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New State aid investigation into Luxembourg Ruling practice: Huhtamäki

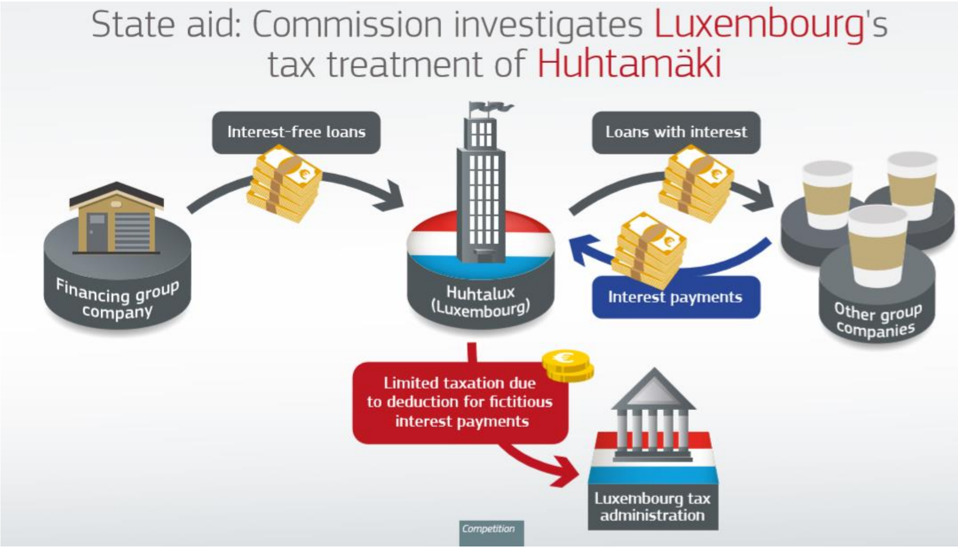
Introduction

On 7 March 2019, the European Commission ("EC") opened a formal State aid investigation into tax rulings granted by the Luxembourg tax authorities ("LTA") to a Huhtamäki group company, Huhtalux S.a.r.l. ("LuxCo"). The EC will examine whether LuxCo was given a selective advantage that distorted competition within the EU's internal market as a result of the tax rulings granted by the LTA, in breach of EU state aid rules.

The Huhtamäki group, headquartered in Finland, is engaged in food and beverage packaging activities. It is a leading converter of plastics and paperboard into food and beverage cups and containers in Europe, Asia and Australia.

Huhtamäki structure

LuxCo is engaged in intra-group financing activities. It receives interest-free loans from a group company based in Ireland ("IreCo"). The funds received by LuxCo are used to finance other group companies through interest-bearing loans.



The rulings under investigation were granted from 2009 to 2013 by the LTA and allow LuxCo to deduct its taxable base with deemed interest payments for the interest-free loans it receives. According to the LTA, taking these deemed expenses into account is in accordance with the arm's length principle because the deemed interest payments reflect the interest payments a third-party would have demanded for the loans LuxCo receives.

As a result of the deduction of the deemed expenses endorsed by the rulings, LuxCo was taxed in Luxembourg on a substantially smaller (arm's-length) profit.

The investigation

The EC doubts that the tax treatment, as endorsed by the tax rulings, can be justified.

The EC is concerned that *"Luxembourg has accepted a unilateral downward adjustment of Huhtalux's taxable base that may grant the company a selective advantage"*.

According to the EC, this possible selective advantage is caused by the LTA allowing the Huhtamäki group to pay less tax than other stand-alone or group companies whose transactions are priced in accordance with market terms. If confirmed, this would constitute illegal state aid.

Observations

In our view, the rationale adopted by the EC as described above is remarkable. By imputing deemed interest expenses and allowing LuxCo to deduct these from its taxable base, the LTA seeks to apply the arm's length principle which should result in a transaction between IreCo and LuxCo that is priced in accordance with market terms. If the arm's length principle is applied correctly, the result of the adjustment is that LuxCo is allowed an interest deduction in line with the interest deduction an independent party would have been allowed.

While the opening of an in-depth investigation does not mean that an illegal aid was indeed granted, as can be seen from the McDonald's case, it does confront multinationals using similar financing structures with major uncertainties.