

E-ALERT | Tax

October 2, 2014

THE EUROPEAN COMMISSION OPENS AN INVESTIGATION INTO TRANSFER PRICING PRACTICES

On Tuesday, September 30, 2014, the European Commission (the Commission) published its decision to open an investigation into Ireland's transfer pricing practices. The Commission is also reviewing the transfer pricing practices of other EU Member States, including the Netherlands and Luxembourg. Any advanced pricing agreement (APA) or other tax ruling within the EU could potentially be subject to this review process, which could lead to increased tax liabilities for the relevant taxpayer for prior periods of up to ten years.

Transfer pricing relates to the prices charged for commercial transactions between parts of the same corporate group (intra-group commercial transactions), *i.e.*, the prices set for goods sold or services provided by one member of a related group to another. APAs are arrangements that determine, before any intra-group transaction takes place, an appropriate set of criteria for setting the pricing for those transactions.

In the decision published on Tuesday, the Commission announced that it will investigate whether Ireland followed transfer pricing guidelines promulgated by the Organization for Economic Cooperation and Development (the OECD) in reaching transfer pricing agreements with Apple Computer. After requesting that Ireland provide additional information on the practice of tax rulings, and in particular, on the tax rulings negotiated with Apple in 1990 and 2007, the Commission concluded that the rulings constitute "State aid" by allowing Apple to understate its profits in Ireland. The Commission stated that the tax ruling of 1991 was not substantiated by either a reference to comparable transactions or by a reference to a pricing method accepted by the OECD.

MORE TO COME

The Commission has stated that "the fight against tax evasion" should be one of the main priorities of the EU's Directorate-General for Competition. This increased attention likely means additional challenges for multinational corporations with a presence in the EU.

RESPONDING TO THE COMMISSION'S INITIATIVE

Multinational corporations that have entered into APAs or other similar arrangements with EU Member States should reassess their positions, including negotiations in process, and prepare to respond to potential State aid claims. Expertise in dealing with State aid issues and EC personnel and procedures is critical to an understanding of the risks and potential responsive measures. Technical tax expertise in transfer pricing and tax residence issues is essential in formulating the best possible responses to claims that tax rulings run afoul of standards applied by the Commission. For example, if it can be demonstrated that the income reported by the company under an APA corresponds to the level of economic activity in the jurisdiction, then a claim of inappropriate State aid can be refuted.

Covington & Burling has deep expertise in the unique business and regulatory environment in which these developments are unfolding, and is well positioned to address both State aid and underlying tax issues.

- Covington’s State aid team in Brussels is led by **Johan Ysewyn**. Johan advises on all aspects of European, International, and Belgian antitrust law. His practice has a strong focus on global and European cartel investigations. He is also one of the leading experts on EU State aid issues, working both for beneficiaries and governments, and he has been practicing antitrust law for 25 years.
- **Sophia Dipla**, also resident in the Brussels office, advises on all aspects of European antitrust law, with a particular focus on EU State aid and EU merger control. She has previously worked at the Commission in the unit dealing with State aid in the financial services sector.
- **Sam Maruca** recently returned to Covington’s Washington DC office after serving for over three years as the first Director of Transfer Pricing Operations at the IRS. In that capacity Sam was responsible for both domestic and global transfer pricing strategy of the U.S. government, and represented the IRS in OECD matters. Sam has worked extensively in all aspects of transfer pricing, including APAs, for 25 years.
- **Michael Caballero** served as International Tax Counsel at the Treasury during the first term of President Obama’s Administration and where he was responsible for tax matters involving the EU as well as the U.S. Government’s participation in OECD’s Committee on Fiscal Affairs.
- **Reeves Westbrook** has specialized in international tax matters for over 40 years. Reeves is co-chair of the tax section of the International Bar Association and is regularly consulted by major multinationals in connection with OECD initiatives.
- **Lee Kelley**, a former IRS and Treasury executive, has dealt extensively with the taxation of U.S. multinationals, and in particular the complex interplay between U.S. tax rules and the tax regimes of major U.S. trading partners in the EU.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our tax practice group:

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