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CLIENT BRIEFING

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APPLE V COMMISSION: THE VERDICT'S IN

Yesterday, the General Court of the European Union released its much anticipated decision in *Apple Sales International (ASI) and Apple Operations Europe (AOE) v Commission*. In short, Apple and Ireland won, the Commission lost, although an appeal to the Court of Justice of the European Union seems inevitable.

It is difficult to think of a tax dispute that has captured the headlines, and the attention of the world's media, more than this case.

Why? It's not just that the headline numbers are eye-watering - €13bn of tax plus interest. It's not just that it introduced the wider world to the often byzantine world of multinational tax planning – 'double Irish arrangement' now has its own lengthy Wikipedia entry. It's because it is seen as raising the (very) hot topic of how a multinational group like Apple should be taxed in a modern, digital world. Ireland did not believe it was owed the tax, the US weighed in because it thought the profits were its to tax in its own good time and the Commission thought Ireland, or possibly Ireland and the EU countries in which the sales giving rise to the profits were made, should tax the profits now and that for Ireland to agree not to do so for Apple was illegal State aid.

So what was the case about?

At its core (pun intended), the Apple dispute is about the fact that ASI and AOE were generating tens of billions of euros in profit each year but paying an effective tax rate of 1%, in 2003, declining to 0.005% by 2014. The reason being that although both companies were Irish incorporated, neither was Irish tax resident. Each did have an Irish branch, but only profits attributable to the Irish branch were subject to Irish tax. Apple had obtained rulings from the Irish tax authority agreeing how much of their profits should be treated as attributable to the Irish branches, and therefore subject to Irish tax, and how much should be attributable to their "head offices" – i.e. not the branches – and therefore outside the scope of Irish taxation.

The Commission's argument was that these tax rulings granted Apple a concession on the amount of tax that it was obliged to pay as compared to the position that would have applied under the Irish tax rules as they stood at the time. Accordingly it conferred a "selective benefit" on Apple within the meaning of the State aid rules.

The primary argument

ASI's and AOE's vast profits were primarily driven by royalty free licences granted by Apple Inc, the US group parent, to manufacture and sell Apple products outside of North and South America and the tax rulings confirmed that those profits were not attributable to the Irish branches.

The Commission's primary argument was that this was wrong. In its view the "head offices" of ASI and AOE only existed on paper and could not have generated the profits allocated to them. Therefore, they should - under existing Irish tax rules - have been allocated to the Irish branches and subject to Irish tax.

The General Court disagreed. Under Irish law, what was subject to tax was the profits derived from the assets and activities of an Irish branch. What the Commission had to show, if it wanted to show a derogation from the normal rules, was that the IP licences were assets of the Irish branches, meaning, under Irish law, that the licences were under the control of the Irish branches, and it had not done so. Its exclusionary approach – arguing that the head offices lacked the resources to generate the profits and so they must therefore be allocated to the branches – was not enough to show that the profits were in fact generated by the Irish branches.

The Commission ran the argument a number of ways, including that EU law allowed it to apply the arm's length principle or the OECD's approach to branch profit allocation as a cross check, but in each case met fundamentally the same objection. It had not done enough to show that, applying its preferred approach in each case, the profits were in fact attributable to the Irish branches. What the OECD's approach required was an analysis of the actual functions performed by the branches whereas the Commission's approach was to presume that any functions that it did not think the head offices were capable of carrying out were carried out by the branches.

The subsidiary argument

The Commission had also argued that the tax rulings suffered from methodological errors that again resulted in less tax being paid than should have been. And,

again, the General Court found that the Commission had come up short.

The General Court noted that the information submitted by Apple to the Irish tax authority prior to the issue of the rulings was "very concise", that agreement seems to have been reached in discussions "without there being any documented objective and detailed analysis regarding the functions of the branches and the assessment of those functions" and that this may be regarded as a "methodological defect" given that the relevant Irish tax provision required a functional analysis of the branches to be performed at the outset.

But, "as regrettable as that methodological defect is", the Commission had failed to show that the lack of information meant that the profit allocations were wrong and that the tax burden of ASI and AOE was lower than it would have been had the tax rulings not been given.

So where does this leave us?

Whilst not the last roll of the dice - it is open to the Commission to appeal the decision and, given the high stakes, it must be highly likely to do so - this decision is a welcome one. It is a decision based on what the relevant Irish law actually said and did rather than what some might like it to say or do to fix a perceived problem of under or no taxation. Changing the rules of international taxation is a job for countries themselves to do prospectively, with the assistance of organisations like the OECD.

Time and again the General Court brought the Commission back to the fact that to show unlawful State aid it had to demonstrate that ASI and AOE had profits that should have been subject to Irish tax, because they derived from assets and activities of their Irish branches, which were not so taxed because of the rulings.

It was not enough to assert that those profits should be attributable to the branches because they could not be attributed to head office, they had to show that they were in fact attributable to the branches. Similarly, it was not enough to assert that the tax rulings were based on insufficient information or an incorrect approach, they had to show that that had actually resulted in a reduced tax burden.

Or, as the General Court put it:

"at the current stage of development of EU law, the Commission does not have the power independently to determine what constitutes the 'normal' taxation of an integrated undertaking while disregarding the national rules of taxation".

The fact that ASI and AOE may have significant profits that are not taxed by anyone, at least pending repatriation to the US, is irrelevant.

This decision is likely to be of most comfort to those groups who have tax rulings from an EU based tax authority that were taken into account in an accounting period in the earlier part of the last decade, before the Commission turned the full glare of its State aid spotlight in the direction of tax. Such rulings, like ASI's and AOE's, might be lighter on information and methodology than one might like in the current environment. However, those groups will have taken comfort from the fact that, nonetheless, those rulings produce the "right" answer and ultimately result in the same tax burden as would have arisen in their absence. The General Court's judgment here can be taken as confirmation that they are right to do so.

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