Tax ‘sweetheart deals’ between multinationals and EU countries at record high

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Summary

Over the last few years, advance pricing agreements (APAs) – also known as ‘comfort letters’ or ‘sweetheart deals’ – have been at the centre of several tax scandals, as well as state aid cases that the European Commission has launched against EU Member States, involving alleged loss of millions of Euros in tax income.

But according to new data, the number of APAs continues to grow, and saw a sharp increase across the European Union from 2015 to 2016. In particular, the number of unilateral agreements – which are the most problematic kind – increased dramatically in EU countries, from 1,252 at the end of 2015 to 2,053 at the end of 2016 (an increase of 64 per cent).

As part of a very harmful ‘race to the bottom’, some government engage in ‘tax competition’, to try and attract multinational corporations to their countries by offering lucrative tax arrangements. But international concern about these types of practices is growing. Earlier this week, the European Commissioner for Economic and Financial Affairs Pierre Moscovici named seven EU Member States as a cause of concern due to their aggressive tax policies. These were Belgium, Cyprus, Hungary, Ireland, Luxembourg, Malta and the Netherlands. Two of these countries – Belgium and Luxembourg – are at the absolute top of the list of countries that have the highest number of secret APAs in force. The Netherlands would also probably be very high on the list if they reported the number of APAs in force in the country.

Advance pricing agreements on the increase

APAs are a special type of tax ruling that takes the form of secret agreements between multinational corporations and governments to define the future terms of taxation. While the content of APAs is secret, EU Member States (with the exception of the Netherlands) report to the European Commission on the number of APAs that are currently in force in their countries. The total number of APAs has increased sharply over the last few years. New data released by the European Commission indicates that the issuing of APAs is now happening at a faster rate than before (see Figure 1).
What are advance pricing agreements?

Advance pricing agreements are a type of ‘advance tax ruling’ that are sometimes referred to as ‘sweetheart deals’ or ‘comfort letters’. They are agreed between tax administrations and specific individual multinational corporations. In some cases, they provide opportunities for these corporations to avoid paying large amounts of tax.¹

These deals usually determine how transfer pricing rules will be applied to certain transactions among subsidiaries of a multinational corporation.² Other types of advance tax rulings can address other issues in corporate taxation, such as how different types of structures will be taxed.

The European Commission releases statistics on the total number of APAs in force across the EU. Unfortunately, however, no such data is available for other types of advance tax rulings.

Figure 1. Source: Eurodad calculations based on data from the European Commission. ¹
What's the problem?

APAs and other types of advance tax rulings are not usually illegal. However, their characteristics raise several concerns:

- **Advance**: the agreements concern the future, and thus the tax administration is not able to see the tax return or country by country report of the multinational corporation before entering into the agreement, since these are submitted after the tax year has ended. If the administration later discovers that the corporation is engaged in large-scale tax avoidance, the advance agreement can limit the administration’s chances of intervening.

- **Binding**: the agreements are often binding for the tax administrations that enter into them, normally for a predetermined period of, for example, five years.

- **Individual**: agreements are requested by individual corporations and issued specifically to them. This introduces the risk of special treatment for powerful and influential corporations.

- **Secret**: the agreements are secret to the public, and whistleblowers that release information about the deals risk ending up in court.

Unilateral APAs give special cause for concern

APAs can be either ‘unilateral’, meaning they have been issued by one country, or bi- or multilateral, meaning that two or more countries have approved them. The concerns outlined above apply to all these types of agreements. However, bi- and multilateral agreements have the advantage over unilateral agreements in that they have been scrutinised by more than one country, and thus may be less controversial.

There is a lower risk of agreements resulting in tax avoidance when they include the country where the multinational corporation has its business activity and generates its profits (the so-called ‘source country’) – since the source country has no interest in such tax avoidance. However, bilateral agreements can also involve two tax havens, in which case there is a risk that both countries are willing to sign an agreement facilitating tax avoidance.

