EUROPEAN COMMISSION

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In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus […]		PUBLIC VERSION This document is made available for information purposes only.

Subject: State aid SA. 38945 (2015/C) (ex 2015/NN) – Luxembourg
Alleged aid to McDonald's

Sir,

The Commission wishes to inform Luxembourg that, having examined the information supplied by your authorities on the measure referred to above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union ("TFEU").

1. PROCEDURE

(1) On 19 June 2013, the Commission sent a letter to Luxembourg requesting information about its tax ruling practice.

(2) By letter of 24 June 2014, the Commission sent an additional request for information to Luxembourg regarding the McDonald's group.

(3) In particular, the Commission requested Luxembourg to confirm that McDonald's was paying taxes in Luxembourg, to provide a complete description of McDonald's corporate structure in Luxembourg, and to explain to what extent the activities of

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McDonald’s benefited from a favourable tax regime on its intellectual property right. The Commission also requested Luxembourg to provide for each activity of the McDonald’s group in Luxembourg the amount of tax due for the years 2011, 2012 and 2013, and an explanation on how those amounts were determined. The Commission also requested the balance sheets, the profit and annual accounts of all legal entities of the McDonald’s group for the years 2011, 2012 and 2013, and copies of tax clearances. As regards revenues derived from McDonald’s intellectual property right, the Commission requested Luxembourg to distinguish those revenues according to whether they derive from a trademark, a patent, a design, a domain or any other type of intellectual property.

(4) In its letter of 24 June 2014, the Commission also requested Luxembourg to provide (i) all the tax rulings issued by its tax administration in favour of the McDonald’s group (including those issued in favour of any legal entity that is part of that group) which were still in force at the date of the Commission’s request for information; (ii) all tax rulings issued by its tax administration in favour of the McDonald’s group (including those issued in favour of any legal entity that is part of that group) since 2004 and until the date of the Commission’s request for information; and (iii) any element relevant to understanding that(/those) tax ruling(s) and, in particular, any transfer pricing report, if any such reports were provided by McDonald’s to the Luxembourg tax administration.

(5) On 4 August 2014, the Luxembourg authorities transmitted their reply to the Commission’s request for information of 24 June 2014. In particular, the Luxembourg authorities provided two rulings addressed to McD Europe Franchising, S.à.r.l. (hereinafter “McD Europe”) dated 30 March 2009 (hereinafter: the “initial tax ruling”) and 17 September 2009 (hereinafter: the “revised tax ruling”) respectively, which are the subject-matter of the present Decision (hereinafter collectively referred to as “the contested tax rulings”). In addition, the Luxembourg authorities provided a number of other tax rulings granted by its administration to the companies of the McDonald’s group.[1]

(6) In their reply of 4 August 2014, the Luxembourg authorities also described the tax ruling practice in Luxembourg and explained why they consider that the rulings granted to the McDonald’s group do not grant State aid within the meaning of Article 107(1) TFEU.

(7) By letter of 23 March 2015, the Commission requested Luxembourg to comment on information received from a coalition of trade unions concerning State aid allegedly received by McDonald’s from Luxembourg. This information was annexed to the letter of 23 March 2015. In addition, the Commission requested Luxembourg to specify for the years 2009 to 2014 the number of employees employed by McD Europe and their respective functions. The Commission also requested Luxembourg to specify for the years 2009 to 2014 the number of persons employed by McD Europe’s Swiss and US branches and their respective functions.

[1] The present investigation is however confined to the contested tax rulings and is without prejudice to the assessment of the other tax rulings granted by the Luxembourg tax administration in favour of the McDonald’s group and its subsidiaries.

(8) By the same letter, the Commission also requested Luxembourg to explain (and provide, if available, supporting documentation relating to) the decision of the Luxembourg tax administration to accept McDonald's decision to allocate its franchise rights to McD Europe's Swiss branch instead of to its head office located in Luxembourg.

(9) On 23 April 2015, the Luxembourg authorities transmitted their reply to the Commission's request for information of 23 March 2015.

(10) By letter of 18 May 2015, the Commission asked Luxembourg to provide it with the documents submitted by McD Europe since the date of the initial tax ruling based on the requirement in that ruling to prove that the profits of McD Europe's US and Swiss branches have been declared and subject to tax in the United States and Switzerland respectively. The Commission also asked Luxembourg to provide it for the years 2009 and following with McD Europe's financial accounts (to the extent they have not been previously provided) and the financial accounts of McD Europe's US and Swiss branches, given that Luxembourg had previously indicated that both branches hold separate accounts.

(11) By letter of 9 June 2015, Luxembourg responded to those requests and submitted the tax declarations and financial accounts of McD Europe's US and Swiss branches respectively. McD Europe's US tax declarations claim that McD Europe has no permanent establishment in the United States. Luxembourg also indicated (and provided the relevant documents) that McD Europe's US branch had been subject to a tax audit in the United States by the Internal Revenue Service (hereinafter: the "IRS") […][*].

2. DESCRIPTION

2.1. The beneficiary of the contested tax rulings

(12) McDonald's is composed of the McDonald's Corporation, a company listed on the New York Stock Exchange, and all the companies directly and indirectly controlled by that corporation.

(13) McDonald's is active in the food service industry through the franchising and operation of McDonald's restaurants. In 2014 McDonald's recorded total revenues of USD 27 billion, of which USD 18 billion was from company operated sales and USD 9 billion from franchised revenues. McDonald's operated 36 258 restaurants in 119 countries, of which 29 544 were operated by franchisees.[2] At the time of the contested tax rulings, McDonald's total revenues amounted to USD 26.216 billion and the company operated 32 478 restaurants.[3]

[*] Parts of this text have been hidden so as not to divulge confidential information; those parts are enclosed in square brackets […]

[2] McDonald's Corporation's 2014 form 10-K : http://d1lge852tjjqow.cloudfront.net/CIK-0000063908/677663d6-cd9d-4db9-992d-1d0f8145fa14.pdf

[3] McDonald's Corporation's 2009 form 10-K https://www.aboutmcdonalds.com/content/dam/AboutMcDonalds/Investors/C-%5Cfakepath%5Cinvestors-2009-annual-report.pdf

(14) From 2005 to 2015, McDonald's business was structured in geographical segments.[4] Of the total revenues generated by the McDonald's Corporation in 2014, USD 11 billion was generated in Europe, USD 8.6 billion in the United States, and the remaining USD 7.7 billion in other countries and through the corporate segment.

(15) Outside of the United States, McDonald's Corporation and its US affiliate, McDonald's International Property Company (hereinafter "MIPCO") license the right to develop and operate McDonald's restaurants on a market-by-market basis to entities which in most major markets are direct or indirect subsidiaries of McDonald's Corporation.

(16) According to the information provided by Luxembourg, as of December 2013 the McDonald's corporation controls five companies in Luxembourg: (i) McD Europe; (ii) McD Europe Holdings S.à.r.l.; (iii) Luxembourg McD Investments S.à.r.l.; (iv) Lux MC Holdings S.à.r.l.; and (v) McD Luxembourg Holdings S.à.r.l.

