless, the Commission has now also announced that it plans to negotiate for state aid provisions in various agreements with third countries as a means to ensure that its vision of “fair tax competition” is adopted internationally.9 So unless member states can change the course of events, US tax treaty policy appears to be on a collision course with the Commission.

International Climate in Which We Consider International Tax Reform

The European Union’s state aid investigations are also one more indication of the urgent need for US international tax reform. Our singularly high corporate tax rate and worldwide system are severely out of line with international norms. These EU investigations highlight yet another negative consequence of having such broken and aberrant international tax rules. Our international tax system is allowing American

businesses and the US fisc to be turned into pawns in an intra-European fight between the likes of (high tax) France and (low tax) Ireland.

Every other G7 country and 28 of the other 33 OECD member countries have international tax rules that allow their resident companies to repatriate active foreign business income to their home country without paying a significant additional domestic tax.\(^\text{10}\) This system of taxation is usually referred to as “dividend exemption.” Another important feature of dividend exemption systems is that they do not provide foreign tax credits for active foreign business income that can be repatriated tax-free.

Unlike exemption systems, our system generally provides a credit for foreign taxes in order to avoid double taxation. Unfortunately, in the current international tax environment, in which many countries are searching for politically painless revenue sources and most countries utilize exemption systems, the foreign tax credits provided by our current system are a ripe target for governments looking to effectuate transfers from US taxpayers to their own coffers.

Indeed, a report prepared by Policy Department A of the Directorate General for Internal Policies of the European Parliament's TAXE Special Committee proposes that the European Union should find ways to ensure state aid assessments are creditable taxes in those countries that “may grant a credit to a resident company for taxes paid abroad on foreign activities.”\(^\text{11}\) Although the language is somewhat opaque, the goal of the proposal is clear: to make certain that the revenue the European Union seeks through state aid investigations is extracted directly from the United States Treasury.

In this regard, it is important to recognize that a reformed system that includes a minimum tax could continue to leave the United States exposed to other countries seeking to extract revenue from US multinationals in ways that leave US taxpayers footing the bill. In contrast, a true dividend exemption system would not be vulnerable to efforts by foreign sovereigns to extract revenue from US taxpayers by way of imposing tax on US multinationals. Promptly enacting a dividend exemption system along with a mandatory deemed repatriation of presently undistributed foreign earnings might also reduce the temptation for the EU or other foreign sovereigns to target those historical earnings for additional foreign taxation.

The interconnectedness of today’s global economy and the mobility of capital, intellectual property, and high-skilled labor makes all attempts to impose high income tax rates on multinational corporations counterproductive. The global market for corporate control combined with the continued home-country bias for high-quality headquarters

\[^{10}\text{See also Evolution of Territorial Tax Systems in the OECD, Report Prepared for Technology CEO Council, PwC 3 (Apr. 2, 2013), www.techecouncil.org/clientuploads/reports/Report%20on%20Territorial%20Tax%20Systems_20130402b.pdf. (illustrating that 91% of the non-US OECD-headquartered companies on the Forbes 500 list of the world's largest companies for 2012 were headquartered in countries with a dividend exemption system).}\]

and R&D jobs means that mistakes in this area can be costly in terms of employment and opportunity, especially for the younger generation. The post-BEPS environment has accelerated the timetable on which we must act to reform our international tax system because BEPS is likely to succeed in requiring companies to align functions with tax benefits. Among other things, the BEPS Project was meant to prevent companies from shifting income to lower-tax jurisdictions without also shifting jobs to those jurisdictions. At least in that sense, BEPS is likely to succeed. Moreover, we cannot unring the BEPS bell. So without pro-growth, internationally competitive tax reform, we may well see high-quality American jobs migrate offshore. At minimum, this suggests moving to a much lower corporate tax rate and a dividend exemption regime that does not incorporate a minimum tax that is akin to a worldwide tax system.

It is also important to recognize that countries around the world are moving away from residence country taxation and towards source country taxation, and away from corporate income taxation and toward consumption taxation. One noteworthy consequence of these developments is to exacerbate the consequences of the disjunction in US law between the treatment of US-domiciled and foreign-domiciled multinationals. Thus, another priority in international tax reform should be to level the playing field in this regard. International tax reform efforts should work to define the US source base we intend to defend and consider taxing in the future exclusively on that basis, rather than on the basis of corporate residence.

