APPLE IN EUROPE – THE UPHILL BATTLE CONTINUES

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Apple Inc. ("Apple") may owe up to $8 billion in back taxes if the European Commission (the "Commission") determines that Ireland's tax arrangements with Apple amount to unjustifiable State Aid in violation of E.U. anti-competition laws. If the Commission determines that Ireland provided a selective tax advantage, and thus illegal State Aid, to Apple, Ireland would be forced to recoup taxes from Apple over a ten-year period. The Commission could reach a decision in the spring.

U.S. officials assert that the European Commissioner for Competition, Margrethe Vestager, is targeting U.S. multinational companies and has no right to claim U.S. companies' offshore profits. Competition Commissioner Vestager rejects U.S. criticism and claims she is examining potential State Aid violations involving several non-U.S. companies. The Commission has been investigating various E.U. Member State's individual tax rulings with U.S. companies, including Starbucks in the Netherlands, Google in the U.K., and Amazon in Luxembourg. U.S. senators have recently been encouraging the U.S. Treasury Department to strike back by increasing taxes on European companies.

APPLE'S IRISH TAX AGREEMENTS

Irish tax officials issued letter rulings[1] or advance pricing agreements ("A.P.A.'s")[2] in favor of Apple in 1991 and 2007. These two rulings gave Apple guidance on how the company could attribute profits to its Irish branches of Apple Sales International and Apple Operations Europe. Apple calculated its taxable profits in accordance with the agreements and the Irish tax authorities determined that Apple's branch attributions were legal. Apple's foreign tax rate is less than 2% and it generates over half of its revenue outside the U.S.[3]

In June 2014, the Commission formally began investigating Ireland's tax rulings for Apple. According to the Commission's preliminary findings, Apple's A.P.A.'s with

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1 A tax letter ruling is a letter from a national tax authority to an individual company that either provides guidance on the interpretation of law or clarifies how the company's corporate tax will be calculated. State aid disputes target the latter if deemed to provide unjustified advantages to certain taxpayers. See Beate Erwin, "Tax Rulings in the European Union – State Aid as the European Commission's Sword Leading to Transparency on Rulings," *Insights* 6 (2015): pp. 13-14.

2 An A.P.A. is an agreement between a taxpayer and a national taxing authority that resolves potential disputes prior to a set of transactions amongst related parties over a fixed period of time.

3 Adam Satariano, "Apple May Face $8 Billion Tax Bill After Eurorpe Probe," *BNA Daily Tax Report*, January 15, 2016.

Ireland may have provided unfair tax advantages to the U.S. company in violation of State Aid laws. The Commission contends that the agreements allow Apple to calculate profits using more beneficial accounting methods since Apple can use low operating costs to determine its Irish taxes. Competition Commissioner Vestager doubts the legality of the agreements and is accusing Apple of using its Irish branches to avoid paying taxes on income generated outside the U.S.

The Commission must show that Apple unfairly benefited from its tax arrangements with Ireland in order to establish that Apple received illegal State Aid. If the Commission finds that Ireland's agreements provided a selective tax advantage to Apple, the company would be liable for back taxes for up to ten years. The amount that may be recovered from a recipient of State Aid is difficult to determine. According to Apple's U.S. Securities and Exchange Commission filing in April 2014, Apple anticipates that the amount of back taxes reflective of disallowed State Aid could be "material," which under U.S. securities law is 5% of a company's average pre-tax earnings for the last three years. If the Commission imposes harsher standards of accounting, Apple could be hit with a 12.5% tax rate on $64.1 billion of revenue earned from 2004 through 2012.[4]

Apple's potential $8 billion tax charge in Europe may be considered damages and not "tax" for purposes of double tax relief under U.S. tax law. Thus, such repayments of State Aid by a U.S. company do not automatically qualify for a foreign tax credit, and even if they do qualify, the amount of credit is limited.[5] U.S. companies facing State Aid charges from their European operations may thus be hit twice, with significant payments to European tax authorities that are only partially, or even not at all, offset by tax credits towards U.S. tax liabilities for the years at issue.

"The Irish government has indicated that it would initiate a legal battle against the Commission if it decides that Ireland's tax arrangement with Apple amount to unlawful State Aid."

The Irish government has indicated that it would initiate a legal battle against the Commission if it decides that Ireland's tax arrangement with Apple amount to unlawful State Aid and that it could challenge the Commission's decision in the E.U. Court of Justice.[6]

> As far as Ireland is concerned and we've been very clear about this – we've dealt with all the issues about reputational damage, about comments that Ireland was some sort of tax haven which was completely without foundation and utterly untrue.