(17) [*Description of the participations of the Luxembourg companies in other European and US companies of the group*][5]

2.2. The applicable legal provisions

(18) Article 159(1) of the Luxembourg Income Tax Law (*Loi concernant l'impôt sur le revenu*, hereinafter "L.I.R.") provides: "*L'impôt sur le revenu des collectivités porte sur l'ensemble des revenus du contribuable.*"

(19) Article 16 of the Luxembourg Tax Adaptation Law (*Steueranpassungsgesetz*) defines the concept of "permanent establishment" under Luxembourg tax law and refers in this respect to every fixed piece of equipment or place which serves for the operation of an established "enterprise" or "business".[6]

(20) On 3 April 1996, Luxembourg and the United States concluded a double tax treaty (hereinafter the "Luxembourg–US DTT")[7]. Double tax treaties are bilateral treaties between contracting states to relieve cross-border double taxation of income or gains. Cross-border double taxation occurs when two countries subject to tax the same item of income or property in the hands of the same taxpayer for the same period. The provisions of double tax treaties are often and generally inspired by the Model Tax Convention (hereinafter "MTC") drafted by the Organisation for Economic Cooperation

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[4] McDonald's business structure was modified in July 2015 with the creation of similar markets segments (United States; International Lead Markets - including Australia, Canada, France, Germany and the United Kingdom; High-Growth Markets - including China, Italy, Korea, Poland, Russia, Spain, Switzerland and the Netherlands; Foundational Markets and Corporate); see Form 8-K submitted by McDonald's Corporation to the US Securities and Exchange Commission on 18 September 2015: http://d1lge852tjjqow.cloudfront.net/CIK-0000063908/13d2fc6b-0541-49e0-a1ad-873c62c50831.pdf, p. 2.

[5] Letter from Luxembourg to the European Commission of 4 August 2014, pp. 7 and 8.

[6] Steueranpassungsgesetz vom 16. Oktober 1934, Rgesetzbl. I S. 925). In its original (German) version Article 16 provides: "*Betriebsstätte im Sinn der Steuergesetze ist jede feste örtliche Anlage oder Einrichtung, die der Ausübung des Betriebs eines stehenden Gewerbes dient.*"

[7] Convention between the Government of the United States of America and the Government of the Grand Duchy of Luxembourg for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital, signed at Luxembourg on April 3, 1996.

and Development (hereinafter "OECD"). The Luxembourg–US DTT was transposed into Luxembourg domestic law on 5 March 1999.[8]

(21) The general scope of application of the Luxembourg–US DTT is defined in Article 1(1) which provides: "*This Convention shall apply only to persons who are resident of one or both of the Contracting States, except as otherwise provided in the Convention.*"

(22) Article 3(2) of the Luxembourg–US DTT on "General Definitions" provides: "*As regards the application of the Convention by a Contracting State any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a common meaning pursuant to the provisions of Article 27 (Mutual Agreement Procedure), have the meaning that it has under the law of that State concerning the taxes to which the Convention applies.*"

(23) Article 5(1) of the Luxembourg–US DTT defines the concept of permanent establishment as: "*For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*"

(24) Article 7(1) of the Luxembourg–US DTT defines the concept of business profits as: "*The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as are attributable to that permanent establishment.*"

(25) Article 25 of the Luxembourg–US DTT is titled "Relief from Double Taxation", Article 25(2) of the Luxembourg–US DTT provides: "*In Luxembourg double taxation shall be eliminated as follows: a) where a resident of Luxembourg derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the United States, Luxembourg shall, subject to the provisions of subparagraph b) and c), exempt such income or capital from tax, but may, in order to calculate the amount of tax on the remaining income or capital of the resident, apply the same rates of tax as if the income or capital had not been exempted.*"

2.3. The contested tax rulings

(26) The present investigation concerns two tax rulings issued by the Luxembourg tax administration in 2009 in favour of McD Europe: the initial tax ruling and the revised tax ruling, both of which concern McD Europe's taxable status in Luxembourg.

(27) The initial tax ruling was issued by the Luxembourg tax administration on 30 March 2009 following a ruling request by McDonald's dated 11 February 2009, supplemented

[8] *Loi du 5 mars 1999 portant approbation de la Convention entre le Gouvernement du Grand-Duché de Luxembourg et le Gouvernement des Etats-Unis d'Amérique tendant à éviter les doubles impositions et à prévenir la fraude fiscale en matière d'impôts sur le revenu et sur la fortune, signée à Luxembourg, le 3 avril 1996, telle qu'elle a été modifiée par l'échange de lettres entre les deux Gouvernements du 28 août 1996*, Journal Officiel du Grand-Duché du Luxembourg, 16 mars 1999, A – N°25. The law was amended in 2010 by *Loi du 31 mars 2010 portant approbation des conventions fiscales et prévoyant la procédure y applicable en matière d'échange de renseignements sur demande*, Journal Officiel du Grand-Duché du Luxembourg, A – N°51, 6 avril 2010.

by further documents submitted on 10 March 2009. In response to the initial tax ruling, McD Europe's tax advisor (hereinafter: the "tax advisor") made a request for a revised tax ruling to the Luxembourg tax administration dated 27 July 2009. That request resulted in the revised tax ruling, which was issued by the Luxembourg tax administration on 17 September 2009.

2.3.1. The initial tax ruling

2.3.1.1. McDonald's corporate structure described in the initial ruling request

(28) McDonald's initial ruling request of 11 February 2009 describes the structure of the McDonald's group and its presence in Luxembourg. It further describes the restructuring of McDonald's Corporation's franchise rights and McD Europe's two branches in the US (hereinafter: the "US Franchise Branch") and Switzerland (hereinafter: the "Swiss Service Branch") respectively. Furthermore, it describes the Luxembourg tax implications of that restructuring based on the application of the Luxembourg–US DTT.

(29) In particular, the ruling request describes that in order to centralise the oversight and management of the European franchise rights within McD Europe, the latter entered into a "Buy-in Agreement" and a "Qualified Cost Sharing Arrangement" (hereinafter "QCS Agreement") with McDonald's Corporation and MIPCO. According to the Buy-in Agreement, McD Europe buys-in to certain pre-existing and future developed franchise rights owned by McDonald's Corporation and MIPCO. As a result, McD Europe acquired beneficial ownership of a number of franchise rights intangibles (hereinafter "franchise rights").[9] Subsequently, McD Europe allocated the franchise rights as well as the obligations to its US Franchise Branch. All royalties that were once received by McDonald's Corporation are now to be received by McD Europe through its US Franchise Branch. Finally, according to the initial ruling request, all the necessary steps in relation to the franchise rights' restructuring for the McDonald's European region were expected to be implemented on or before 1 March 2009.

(30) According to the initial ruling request, McD Europe's US Franchise Branch has its office in Oak Brook, Illinois, United States of America. According to the initial ruling request, that branch assumes various economic risks associated with the development of the franchise rights and bears associated costs. In bearing those costs, the US Franchise Branch is, according to the ruling request, effectively participating in the QCS Agreement with McDonald's Corporation and MIPCO. The related activities at McDonald's Corporation (or its affiliates) that are reimbursed by the US Franchise Branch are directed and performed by employees within McDonald's Corporation.

(31) The US Franchise Branch maintains operations within the United States and is controlled by a branch manager[10] located in the United States who oversees certain

[9] The franchise rights intangibles are: brand development and positioning, advertising and marketing, restaurant design and specifications, restaurant re-imaging, food and menu development, supply chain, operating platform and systems (including training intangibles), systems implementation, franchising administration, business analysis, quality assurance, human resources, legal.

[10] According to the information submitted by Luxembourg to the Commission, the US Franchise Branch does not employ any direct staff.

activities associated with the franchise rights[11] and who is provided by McDonald's Corporation on a part-time basis under a services agreement in return for a cost-plus charge determined in that services agreement. The US Franchise Branch management services are services related to the management of the branch […][12] [13].