Thank you for the opportunity to testify before you today. I would be delighted to answer any questions you may have.
EU State Aid Investigations Demand an Aggressive Response

by Grant Aldonas and Itai Grinberg

Grant Aldonas is the principal managing director of Split Rock International. He previously served as the undersecretary for international trade with the Commerce Department and chief international trade counsel on the Senate Finance Committee. Itai Grinberg is a professor at Georgetown University Law Center. He previously served in the Office of International Tax Counsel at the U.S. Treasury, where his responsibilities included representing the United States on issues of multilateral tax cooperation.

This article is the first in a multi-part series addressing the concerns raised by the European Commission’s state aid investigations. In this installment, the authors provide background on the state aid investigations and describe the ways in which these investigations represent a sharp departure from past commission practice. Subsequent pieces will respectively address the tax, investment law, and trade law concerns raised by the commission’s investigations.

Preliminary and final state aid decisions by the European Commission’s Directorate General for Competition (DG Comp) against Amazon, Apple, McDonald’s, and Starbucks have attracted enormous attention on both sides of the Atlantic — with good reason. If upheld on appeal, the commission’s decisions will retroactively assess higher taxes on these U.S. companies’ income, with interest, going back 10 years. Such payments could be creditable taxes under U.S. law. Thus, if one accepts the public reports about the potential magnitude of these decisions, the result may amount to the EU demanding a $10 billion to $20 billion transfer from U.S. taxpayers to the EU member states the commission says acted illegally. Moreover, commission officials have stated publicly that they are examining rulings held by 50 to 60 companies.

The commission’s proceedings are highly objectionable. They undermine both the integrity of the international tax system and the prospects for international tax cooperation over the longer term. In lieu of making a fair comparison between the rulings granted U.S. firms and the treatment generally available to multinational companies (MNCs) under member state law, the commission has adopted what is, by its own admission, a unilaterally created “European” standard for arm’s-length transfer pricing. The goal may be to produce a finding that some U.S. companies owe back taxes, irrespective of what either the relevant individual member state’s law actually says or what the OECD’s transfer pricing guidelines provide.

The OECD transfer pricing guidelines, as implemented in most EU member states’ laws, formed a critical basis on which the United States and other treaty partners negotiated their tax treaties with EU member states. The commission’s unilateral redefinition of the arm’s-length transfer pricing standard contravenes these OECD norms, and thereby denies the United States and any other country the treatment they bargained for in the context of their agreements with individual EU member states. The commission’s ill-considered approach in effect abrogates EU member states’ bilateral tax treaties with the United States and other countries.

Significantly, the EU’s approach would leave the U.S. firms without the remedy for double taxation that tax treaties normally provide. The EU’s retroactive tax assessments based on its unilaterally adopted arm’s-length standards cannot be challenged under the mutual agreement procedures that form a core element of
bilateral tax treaties. What that means is that the EU’s actions effectively deny a remedy in an area — transfer pricing — that represents the single largest source of cross-border tax disputes.

Forcing the EU member states to violate their tax treaty commitments reflects a broader disregard for international law by the commission. Indeed, the commission’s approach to these state aid investigations is remarkable for the range of international commitments it would disregard. Beyond potentially compelling EU member states to violate their tax treaties and undermining the OECD’s efforts at international tax cooperation, retroactive assessments imposed under state aid rules also violate guarantees of reasonable expectations and fair and equitable treatment provided to U.S. investors under Friendship, Commerce and Navigation (FCN) treaties with EU member states. These treaty guarantees are meant to ensure that written representations provided by one of the treaty participants, such as those provided to a foreign investor in a tax ruling, will not be retroactively withdrawn.

The commission’s actions would, furthermore, present a prima facie violation of the guarantees of non-discriminatory treatment that the European Union and each of its member states owes the United States under WTO rules. Both the process by which DG Comp is identifying U.S. company rulings by specific member states to be in violation of state aid rules and the potential penalty — a retroactive and unwarranted imposition of higher taxes on these U.S. companies — represents treatment less favorable than that afforded similarly situated European companies in violation of WTO rules.

Because of their impact on trade, WTO members have agreed to a highly developed set of disciplines regarding both subsidies and countervailing measures. The commission’s state aid rulings are inconsistent with those disciplines in two critical respects. First, its decisions regarding the member state tax rulings ignore the internationally agreed definition of “subsidy” and how it should be measured. Second, in demanding the payment of back taxes, it ignores that, under the WTO rules, countervailing measures may only be applied prospectively.

