

IT TAKES ONE BAD APPLE TO SPOIL THE BUNCH: AN ANALYSIS OF THE EUROPEAN UNION’S 2016 APPLE SALES INTERNATIONAL AND APPLE OPERATIONS EUROPE DECISION

This Perspective examines the aftermath of the European Union’s Competition Commission’s (the “Commission”) 2016 decision concerning Ireland’s tax rulings of Apple, Inc.’s subsidiaries, Apple Sales International and Apple Operations Europe (collectively, “Apple’s Subsidiaries”). The Commission’s decision, which orders Apple’s Subsidiaries to pay Ireland 13 billion euros for unpaid taxes, raises financial and tax planning concerns for other multinational companies operating in the European Union.¹ In 2011, Apple, Inc. paid a tax rate² on all its worldwide income equal to the rate of a single U.S. citizen in 2016 earning between \$0 and \$9,275, or 10%.³ Apple, Inc. primarily uses two instruments to lower its tax liability worldwide: cost-sharing arrangements and special agreements with certain jurisdictions.⁴ This Perspective focuses only on special agreements.

Due to special agreements with the Irish government, Apple Sales International paid a corporate tax rate that began at 1% in 2003 and declined to 0.005% in 2014.⁵ This treatment is the result of two tax rulings⁶ granted by Ireland in 1991.⁷ The two tax rulings for Apple’s Subsidiaries allowed each entity to allocate most of their sales and profits from the entire European Union market to a “head office,” which was not based in any country nor had its own

¹ European Commission Press Release IP/16/2923, The Commission, State aid: Ireland gave illegal tax benefits to Apple worth up to €3 billion (August 30, 2016).

² Dean Harris, Comment, *International Tax Implications Of The Organisation For Economic Co-Operation And Development Proposal To Neutralize Hybrid Mismatch Arrangements*, 65 CATH. U.L. REV. 635, 635 (2016).

³ Kyle Pomerleau, *2016 Tax Brackets*, TAX FOUNDATION (Oct. 14, 2015), <http://taxfoundation.org/article/2016-tax-brackets>.

⁴ Harris, *supra* note 2, at 635; see *Senate Subcommittee Holds Hearing on Apple’s Multi-Billion Dollar Tax Strategies*, 113th Cong. (2013); see also Bebra Brubaker Burns, Article, *Golden Apple Of Discord: International Cost-Sharing Arrangements*, 15 HOUS. BUS. & TAX L.J. 55 (2015).

⁵ European Commission Press Release IP/16/2923, *supra* note 1.

⁶ For purposes of this perspective, tax ruling means an instructional letter from a tax authority of the state that is requested by an business entity to clarify how the business entity’s corporate tax rate will be calculated. *Id.*

⁷ *Id.*

employees or premises.⁸ Apple's Subsidiaries effectively allocated the majority of their profits from the E.U. to a fictional location where it went untaxed.⁹ In 2011, Apple Sales International had only 50 million euros subject to Ireland's corporate tax while it recorded 16 billion euros in profits.¹⁰ Specifically, 15.95 billion euros of Apple Sales International's profits that year went untaxed.¹¹ Its corporate tax rate was only 0.05%.¹² Apple Operations Europe operated on the same model.¹³

Eventually, the press caught wind of Apple's Subsidiaries' tax discrepancies, which prompted the Commission to launch several in-depth investigations pursuant to Article 107(1) of the Treaty on the Functioning of the European Union (the "Treaty").¹⁴ Under the Treaty, any state action that favors a certain business entity and as a result affects trade between Member States is not in accordance with the E.U.'s concept of a Single Market.¹⁵ The Commission found that Ireland had no factual or economic justification for its treatment of Apple's Subsidiaries and, thus, violated the Treaty.¹⁶ As a result, it ordered Apple's Subsidiaries to pay back Ireland and Ireland to recover these unpaid taxes plus interest.¹⁷ However, Apple's Subsidiaries and Ireland plan to appeal the decision.¹⁸ Interestingly, Apple, Inc. is not the only multinational company in Europe facing scrutiny.¹⁹ Between October 2015 and January 2016, the Commission found Fiat Automobiles S.p.A., Starbucks Corporation, and several others in violation of the Treaty through similar special agreements that granted state aid tax advantages, but the Commission's Apple's

⁸ European Commission Press Release IP/16/2923, *supra* note 1.