(32) According to the initial ruling request, McD Europe's Swiss Service Branch has its registered office in Geneva, Switzerland. That branch licences the franchise rights to franchisors in various European countries[14] (hereinafter: "Master Franchisors") and provides management, support, development, and other similar or related services associated with the franchise rights.[15] In exchange for those services, the US Franchise Branch reimburses the Swiss Service Branch for all its costs and provides the Swiss Service Branch with a service fee equivalent to the costs of the Swiss Service Branch plus […] percent.[16]

(33) The primary individuals employed, seconded or contracted for by the Swiss Service Branch are the "Key European Management". At the time that the contested tax rulings were issued in 2009, […] persons were employed by the Swiss Service Branch; in 2014, that branch had […] employees. Although the Swiss Service Branch pays the costs related to those individuals, including salaries/bonuses expenses, according to the initial ruling request those costs are ultimately borne by the US Franchise Branch through a reduction in the royalties paid through the Swiss Service Branch to the US Franchise Branch.

(34) Finally, according to the initial ruling request, McD Europe, with its principal place of business in Luxembourg, will provide through its managers' meetings general and administrative services, setting up of business strategies and other support services. A fee of EUR […] per year is to be paid by the US Franchise Branch to McD Europe for those services.[17]

(35) In 2013, out of McD Europe's [10-20] average employees, […] were located in Luxembourg and the rest at the Swiss Service Branch. In 2014, out of McD Europe's [10-20] average employees, […] were located in Luxembourg, including McD Europe's European Corporate Counsel. Before 2012, all of McD Europe's employees were located at the Swiss Service Branch.

2.3.1.2. Payments between the branches and the head office described in the initial ruling request

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[11] Such as coordinating the cost sharing agreement between McD Europe and McDonald's Corporation which covers the franchise rights associated with McDonald's European region; performing the accounts payable and accounts receivable function of the branch, maintaining branch accounts in US GAAP.

[12] Appendix 4 to the initial ruling request.

[13] Appendix 5 to the initial ruling request […].

[14] *[List of franchisors in various European countries]*.

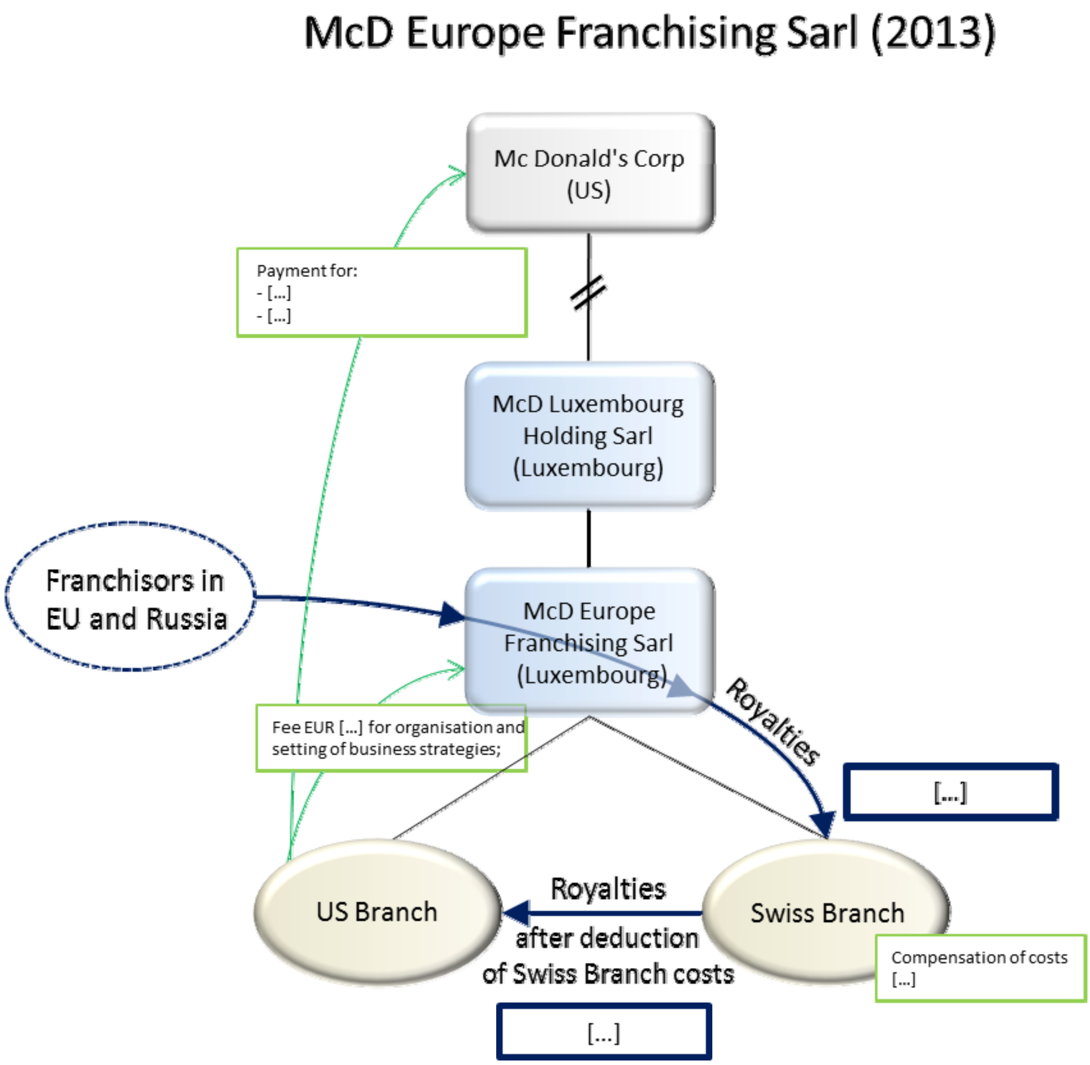
[15] In particular, the services are expected to include management and strategic assistance associated with financial operations, operating platform management, supply chain design, real estate development, restaurant design, menu management, local market trend analysis, human resources, quality assurance and marketing, all associated with the European operations.

[16] Appendix 8 to the initial ruling request.

[17] Appendix 6 to the initial ruling request.

(36) The Swiss Service Branch receives royalty income from the Master Franchisors. The royalty income received by the Swiss Service Branch is paid to the US Franchise Branch. The costs associated with the services provided by the Swiss Service Branch are reflected in a reduction of the royalties paid by the Swiss Service Branch to the US Franchise Branch. The royalty payments and the compensation payments are illustrated in Figure 1 below.

Figure 1 – Payments relating to franchise rights between Luxembourg Head Office, the Swiss Service Branch and the US Franchise Branch (compensations amounts according to Appendices to the initial ruling request and royalty amounts based on the 2013 Swiss Service Branch accounts)



(37) The main profitability information in McD Europe's financial statements as provided by Luxembourg are presented in Table 1 below:

Table 1 – Financial information of McD Europe for years 2010-2013

USD	2010	2011	2012	2013
Net turnover	[700 000 000-900 000 000]	[900 000 000-1 100 000 000]	[900 000 000-1 100 000 000]	[900 000 000-1 100 000 000]
Other external charges[18]	[500 000 000-700 000 000]	[600 000 000-800 000 000]	[500 000 000-700 000 000]	[500 000 000-700 000 000]
Profit	[40 000 000-60 000 000]	[160 000 000-180 000 000]	[160 000 000-180 000 000]	[270 000 000-290 000 000]

(38) Since the Swiss Service Branch and the US Franchise Branch are part of the same legal entity – McD Europe, which has consolidating accounts in Luxembourg – McD Europe's financial statements include both of those branches. […].