The European Commission cannot reasonably claim that its actions are somehow exempt from WTO rules, or that it was unaware of the extent to which its state aid decisions might conflict with WTO disciplines. The relevant standards are the same ones that the EU asked the WTO to apply in its complaint against the foreign sales corporation provisions of the U.S. Internal Revenue Code.

In short, despite the EU’s frequent appeals for international cooperation and its posturing as a defender of international law, the commission’s state aid investigations undermine cooperation and ignore the dictates of international law. At the same time, by targeting U.S. MNCs, the commission’s actions create an unlevel playing field for U.S. companies in Europe.

Predictably, EU officials have sought to minimize the implications of their actions. But the reality is that the state aid proceedings against specific tax rulings granted by the smaller EU member states risk establishing a dangerous global precedent for retroactive assessment of additional tax liability against U.S. multinationals. It puts the U.S. tax base up for grabs.

Tax authorities globally are looking for new sources of revenue to plug holes in their budgets created by sharp increases in deficit spending in response to the 2008 financial crisis and anemically slow global growth. If the EU succeeds in unilaterally redrawing the tax landscape in contravention of established international norms and law, one should look for other countries to follow its lead with all that implies for U.S. firms, U.S. workers, and U.S. taxpayers.

These circumstances establish a predicate for forceful action by the United States to limit and constrain the commission’s actions in the state aid area. Although the state aid proceedings have been well covered in these pages, the myriad legal and policy questions raised by the proceedings merit a systematic exploration.

Background on State Aid

EU law generally prohibits so-called state aid that threatens to distort competition within the EU by favoring certain businesses. Specifically, article 107 of the Treaty on the Functioning of the European Union (TFEU) prohibits any “aid” granted by a member state that distorts or threatens to distort competition by favoring certain enterprises or the production of certain goods insofar as that distortion affects trade between member states.

The Court of Justice of the European Union describes the state aid rules as an integral part of the European Union’s mandate to strengthen the EU’s internal market and European competitiveness generally. DG Comp is accorded wide latitude in determining what countries, companies, and practices to investigate under the state aid rules. When it finds illegal state aid, it can demand assessments that claw back that aid, including what it views as underpaid taxes, going back 10 years with interest.

Despite its broad scope, DG Comp’s state aid authority is limited by objective criteria. A finding of state aid requires four elements: (1) an “advantage”; (2) granted by a state or through state resources; (3) that affects competition and trade between EU member

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1 Consolidated Version of the Treaty on the Functioning of the European Union, article 107(1) (May 9, 2008) [hereinafter TFEU].

2 TFEU article 107(1).

states; and (4) that is specific or selective in that it favors "certain undertakings or the production of certain goods."4

The state aid rules date to the late 1950s and were originally designed to prevent EU member states from subsidizing domestic "national champion" companies in ways that would undermine a competitive marketplace within Europe. In a series of decisions reaching back 50 years, the commission has found specific cases of state aid to violate EU rules and required the offending member state to recover that aid from the affected company.

State aid decisions focusing on indirect subsidies provided through tax benefits are not new as a general matter. The first tax-related state aid case dates to the 1970s. Such cases have a lengthy history and a progressively expanding reach.

In the late 1990s the commission issued a notice on the application of state aid rules to business taxation. That document outlined the commission’s views about when a member state provides illegal state aid by adopting a tax measure.5 It underscored that "the main criterion" in applying state aid to tax measures was an inquiry about whether the relevant measure provides "in favour of certain undertakings in the Member State an exception to the application of the tax system."6

Thereafter, the commission more broadly interpreted its authority under the state aid rules and began to look at corporate tax issues more closely. CJEU case law confirmed the idea that "selective" advantages could be conferred through the corporate tax system, if a business received preferential treatment relative to other similarly situated businesses and that treatment was inconsistent with the relevant generally applicable features of the tax system in use in the relevant member state.7

Nevertheless, until recently, state aid cases in the corporate tax area generally involved rules that selectively favored domestically headquartered companies in a given EU member state. This focus conformed to the original intent of the state aid rules, which was to limit the ability to subsidize national champions. It also explains why EU state aid policy did not raise concerns regarding U.S. interests in the European market in the past.

