

Public release of the European Commission's State aid opening decision in McDonald's Luxembourg Tax Alert

On June 6th, the European Commission published its opening decision in connection with two Luxembourg tax rulings granted to a McDonald's Luxembourg entity (McD Europe franchising S.à.r.l (Luxembourg): "McD Europe" in March and September 2009.

This opening decision does not prejudge the final outcome of the EC's formal investigation. Tax measures for companies would be:

Facts

McD Europe acquired beneficial ownership of a number of franchise rights intangibles that were subsequently allocated to its US Franchise Branch. The US Franchise branch maintained operations within the US and was controlled by a Branch Manager.

The initial ruling of March 2009 confirmed that the US Franchise Branch constituted a permanent establishment and that on the basis on articles 7 and 25 of Luxembourg-US double tax treaty ("DTT"), the profit imputable to the branch was subject to tax in the US and tax exempt in Luxembourg. This ruling further requires that proof be submitted on a yearly basis that those profits have been declared and are subject to tax in the US.

A revised ruling was introduced explaining that the activity performed by the Branch in the US was not considered according to US domestic tax rules as US trade or business and therefore was not effectively taxed in the US and confirmed that the effective taxation in the US was not required by the Luxembourg US DTT.

Luxembourg views

Luxembourg in its response to the Commission confirms the tax treatment contained in the revised ruling is in line with Luxembourg tax law and constituted an interpretation of the relevant provisions of Luxembourg tax law and in line with the provisions of the DTT the profit derived at the level of the PE is tax exempt in Luxembourg.

Commission views

In its opening decision, the Commission considers that the revised tax ruling can be considered as State aid mainly on the grounds that:

- The revised ruling gives an interpretation that contradicts both the provisions of the Luxembourg-US DTT and the Luxembourg law which transposes that DTT into national law and which, as its guiding principle, requires worldwide taxation of profits.
- Since, the US branch does not constitute a permanent establishment for US tax purposes, the United States cannot tax any income attributed to that branch.

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