THE APPLE CASE: AN IRISH PERSPECTIVE

The European Commission’s decision that Ireland granted undue tax benefits of up to EUR13 billion (US$14.5 billion), plus interest, to Apple has sent shockwaves across the Atlantic and dealt a significant blow to EU/US economic relations. Ireland is caught in the middle of the cross-fire.

BACKGROUND

The decision is the conclusion of a two-year investigation by the EU Commission into the corporate tax affairs of Apple in Ireland. An EU competition law case, the decision centres on two tax rulings issued by Ireland to Apple in 1991 and 2007, which the Commission has concluded amount to illegal State Aid. The effect is that Ireland is now required by the Commission to recover unpaid taxes from Apple going back 10 years of up to EUR13 billion, plus interest. Both Apple and Ireland intend to appeal.

Under the Treaty on the Functioning of the European Union, “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings… shall, in so far as it affects trade between Member States, be incompatible with the internal market”. The Commission has concluded that the tax rulings granted by Ireland to two Apple companies conferred a selective advantage over other businesses that are subject to the same national taxation rules. In other words, the Commission’s decision effectively forces Ireland to levy back taxes on the basis of current rules which were not in force in Ireland at the time that the arrangements in question were in place. The retroactive nature of the decision will be a key ground of any appeal.

THE IRISH POSITION

While Ireland taxes Irish resident companies on their worldwide profits, non-Irish resident companies are only subject to corporation tax on the income attributable to their activities in Ireland. Ireland’s approach in agreeing the tax rulings was to tax Apple under the applicable Irish rules which required that the two Apple companies be taxed in Ireland on the basis of the income generated by their Irish branches only. As the remainder of the income of those companies was not generated by their Irish branches, it was not subject to tax in Ireland.

Transfer pricing rules and the “arm’s length principle” as set out in the OECD’s Transfer Pricing Guidelines were introduced in Ireland in 2010, almost two decades after the 1991 ruling, and three years after the 2007 ruling. Ireland also unilaterally amended its corporate tax residence rules in October 2013 to address a mismatch between the tax rules in Ireland and other jurisdictions (principally the US) which had resulted in so-called “stateless” companies. However, the Commission’s decision is effectively forcing Ireland to levy back taxes on the basis of current rules which were not in force in Ireland at the time that the arrangements in question were in place. The retroactive nature of the decision will be a key ground of any appeal.

EU STATE AID – A SHIFT IN APPROACH?

While less emotive than retroactivity, much of the legal argument of any appeal is likely to focus on the more nuanced interpretation of what constitutes State Aid and whether the Commission has departed from prior EU case law and Commission decisions. A key criterion of State Aid is that the advantage conferred by a Member State is selective, i.e. it favours certain undertakings or the production of certain goods. According to the Commission, the profit allocation method endorsed in the tax rulings amounted to selective tax treatment “because it gives Apple a significant advantage over other businesses that are subject to the same national taxation rules.” In its press release the Commission identifies this selective advantage as being a profit allocation that does not reflect economic reality and is not in line with the “arm’s length principle”. (At the time of writing the full text of the Commission decision is not publicly available and it could be several months before a redacted version is released.)

However, the approach of the Commission is regarded by some as novel and out of step with State Aid jurisprudence. In a White Paper released in advance of the Commission’s decision, the US Treasury asserted that the Commission has collapsed the distinct requirements of “advantage” and “selectivity” into a single requirement of whether the measures confer a “selective advantage” without separately examining the selective character of the advantage. As a result, the Commission’s new approach is to reduce a State Aid inquiry into whether it believes that a transfer pricing ruling satisfies “its view of the arm’s length principle”. This, the US Treasury claims, is a departure from the EU’s previous State Aid cases involving tax rulings cited by Commissioner Vestager as having been concluded since 1991 and appears to expand the role of the Commission’s Directorate-General (DG) for Competition into that of a “supra-national” tax authority that reviews Member State’s transfer pricing determinations.

COMMISSION OVERREACH?

Direct taxation remains within the competence of EU Member States. Member States retain sovereignty over their direct tax affairs as regards the manner and extent to which companies are taxed, subject to compliance with the EU’s fundamental freedoms and State Aid law. However, in seeking to rewrite Ireland’s tax rules and override its transfer pricing rulings, it is contended that the Commission is encroaching into the sovereign Member State competence of taxation.

Support for encroachment by the Commission beyond competition law is also implicit in the Commission’s announcement of its decision when it effectively invites other countries to claim some of the unpaid taxes for themselves. The apparent contradiction in the Commission requiring Ireland to tax the total sales profits of the two Apple companies, while acknowledging that the sums may in fact be taxable in other jurisdictions (including the US), is not lost on Ireland. The concept that Ireland would not be judged to have granted illegal State Aid if another jurisdiction had exercised taxing rights over the same profits is, according to the Irish Government, “difficult to understand”.

BEYOND THE HEADLINES

Unfortunately, few will see beyond the damaging headlines to Ireland’s reputation. However, the case is one of a series of State Aid investigations by the Commission since 2014 into perceived aggressive tax practices by a number of (mostly US headquartered) multinationals. In October 2015 the Commission concluded that Luxembourg and the Netherlands had granted selective tax advantages to Fiat and Starbucks, respectively. Investigations into tax rulings granted by Luxembourg to Amazon and McDonald’s are ongoing. The US sees these investigations as unfairly targeting US companies and the sheer quantum of the tax assessment in this decision significantly ups the ante.

While the decision requires Ireland to assess Apple for up to EUR13 billion, plus interest, of unpaid taxes, it is argued that US taxpayers could ultimately foot the bill. “Should Apple repatriate its profits back to the US, the tax paid in Ireland may be available as a foreign tax credit in the US to offset Apple’s US tax bill. Many blame the tax practices of multinationals on the US tax rules which permit US multinationals to defer US taxes on offshore income. However, the Commission’s decision may provide the impetus for US politicians to reach consensus on US tax reform and reduce the tax on profits repatriated to the US.

Despite the headlines, there are some positives for Ireland. The Commission has expressly stated that the decision “does not call into question Ireland’s general tax system or its corporate tax rate.” No fine or penalty is imposed on Ireland. No changes are required to Ireland’s tax regime and Ireland’s attractiveness as a competitive, low corporate tax and business-friendly jurisdiction should remain. Ireland’s intention to appeal the decision and defend the integrity of the Irish tax system will be welcomed by the international business community. The Irish Government’s position is clear: “Ireland did not give favourable tax treatment to Apple. Ireland does not do deals with taxpayers.”

A lengthy appeals process lies ahead which could take up to a decade to conclude.

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