Previous DG Comp state aid decisions in the tax arena also generally focused on tax programs that were either expressly designed for or benefited a limited number of taxpayers. In a few decisions in the early 2000s, the commission challenged tax ruling regimes created by Belgium, France, Germany, and Luxembourg, none of which ever benefited more than a handful of taxpayers.8 In those instances, however, there was a clear distinction between the treatment that was otherwise afforded under the individual member state's tax laws and the tax benefits granted to the more limited group eligible for the regime under challenge. As a result, there was a clear normative benchmark within national law against which the treatment afforded the more limited group of beneficiaries could be assessed.

Separately, the remedies the commission sought in the cases involving the tax ruling regimes were prospective, rather than retroactive. Indeed, only one of these cases ever reached the CJEU, primarily because in each of these cases the commission concluded that legitimate expectations of the businesses involved required the commission to act only prospectively when finding the ruling regime in question in conflict with EU law.

In contrast, in the cases against Amazon, Apple, Starbucks, and McDonald's, the commission is claiming that EU member states provided illegal state aid to foreign-headquartered companies merely by providing them legal certainty through tax rulings that clarified how generally applicable national law would apply to those companies' facts. The commission is taking forward its proceedings without challenging other rulings issued under the same generally available ruling system.

**A Sharp Departure From the Past**

DG Comp's actions mark a sharp departure from past practice in four important respects. The first and most obvious is that in these investigations the commission is, for the first time, attacking individual rulings without also challenging the regime of which they are a part. That is unusual in that, unlike an assessment of whether a particular rule or policy confers a subsidy, here the commission would substitute the

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5Id.

6Id.

7See, e.g., P Oy v. Finland, C-6/12 (CJEU 2013), para. 19 ("[I]n order to classify a domestic tax measure as 'selective', it is necessary to begin by identifying and examining the common or 'normal' tax regime applicable in the Member State concerned. It is in relation to this common or 'normal' tax regime that it is necessary, secondly, to assess and determine whether any advantage granted by the tax measure at issue may be selective by demonstrating that the measure derogates from that common regime inasmuch as it differentiates between economic operators who, in light of the objective assigned to the tax system of the Member State concerned, are in a comparable factual and legal situation"); Ministero dell’Economia e delle Finanze v. Paint Graphos, Soc. coop. arl., Joined Cases C-78, C-79, and C-80/08 (CJEU 2011); and Portugal v. Commission, C88/03 (CJEU 2006) ("The determination of the reference framework has a particular importance in*

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8See, e.g., Kingdom of Belgium v. Commission, Joined Cases C-182/03 and C-217/03 (CJEU 2006).
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judgment of nontax officials at the European Commission for that of member state tax authorities regarding the application of the member state’s own law to the specific facts presented by an individual taxpayer.

The second, related issue involves the explicit departure from a normative benchmark intrinsic to the member state’s tax system (a “reference system”) against which the alleged “aid” granted to U.S. companies could be measured. The U.S. companies DG Comp is now investigating were accorded the same treatment as similarly situated European-based taxpayers, which routinely obtained similar rulings through a generally available national system. Recognizing that it is unlikely to be able to sustain the argument that the rulings it wishes to challenge represent a deviation from the generally applicable system of transfer pricing in the member states that issued the rulings, DG Comp is now asserting that a transfer pricing benchmark independent of national law arises out of the constitutive treaties of the EU.

The third way in which the current investigations mark a sharp departure from past practice involves their retroactivity. DG Comp has pursued retroactive “recovery” in other state aid contexts. But in the proceedings in the early 2000s that focused on rulings that offer the closest parallel to the instant proceedings, the commission recognized that the legitimate reliance by the taxpayers in question on the rulings granted them required the commission to seek prospective relief (that is, only the elimination of the rulings in the future).

In contrast, DG Comp is currently demanding retroactive assessments reaching back 10 years with interest from the individual U.S. multinationals it is targeting. The assessment amounts are determined without regard to the legitimate reliance of the taxpayers involved on the bona fide of the member state tax officials in interpreting their own domestic law in a manner consistent with known, generally available practice in that member state. In fact, no multinational would have structured its affairs as it did if it believed retroactive assessments of the type the commission is now attempting to impose were possible.

The fourth and final way in which DG Comp’s current actions diverge from past practice is perhaps the most egregious. DG Comp is disproportionately targeting U.S. companies. All but one of the company-specific investigations and almost the entire potential amount in controversy involve U.S. multinationals. The enforcement reality that almost all the revenue at stake comes from U.S. multinationals contrasts with the simple fact that tax rulings of the type that the commission has recently decided to examine were also routinely procured by European-headquartered multinationals. Commission staff members have publicly acknowledged that they chose the U.S. firms as targets based on press reports suggesting that they had paid very little tax in European jurisdictions, rather than any objective inquiry into the surrounding facts and whether the circumstances involving U.S. firms were materially different from those involved in the rulings granted to European firms.