Impact on tax payments by multinational corporations

APAs and other types of advance tax rulings can have a very significant impact on the level of corporate tax paid by a multinational corporation. This became obvious when over 500 agreements from Luxembourg were leaked to the media and resulted in the so-called ‘LuxLeaks scandal’, which broke in 2014. The deals were made with more than 300 corporations, in some cases allowing them to substantially lower their tax payments, occasionally to below one per cent.
Advance tax rulings have also played a very central role in several large-scale state aid cases launched by the European Commission against EU Member States (see Table 1).

Table 1: Expensive tax deals. Examples of state aid cases launched by European Commission against EU Member States concerning APAs and other advance tax rulings

<table>
<thead>
<tr>
<th>Case</th>
<th>Number of ‘sweetheart deals’ involved</th>
<th>European Commission’s estimate of tax avoided</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg and Amazon (2017)</td>
<td>1 APA(^8)</td>
<td>Around €250 million (^9)</td>
</tr>
<tr>
<td>Ireland and Apple (2016)*</td>
<td>2 tax rulings(^{10})</td>
<td>Up to €13 billion(^{11})</td>
</tr>
<tr>
<td>Belgium’s “excess profit tax ruling scheme” (2016)</td>
<td>Tax rulings issued to 35 multinational corporations(^{12})</td>
<td>Around €700 million(^{13})</td>
</tr>
<tr>
<td>Netherlands and Starbucks (2015)*</td>
<td>2 APAs(^{14})</td>
<td>€20-30 million(^{15})</td>
</tr>
<tr>
<td>Luxembourg and Fiat (2015)*</td>
<td>1 APA(^{16})</td>
<td>€20-30 million(^{17})</td>
</tr>
</tbody>
</table>

\* The state aid cases on Ireland/Apple, Netherlands/Starbucks, Luxembourg/Fiat the Belgian excess profit scheme have all been appealed and are pending at the European Court of Justice.\(^{18}\)

APAs and concerns about equality before the law

APAs usually concern issues relating to transfer pricing, and are therefore of no use to companies that consist of only one entity, such as many small- and medium-sized enterprises. This, and the fact that each corporation can receive its own secret agreement, undermines the principle of equality before the law. The lack of transparency also creates a very serious absence of clarity about how corporate tax rules are being applied in practice. Because the general transfer pricing legislation and its ‘arm’s length principle’ is in itself very unclear, APAs – which are a type of interpretation of the law – become essential information for understanding how multinational corporations are, in reality, being taxed.

Which EU countries have unilateral APAs?

Table 2 provides an overview of the number of unilateral APAs in force in EU Member States. The data, which is provided by the European Commission, is based on reports from the Member States themselves.
Table 2. Overview of unilateral APAs in force in EU Member States. The following EU Member States have reported that they do not have any unilateral APAs in force: Austria, Bulgaria, Croatia, Cyprus, Denmark, Estonia, Germany, Ireland, Malta, Slovenia and Sweden. For data on the Netherlands, see Table 3.

Source: Eurodad calculations based on data from the European Commission.

<table>
<thead>
<tr>
<th>Number of unilateral APAs in force</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>No data</td>
<td>157</td>
<td>396</td>
<td>1,081</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>119</td>
<td>347</td>
<td>519</td>
<td>599</td>
</tr>
<tr>
<td>Italy</td>
<td>47</td>
<td>51</td>
<td>61</td>
<td>73</td>
</tr>
<tr>
<td>Hungary</td>
<td>58</td>
<td>79</td>
<td>70</td>
<td>63</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>33</td>
<td>34</td>
<td>46</td>
<td>54</td>
</tr>
<tr>
<td>Finland</td>
<td>21</td>
<td>15</td>
<td>23</td>
<td>45</td>
</tr>
<tr>
<td>UK</td>
<td>25</td>
<td>35</td>
<td>44</td>
<td>44</td>
</tr>
<tr>
<td>Spain</td>
<td>44</td>
<td>40</td>
<td>45</td>
<td>43</td>
</tr>
<tr>
<td>Poland</td>
<td>17</td>
<td>13</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>France</td>
<td>14</td>
<td>16</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>Romania</td>
<td>4</td>
<td></td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>Portugal</td>
<td>2</td>
<td>4</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Lithuania</td>
<td>1</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Slovakia</td>
<td>15</td>
<td>3</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Greece</td>
<td></td>
<td></td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Latvia</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>399</td>
<td>802</td>
<td>1,252</td>
<td>2,053</td>
</tr>
</tbody>
</table>

