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The Implications of the European Commission's Decision in the Apple Tax Case

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The decision of the European Commission on the aid granted to Apple by Ireland is likely to influence the way EU Member States conduct their fiscal policies. It also sets the direction for the evolution of the common market towards tightening the enforcement of competition rules by the European Commission. On a global scale, it is a serious attempt to limit the influence of transnational corporations and reduce tax evasion. Meanwhile, it sends a warning to EU Member States helping large companies to minimise their tax burdens and undermining the principle of equality in the functioning of the single market.

After more than two years of investigation into Ireland's tax arrangements with technology company Apple, the European Commission (EC) stated that the iPhone manufacturer owes, and is obliged to pay €13 billion in tax, and that the Irish tax authorities are required to collect this money. The decision covers the period 2004 to 2013, during which Apple paid income tax in Ireland at an effective rate ranging from 1% in 2003 to only 0.005% in 2014. According to the European Commission, this significantly and artificially lowered rate was made possible thanks to the two tax arrangements concluded by Ireland and Apple. They allowed the taxable income of two Irish companies owned by Apple (Apple Sales International and Apple Operations Europe) to be calculated in a manner that did not correspond to reality. All sales profits in EU countries generated by these companies, with the exception of those earned in Ireland, were attributed to the "head offices" of both companies (which existed only on paper), and were not taxed at all. Consequently, the tax was payable only on income earned in Ireland, which accounted for just a small percentage of Apple's total European profits. This was the reason that, for example, while Apple Sales International recorded profits amounting to €16 billion in 2011, only €50 million was deemed taxable in Ireland, leaving €15.95 billion of profit completely untaxed. According to the EC, the taxation rules applied to Apple agreed by Dublin constitute state aid illegal under EU law.

Apple executives claim that the EC decision is political in nature, saying it has "no basis in fact or in law." The ruling is also disputed by the U.S. Department of the Treasury, which considers it biased. In turn, the Irish government deems it to be Brussels interference in the fiscal independence of the state. Dublin is also surprised by the amount of tax to be recovered by Ireland from Apple pursuant to the decision, dozens of times higher than in previous similar decisions. Determined to defend the integrity of its tax system and fearing loss of credibility in the eyes of foreign investors, the Irish government has decided to appeal to the EU Court of Justice (CJEU).

Although from a legal and political point of view there is no doubt that the EC had the right to adopt a decision concerning Apple, this does not mean that the CJEU will confirm that the Commission correctly applied the criteria of state aid. There is also a question as to whether the decision in the Apple case may undermine the economic development model of some EU Member States, and result in the outflow of capital from Europe.

The Legal Basis. While, as a rule, the policy in the area of direct taxation lies within the competence of EU Member States, competition policy, including the rules regarding the compatibility of state aid, is exclusively an EU matter. The rules on granting aid are therefore established at EU level, not left to national governments. In this regard, Article 108 of the Treaty on the Functioning of the European Union (TFEU) authorises the Commission to monitor the state aid regimes in Member States and, in the event of violations, to issue decisions ordering recovery of the aid already granted.

According to Art. 107 TFEU, any aid granted by a Member State in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, is incompatible with the internal market and prohibited, unless previously approved by the Commission. Guidance on how to assess whether a given measure constitutes state aid may be found in EC notices, which serve as sources of official interpretation of the treaty rules in this regard. Some hints on how to interpret the notion of state aid may also be found in the judicial practice of the CJEU. In the past, its judgments either recognised preferential taxation as a form of state aid, or questioned the correctness of EC decisions.

Although at this stage it is difficult to determine whether in the case of Apple we are dealing with state aid, there are indications that may confirm the correctness of the EC's position. The tax arrangements concluded with Apple by Ireland seem to meet the characteristics of state aid within the meaning of Article 107, and according to Commission notices. They conferred on Irish companies belonging to Apple an advantage, by exempting them to a considerable extent from the burdens that they would normally have had to bear. The amount of unpaid tax was in fact disproportionate to that which would have been due to be paid in the event of no agreement. The adopted solution was also selective and discretionary, since it was not applied to such an extent with regard to other entities and placed Apple in a better financial situation than other Irish taxpayers. In addition, by adopting its position, the Irish government lost significant tax revenues, equivalent to the annual budget needs of the Irish health service. Finally, the aid threatened to distort competition within the EU.

The Political Dimension. When in 2013 Member States, plagued with excessive public deficits, realised that the scale of their budgetary losses was to a great extent due to multinational companies transferring profits to tax havens, they called on the Commission to propose concrete steps to tackle this. Recent years have highlighted, however, that tax optimisation also has an intra-EU dimension and involves Member States. One example was the "Luxleaks" scandal of 2014, revealing the scale of tax benefits offered by the Luxembourg authorities to foreign corporations in return for locating offices in that country.

The EU's attempts to limit the granting of state aid through tax instruments illustrate the conflict between the development model of some Member States and the underlying logic of the internal market. On the one hand, states, providing preferential tax solutions for companies, attract foreign direct investment on an unprecedented scale and create well-paid jobs. On the other hand, the EU institutions seek to improve the functioning of the single market by maintaining equal rules of free competition. Selective aid disrupts competition and intra-EU trade, strengthening the position of some to the detriment of the others.

The Commission is all the more determined to fight tax evasion since social pressure to restrict abuses by transnational corporations has risen sharply since the financial crisis. Margrethe Vestager, the EU Commissioner for Competition, leads a major campaign in this field and does not tolerate leniency. She does not seem to be selective either, as she has issued decisions concerning both EU and U.S. entities. For example, in 2015, the Commission ruled that the Netherlands and Luxembourg applied illegal state aid to Starbucks and Fiat. Moreover, in the case of Apple, Vestager suggested that other Member States and the U.S. may examine how the company operated on their territory and, if they consider such a move to be justified, claim some part of the tax estimated by the Commission. This might be of interest to Poland, where Apple earns a sizable sum on sales, but by transferring profits abroad does not pay any income tax.

Despite these facts, it seems that the Apple case has already worsened transatlantic relations. But taking into account that using European tax laws as a means of circumventing higher taxes in the U.S. has long been the practice of U.S. companies, American protest seems paradoxical. The U.S. government complained some time ago that the iPhone producer does not pay taxes in the country. It was precisely the hearing in the U.S. Senate that gave Vestager's predecessor, Joaquín Almunia, a reason to request that both Apple and Ireland disclose their tax agreement. This year, on the other hand, the Obama administration took measures to prevent tax avoidance by pharmaceutical company Pfizer Inc. in its planned merger with Irish Allergan Plc, after which the deal was called off.

Repercussions for EU Member States. If the Commission's decisions concerning Fiat, Starbucks and Apple are upheld by the CJEU, EU rules aimed at unlawful state aid may become the strongest weapon in the fight against tax avoidance by big multinationals. That would, in turn, entail an increase of the margin of the Commission's interference in Member States' tax policies aimed at unifying the rules of competition in the common market. However, the repercussions could be broader. Foreign companies benefit from being located in countries such as Ireland and Luxembourg for two reasons. They profit from preferential taxes, but they also have access to the broader common market. If the CJEU upholds the Commission's decision, the free market might cease being so attractive for large companies. They might be reluctant to enter into investment agreements with EU Member States, fearing that any investigation carried out by EU institutions might increase, ex-post, the initial costs of their projects. This in turn may start an outflow of foreign capital from the EU.