Table 2 – Financial information of the Swiss Service branch for years 2010-2013

CHF	2010	2011	2012	2013
Royalties billed to Switzerland and other countries	[…]	[…]	[…]	[…]
Royalties billed by the US Franchise Branch	[…]	[…]	[…]	[…]
Total income reported[19]	[…]	[…]	[…]	[…]
Total expense	[…]	[…]	[…]	[…]
Profit according to ruling[20]	[…]	[…]	[…]	[…]

(39) Unlike the Swiss Service Branch's accounts, the US Franchise Branch's accounts do not provide an overview of the aggregate profit and loss items. Rather, they list the income and expense on individual accounts. According to those accounts, the largest income for years 2012 and 2013 recorded by the US Franchise Branch was the royalty payments from a […] intercompany account in the amount of USD […] million and USD […] million in 2012 and 2013 respectively. Royalty income reported on a […] intercompany account amounted to USD […] million. The largest recorded expense in 2013 would be the USD […] million reported as a buy-in payment relating to franchise rights. It is not clear why royalty payments on European country intragroup accounts are reported

18 Other external expenses consist of cost sharing expenses, royalty expenses and management fees.

19 Total income reported is presented as the difference between the royalties billed to Europeans countries and Switzerland and the royalties billed by the US Franchise Branch, to this difference interest income is added.

20 It is not clear from the accounts of the Swiss Service Branch whether reference is being made to tax rulings obtained in Luxembourg or another ruling. Expenses of the Swiss Service Branch are deducted from this total income to arrive at the profit, which is presented in the accounts to correspond to 10% of costs of the branch. A small difference between taxable profit and the difference between total income and total expense is due to interest income.

directly in the US Franchise Branch's accounts, as they also seem to appear in the Swiss Service Branch's accounts.

2.3.1.3. Luxembourg tax implications described in the initial ruling request

(40) According to McDonald's tax advisor, McD Europe should be considered as tax resident in Luxembourg pursuant to Article 159(1) of the L.I.R. McD Europe is thus fully liable for corporate income tax in Luxembourg. However, as a Luxembourg tax resident, McD Europe also benefits from all of the provisions of any double tax treaty concluded by Luxembourg.

(41) Furthermore, according to the tax advisor, by virtue of Article 5 of the Luxembourg–US DTT, the activities of US Franchise Branch will be considered to be performed in the United States. Consequently, the profits generated by the US Franchise Branch will only be subject to possible taxation in the United States and exempt from corporate income tax in Luxembourg by virtue of Articles 7 and 25 of the Luxembourg–US DTT.

(42) Similarly, according to the tax advisor the activities performed by the Swiss Service Branch, i.e. the sub-licensing of the franchise rights to the Master Franchisors, are considered to be performed in Switzerland by virtue of Article 5 of the Luxembourg-Switzerland DTT.[21] As a consequence, the profits generated by the Swiss Service Branch will only be taxable in Switzerland and exempt from corporate income tax in Luxembourg by virtue of Articles 7 and 25 of the Luxembourg–Switzerland DTT.

2.3.1.4. Confirmation by the Luxembourg tax administration

(43) The initial ruling request concludes with the request to the Luxembourg tax administration to confirm its agreement of the tax advisor's understanding of the Luxembourg tax implications of the transactions described therein.

(44) In a letter dated 30 March 2009 (the initial tax ruling), the Luxembourg tax administration confirmed that McD Europe is to be considered tax resident in Luxembourg and, as such, can benefit from the DTTs currently in force. Furthermore, the Luxembourg tax administration confirmed that, in light of the explanations provided in the initial ruling request, the Swiss Service Branch and the US Franchise Branch constitute permanent establishments (hereinafter "PEs"). The Luxembourg tax administration therefore accepts that the profits of McD Europe that are imputable to those two branches are subject to tax in their respective countries and tax exempt in Luxembourg. The initial tax ruling subsequently concludes that "*in order to benefit from these exemptions in Luxembourg, the company [McD Europe] must submit proof on a yearly basis that those profits have been declared and are subject to tax in Switzerland and the United States respectively*".[22]

2.3.2. The revised tax ruling

2.3.2.1. The request for a revised tax ruling

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21 Convention entre le Grand-Duché de Luxembourg et la Confédération suisse en vue d'éviter les doubles impositions en matière d'impôts sur le revenu et sur la fortune, signed at Bern on 21 January 1993.

22 In the original French: "*En vue de bénéficier de ces exonérations au Luxembourg, la société [McD Europe] doit annuellement apporter la preuve que ces revenus et biens ont été déclarés et soumis aux impôts respectivement en Suisse et aux Etats-Unis.*"

(45) In response to the initial tax ruling, McD Europe’s tax advisor provided a detailed analysis to the Luxembourg tax administration on whether the US Franchise Branch effectively constitutes a PE from a US tax perspective, on the one hand, and from a Luxembourg tax perspective, on the other.

(46) On the one hand, McD Europe’s tax advisor explains that based on US domestic law and although the US Franchise Branch has a fixed place of business through which the branch manager conducts certain activities, the US Franchise Branch does not constitute a PE for US tax purposes: “*even though the branch (a) holds the franchise rights associated with the group’s European region, (b) assumes various economic risks associated with the development and maintenance of the franchise rights acquired, and (c) conducts certain activities associated with the franchise rights, the global McDonald’s organisation view the primary business operations as performed through other members of the group and does not consider the activities of the branch as constituting a US trade or business.*”[23]

(47) On the other hand, the tax advisor explains that as regards the Luxembourg tax perspective and, in particular, the Luxembourg–US DTT, Article 5(1) of that DTT defines a PE as a “*fixed place of business through which the business of an enterprise is wholly or partially carried on*”. According to Article 3(2), the term “business” in that provision should generally be given the meaning which it has under the domestic law of the contracting State that applies that DTT.

(48) McD Europe’s tax advisor further explains that if under Luxembourg tax law (see recital (49)) the activities of the US Franchise Branch fall under the definition of a “business” or “PE”, “*then Luxembourg would expect that the income may be taxed in the US because it may be treated as a PE from a Luxembourg tax perspective. There is however no requirement that the other contracting state (US) effectively taxes this income. Article 25(2)(a) of the DTT provides that Luxembourg will exempt from tax income that ‘may be taxed in the United States*”. According to the tax advisor, “*there is however no requirement that the other contracting state (US) effectively taxes this income*”.[24]

(49) McD Europe’s tax advisor then proceeds to analyse whether under Luxembourg tax law the activities of the US Franchise Branch constitute a “business”. The tax advisor concludes that, based on the facts and circumstances of the specific case, the US Franchise Branch carries on an established business through a fixed place and qualifies as a PE under Luxembourg law. More particularly, according to the tax advisor under Article 16 of the Tax Adaptation Law the activities of the US Franchise Branch constitute an established business which is conducted through a fixed place. According to the tax advisor, in conjunction with the interpretation of the Luxembourg–US DTT from a Luxembourg tax perspective (see recitals (46) and (47)), “*one should come to the conclusion that the [US Franchise Branch] carries on intellectual property activities through a US PE by virtue of Article 5 of the US–Luxembourg Treaty.*”[25]

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23 P. 3 of the request for a revised ruling.
24 P. 4 of the request for a revised ruling.
25 P. 8 of the request for a revised ruling.