Figure 2 provides an overview of developments in some of the countries that have most recently seen sharp increases in the number of unilateral APAs in force.

Figure 2. Source: Eurodad calculations based on data from the European Commission.
Table 3 focuses on the special case of the Netherlands, which does not report on the total number of agreements in force, and does not distinguish between unilateral, bilateral or multilateral APAs. The Netherlands does, however, report on the number of APAs approved each year, and since the normal duration of an APA in the Netherlands is four to five years, the number of APAs approved since 2013 can be used to calculate a rough estimate of the number of APAs currently in force in the Netherlands.

Table 3: Overview of APAs approved by the Netherlands between 2013 and the end of 2016

<table>
<thead>
<tr>
<th>Year</th>
<th>APAs approved</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>228</td>
</tr>
<tr>
<td>2014</td>
<td>203</td>
</tr>
<tr>
<td>2015</td>
<td>236</td>
</tr>
<tr>
<td>2016</td>
<td>191</td>
</tr>
<tr>
<td>Total</td>
<td>858</td>
</tr>
</tbody>
</table>

Note: The Netherlands does not report on the total number of APAs in force, but since APAs are normally valid for four to five years, the number of APAs approved over the last few years can give a rough estimate of the number of APAs that were in force in the Netherlands at the end of 2016. Source: Eurodad calculations based on data from the European Commission.

Belgium

From 2015 to 2016, Belgium overtook Luxembourg as the EU country with the highest number of unilateral APAs in force. Belgium has previously been the subject of a state aid investigation by the European Commission, due to a tax scheme known as the “excess profit scheme”. The core of the scheme was the issuance of advance tax rulings to multinational corporations. In 2016, the European Commission decided that the scheme in its entirety was a violation of EU state aid rules. This decision has been appealed by Belgium, as well as by a number of multinational corporations, and is now pending at the European Court of Justice.

In early March 2018, the EU Commissioner for Financial Affairs raised concerns about aggressive tax planning in seven EU member states, one of which was Belgium.

Luxembourg

In 2014, Luxembourg was at the centre of the LuxLeaks scandal. At the core of the scandal were leaked documents that revealed secret advance tax rulings between the Luxembourg tax administration and more than 300 multinational corporations. According to the International Consortium of Investigative Journalists (ICIJ), which published the story, these deals appear to have allowed multinational corporations to save billions of dollars in tax payments.

Since LuxLeaks, the ruling practices of Luxembourg have also been the centre of several state aid investigations by the European Commission. In 2015, the Commission concluded that an APA issued by Luxembourg to Fiat violated state aid rules. In 2017, the Commission reached the same conclusion.
regarding and APA issued by Luxembourg to Amazon. Both these decisions have been appealed and are pending at the European Court of Justice.

Despite these cases, Luxembourg has continued to issue large numbers of unilateral APAs to multinational corporations, as can be seen in Table 2 and Figure 2.

The Netherlands

As explained above, the Netherlands does not report on the total number of APAs it has in force, nor on whether these APAs are unilateral, bilateral or multilateral. However, as shown in Table 3, the Netherlands has reported that a total of 858 APAs have been approved between 2013 and 2016.

