

# Kluwer Competition Law Blog

## Uncle Sam Is Right: The EU Probe Into Ireland's Tax Treatment of Apple Is Overreach

Philip Andrews (McCann FitzGerald) · Thursday, June 30th, 2016

“Improper and plainly undermines legal certainty and the rule of law.” This is how four U.S. senators – including the Chairman and Ranking Member of the U.S. Senate Finance Committee – recently described the European Commission’s State aid investigation into tax rulings by Member States, including into Ireland’s tax treatment of Apple.

Of course the U.S. Senators’ concern, plainly stated in their 23 May letter (to U.S. Secretary of the Treasury, Jacob Lew), is “to protect U.S. interests in these matters.” The U.S. view is that “four of the five investigations of company-specific tax rulings, and nearly all of the amounts at stake, involve U.S. companies” and that the European Commission is “disproportionately targeting U.S. companies.”

But in addition to anti-U.S. bias, the Senators claim the EU investigation involves “applying new theories of State aid retrospectively in a manner that is inconsistent with international tax standards.” Is there basis to this claim?

- The Apple Investigation – What We Know So Far

The EU probe into Apple’s Irish tax treatment focuses on tax paid by two Apple units: Apple Operations Europe and Apple Sales International. Both are Irish registered, both Irish non-tax resident. Under Irish rules, this means that each pays Irish tax on profits properly attributable to their Irish-based activities.

That an Irish branch of a non-tax resident company pays Irish tax on the branch’s profits is not controversial. What Brussels is investigating is how profits of each Apple unit were calculated for this purpose.

The Commission says that in two “tax rulings” (one in 1991, another in 2007) Irish Revenue officials unjustifiably acceded to Apple proposals to calculate profit by reference to a percentage of each unit’s costs (the so-called “cost plus” method). This resulted from “a negotiation rather than a pricing methodology,” was not underpinned by a “transfer pricing report,” and was therefore not “arm’s length,” the Commission argues.

This is a lynchpin of the case against Ireland. Deviation from the “arm’s length” standard in assessing a local corporate unit’s tax liability confers selective advantage, says the European Commission. In turn, this provides legal basis on which the European Commission may intervene:

namely, EU Treaty rules on State aid.

- Corporate Tax and EU State Aid Rules

Corporate tax rules are a matter for national governments in EU law. This is clear. As the European courts put it, “each Member State is free to lay down its own rules relating to corporation tax.” In practice, this means that each Member State sets its own rules for calculating corporate tax bases and no two Member States have the same rules.

But the European courts have also held that favourable corporate tax treatment can, in certain circumstances at least, amount to State aid (see, *e.g.*, in *Commission v Gibraltar*). And under EU State aid rules, the Commission has relatively wide powers to review and prohibit national measures granted selectively to distort competition.

As the Commission tells it, EU State aid jurisprudence provides “firm legal ground” for the current tax probes. Specifically, in its preliminary view in the Irish case, the Commission says “[t]he Court of Justice has confirmed that if the method of taxation for intra-group transfers does not comply with the arm’s length principle ... it provides a selective advantage to the company concerned.”

- Is the “Arm’s Length” Standard New?

The Commission cites just one court ruling in support of its “selectively” contention (the *Belgian Coordination Centres* case). In *Belgian Coordination Centres*, the Court states that transfer prices should “resemble those which would be charged in conditions of free competition” (para. 96).

The Court doesn’t hold, however, that determining branch profits using a cost-plus method violates this principle or otherwise involves State aid. Rather the judgment establishes that exclusion of specific costs when using this method to calculate profits may constitute State aid.

Nor is there any reference in *Belgian Coordination Centres* to an “arm’s length” principle. (Indeed, *Belgian Coordination Centres* can be read as endorsing the cost-plus method, properly applied, which the court notes is “recommended by the Organisation for Economic Cooperation and Development” (OECD).)

To our knowledge, the European courts have never required Member States to apply an “arm’s length principle” for purposes of calculating transfer pricing. (We could find two cases only in which the term “arm’s length” is used by the European courts in the context of tax calculations: C-524/04 *Thin Cap Group Litigation* and C-311/08 *SCI* – neither involves State aid or transfer pricing.)

- Is the EU Approach Consistent with International Tax Standards?

In a preliminary decision in the Irish case, the Commission refers to 2010 OECD guidelines on transfer pricing – guidelines that are widely followed internationally. But the European Commission also says its “arm’s length” principle is “not that derived from ... the OECD Transfer Pricing Guidelines.”

What’s more, in the Irish case, the European Commission actually concedes that the Irish position *is* consistent with OECD guidelines (at para. 60). So what standard is it using?

- Are the Americans Right?

In February 2014, when first confirming these own-initiative investigations into “aggressive tax planning,” then EU Competition Commissioner, Joaquín Almunia, said he had “a political consideration” in mind. European Parliament elections were just three months away and the Commissioner was concerned that “a growing proportion of voters across the EU ... may be tempted by anti-European messages.” “Pro-active policies” were needed, the Commissioner said, to show voters “the way forward is more integration, not a beggar-thy-neighbour attitude.”

The Commissioner reiterated this agenda on 11 June 2014 when announcing full-blown investigations into Irish, Dutch and Luxembourg tax practices: *“In the current context of tight public budgets, it is particularly important that large multinationals pay their fair share of taxes.”*

As a matter of EU law, however, it is questionable whether the European Commission should take account of such matters to launch State aid investigations or, worse, use State aid law to pursue such goals (whatever a “fair share” means exactly).

- You Started It!

In October last year, the European Commission found that tax treatment by the Dutch and Luxembourg authorities of, respectively, Starbucks and Fiat Finance and Trade were State aid. Recovery of unpaid tax of between €20 and €30 million in each case was ordered.

Why the Irish investigation is delayed is unclear – latest reports are that Brussels is looking for yet more information from the Irish authorities.

In January of this year, Bloomberg reported that Apple “could owe more than \$8 billion in back taxes as a result of a European Commission investigation.” We disagree with how this estimate was calculated and doubt Apple’s exposure is anywhere near as high. But there is clearly a lot at stake.

The Irish authorities will almost certainly appeal any adverse finding. Already appeals have been lodged by the Dutch and Luxembourg Governments – focusing, predictably, on the European Commission’s application of the selective advantage criteria. Expect resolution in a few years.

An irony is that headline-grabbing hearings before the U.S. Senate opened this Pandora’s Box back in 2013. Yes, the EU investigations are regulatory overreach; plain as Apple pie. But it was U.S. politicians that first branded Apple’s tax practices “completely outrageous” and “pernicious.”

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