At the same time, it cannot have escaped the commission’s notice that the United States is unique among industrialized countries in having a worldwide, as opposed to a territorial, tax system. As a result, there is less incentive for U.S.-headquartered firms to manipulate transfer pricing than European-headquartered multinational firms. What the commission views as an unfair advantage is in the end a timing issue about when that income is recognized by U.S.-headquartered firms for U.S. tax purposes. In contrast, because European multinationals benefit from territorial tax systems, any euro that benefits from a low rate of tax in one European jurisdiction will entirely escape taxation in a higher-tax European residence jurisdiction. The fact that the commission has largely ignored member state transfer pricing rulings granted to European multinationals, despite the higher incentive they have to manipulate their transfer prices, further suggests that the commission’s aim was to target U.S. firms from the outset.

The discriminatory targeting of U.S.-based corporations stands in marked contrast to DG Comp’s past practice, which generally focused on assistance afforded by a member state government to a local champion or to increase the production of locally produced goods and services. This discriminatory treatment of U.S. companies suggests that DG Comp’s latest decisions represent the use of the commission’s state aid authority for what are, in effect, mercantilist purposes (that is, they are designed to ensure that European firms gain a material advantage over potential U.S. competitors).

The commission’s goal would appear to be to vindicate the idea of a competitive European internal market by creating artificial barriers to entry by highly competitive and innovative U.S. firms. These are the sorts of practices that the global rules governing international trade and investment were expressly created to prevent.

Conclusion

The nature of DG Comp’s proceedings, the standard being applied, and the retroactive penalties that could result are controversial because they challenge widely held notions of the rule of law and threaten a less favorable atmosphere for cross-border trade and investment within Europe. They also involve the European

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9Indeed, President Obama has suggested that, at least in the technology sector, the commission’s regulatory agenda has often amounted to a protectionist attack on U.S. companies, driven by frustration at European companies’ inability to compete in that area. See, e.g., Murad Ahmed, Duncan Robinson, and Richard Waters, “Obama Attacks Europe Over Technology Protectionism,” Financial Times, Feb. 16, 2015.
Commission’s usurpation of the taxing power expressly reserved to the member states by the TFEU. Seen in that light, DG Comp’s recent actions represent an act untethered from any discernible legal or economic principle.

Given the profound implications of the EU’s recent state aid investigations — for the rule of law internationally, the future of international tax cooperation, Europe’s trustworthiness as a trading partner, and U.S. economic interests, including a defense of our tax base — the EU’s actions deserve a more thorough examination than one article can provide. Our aim in subsequent articles in this series will be to more clearly examine the various substantive issues involved.

COMING ATTRACTIONS
A look ahead at upcoming commentary and analysis.

A price-based royalty tax? (Tax Notes International)
Kimberly A. Clausing and Michael C. Durst consider the merits of a price-based royalty whose rate varies with product price as a fiscal instrument for taxing extractive industries.

Are the final BEPS reports on actions 8-10 effective now? (Tax Notes International)
Jason Osborn, Brian Kittle, and Kenneth Klein discuss the impact of the final base erosion and profit-shifting actions 8-10 reports, which contain final, currently applicable revisions to the OECD transfer pricing guidelines.

Target stock basis after a double dummy: Section 351 vs. section 368 (Tax Notes)
Stephen Cohen asks whether section 351 offers the extra advantage of a bump in basis not available under section 368 to corporate mergers that use the so-called horizontal double-dummy transaction.

The negative capital account maze (Tax Notes)
Walter Schwidetzky discusses how partners’ negative capital accounts affect partnership taxation, calling attention to the issues raised from the disconnect between limited liability company law and the relevant partnership law.

Hamilton and taxes! (State Tax Notes)
Influenced by the musical Hamilton, Lynn Gandhi helps us remember the past to prepare for the future with a discussion on the importance of international, federal, state, and local taxation to the early economic growth and public policy of the United States.