(50) The tax advisor's detailed analysis concludes with a request to the Luxembourg tax administration to confirm its agreement of this conclusion by letter. The concluding sentence of the analysis states "*[t]his letter would supersede your confirmation letter dated 30 March 2009. Therefore, it would be much appreciated if this letter could also confirm our understanding of the Luxembourg tax implications as described in our letter dated 11 February 2009.*"[26]

2.3.2.2. The revised tax ruling issued by the Luxembourg tax administration

(51) By letter of 17 September 2009 (the revised tax ruling), the Luxembourg tax administration confirmed its agreement with the tax advisor's interpretation of the Luxembourg–US DTT in the request for a revised tax ruling as regards the tax treatment under Luxembourg law of the profits generated by McD Europe's US Franchise Branch in the United States.

2.4. Non-taxation of the US branch

(52) At the request of the Commission, Luxembourg provided the US income tax returns of the US Franchise Branch for the period 2009 to 2013. For each of those years, *[content of the US tax returns*]. To the question included in the tax forms: *[content of the US tax returns*] McDonald's replied [*content of the US tax returns*]. McDonald's also replied [*content of the US tax returns*] in each of those tax returns to the question: [*content of the US tax returns*].

(53) In addition, Luxembourg provided the documentation showing that the US Franchise Branch had been subject to a tax audit in the United States by the IRS from February 2013 to February 2014 for the tax years 2009/2010. The IRS, after describing the business activity of the US Franchise Branch, refers to […].

(54) […] Whether or not the US Franchise branch constitutes a taxable presence in the US as being effectively connected to a US trade or business, i.e. whether the US actually exercises its taxing right under the DTT, is therefore irrelevant; there is no need to assess whether the nexus for taxation in the US is fulfilled (the "effectively connected to a US trade or business") under Luxembourgish law. Luxembourg knew or should have known of this assessment.

(55) Furthermore, in its tax returns for US income tax purposes, McDonalds stated that they did not have a permanent establishment for the purposes of any applicable tax treaty between the United States and a foreign country. In the Commission's views, Luxembourg therefore deliberately granted the ruling with a tax exemption under the Luxembourg-US DTT, although having all information necessary to be aware that no taxation would take place in the US, and although it seems that the US branch would not normally fulfil the criteria under Luxembourgish law to qualify as a permanent establishment.

3. POSITION OF LUXEMBOURG

(56) Luxembourg submits that the measures are fully in line with Luxembourg law and do not constitute State aid. Given that the contested tax rulings merely constitute an

[26] P. 8 of the request for a revised ruling.

interpretation of the relevant provisions of Luxembourg law, they cannot lead to a discriminatory treatment of taxpayers. According to Luxembourg, there exists a distinction between the exercise of discretion when issuing a tax ruling and the mere interpretation of a legal provision. Tax administrations need to be allowed a certain degree of flexibility when applying the provisions of their tax law to cases of individual taxpayers. When doing so, and where the national tax administrations do not deviate from the generally applicable tax provisions, there cannot be any State aid. Thus, the Commission can only intervene when either the tax ruling deviates from the tax ruling practice of the tax administration, international fiscal conventions or OECD principles, or the tax administration has committed a manifest error in its analysis of legal, economic or factual elements leading to the tax ruling.

(57) As regards the fiscal treatment of the US Franchise Branch and the Swiss Service Branch, Luxembourg claims that pursuant to the DTTs Luxembourg concluded with the United States and Switzerland, the presence of McD Europe in the United States and Switzerland, respectively, constitutes a PE. In line with the provisions of those DTTs, the profits derived at the level of the PEs are exempt from corporate income tax in Luxembourg.[27] Moreover, the decision to allocate the franchise rights to the US Franchise Branch was justified since it is that branch that bears all the risks related to those franchise rights (see recital (31)). That branch assures control of the intellectual property registered in the United States.

(58) Furthermore, Luxembourg confirms that none of the five companies of the McDonald's group in Luxembourg (see recital (16)) claims benefits pursuant to Article 50bis of the L.I.R. which provides for an 80% tax exoneration on certain intellectual property revenue.[28]

(59) In response to the information forwarded by the Commission from the coalition of trade unions (see recital (7)), Luxembourg considers that this information is without substance and therefore irrelevant for the tax treatment of McD Europe by the Luxembourg tax administration.

(60) With respect to the allocation of the franchise rights, Luxembourg states that where legal ownership of an asset has been transferred to, for instance, a subsidiary, also the profits derived from the legal ownership should be allocated to that subsidiary. However, the transfer of legal ownership is not possible between a head office and its branch. In that case, there is a legal fiction of the head office and the branch being distinct legal entities and the revenues of the branch are exempt from corporate income tax under the DTT as they would be in the case of a subsidiary.[29]

4. ASSESSMENT OF THE CONTESTED MEASURES

4.1. Existence of aid

(61) According to Article 107(1) TFEU, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by

[27] Letter of Luxembourg of 4 August 2014.

[28] Letter of Luxembourg of 4 August 2014.

[29] Letter of Luxembourg of 23 April 2015.

favouring certain undertakings or the provision of certain goods shall be incompatible with the internal market, in so far as it affects trade between Member States.

(62) According to the settled case-law of the Court of Justice of the European Union, for a measure to be categorised as aid within the meaning of Article 107(1) of the Treaty, all the conditions set out in that provision must be fulfilled.[30] It is thus well established that, for a measure to be categorised as State aid within the meaning of that provision, there must, first, be an intervention by the State or through State resources; second, the intervention must be liable to affect trade between Member States; third, it must confer a selective advantage on an undertaking and, fourth, it must distort or threaten to distort competition.[31] Notwithstanding the competence of the Member State over their systems of taxation, tax measures are not excluded from the scope of Article 107(1) TFEU.[32]

(63) As regards the first condition for a finding of State aid, the revised tax ruling was issued by the Luxembourg tax administration (*Administration des contributions directes*), which is an organ of the Luxembourg State. It is thereby irrelevant that the Luxembourg–US DTT constitutes a bilateral treaty as the aid measure in this case, i.e. the tax ruling, derives from a unilateral act of the Luxembourg tax administration.[33] That tax ruling is used by McD Europe to determine its yearly corporate tax liability in Luxembourg. The ruling confirms that the revenues of McD Europe's PEs in the United States and Switzerland (i.e. the US Franchise Branch and the Swiss Service Branch) are subject to tax in those two countries and therefore exempt from corporate income tax in Luxembourg. In other words, the ruling reduces McD Europe's corporate tax liability in Luxembourg and therefore gives rise to a loss of State resources. That is because any revenues of McD Europe declared tax-exempt in Luxembourg results in a loss of tax revenue that would otherwise have been available to Luxembourg[34].

(64) As regards the third and fourth conditions for a finding of aid, McD Europe is part of the McDonald's Corporation, a globally active firm that operates in numerous Member States of the Union. Any aid in its favour distorts or threatens to distort competition and has the potential to affect intra-Union trade.

(65) As regards the second condition for a finding of aid, to the extent it can be shown that the revised tax ruling results in an unjustified lowering of McD Europe's tax liability in Luxembourg as compared to economic operators in a comparable factual and legal situation, that ruling will be considered to confer a selective advantage upon McD Europe and the McDonald's Corporation.

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30 Case C-399/08 P *Commission v Deutsche Post* ECLI:EU:C:2010:481, paragraph 38 and the case-law cited.

