EU Direct Tax Newsalert

European Commission concludes Gibraltar's corporate tax exemption regime for interest and royalties, as well as five tax rulings, are State aid

PwC's EU Direct Tax Group

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On 19 December 2018, the European Commission (EC) concluded the State aid investigation which it originally opened in October 2013 and which it extended in October 2014. The EC found that Gibraltar's corporate tax exemption regime for interest and royalties, as well as five tax rulings, are unlawful under EU State aid rules. The beneficiaries now have to return unpaid taxes which are estimated to be in the region of €100 million to Gibraltar.

Background

In October 2013, the EC opened an in-depth investigation into Gibraltar's corporate tax regime, to verify whether the non-taxation of intercompany loan interest during the period 1 January 2011 to 30 June 2013 and royalty income during the period 1 January 2011 to 31 December 2013 selectively favoured certain categories of companies, in breach of EU State aid rules. The relevant legislation was amended to tax these income streams in 2013 to the EC's satisfaction.

The EC extended the investigation in October 2014 to also cover Gibraltar's tax rulings practice. The investigation focused on 165 tax rulings granted between 2011 and 2013. The EC had concerns that these tax rulings involved State aid because in their view they were not based on sufficient information to ensure that the companies which received these rulings were taxed on equal terms with other companies generating or deriving income from Gibraltar.

Non taxation of inter company interest and royalty income

The EC concluded that in their view there was no valid justification for the non-taxation of inter- company interest and royalty income. The EC found that it provides a selective advantage as they consider that the measure was designed to attract companies belonging to multi-national groups.

The Gibraltar tax ruling practice

The EC concluded that 5 of the 165 rulings reviewed involved unlawful State aid.

All 5 rulings concerned the tax treatment of certain income generated by Dutch Limited Partnerships. According to the EC, under the tax legislation applicable in both Gibraltar and the Netherlands, the profits made by a limited partnership in the Netherlands should be taxed at the level of the partners. In all 5 cases the partners of the Dutch partnerships were resident for tax purposes in Gibraltar and the EC's conclusion is that they should have been taxed there.

The EC **did not identify any selective advantage in relation to the other 160 rulings** investigated and therefore found that these rulings do not infringe EU State aid rules.

The EC also welcomed recent changes made by the Gibraltar Government to enhance its tax ruling procedure.

Recovery

EU State aid rules require that incompatible State aid is recovered in order to remove the distortion of competition created by the aid.

Gibraltar must now recover unpaid taxes on the basis of the methodology established in the EC decision from:

- the companies that benefitted from Gibraltar's corporate tax exemption regime for interest and royalties between 2011 and 2013;
- the companies that the EC claim benefitted from the tax treatment under the five tax rulings.

Takeaway

Since June 2013, the EC has investigated individual tax rulings of Member States under EU State aid rules. It extended this information inquiry to all Member States in December 2014.

Since 2015 there has been a number of high profile decisions involving multinational groups and unlawful state aid. Investigations involving companies and regimes in other Member States are ongoing.

At present only the press release is available in respect of the current decision. We will need to wait for the publication of the detailed decision to better understand the full implications of this case.

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