Income tax nexus in the new economy: Third-party service providers (State Tax Notes)
Mike Porter, Alexis Morrison-Howe, Jeremy Sharp, and Laura Souchik consider the state income tax nexus implications of the shift toward the remote delivery of goods and services as states more aggressively assert jurisdiction to tax.
A Constructive U.S. Counter to EU State Aid Cases

by Itai Grinberg

Itai Grinberg is an associate professor of law at Georgetown University Law Center in Washington. The author proposes that the U.S. Treasury consider applying a little-known U.S. tax law to counter the European Commission’s pending state aid investigations.

U.S. Treasury officials and members of Congress from both parties have expressed concern that the European Commission’s current state aid investigations are disproportionately targeting U.S.-based multinational enterprises. At the same time, a Treasury official recently suggested in congressional testimony that there are limits to what Treasury can do beyond strongly expressing its concerns to the commission. In that testimony, Treasury’s representative hinted at two specific pressure points: whether the state aid investigations could undermine U.S. tax treaties with EU member states; and whether any assessments paid by the foreign subsidiaries of U.S. MNEs as a result of state aid investigations would be creditable for U.S. income tax purposes.

Thus far, no one has raised a third pressure point: the potential application of section 891 of the U.S. tax code, which specifically addresses discriminatory taxation of U.S. MNEs. If the Obama administration were to find that the EU state aid cases imposed discriminatory taxes on corporations of the United States, U.S. income tax rates on citizens and corporations of certain European countries could double. Although the United States has never applied section 891, this may be a case where its consideration is appropriate.

Why wouldn’t Treasury study the issues raised by the EU state aid investigations under section 891? The answer might be that section 891 feels like a provision from a bygone era, primarily because the issues it addresses simply have not arisen in decades.

But section 891 seems to have been enacted precisely to address concerns like those raised by the EU state aid investigations. Moreover, studying the questions that arise under section 891 represents a less drastic and more pragmatic U.S. response than threatening to terminate our tax treaties. It also opens the possibility of imposing a consequence that is meaningful to foreign sovereigns, unlike the prospect that the United States would deny foreign tax credits to U.S. MNEs. Finally, as a legal matter, the questions that arise under section 891 regarding the EU state aid investigations may chronologically precede the questions that arise under section 901. Thus, focusing on the questions that section 891 poses could be a means to encourage European institutions to conclude the EU state aid cases in a sensible manner.

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EU State Aid

Article 107(1) of the Treaty on the Functioning of the European Union (TFEU) provides that state aid that affects trade between EU member states and threatens to distort competition by favoring certain undertakings is incompatible with the EU single market. EU state aid rules require that incompatible state aid be recovered in order to ameliorate the distortion of competition created by the aid.

The state aid rules were originally designed to prevent EU member states from subsidizing domestic enterprises. Under the state aid rules, the commission can demand assessments that claw back state aid, including what it views as underpaid taxes, going back 10 years with interest. In a series of decisions reaching back decades, the commission has found specific cases of state aid that violate EU rules and required the offending member state to recover that aid from the affected company.

State aid decisions focusing on indirect subsidies provided through tax benefits are not new as a general matter. The commission has been bringing tax-related state aid cases since at least the mid-1980s. Tax-related state aid decisions reached by the commission have almost always been upheld by the Court of Justice of the European Union.

Until the recent assault on U.S.-based MNEs, however, state aid cases in the tax area generally involved statutory rules that selectively favored domestically headquartered companies in a given EU member state. In contrast, in the new cases the commission is claiming that sovereigns provided illegal state aid to foreign-headquartered companies merely by providing them legal certainty through tax rulings that do not even seem to be “selective” — in that similar rulings were broadly available from the tax administrations of those same EU governments. In addition, the new state aid cases largely relate to transfer pricing matters, which present notoriously difficult fact-specific determinations. For these reasons, the current EU state aid tax investigations are novel and unprecedented.

Moreover, the remedy state aid law imposes against member states that provide illegal state aid is deeply inappropriate when applied to a foreign firm instead of the domestic “national champion” firms for which state aid law was originally intended. In these cases, when the commission finds that a member state has provided illegal state aid, the remedy is to require that member state to collect a revenue windfall from a foreign-headquartered MNE. That does make for great politics: When the commission reprimands a member state for violating EU law, that member state wins.

President Obama and others have suggested that, at least in the technology sector, the European Commission’s regulatory agenda in the past few years has often amounted to a protectionist attack on U.S. companies, driven by frustration at European companies’ inability to compete in that area. The new state aid investigations could be seen as part of that broader trend. Starting in 2013, the commission’s tax-related state aid investigations have focused like a laser on rulings issued to U.S. MNEs. In fact, all but one of the company-specific investigations and almost all of the amounts in controversy involve U.S. MNEs. This enforcement reality contrasts with the fact that tax rulings of the type that the commission has recently decided to examine were also routinely procured by European-headquartered multinationals.