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ European Commission Press Release IP/14/663, The Commission, State aid: Commission Investigates Transfer Pricing Arrangements on Corporate Taxation of Apple (Ireland) Starbucks (Netherlands) and Fiat Finance and Trade (Luxembourg) (June 11, 2014).

¹⁵ *Id.*; For purposes of this perspective, Single Market refers to the E.U. as one single economic market allowing for fair competition and the free movement of goods and services without any regulatory obstacles between Member States. *The European Single Market*, European Commission, https://ec.europa.eu/growth/single-market_en (last visited Nov. 26, 2016).

¹⁶ European Commission Press Release IP/14/663, *supra* note 14.

¹⁷ European Commission Press Release IP/16/2923, *supra* note 1.

¹⁸ Nate Lanxon, *Apple's \$14.5 Billion EU Tax Ruling: What You Need to Know*, BLOOMBERG (Aug. 30, 2016, 7:39 AM), <http://www.bloomberg.com/news/articles/2016-08-30/apple-s-14-5-billion-eu-tax-ruling-what-you-need-to-know>.

¹⁹ European Commission Press Release IP/14/663, *supra* note 14.

Subsidiaries decision, ordering the collection of 13 billion euros with interest, is by far the biggest blow in this struggle.²⁰

Assessing potential arguments in favor of and against the Commission's decision is relevant here as more multinational companies are criticized not only by the Commission, but also by the public for tax avoidance schemes.²¹ Even U.S. President-elect Donald J. Trump faced criticism for reportedly paying no income tax due to a \$900 million loss reported in 1995, which could offset income for 18 years.²² Currently, the Commission has two on-going investigations into Amazon.com, Inc. and McDonald's Corporation with Luxembourg for similar special agreements providing state aid tax advantages.²³

The driving force of the Commission's investigations and worldwide criticism is largely due to the view that each business entity should operate on a level playing field.²⁴ As Eurogroup President Jeroen Dijsselbloem stated, "American companies or any company that uses all these different tax plans and at the end of the day pays no tax, that's not fair."²⁵ This view is magnified when the current financial climate of the world economy is taken into account as such tax avoidance practices only serve to erode tax bases and shift tax burdens onto those who are unable to take advantage of tax codes.²⁶ Special agreements, such as Apple's Subsidiaries', allow multinational companies to avoid paying their fair share, especially in areas from which they receive substantial profits. Another driving force in favor of Apple's Subsidiaries paying back taxes is the concern of growing power and influence multinational

²⁰ *After Apple, the other tax deals in the European commission's sights*, THE GUARDIAN (Aug. 30, 2016, 4:19 PM), <https://www.theguardian.com/world/2016/aug/30/after-apple-the-other-tax-deals-in-the-european-commissions-sights>.

²¹ See also Camila Domonoske, *Fallout From Panama Papers Echoes Around The World*, NPR (Apr. 5, 2016, 4:19 PM), <http://www.npr.org/sections/thetwo-way/2016/04/05/473115334/fallout-from-panama-papers-echoes-around-the-world>.

²² Allan Sloan, *The most shocking part of Donald Trump's tax records isn't the \$916 million loss everyone's talking about*, THE WASHINGTON POST (Oct. 2, 2016, 4:22 PM), <https://www.washingtonpost.com/news/wonk/wp/2016/10/02/the-most-shocking-part-of-donald-trumps-tax-records-isnt-the-916-million-loss-everyones-talking-about/>.

²³ European Commission Press Release IP/16/2923, *supra* note 1; See *After Apple, the other tax deals in the European commission's sights*, *supra* note 20.

²⁴ European Commission Press Release IP/14/663, *supra* note 14.

²⁵ James Mackintosh, *Eurozone Finance Chief Lashes Out at Apple's Response to Tax Ruling*, THE WALL STREET JOURNAL (Sept. 4, 2016, 12:02 PM), <http://www.wsj.com/articles/eurozone-finance-chief-lashes-out-at-apples-response-to-tax-ruling-1473004954>.