31 Case C-399/08 P *Commission v Deutsche Post* ECLI:EU:C:2010:481, paragraph 39 and the case-law cited.

32 Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384, of 10.12.1998, p. 3. See also Joined Cases C-182/03 and C-217/03 *Belgium and* Forum 187 ASBL v Commission, ECLI:EU:C:2006:416, paragraph 81.

33 It should be noted that outside the scope of application of the Luxembourg–US DTT, Luxembourg applies the foreign tax credit method to the extent and in the amount of tax paid abroad.

34 See Joined Cases C-106/09 P and C-107/09 P *Commission v. Government of Gibraltar and United Kingdom*, ECLI:EU:C:2011:732, paragraph 72 and the case-law cited.

4.2. Existence of a selective advantage

(66) According to settled case-law, "*Article 107, paragraph 1 of the Treaty requires it to be determined whether, under a particular statutory scheme, a State measure is such as to favour 'certain undertakings or the production of certain goods' in comparison with others which, in the light of the objective pursued by the scheme in question, are in a comparable legal and factual situation. If it is, the measure concerned fulfils the condition of selectivity.*"[35]

(67) In fiscal cases, the Court of Justice has devised a three-step analysis to determine whether a particular tax measure is selective.[36] First, the common or normal tax regime applicable in the Member State is identified: "the reference system". Second, it is determined whether the tax measure in question constitutes a derogation from that system, in so far as it differentiates between economic operators who, in light of the objectives intrinsic to the system, are in a comparable factual and legal situation. If the measure constitutes a derogation from the reference system, it is then established, in the third step of the analysis, whether that measure is justified by the nature or the general scheme of the reference system. A tax measure which constitutes a derogation to the application of the reference system may be justified if the Member State concerned can show that that measure results directly from the basic or guiding principles of that tax system.[37] If that is the case, the tax measure is not selective. The burden of proof in that third step lies with the Member State.

4.2.1. Determination of the reference system

(68) As a general rule, for the purposes of the selectivity analysis a reference system is composed of a consistent set of rules that apply on the basis of objective criteria to all undertakings falling within its scope as defined by its objective.

(69) In the present case, the Commission considers the reference system to be the general Luxembourg corporate income tax system, which has as its objective the taxation of profits of all companies subject to tax in Luxembourg.[38] The Luxembourg corporate income tax system applies to domestic and foreign companies tax resident in Luxembourg.

(70) More specifically, according to Article 159 L.I.R. capital companies that have either their registered office or their place of central administration in Luxembourg are subject to corporate income tax on their profits.[39] Domestic and foreign companies tax resident in Luxembourg are thus liable to corporation tax on their worldwide profits[40], unless a tax treaty applies.

(71) Luxembourg corporate income tax is payable on profits realised minus tax-deductible expenses and losses, which may be carried forward indefinitely. For the determination

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35 See C-172/03 *Heiser* ECLI:EU:C:2005:130, paragraph 40.

36 See Joined Cases C-78/08 to C-80/08 *Paint Graphos* ECLI:EU:C:2009:417.

37 See Joined Cases C-78/08 to C-80/08 *Paint Graphos* ECLI:EU:C:2009:417, paragraph 65.

38 See also Joined Cases C-78/08 to C-80/08 *Paint Graphos* ECLI:EU:C:2009:417, paragraph 50.

39 Article 159 further clarifies that limited liability companies ("société à responsabilité limité" or "S.à.r.l") qualify as a capital company.

40 Article 159 L.I.R. reads: "*L'impôt sur le revenue des collectivités porte sur l'ensemble des revenus du contribuable.*"

of the taxable profit, in principle, the commercial accounts of the taxpayer are followed, subject to adjustments imposed by Luxembourg tax law mainly relating to dividend/capital gains exemption, add-back expenses[41], corrections to the tax result from transactions not executed at arm's length, and the application of different depreciation rules under tax and accounting rules.

(72) The Commission is therefore of the opinion that with respect to the revised tax ruling, the Luxembourg corporate income tax system constitutes the reference system against which that ruling should be examined for the presence of a selective advantage for the purposes of Article 107(1) TFEU. In this regard, the Luxembourg corporate tax system should also be considered to include the double tax treaties to which Luxembourg is a party.

4.2.2. Selective advantage due to a derogation from Luxembourg tax law and the Luxembourg–US DTT in the revised tax ruling

(73) Having determined that the Luxembourg corporate income tax system constitutes the applicable reference system, it is necessary to establish whether the revised tax ruling gives rise to a derogation from that system leading to an unequal treatment of McD Europe as compared to economic operators that are factually and legally in a similar situation.

(74) In relation to that second step of the selectivity analysis, whether a tax measure constitutes a derogation from the reference system will generally coincide with the identification of the advantage granted to the beneficiary under that measure. Indeed, where a tax measure results in an unjustified reduction of the tax liability of a beneficiary who would otherwise be subject to a higher level of tax under the reference system, that reduction constitutes both the advantage granted by the tax measure and the derogation from the system of reference.

(75) According to the Court of Justice of the European Union, in the case of an individual aid measure, as opposed to a scheme, "*the identification of the economic advantage is, in principle, sufficient to support the presumption that it is selective*"[42].

(76) McD Europe is tax resident in Luxembourg. Therefore, in accordance with Article 159 L.I.R., McD Europe is liable to Luxembourg corporation tax on its worldwide profits, including those profits attributed to its Swiss Service Branch and its US Franchise Branch, unless a double tax treaty applies which exempts those profits from Luxembourg corporate income tax.

(77) In the initial tax ruling request, McDonald's tax advisor claimed that McD Europe's US Franchise Branch constitutes a permanent establishment and that the franchise right exploitation by that branch is considered to be performed in the United States in accordance with Article 5 of the Luxembourg–US DTT. According to the tax advisor, the profits generated by McD Europe's US Franchise Branch are only subject to possible taxation in the United States and therefore exempt from corporate income tax

[41] E.g. interest expenses on assets generating tax-exempt income or directors' fees, which are not for the day-to-day running of the company.

[42] Case C-15/14 P *Commission v MOL* ECLI:EU:C:2015:362, paragraph 60; See also, Case T-385/12 *Orange v Commission* ECLI:EU:T:2015:117.

in Luxembourg by virtue of Articles 7 and 25 of the Luxembourg–US DTT. Consequently, in the initial tax ruling, the Luxembourg tax administration confirmed that McD Europe is to be considered tax resident in Luxembourg benefitting from the Luxembourg–US DTT currently in force and that its US Franchise Branch constitutes a permanent establishment whose profits are subject to tax in the United States and, on the condition that McD Europe "*submits proof on a yearly basis that those profits have been declared and are subject to tax in […] the United States*", those profits are tax exempt from corporate income tax in Luxembourg by virtue of that DTT.

(78) In the request for a revised tax ruling, McDonald's tax advisor clarified that the US Franchise Branch does not constitute a permanent establishment for US tax purposes,[43] but that it only constitutes a permanent establishment under Luxembourg tax law.[44] According to the tax advisor, since the activities of the US Franchise Branch fall under the definition of a permanent establishment under Luxembourg tax law, "*Luxembourg would expect that the income may be taxed in the US because it may be treated as a PE from a Luxembourg tax perspective. There is however no requirement that the other contracting state (US) effectively taxes this income.*" The tax advisor further argues that since Article 25(2)(a) of the Luxembourg–US DTT exempts from Luxembourg corporate income tax income that "*may be taxed in the United States*", there is "*no reference that there effective taxation should occur*."[45] In the revised tax ruling, the Luxembourg tax administration confirmed that interpretation of those legal provisions.

