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Apple Tax Case and the Implications for Ireland

Jim Stewart,
Adjunct Professor in Finance,
School of Business, Trinity College Dublin

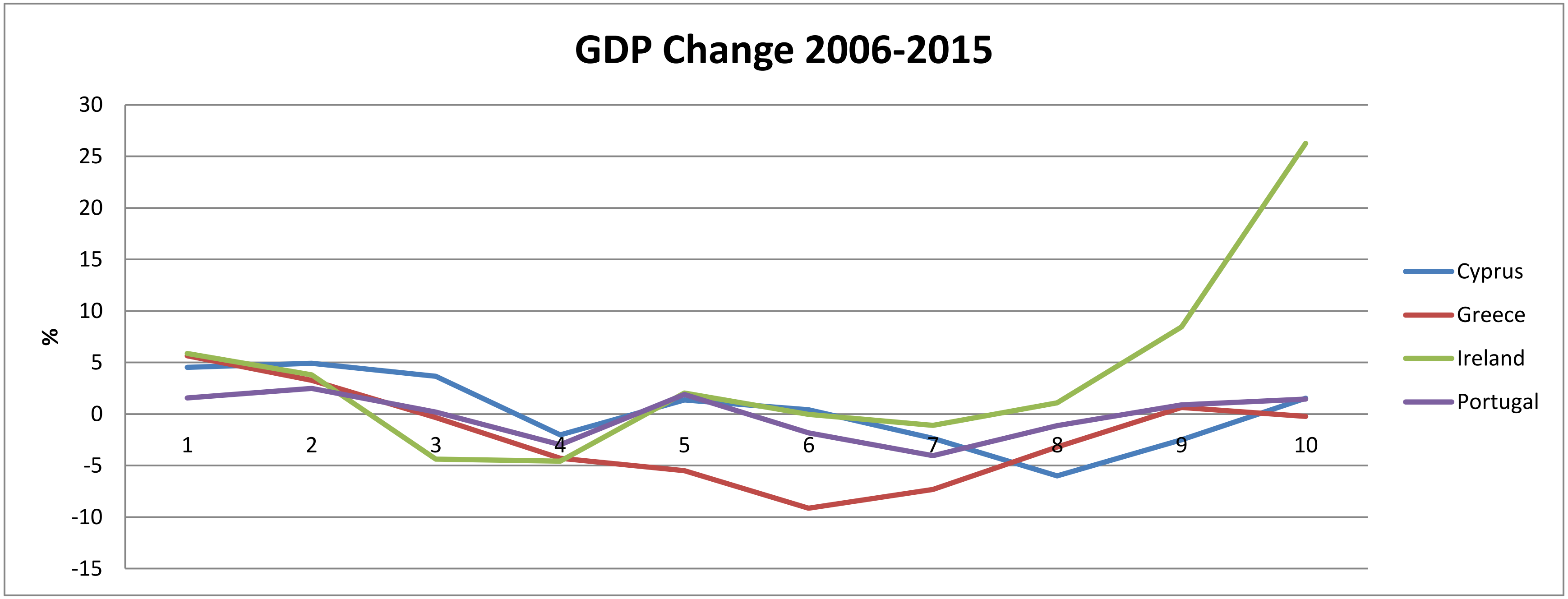
- The focus of this paper is on tax strategies that stem from Ireland's corporate tax regime.
- The paper deals in particular with Apple tax strategies, and the European Commission ruling on Apple.
- Issues relating to a possible windfall gain of more than two times tax revenues are not discussed.
- Main focus of industrial policy is "on attracting and retaining foreign direct investment and a competitive corporate tax strategy is a key tenet of that policy" (Department of Finance, 2013).
- The Apple case is significant because it signals favorable corporate tax regimes to attract FDI may be illegal.

Chart one shows the recent fall in Irish GDP followed by recovery.

The chart also shows that all four bailout countries have experienced growth in recent years.

But Irish economic growth has been spectacular at 26.5% for 2015.

Some reasons for this will be discussed later.