²⁶ European Commission Press Release IP/14/663, *supra* note 14.

companies boast.²⁷ On its face, the case here is a tax issue, but by ordering Ireland to collect on past taxes the Commission in a sense is reeling in multinational companies and asserting its control.

Conversely, companies like Apple, Inc. create many jobs and provide substantial investments in the countries where they do business. Forcing such a company to repay taxes may have an adverse effect on its operations. Tim Cook, CEO of Apple, Inc., in his open letter response to the Commission's decision confirms this. "Beyond the obvious targeting of Apple, the most profound and harmful effect of this ruling will be on investment and job creation in Europe."²⁸ The feeling is shared by Irish locals, who are grateful for the investments in Ireland by multinational companies, because the investments are believed to have offset the effects of the global financial crisis in 2008.²⁹ Even the U.S. Treasury Department weighed in on the decision stating, "We believe that retroactive tax assessments by the Commission are unfair, contrary to well-established legal principles and call into question the tax rules of individual Member States."³⁰ Besides the adverse impact the decision may have on jobs and investments as well as the legal issue of retroactive enforcement, there is also the argument that nothing Apple's Subsidiaries did was illegal. It may be widely unfair and shocking, but it was legal. Apple's Subsidiaries were following Ireland's tax instructions, which were published tax rulings. Therefore, it is hard to claim that Apple's Subsidiaries should be punished for simply complying with the local law.³¹ The same argument has appeared in the U.S. regarding its "Swiss-cheese corporate tax code."³² In the U.S., holes in the U.S. tax code have resulted in multinational companies establishing legal cost-sharing arrangements that reduce their overall corporate tax liability.³³

Regardless of the result of Apple's Subsidiaries' appeal, I believe Apple, Inc. and other multinational companies have already won. First, the

²⁷ *Apple should repay Ireland 13bn euros, European Commission rules*, BBC NEWS (Aug. 30, 2016), <http://www.bbc.com/news/business-37220799>.

²⁸ Tim Cook, *A Message to the Apple Community in Europe*, APPLE (Aug. 30, 2016), <http://www.apple.com/ie/customer-letter/>.

²⁹ Mark Thompson, *Ireland doesn't want \$14.5 billion in tax from Apple*, CNN MONEY (Sept. 2, 2016, 9:46 AM), <http://money.cnn.com/2016/09/02/technology/ireland-apple-eu-tax-appeal/>.

³⁰ Greg Robb, *U.S. Treasury 'disappointed' with EU ruling on Apple taxes*, MARKETWATCH (Aug. 30, 2016, 9:18 AM), <http://www.marketwatch.com/story/us-treasury-disappointed-with-eu-ruling-on-apple-taxes-2016-08-30>.

³¹ See European Commission Press Release IP/16/2923, *supra* note 1.

³² Burns, *supra* note 4, at 63.

³³ *Id.*

Commission can only order the repayment of taxes for a ten-year period preceding the date the Commission first requested information.³⁴ Thus, if Apple's Subsidiaries were to comply, they would only have to repay taxes owed from 2003 to 2013, despite the fact that the original tax rulings were issued in 1991.³⁵ Thus, Apple's Subsidiaries benefited immensely for twenty years, but only have to repay taxes for ten years. Second, Apple's Subsidiaries while in a sense are being punished, they are not forced to pay any punitive damages.³⁶ There are no fines attached to the Commission's decision, which calls only for the restoration of equal treatment.³⁷ Third, since Apple's Subsidiaries plan to appeal, the decision effectively remains in limbo and carries no precedential power. Lastly, Ireland is also appealing in conjunction with Apple's Subsidiaries to avoid collecting the 13 billion euros. Under these facts, it is hard to view this brouhaha negatively for Apple, Inc. and other multinational companies operating in the European Union. Market forces appear to agree with this assessment as Apple, Inc.'s stock dropped less than one percent following the announcement of the Commission's decision.³⁸ Therefore, multinational companies should not panic nor lose any sleep over the Commission's decision for the time being.

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³⁴ European Commission Press Release IP/16/2923, *supra* note 1.

³⁵ *Id.*

³⁶ European Commission Press Release IP/16/2923, *supra* note 1.

³⁷ *Id.*

³⁸ Lanxon, *supra* note 18.

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