STATE AID AND TAX RULINGS – A FEW COMMENTS IN LIGHT OF THE APPLE DECISION

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The great unbundling

- ASI and AOE are not tax resident anywhere (not challenged by the Commission)
- The Irish Branches procure the iphones (from China), sell and distribute them (outside the Americas)
- ASI and AOE have a « cost sharing agreement » with Apple US. Such that, under US tax law, income from the sale of manufactured products abroad escapes US taxes (normally based on worldwide income) even when valuable IP/intangibles are embedded in the product.
- Under Irish tax law, the profit of the local branches has to taxed in Ireland.
- The tax rulings effectively consider a fixed mark up on the cost incurred by the Irish branches
- Hence, what is taxed is a notional profit on the plastics and the electronic component. The value brought by the brand name (intangible) and the IP is untaxed outside the US.
- The Commission challenges the allocation of profit between ASI/AOE and their Irish branches.

- The Commission allocates all value to the Irish branches
- On what terms would an independent entity perform the functions of procurement and distribution : mark up over cost is not unreasonable. (The Irish government)
- Would on what terms would an independent entity perform the function of the head office : a very small fee (the Commission)
- The answer depends on what is the “tested party”. “In principle”, the party performing the less complicated task.
- Or « two-sided test » ? A negotiation between the two parties ?
- The economic reality is that Apple Inc would appear to be the natural principal (the products are manufactured according to design produced in the US).
- Hence, the Commission uses an clumsy instrument to address a problem created by US tax law (and Irish tolerance)

Consequences for international taxation

- The Commission decision seems to ensure that taxes are paid where the value is created (principle of territoriality)
- But not quite.
- Why should the profit from sales of iphones in France not be taxed in France (instead of Ireland)
- The Commission decision actually enhances tax competition among member states.
- Previously, the benefit to a host country of a tax sweetener was limited (as Apple appropriated most of the rent from the transaction).
- The matter is now different. Attracting ASI/AOE is becoming much more attractive (as Apple can no longer appropriate rents) through other instruments (like investment aid)
- All of this is a poor substitute for a proper coordinated reform of taxes on multinationals. But it may be the best option available

State aid control perspective

- Exemption from profit tax is like "operating aid" (the Court said so)
- Not really. A subsidy to marginal cost affects prices. A profit tax does not.
- But it affects investment incentives (the Commission writes somewhat inacurrately that "the contested tax frees up resources to invest in the business")
- But this is very much a second order effect.
- In any event, why should the Commission worry about the investment incentives in the global market place ?
- State aid control is meant to be about the achievement of the internal market
- And the decision misses the most legitimate theory of harm from this perspective : the tax ruling were meant to attract investment in Ireland in the first place