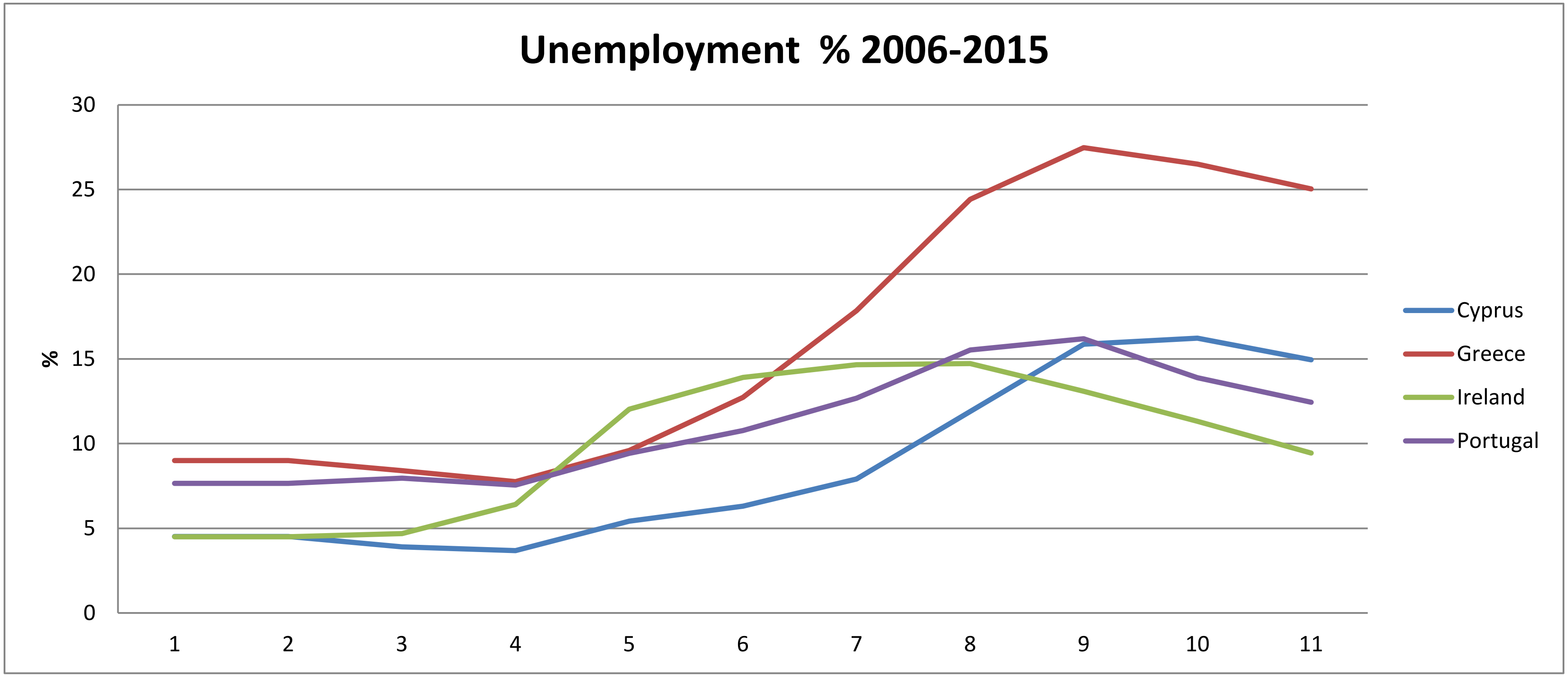


Unemployment % 2006-2015

Chart (2) shows rising rates of unemployment followed by a fall in all countries.

Again Ireland has shown the steepest decline in unemployment rates.

An important question: was the fall in employment due to Ireland's industrial policy to attract FDI?



What Explains Ireland’s Economic Success

Ireland’s very favorable corporate tax regime and Foreign Direct Investment are often cited as the main reason for the economic recovery in Ireland.

- GDP growth is an unreliable indicator as interpreting Irish national account figures due to the effects of MNE tax strategies, for example switching profits to Ireland via transfer pricing.
- The recent growth in GDP (and large growth in corporate tax payments) is explained by increased value added and profits by MNE’s operating in Ireland, and again this may be explained by MNE tax strategies.
- The U.S. Bureau of Economic Analysis (BEA) has consistently reported large net income of U.S. owned investment in Ireland (see Table 1).
- Irish national accounts data did not reflect this large net income for a number of reasons.
- ‘stateless’ tax status - Apple.
- MNE subsidiaries using a ‘double Irish’ tax strategy, for example Google, were allocated to where they were deemed to be ‘managed and controlled’ that is Bermuda or the Cayman Islands.

What About Employment ?

- The impact of FDI if often dicussed in terms of the total number employed .

- Department of Jobs, Enterprise and Employment (2014, p. 1) states:-
- “Foreign Direct Investment (FDI) has been a key contributor to Ireland’s economic development and growth through providing rewarding employment for over 250,000 people directly, knowledge transfer, and transformation of the enterprise base”.

- The CSO estimated the total numbers employed in foreign owned firms at 297,700in 2012 and 305,900 in 2015, an increase of 7,200

- But total employment increased between these two dates by 186,000

- This would seem to indicate that employment in foreign owned firms while important is not the most important contributor to recovery.