Edna Kenny, Taoiseach (head of government) of Ireland, said in an interview with Bloomberg TV in Davos, Switzerland on January 21, 2016. "From our perspective we're very clear that our Revenue Commissioners have never done specific deals or a favorable deal with any particular company."[7]

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4 *Id.*

5 See Heather Self cited in "Apple tax State Aid decision expected before Christmas, says Irish Finance Minister," Out-law.com, November 10, 2015. The unanimous view amongst tax experts is that the nature of the State Aid back taxes is unclear at this time.

6 Joe Brennan, "Ireland Seen Losing Apple Tax Skirmish, Triggering Legal Battle," *Bloomberg Business*, September 4, 2015.

7 *The Irish Times*, January 21, 2016.

STATE AID

The Commission is concerned with anti-competitive tax practices by E.U. Member States. Accordingly, the Competition Commissioner has vowed to crackdown on corporate tax avoidance. The Commission estimates that tax evasion occurring throughout the E.U. costs about $1.11 trillion a year.[8]

The Commission does not have direct power over Member States' tax systems; however, it does have the power to investigate a national tax authority's actions that potentially infringe on E.U. laws. Member State's grant of a tax advantage to a certain company operating within its jurisdiction could amount to unlawful State Aid in violation of E.U. anti-trust laws. The Commission asserts that it is taking a structured approach when using its State Aid enforcement powers to investigate selective tax advantages that distort fair competition.[9]

As explained in a previous Insights article, "Tax Rulings in the European Union – State Aid as the European Commission's Sword Leading to Transparency on Rulings,"[10] State Aid is any aid granted by a Member State or through Member State resources, in any form whatsoever, that distorts or threatens to distort competition by favoring certain undertakings and is incompatible with the internal market as far as it affects the trade between Member States.[11] A measure qualifies as "State Aid" if the following conditions are met:[12]

- The relevant intervention is granted by a Member State or through Member State resources.[13]
- The intervention provides an economic advantage to the recipient.[14]
- The intervention affects or may affect competition and trade between the Member States.[15]
- The advantage is selective, *i.e.*, it is only granted to specific recipients.[16]

The Commission has the authority to review existing State Aid measures under

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8 *Id.*

9 Out-law.com, April 2015; Erwin, "Tax Rulings in the European Union," pp. 13-14.

10 *Id.*, pp. 13-14.

11 Treaty on the Function of the European Union ("T.F.E.U."), Art. 107, sec. 1; See Matthias Scheifele, "State Aid, Transparency Measures and Reporting Standards in the EU," in *The Corporate Tax Practice Series: Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Reorganizations & Restructurings*, ed. Louis S. Freeman (Practicing Law Institute, 2015).

12 Erwin, "Tax Rulings in the European Union," p. 13-14.

13 "Commission Notice on the Application of State Aid Rules to Measures Relating to Direct Business Taxation," *Official Journal C* 384 (December 10, 1998): p. 3, ¶10.

14 *Id.*, ¶9.

15 *Id.*, ¶10.

16 Jestaedt, §8 in European State Aid Law, ed. Martin Heidenhain (München: Verlag C.H. Beck, 2010).

T.F.E.U. art. 108(1).[17] If the Commission finds that an existing State Aid measure is incompatible with the internal market, it then decides whether the Member State granting the State Aid should amend or abolish the respective measure within a period of time determined by the Commission.[18] Under Council Regulation (E.U.) No. 734/2013, art. 14, illegal State Aid must be recovered from the recipient entity, and the recovery period is limited to ten years.[19]

Tax rulings or A.P.A.'s between a Member State's tax authority and an individual company are compliant with E.U. anti-trust laws if they serve as guidance on the respective tax authority's interpretation of the tax laws. However, such arrangements may involve State Aid and be in violation of E.U. anti-trust laws if a Member State's tax authority provides selective advantages to a specific company, or related companies, and such advantage is not justified by general economic development, as outline above.[20] Therefore, in order for the Commission to establish that Apple received illegal State Aid, it must show that Ireland provided a tax advantage to Apple and that Apple benefited from its tax arrangements.

U.S. REACTION

U.S. officials claim that the Commission is targeting U.S. multinational corporations in its State Aid investigations. In 2014 and 2015, the Commission initiated formal State Aid investigations involving the following U.S. companies: Apple in Ireland, Starbucks in the Netherlands, Fiat Finance & Trade in Luxembourg, Amazon in Luxembourg, and McDonald's in Luxembourg.[21] In 2016, the Commission determined that Belgium must recoup corporate taxes from unlawful State Aid, and the Commission may also investigate Google's recent tax settlement with the U.K.

Robert Stack, Deputy Assistant Secretary for International Tax Affairs at the U.S. Treasury Department, questions the "basic fairness" of Commissioner Vestager's examinations of U.S. multinational companies, and he asserts that the Commissioner is making unreasonable demands.[22] Other U.S. officials are also expressing concerns about the Commission's State Aid probes.