Section 891

Section 891 provides:

Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by sections 1, 3, 11, 801, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign country.

In the course of congressional debate over section 891, Sen. David I. Walsh, D-Mass., presented a floor statement that provides some insight into the statute’s purpose. He suggested that if an administration were to “cause inquiry to be made” into whether a foreign tax was discriminatory, “it would seem natural that the President, through his executive offices, might obtain an agreement . . . to remove such features. If this were done there would be no occasion for the President to issue [a proclamation under Section 891], and the section would have accomplished its result in an amicable manner.”

2 Consolidated Version of the TFEU, article 107(1), May 9, 2008, 2008 O.J. (C 115) 91-92.
In the context of the EU state aid investigations targeting foreign subsidiaries of U.S.-headquartered MNEs, the language of section 891 raises two preliminary issues of statutory interpretation: the meaning of "corporations of the United States" and the meaning of "being subjected to discriminatory taxes."

Walsh's floor statement helps clarify the intent of Congress as to those issues. He explained that the language "corporations of the United States" was intended to refer to "American concerns." The discrimination section 891 was intended to combat does not seem to be limited to tax burdens formally imposed on the domestic subsidiaries of a U.S. MNE. Rather, in light of the legislative history, the statutory term "corporations of the United States" may be best understood to encompass any subsidiary within the worldwide affiliated group of a U.S. MNE. Thus, for purposes of section 891, European subsidiaries of Amazon, Apple, McDonald’s, and Starbucks are all likely to be "corporations of the United States."

Walsh also explained that being subjected to discriminatory taxes under the laws of a foreign country referred to those taxes that are framed, imposed, and enforced "so as to result in a special tax burden upon American concerns, greater than those imposed on the enterprises of [the foreign country] or of the most-favored nation." The issue that section 891 focuses on is not, in the senator's telling, solely about whether the legal rule imposing a tax on an American concern is facially neutral. Rather, whether a tax is discriminatory seems intended to focus on the impact of the foreign rule as applied.

**Open Questions**

A wide variety of questions about how section 891 might interact with the state aid cases — as well as the application of section 891 more generally — have received almost no attention. It might, therefore, be fruitful for Treasury to make an open-ended request for public comments. For instance, there are important questions to be addressed about the relationship between section 891 and U.S. tax treaties, the circumstances under which a tax measure should be viewed as being discriminatory, and the meaning of the term "foreign country" for purposes of section 891.

**Section 891 and U.S. Tax Treaties**

One might contend that section 891 contravenes U.S. tax treaties and therefore has no effect. U.S. tax treaties generally override domestic law by reducing U.S. taxes on foreign persons in exchange for reciprocal reductions in foreign taxes on U.S. persons. They also uniformly include nondiscrimination articles. Under U.S. law, treaties and statutes have coequal status. When a revenue statute and a tax treaty provision conflict, generally the later-in-time rule is controlling. Thus, one view might be that by doubling the rate of tax on a foreign country's citizens and corporations, section 891 contravenes our treaties. In that case, since all the relevant treaties were concluded after the enactment of section 891, those treaties would prevail and prevent application of section 891, so long as a treaty with the particular EU member state remains in force.

On the other hand, a fundamental judicial tenet is that treaties and statutes are to be reconciled wherever possible. One question, therefore, is whether the application of EU state aid rules in a discriminatory manner, followed by retroactive revenue reclamation, would be permissible under the United States' tax treaties with the relevant EU member states. For EU law purposes, the TFEU generally trumps bilateral income tax treaties, and so the fact that state aid findings may violate the tax treaties of EU member states may not be dispositive.

But for U.S. law purposes, the TFEU does not have and cannot be granted this quasi-constitutional status. To the extent that the outcomes of discriminatory state aid cases violate the United States' tax treaties with EU member states, application of section 891 may not be inconsistent with our tax treaties. Rather, the better reading may be that section 891 remains an operative provision, at least in part, to the extent that discriminatory or extraterritorial taxation by a foreign country violates the terms of a tax treaty of the United States.

