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EU Hunts McDonald's No-Tax Secret Sauce, Could End Love For Tax-Free Royalties

The EU wants the recipe for McDonald's tax deal with Luxembourg. The long discussed major investigation into McDonald's tax deals is now official, and that means mean more trouble for the iconic Golden Arches. The official opening of the investigation can hardly be a surprise. For six months now, observers have been asking whether McDonald's is next in line for European tax probe.

Formal investigations have already cast a cloud over Fiat and Amazon. McDonald's has been accused by some of avoiding up to $1 billion in taxes between 2009 and 2013 by virtue of its Luxembourg secret sauce. It as familiar royalty arrangement, and with stable jurisdictions offering the deals, it may be no wonder that McDonald's decided to partake. Of course, McDonald's has announced that it fully complies with the tax law. The company went on to defend itself by noting:

Ronald McDonald stands behind the counter during his appearance at a McDonalds (Photo credit should read PAUL J. RICHARDS/AFP/Getty Images)

> From 2010-2014, the McDonald's companies paid more than $2.1 billion just in corporate taxes in the European Union, with an average tax rate of almost 27 percent. Additionally, we pay social, real estate and other taxes. Our independent franchisees, who own and operate approximately 75 percent of our restaurants in Europe, also pay corporate tax and many other taxes."

At the center of the dispute is McDonald's Luxembourg franchise company, which the EU says has not paid tax since 2009. Yet the company receives hundreds of millions in royalty payments from across Europe and Russia for the right to use the brand and associated service. The profits and the sweetheart deal are incredible, enough to put a grin on Ronald McDonald's already smiling face.

Other companies have faced scrutiny, including Starbucks and Fiat Chrysler Automobiles. Apple's Irish tax deal and Amazon's Luxembourg one are also under attack. But the attack against McDonald's could get more testy. A collation of trade unions accuses the company of Golden Dodges: How McDonald's Avoids Paying its Fair Share of Tax. The report is by Public Services International (PSI), the International Union of Foodworkers and the Service Employees International Union (SEIU)

One fact making McDonald's a big target is that it is the world's larges fast food company. It is also the world's largest franchiser. McDonald's has 36,000 stores serving approximately 69 million customers a day. It had $87.8 billion in sales in 2014 alone. But some critics find it abusive that McDonald's generates much of its revenue as royalties from franchisees.

Part of the company's tax planning is to route the royalty payments through subsidiaries in tax-favored jurisdictions. Yes, that means tax havens. The Golden Dodges report claims that McDonald's did not disclose many of its tax haven companies in its annual report. Like Apple and many other companies, McDonald's is said to have a tidy offshore cash hoard, including a whopping $1.9 billion in Luxembourg alone.

McDonald's restructured its business affairs in 2009, after Luxembourg began allowing companies to pay a low tax rate on income from intellectual property. McDonald's set up a Luxembourg based intellectual property holding company. It also moved its headquarters from London to Geneva. The report says that McDonald's is being investigated over the deal it struck in Luxembourg.

With a kind of FATCA ‘let’s share data’ approach, the reports calls on foreign governments to investigate McDonald’s tax arrangements. And whatever they find, they should share, the report suggests. Meanwhile, as McDonald’s tax avoidance strategies in Europe are now being probed officially, it could like a decidedly unhappy meal. for supersizing the tax-favored royalty.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not intended as legal advice.