On December 1, 2015, the Senate Finance Committee held a hearing on "International Tax: O.E.C.D. B.E.P.S. and E.U. State Aid," during which Mr. Stack testified that the Treasury Department is concerned that the Commission's investigations

- appear to disproportionately target U.S. companies;
- potentially undermine U.S. rights under its bilateral tax treaties with E.U. Member States;
- take a novel approach in applying E.U. State Aid rules and apply that approach retroactively, rather than prospectively;

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17 Erwin, "Tax Rulings in the European Union," p. 14.

18 T.F.E.U., art. 108(2); Erwin, "Tax Rulings in the European Union," p. 14.

19 *Id.*, p. 15.

20 *Id.*, p. 16.

21 "European Commissioner Rejects U.S.'s Criticism of EU State Aid Probes Targeting U.S. MNEs," *Checkpoint International Taxes Weekly*, February 9, 2016.

22 Stephanie Bodoni, "U.S. Tax Official Criticizes EU Probes of American Companies," *BNA Snapshot*, January 29, 2016.

- could give rise to U.S. companies paying E.U. Member States billions of dollars in tax assessments that may be creditable foreign taxes, resulting in U.S. taxpayers "footing the bill;" and

- substantively amount to E.U. taxation of historical earnings that, under internationally accepted standards, no E.U. Member State had the right to tax.[23]

"Articulating their concerns about the impact of the Commission's State Aid investigations... the senators even requested that the President consider utilizing Code §891 to impose double tax rates on E.U. citizens or corporations."

The House Ways and Means Subcommittee on Tax Policy also held a hearing where Mr. Stack testified that the Treasury Department questioned the Commission's imposition of authority over Member States, as well as the right to go after offshore profits held by U.S. companies.[24]

On January 15, 2016, a bipartisan group of senators from the Senate Finance Committee wrote to Treasury Secretary Jacob Lew articulating their concerns about the impact of the Commission's State Aid investigations on U.S. policy. The letter, written by Senators Orrin G. Hatch (R-U.T.), Ron Wyden (D-O.R.), Rob Portman (R-O.H.), and Charles E. Schumer (D-N.Y.), stated:

> We recognize that the EU Commission believes it is on solid ground in pursuing these cases and enforcing EU competition law against its EU member states…It alarms us, however, that the EU Commission is using a non-tax forum to target U.S. firms essentially to force its member states to impose taxes, looking back as far as ten years, in a manner inconsistent with internationally accepted standards in place at the time. By all accounts, these cases have taken the member states, companies, and their advisors by surprise.[25]

The letter further urges the Treasury Department to caution the Commission. The senators even requested that the President consider utilizing Code §891 to impose double tax rates on E.U. citizens or corporations due to the E.U.'s "discriminatory or extraterritorial taxes" on U.S. citizens or corporations.[26]

On January 29, Deputy Secretary Stack met with three European Commission officials: Ditte Juul-Joergensen and Linsey McCallum, heads of Vestager's cabinet, as well as Gert-Jan Koopman, the Commission's Deputy Director-General for State Aid. During the meeting, Stack conveyed the U.S.'s enumerated concerns that the Commission's State Aid investigations single out U.S. companies.[27]

Although Commissioner Vestager did not attend the meeting with Stack, she met with Tim Cook, Apple's Chief Executive Officer, a week prior to discuss the State Aid probe into Apple's tax arrangements with Ireland.[28]

On February 1, Commissioner Vestager announced that she dismissed the U.S.'s criticism of her crackdown on U.S. companies and asserted that she has been targeting European companies as well. At a conference organized by the Global

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23 "European Commissioner Rejects U.S.'s Criticism."

24 *Id.*

25 Alex M. Parker, "Hatch, Wyden Seek U.S. Retaliation for EU State Aid Probe," *BNA Snapshot*, January 15, 2016.

26 *Id.*

27 "European Commissioner Rejects U.S.'s Criticism."

28 *Id.*

Competition Law Centre, Vestager stated, "Just as it is an obvious right for U.S. tax authorities to tax revenues when they are repatriated, it is also for European tax authorities to tax money that is made in the member states."

On February 11, Secretary Lew took the four senators' suggestion and wrote a letter to the President of the European Commission, Jean-Claude Junker, urging him to reconsider the Commission's approach to State Aid investigations of U.S. companies.

Secretary Lew expressed the U.S.'s apprehensions that the Commission's "sweeping interpretation of the EU legal doctrine of 'state aid' threatens to undermine [the progress of state governments working together]…to curtail the erosion of our respective corporate tax bases."[29] Secretary Lew further conveyed the U.S.'s disappointment that the Commission "appears to be pursuing enforcement actions that are inconsistent with, and likely contrary to, the BEPS project."