**When a Tax Is Discriminatory**

Under section 891, whether corporations of the United States are subjected to discriminatory taxes under the laws of a foreign country appears to refer to the manner in which the taxes are imposed and enforced, rather than merely whether the underlying foreign rules being applied to corporations of the United States are themselves facially neutral. That conclusion, however, leaves open a very wide set of questions about the standard for determining whether corporations of the United States are being subjected to discriminatory taxes.

**The Meaning of 'Foreign Country'**

Another open question turns on the meaning of the term "foreign country" for purposes of section 891. The meaning is important because if the administration were to conclude that U.S. corporations were being subjected to discriminatory taxes under the laws of the EU (as opposed to the laws of a member state), a question would arise whether the EU is a "foreign country" for purposes of section 891.

Our understanding of the meaning of the term "foreign country" for international tax purposes depends to a significant degree on a 1932 Supreme Court case. 

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Burnet v. Chicago Portrait Co. In that case, the Court held that subnational taxes imposed by the Australian state of New South Wales were imposed by a foreign country for purposes of the foreign tax credit because the purpose of the FTC was to alleviate double taxation and the Court recognized that double taxation can occur whether a foreign tax burden is imposed by a national government or a regional one. In reaching that conclusion, the Court made clear that "foreign country" is ambiguous. As the Court noted, "the term 'foreign country' is not a technical or artificial one, and the sense in which it is used in a statute must be determined by reference to the purpose of the particular legislation."10

When crafting section 891 in 1934, Congress would have been aware of the 1932 decision in Chicago Portrait — which at the time was the Court's most recent international tax decision. Depending on the purpose of the statute at issue, Chicago Portrait made clear that "foreign country" could mean either "foreign territory" or "foreign government" and, when referring to a foreign government, "it may describe a foreign state in the international sense," but it might also mean "a foreign government which has authority over a particular area or subject-matter."11 Of course, the European Union has a territory and is arguably a foreign government with authority over particular subject matter, including competition policy, as the commission's actions in imposing state aid assessments clearly establish.

Sequence of Analysis

As Treasury considers the tax treaty issues, FTC issues, and section 891 issues that arise when dealing with the state aid investigations, one practical question is: Which of these issues has to be dealt with first? Tax treaty termination is a pure policy decision with no required time frame for decision. Foreign tax creditability is determined under the compulsory payment rules, which require that a taxpayer exhaust all effective and practical remedies, including available judicial appeals, before claiming the credit.12

In contrast, EU law provides that once the commission decides that a member state provided a taxpayer with illegal state aid, that state must act without delay to recover that aid from the taxpayer.13 As a result, although FTCs quite likely would not be available at the time the commission reached a decision (since appeals would be in process), that decision may mark the point at which a corporation of the United States is subjected to tax for purposes of section 891. Thus, the section 891 issues may arise well before either the tax treaty termination or section 901 issues are ripe.

Political Economy Considerations

The history of state aid law suggests that credible sources of economic and political pressure have significantly affected the development of EU state aid investigations over time. Hinting that tax treaties might need to be terminated is not, however, particularly credible as a source of pressure on the European Commission. The collateral damage caused by tax treaty termination would be very substantial and probably disproportionate to the harm caused by the current state aid investigations for all parties concerned. Nor can the U.S. bring credible pressure to bear on the commission by threatening that EU state aid assessments will not be creditable to U.S. MNEs. Indeed, the U.S. has already indicated to the commission that EU state aid assessments may be creditable foreign taxes for U.S. tax purposes, in order to explain that the United States has a direct stake in these proceedings, because if the FTC applies, U.S. taxpayers will foot the entire bill for any state aid assessments.

In contrast, section 891 constitutes a plausible source of leverage in connection with the state aid cases. Although the United States should be reluctant to invoke section 891, that step is substantially less drastic than terminating all EU member state tax treaties. Moreover, given the lack of guidance on precisely how section 891 applies, Treasury might be able to appropriately limit the impact of any finding under section 891.

Conclusion

This article started with a simple question: Why shouldn’t Treasury consider the issues raised by EU state aid investigations under section 891? True, tax rates have never doubled under section 891, and many tax lawyers have never heard of section 891. In an important sense, however, Congress intended these results: Section 891 was designed to create a deterrent that would discourage foreign governments from discriminating against U.S. citizens and businesses. Thus, when the rule of law works as it should abroad, section 891 simply does not come up. Maybe it is time for Treasury to study section 891, if only to remind our friends in the European Commission that it is the law of the United States.

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13OJ L 83/1 (Mar. 27, 1999), as amended, article 14.