If these APAs were bi- or multilateral, it could be expected that other EU countries would have reported similarly high numbers of bi- or multilateral APAs (since these types of APAs require approval by minimum two countries). However, according to the European Commission’s data, EU Member States reported that 212 bi- and multilateral APAs were in force at the end of 2016. Therefore, there is reason to believe that a large part of the Dutch APAs are unilateral.

The Dutch practice for issuing APAs and other tax rulings has been an issue of debate during the last few years. During the Paradise Papers scandal in November 2017, the Dutch news media Trouw reported that the Netherlands had issued a tax ruling to the corporation Procter & Gamble (P&G), which allegedly allowed the corporation to save US$ 169 million in taxes. While the Dutch government defended its use of tax rulings, it did also note that the tax ruling revealed by the Paradise Papers did not meet the official Dutch requirements, since one of the two required official signatures was missing on the APA issued to P&G. In February 2018, the Dutch government announced that in response, a total of 4462 rulings had been reviewed, of which procedural errors were found in 78 rulings.

The Paradise Papers was not the first time concerns were raised about the Dutch ruling practice. In 2014, the European commission concluded that two APAs issued by the Netherlands to Starbucks constituted illegal state aid. The decision has been appealed and is pending at the European Court of Justice. Meanwhile, at the end of 2017, the Commission initiated another state aid case to look into two Dutch tax rulings issued to IKEA. The investigation has not yet been finalised.

Which countries are impacted by EU APAs?

APAs concern taxation of multinational corporations, and the decisions made through an APA can have a significant impact on the international tax payments of the corporation in question, even when the APA is issued unilaterally by the tax administration in one country.
The data published by the European Commission includes an assessment of whether the unilateral APAs of EU Member States only affect EU countries, or whether they also affect non-EU countries. This information is summarised in Table 4.

**Table 4. Overview of whether unilateral APAs in force at the end of 2016 only concern EU countries, or also concern countries outside of the EU**

<table>
<thead>
<tr>
<th>Unilateral APAs in force at the end of 2016</th>
<th>Only concern EU countries</th>
<th>Also concern non-EU countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>647</td>
<td>434</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>599</td>
<td>0</td>
</tr>
<tr>
<td>Italy</td>
<td>35</td>
<td>38</td>
</tr>
<tr>
<td>Hungary</td>
<td>43</td>
<td>20</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>44</td>
<td>10</td>
</tr>
<tr>
<td>Finland</td>
<td>20</td>
<td>25</td>
</tr>
<tr>
<td>Spain</td>
<td>30</td>
<td>13</td>
</tr>
<tr>
<td>Poland</td>
<td>11</td>
<td>6</td>
</tr>
<tr>
<td>France</td>
<td>7</td>
<td>8</td>
</tr>
<tr>
<td>Romania</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>Portugal</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Lithuania</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Slovakia</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Greece</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Latvia</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,450</strong></td>
<td><strong>603</strong></td>
</tr>
</tbody>
</table>

*Source: Eurodad calculations based on data from the European Commission.*

As can be seen in Table 4, the majority of the unilateral APAs in force in the EU only concern other EU Member States. However, more than 600 of the APAs (roughly 25 per cent) also concern non-EU countries. Therefore, the APA practices of EU Member States is not just a concern internally in the EU, but also for developing countries, for example.

The impacts on developing countries are a particular concern, both because these countries are desperate need of income to fight poverty and ensure development, but also because these countries are particularly dependent on income from corporate taxation. But corporate tax avoidance has strong negative impacts on both rich and poor countries, and conservative estimates have found that tax avoidance by multinational corporations is costing the EU alone between €50 billion and €70 billion per year.
Automatic exchange and other EU discussions about APAs and other tax rulings

The European Parliament has called for the essential elements of corporate tax agreements to be made public, but this has not been accepted by the European Commission or by Member States. Instead, Member States have decided that APAs and other advance tax rulings should remain secret to the public, but at the same time exchanged confidentially between tax administrators in the EU. However, even if tax administrators are allowed to see the agreements issued by other Member States, they might have very limited possibilities for challenging deals that appear to facilitate corporate tax avoidance. In its state aid cases, the European Commission has taken several years to investigate even a small number of agreements. And even in the cases where it has concluded that state aid law has been violated, the decision has often been appealed at the European Court of Justice, as mentioned above. It is difficult to imagine that country tax administrations that already struggle with lack of resources will have an easier time challenging the tax practices of other Member States.