The letter also reiterates the concerns recently enumerated by Deputy Secretary Stack about the Commission's disproportionate targeting of U.S. companies, retroactive imposition of penalties on income that rightfully belongs to the U.S., and extent of other states' right to tax under international standards, as well as concern that the Commission's approach could undermine U.S. tax treaties with E.U. Member States. Lastly, Secretary Lew cautions President Juncker that the "Treasury department is not alone in this view. Many Members of our Congress have strongly echoed these concerns, and have urged Treasury to take strong action."[30]

Secretary Lew also met with the House Ways and Means Committee on February 11 to discuss President Obama's Fiscal Year 2017 Budget, where he "expressed support for immediate U.S. business tax reform and stopping corporate inversions."[31]

The latest move toward finding a solution to this controversy came on February 18, 2016, in the form of a recommendation from former French Finance Minister Alain Lamassoure, now the chairman of the European Parliament's Special Committee on Tax Rulings ("T.A.X.E.").[32] Mr. Lamassoure suggested a joint session of the U.S. Congress and E.U. Parliament, in which multinationals would testify about their tax arrangements in order to determine whether European nations have targeted U.S. companies more than other multinationals.[33]

The panel, headed by Lamassoure, is expected to travel to the U.S. in May for this joint session. This would follow hearings by the T.A.X.E. scheduled for March 14 and 15. Apple Inc.'s Chief Executive Officer ("C.E.O."), Tim Cook,[34] has been asked to testify before the committee on March 15, along with Google Inc.'s C.E.O. And

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29 Treasury Secretary Jacob Lew's Letter to European Commission President Jean-Claude Junker, February 11, 2016, p. 1.

30 *Id.*, p. 2.

31 "U.S. Treasury Secretary Addresses EU State Aid, Inversions, & Obama's FY 2017 Budget," *Checkpoint International Taxes Weekly*, February 16, 2016.

32 The T.A.X.E. is the special committee formed by the E.U. Parliament to investigate tax rulings. See Erwin, "Tax Rulings in the European Union."

33 *Bloomberg BNA International Tax Monitor*, February 18, 2016.

34 In January, 2016 Apple C.E.O. Tim Cook met privately with Margrethe Vestager. Neither Apple nor the commission disclosed the substance of their discussion (*The Irish Business Times*, February 12, 2016).

as if to prove that not only U.S. companies are being targeted, T.A.X.E. has also asked for testimony from officials of the Italian-U.S. company Fiat Chrysler Automobiles NV and the Swedish company Inter-Ikea Group. In what will be the second request for testimony, McDonald's Corp. and Starbucks Corp.[35] were invited to answer questions about their respective corporate tax policies – as were officials from independent tax haven territories, including the Cayman Islands, Jersey, Guernsey, and Liechtenstein.[36] At this time it is unknown whether officials from Apple, Google, Fiat Chrysler, and McDonald's will attend the March 15 hearing.

Meanwhile, the Commission's position remains determined: "We will make it very clear to Secretary Lew that the investigations are not discriminating against U.S. companies but are designed to make sure that companies do not receive favorable tax treatment," E.U. Tax Commissioner Moscovici recently said. "That is the sole purpose of these investigations. We also will reject the claim that the investigations undermine the O.E.C.D. B.E.P.S. reforms."[37]

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CONCLUSION

The number of Commission investigations into tax agreements bewteen Member States' and multinational companies is steadily increasing. These are high-profile cases, not only because they target some of the biggest companies in the world but also because of the way the Commission's exercise of its investigatory powers affects autonomous Member States and the U.S.

U.S. officials are obviously frustrated by the Commission's investigations, which disproportionately target U.S. companies, and fear that the Commission is taking away income that rightfully belongs to the U.S. As the global crackdown on corporate tax avoidance intensifies, it will continue to impact the policies of the U.S., the Commission, and other states; and it will significantly impact the environment for multinationals structuring their enterprises.

E.U. Member States are also expressing increased concerns that the Commission is overreaching in its capacity in these cases. Does this mean the U.S. will have allies in its efforts to push back against the Commission's State Aid investigations? Whether common ground can be found, remains to be seen. However, the Commission's determination of whether Ireland's agreements with Apple constitute unlawful State Aid will be the next cornerstone in this regard, and U.S. companies with European operations would be wise to monitor the developments closely.

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35 According to European Parliament officials, Starbucks declined the invitation because it plans to appeal the Commission's October 15 decision that it received illegal State Aid.

36 So far only the latter three were reported to have accepted the invitation (see *Bloomberg BNA, International Tax Monitor*, February 23, 2016).

37 *Bloomberg BNA International Tax Monitor*, February 17, 2016.