(79) At this stage, the Commission considers that the tax advisor's interpretation of the Luxembourg–US DTT in the request for a revised tax ruling, as confirmed by the Luxembourg tax administration in the revised tax ruling, 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. Rather, the Commission considers the initial tax ruling to reflect a proper interpretation of those provisions.

(80) According to paragraph 22 of the Commission Notice on Direct Business Taxation[46], a decision of a tax administration that departs from the general rules of taxation to the benefit of an individual undertaking in principle leads to a presumption of State aid and must be analysed in detail. In particular, a tax ruling that has been issued in contradiction to the applicable tax provisions resulting in a lower tax liability for its addressee than what would have been the case if the general rules of taxation had been properly applied gives rise to a selective advantage to that undertaking. Accordingly, the misapplication of the Luxembourg–US DTT and the national provisions transposing that DTT by the Luxembourg tax administration in the revised tax ruling, if confirmed, results in the grant of a selective advantage in favour of McD Europe due to a derogation from the applicable legal provisions of the general Luxembourg corporate income tax system to the extent that it results in a reduction of that undertaking's tax liability in Luxembourg as compared to economic operators that are in a comparable

[43] See Recital (46).

[44] In the initial ruling request, the law under which the tax advisor considers the branch to constitute a PE was not specified.

[45] P. 4 of the request for a revised ruling.

[46] Commission Notice on the application of the State aid rules to measures relating to direct business taxation, OJ C 384, 10.121998, p. 3.

factual and legal situation and whose profits are subject to Luxembourg corporate income tax by virtue of Article 159 L.I.R. or exempt from Luxembourg corporate income tax by virtue of the proper application of a double tax treaty.

(81) In the present case, whereas McD Europe is considered a "disregarded entity" for US tax purposes and therefore not considered tax resident in the United States,[47] for Luxembourg tax purposes, as a *société à responsabilité limité*, McD Europe is considered a Luxembourg tax resident. Accordingly, pursuant to Article 159 L.I.R., McD Europe is taxable in Luxembourg on its worldwide income.

(82) In the case of a tax resident company that is taxable on its worldwide income but performs business activity abroad, Luxembourg can either unilaterally provide a foreign tax credit or, where a tax treaty applies, apply the relevant provisions of that tax treaty. As a Luxembourg tax resident company, McD Europe benefits from all double tax treaties concluded by Luxembourg, including the Luxembourg–US DTT.[48] Article 1 of the Luxembourg–US DTT provides, as regards it scope of application, that "*[t]his Convention shall apply only to persons who are residents of one or both of the Contracting States, except as otherwise provided in the Convention*". Thus, McD Europe is covered by the Luxembourg–US DTT.

(83) In the tax ruling requests, McDonald's tax advisor relies in particular on Article 25(2) of the Luxembourg–US DTT to exempt the profits attributed to the US Franchise Branch from Luxembourg corporate income tax. That provisions provides: "*In Luxembourg double taxation shall be eliminated as follows: (a) where a resident of Luxembourg derives income or own capital which, in accordance with the provisions of this Convention, may be taxed in the United States, Luxembourg shall [...] exempt such income or capital from tax […]*." Thus, in the present case, relief from double taxation of income generated by McD Europe is not provided via a foreign tax credit, but by exempting under the Luxembourg–US DTT McD Europe's income "*that may be taxed in the United States*."

(84) To justify that exemption, McDonald's tax advisor interprets Article 25(2) of the Luxembourg-DTT in its request for a revised tax ruling in such a manner that since the US Franchise Branch constitutes a PE under Luxembourg tax law, the profits attributed to it should be exempt from Luxembourg corporate income tax, irrespective of whether it also constitutes a PE under US tax law. According to the tax advisor, it is sufficient that Luxembourg "*would expect that the income may be taxed in the US*" because of the existence of a PE, without any requirement of effective taxation. In other words, the tax advisor considers only the definition of a PE under Luxembourg domestic law to be relevant for the application of that provision and not whether the branch also constitutes

47 For US tax purposes, a "disregarded entity" is a business entity that is separate from its owner but which elects to be disregarded as separate from the business owner for federal tax purposes. This status is relevant for "check-the-box" elections. A foreign eligible entity whose owners have limited liability will be treated by default as a corporation for US tax purposes. By making a check-the box election on IRS Form 8832, that entity can elect to be considered a "disregarded entity".

48 This was confirmed by the Luxembourg authorities in the initial tax ruling which reads: "*La s.à.r.l. MCD Europe Franchising est actuellement consideréé comme collectivité pleinement imposable au Luxembourg. Les restructurations décrites dans votre courrier n'affectent en rien la qualité de contribuable résident pleinement imposable de la société. En tant que telle, elle bénéficie des conventions contre les doubles impositions actuellement en vigueur.*"

a PE under the laws of the United States. Thus, according to the tax advisor, the fact that US tax law does not consider the US Franchise Branch to constitute a PE should not prevent the application of the exemption from Luxembourg corporate tax of the foreign business income under the Luxembourg–US DTT.

(85) The consequence of the Luxembourg tax administration's confirmation of that interpretation in the revised tax ruling is that the income attributed by McD Europe to its US Franchise Branch is neither taxed in the United States nor in Luxembourg. It is not taxed in the United States because the US Franchise Branch does not constitute a PE under US tax law, nor is it taxed in Luxembourg since the Luxembourg tax administration has agreed to exempt foreign income attributed to a US branch for the sole reasons that it qualifies as a PE under Luxembourg's domestic tax law[49].

(86) However, that interpretation of the Luxembourg–US DTT seems neither faithful to the wording of its provisions nor their objective. Article 25 of the Luxembourg–US DTT prescribes that where a tax resident of Luxembourg derives foreign income which, "*in accordance with the provisions of this Convention, may be taxed in the US*", Luxembourg shall exempt such income from tax. To determine whether the income "*may be taxed in US (…) in accordance with provisions of this Convention*", reference should be made to Article 7 of the Luxembourg–US DTT, which deals with business income.

(87) Article 7 provides that the "*business profits of a Contracting State (the Country of Residence) shall be taxable only in that State (i.e. Luxembourg) unless the enterprise carries on business in the other Contracting State (i.e. US, the Source State) through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in the other State (i.e. US) but only so much of them as are attributable to that permanent establishment.*" Thus, the United States (Source State) may only tax that income to the extent that a PE exists to whom the business profits can be attributed, otherwise those profits are taxable only in Luxembourg. Consequently, if no PE is present in the United States, the United States may not tax that income under the DTT.

(88) The Commission does not consider that the requirement of "may be taxed" in Article 25(2) of the Luxembourg–US DTT should be read as a requirement to be effectively taxed. As double tax treaties are aimed at avoiding double taxation, they do not oblige contracting States to effectively impose taxes. Rather, the decisive element is whether the Source State (the United States) may tax the income in question under the tax treaty because of the existence of a PE subject to tax in the United States, not that the United States actually imposes taxes pursuant to its domestic tax law on that income.