The European Commission will not be fully included in the confidential exchange of information, since the EU Member States decided that the Commission should only have access to “a limited set of basic information” about APAs and other advance tax agreements issued by Member States. They also decided that the Commission should not have access to information about which multinational corporations have obtained such agreements, or any summary of the content. Member States further underlined that the Commission may not use this information for any other purpose other than to monitor and evaluate the effective application of the automatic exchange between Member States themselves.

A tax administrator’s dilemma

The secret exchange of APAs and other advance tax agreements can place EU tax administrators in a difficult situation. First, in the case where a tax administrator receives information from another EU country, which documents corporate tax avoidance by a multinational corporation, it should be kept in mind that this is often not illegal, and can therefore be difficult to stop it with regular tax compliance procedures. Second, pursuing corporate tax avoidance is often a very political issue, and the tax administrator might not have the necessary support from political decision-makers to go after a powerful multinational corporation. And last but not least, the information is strictly confidential. Therefore, the tax administrator is not allowed to tell the public or, for example, parliamentarians about the tax behaviour of corporations. This confidentiality also limits the possibility for tax administrators to discuss with other experts and tax administrations. Violating this confidentiality can put the tax administrator at risk of being fired, prosecuted or potentially of facing heavy penalties.

Worryingly, because developing country tax administrators have much less access to key information about multinational corporations, a tax administrator in a developed country can also end up looking at information that indicates that a corporation is dodging taxes in developing countries, but not be allowed to share this information with the tax administrators in the countries that are being affected.
What needs to happen?

Keeping in mind that corporate tax avoidance is every year costing countries around the world billions of Euros in much needed tax income, the urgent need for action on this issue cannot be overstressed. As part of this, the growing trend of secret tax deals between multinational corporations and tax administrations must be addressed.

Corporate taxation should be based on clear legislation, rather than on agreements between individual corporations and governments. The best solution would, of course, be to replace transfer pricing legislation with a system that brings clarity and consistency to the taxation of multinational corporations. But until this happens, public information about the basic content of APAs and other advance tax rulings issued to multinationals is vital information for understanding the tax system we currently have. Furthermore, although the public can never replace tax administrators, scrutiny of public information by journalists and civil society groups, for example, can help identify cases where multinational corporations are engaged in questionable tax practices. More freely available public information would also allow tax administrators to openly share thoughts, insights and experiences with other tax administrators around the world.

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2 See for example Box 1.


4 While the legality of advance pricing agreements and other types of advance tax rulings in general has not been disputed, some of the tax-related state aid cases initiated by the European Commission have led to the Commission concluding that specific agreements have violated EU state aid law. There are, however, several cases on this matter pending at the European Court of Justice. See also Box 1.


http://ec.europa.eu/competition/state_aid/cases/253200/253200_1851004_674_2.pdf As is it noted in the decision, Ireland has referred to the agreements as ‘advance opinions’ rather than ‘tax rulings’. However, in its decision, the European Commission points out that the two notions are the same.


25 See figure 2


33 European Commission, ‘Statistics on APAs in the EU at the End of 2016’, 8 March 2018, accessed 14 March 2018, https://ec.europa.eu/competition/taxation_customs/sites/taxation/files/2016_jpf_apas_statistics_en.pdf It should be noted that bi- or multilateral APAs might have been reported by more than one EU country, and thus be double-counted in the data. Therefore, the total number of bi- or multilateral APAs might be less than 212. Since unilateral APAs only involve one country, the risk of double-counting does not apply to this type of APAs.