(89) In the case of McD Europe, the profits attributed to the US Franchise Branch cannot be taxed in the United States. Since the US Franchise Branch does not constitute a permanent establishment for US tax purposes, the United States cannot tax any income attributed to that branch. In other words, there is no possibility that those profits "may

[49] The income attributed to the US Franchise Branch is all royalties with the deduction of the costs and remuneration of the Swiss Service Branch. In fact the income from royalties is not declared in the total income of the Swiss Service Branch, only the difference between the income billed to Switzerland and other European countries and the income billed to the Swiss Service Branch by the US Franchise Branch is declared as income in Switzerland, see table in recital (38).

be taxed" by the United States within the meaning of Article 25(2) of the DTT. Since there is no possibility to tax the income of McD Europe in United States, as explained in the request for a revised tax ruling, the Luxembourg tax administration, being fully aware of this non-possibility of taxation, should not have agreed to the interpretation of the tax advisor which results in the exemption of the income attributed to the US Franchise Branch from corporate income tax in Luxembourg.

(90) The Commission's understanding of Article 25 of the Luxembourg–US DTT is in line with the OECD Commentaries on the Model Tax Convention (hereinafter: "MTC") with respect to conflicts of qualification, in particular, paragraph 32.6 thereof which comments on Article 23 A of the MTC.[50] Article 23 A of the MTC corresponds to Article 25 of the Luxembourg–US DTT and provides: "*Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax*." Paragraph 32.6 of the OECD Commentaries explains that: "*[t]he phrase 'in accordance with the provisions of this Convention, may be taxed' must also be interpreted in relation to possible cases of double non-taxation that can arise under Article 23 A. Where the Source State considers that the provisions of the Convention preclude it from taxing an item of income or capital which it would otherwise have had the right to tax, the State of residence should, for purposes of applying paragraph 1 of Article 23 A, consider that the item of income may not be taxed by the State of source in accordance with the provisions of the Convention, even though the State of residence would have applied the Convention differently so as to have the right to tax that income if it had been in the position of the State of source. Thus the State of residence is not required by paragraph 1 to exempt the item of income, a result which is consistent with the basic function of Article 23 which is to eliminate double taxation*."[51]

(91) Accordingly, to avoid conferring a selective advantage on McD Europe the Luxembourg tax administration should have only agreed to exempt income from corporate taxation to the extent that that income may be taxed in the United States pursuant to Article 7 of the Luxembourg–US DTT. That was also the conclusion reached by the tax administration in the initial tax ruling by which it required McD Europe to demonstrate that "*those profits have been declared and are subject to tax in […] the United States*" if it wished to benefit from the tax exemption resulting from Article 25(2) of the Luxembourg–US DTT. The fact that the Luxembourg tax administration was fully aware when it issued the revised tax ruling that the US Franchise Branch does not constitute a PE for US tax purposes, because that was explained in detail by McDonald's tax advisor in the request for a revised ruling, means that it was also fully aware that its business income may not be taxed in the United States as required by Article 7 of the Luxembourg–US DTT. Consequently, the Luxembourg tax administration confirmation that that income could be exempted from Luxembourg corporate income tax by virtue of Article 25 of the Luxembourg–US DTT rests on a misapplication of that provision.

[50] The same reasoning is also expressed in the following paragraph.
[51] Emphasis added.

(92) In conclusion, the Commission considers, at this stage, that the Luxembourg tax administration, by confirming in the revised tax ruling an erroneous interpretation of the Luxembourg–US DTT and the Luxembourg domestic law that transposes it, in full knowledge of the fact that the US Franchise Branch is not subject to taxation in the United States, confers a selective advantage to McD Europe for the purposes of Article 107(1) TFEU as compared to Luxembourg tax resident companies in a similar legal and factual situation that are taxed on all their accounting profits, since that erroneous interpretation results in the non-taxation of a sizeable portion of McD Europe's accounting profits.

4.2.3. Justification by the nature or general scheme of the tax system

(93) Luxembourg has not provided any possible justification for the selective treatment of McD Europe resulting from the revised tax ruling. The Commission recalls that the burden of establishing such a justification lies with the Member State.

(94) In any event, the Commission has not been able to identify any possible ground for justifying the preferential treatment that could be said to derive directly from the intrinsic, basic or guiding principles of the reference system or that is the result of inherent mechanisms necessary for the functioning and effectiveness of that system.[52]

4.2.4. Conclusion on the existence of aid

(95) For all the foregoing reasons, the Commission considers, at this stage, that the tax ruling issued by the Luxembourg tax administration on 17 September 2009 in favour of McD Europe constitutes State aid within the meaning of Article 107(1) TFEU.

4.3. Compatibility with the internal market

(96) As the measure appears to constitute State aid within the meaning of Article 107(1) TFEU, it is necessary to examine whether that aid could be considered compatible with the internal market.

(97) At this stage, the Commission has no indication that the treatment afforded to McD Europe as a result of the revised tax ruling could be considered compatible with the internal market. The Luxembourg authorities did not present any argument to indicate that any of the exceptions provided for in Article 107(2) and 107(3) TFEU apply in the present case.

(98) The Commission considers that the revised tax ruling appears to result in a reduction of charges that should normally be borne by the entity concerned in the course of its business, and should therefore be considered as operating aid. According to Commission practice, such aid cannot be considered compatible with the internal market in that it does not facilitate the development of certain activities or of certain economic areas, nor are the incentives in question limited in time, digressive or proportionate to what is necessary to remedy to a specific economic handicap of the areas concerned.

[52] Joined Cases C-78/08 to C-80/08 *Paint Graphos and others* ECLI:EU:C:2009:417, paragraph 69.

5. DECISION

In the light of the foregoing considerations, the Commission's preliminary view is that the tax ruling issued by the Luxembourg tax administration on 17 September 2009 in favour of McD Europe Franchising S.à.r.l. grants State aid to the latter and to the McDonald's Corporation as a whole within the meaning of Article 107(1) TFEU. The Commission also has doubts as to the compatibility of that State aid with the internal market. The Commission has therefore decided to initiate the procedure laid down in Article 108(2) TFEU with respect to that tax ruling.

The Commission requests Luxembourg to submit its comments on this decision and to provide all such information as may help to assess the contested tax rulings, within one month of the date of receipt of this letter. In particular, the Commission wishes to receive the following information:

- Please provide the financial accounts of McD Europe Franchising S.à.r.l. for the years 2009, 2010 and 2014;
- Please provide a breakdown of the costs reported in the financial accounts of McD Europe in the form of "other external charges" for the years 2009 to 2014;
- Please provide a breakdown of the income per type of income and per counterparty of the financial accounts of McD Europe Franchising S.à.r.l. for the years 2009 to 2014;
- Please provide the accounts of the Swiss Service Branch for the year 2014;
- Please explain all the positions in the accounts of the US Franchise Branch as provided by McDonald's to the Luxembourg tax administration and by the Luxembourg authorities to the European Commission in your letter dated 4 August 2014. Please provide a profit and loss statement and balance sheet of the US Franchise Branch in a format similar to the accounts of the Swiss Service Branch and the filed accounts of McD Europe Franchising S.à.r.l.

The Commission further requests Luxembourg to forward a copy of this letter to the potential beneficiary of the aid identified herein immediately.

The Commission wishes to remind Luxembourg that Article 108(3) of the Treaty on the Functioning of the European Union has suspensory effect, and would draw your attention to Article 16 of Council Regulation (EU) No 2015/1589,[53] which provides that all unlawful aid may be recovered from the recipient of that aid.

The Commission warns Luxembourg that it will inform interested parties by publishing this letter and a meaningful summary of it in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the *Official Journal of the European Union* and will inform the EFTA Surveillance Authority by sending a copy of this letter to it. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of

[53] OJ L 2015 L 248/9.

the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
Directorate H
State aid registry
1049 Brussels
Belgium
Fax : +322 296 12 42

Yours faithfully,

For the Commission

Margrethe VESTAGER
Member of the Commission