- Total employment in foreign owned firms includes for example, Tesco , 14,500 employees, Mcdonalds ,etc <u>hence</u> most analysis focuses on ‘agency supported’ FDI in particular U.S. owned firms.

- According to the Industrial Development Authority there were 111,6 00 employees in US. companies in Ireland in 2012 and 137,7 00in 2015, giving an increase in employment of 26,000
- CSO data for FDI employment shows a much smaller increase of 6,100 to 115,900 over the same period.

- In conclusion most employment growth in the period Q3 2011 and Q4 2015 came from sectors other than those dominated by U.S. MNE’s.
- The role of FDI in Ireland’s recovery has been exaggerated..
- The negative effects following the Commission Directorate Apple decision have also,been exaggerated in terms of reputational damage etc.

State Aid Cases

- State aid cases have played an important part in reforming corporate tax within the EU.
- The State aid cases are important because for many countries such as Ireland, the corporate tax regime is more important than the nominal tax rate.
- Tax rulings that permitted Stateless income, or the ‘double Irish’ and legislation that enables ‘section’ 110 firms to have an effective tax rate close to zero, are far more important than the nominal tax rate.
- State aid cases have resulted in a number of these tax rulings becoming illegal, and furthermore has signaled that rulings that give tax concessions to one sector could potentially be challenged by the Competition Directorate.

State Aid Cases

- Decisions that tax rulings constituted illegal State aid have been made for Belgium , Luxemburg in relation to Fiat, and the Netherlands in relation to Starbucks .

- Preliminary findings of illegal State aid have also been made for Amazon and McDonalds in Luxembourg and further investigations of other companies are possible.

- Pre-publication of the Commission rulings, the Governments of all countries issued similar statements to the effect that they expected to be exonerated.
- The Irish Minister for Finance stated that “Ireland is confident that there is no state aid rule breach in this case”.

- Even though Ireland would benefit from any tax payments (Eur 13 billion plus) the Minister stated that “we will defend all aspects vigorously”.

- Post publication of the Commission findings the Minister stated:-
- “The Government has decided unanimously to bring an appeal before the European Courts to challenge the European Commission’s decision on the Apple State aid case. I believe that there are some very important principles at stake in this case and that a robust legal challenge before the Courts is essential to defend Ireland’s interests” .

- There are a number of reasons given why the Irish Government is appealing the Apple decision, for example “to challenge the encroachment of EU state aid rules into the sovereign Member state competence of taxation” and other reasons which will be discussed later.

The Table shows that market values are approx twice Balance Sheet values
The largest valued item in the Balance sheet is cash and near cash.
All non – cash assets (buildings, machinery, inventories) are under 15% of market values for each year 2012-2016.
Apple tax strategy is in many ways a function of its intangible capital including I.P..
In tax planning this can be extremely important as location can be ambiguous.

	Market value	Balance Sheet values	Balance Sheet/market values %	non cash assets/total B/S assets %	Non cash assets/Market values	Cash and near cash/Balance Sheet values
2016	617.588	321.686	52.1	26	13.5	74
2015	598.344	290.345	48.5	29	14.0	71
2014	647.361	231.839	35.8	33	11.8	67
2013	504.770	207.000	41.0	29	11.9	71
2012	500.610	176.064	35.1	31	10.9	69

Why is Apple so successful – not just IP

- The development of ‘organizational competencies’, market power, and intellectual property.
- Organizational competencies includes ‘factoryless production’ (contract manufacturing).
- Apple has built considerable market power through bundled technologies and products that are not compatible with rival producers;
- marketing, and obsolescence in products through continuous software updates, enhanced features, requiring far greater memory and computing capacity.
- Mazzacuto (2015, p. 210) states:-
- “Apple’s success did not hinge on its ability to create novel technologies; it hinged on its designing, operational and organizational capabilities in integrating, marketing and selling those low-hanging technologies”.

- Once Apple gained control of these technologies, Apple has been involved in law suits over several years where Apple has been sued by rivals such as Nokia (Waters and Dye, 2016).

Effective tax Rates

Ireland is very important to Apple in terms of profitability and tax structure.

Since 2013 Apple (Form 10K) states:-

- “Substantially all of the Company’s undistributed international earnings .. .. .. were generated by subsidiaries organized in Ireland”.

Table (6)

Profits and Taxes Paid ($ billions) for Apple Sales International (ASI) 2004-2014

	2004	2005	2006	2007	2008	2009	2010	2011	2014
Pre-Tax profits	$0.268	$0.725	$1.18	$1.844	$3.127	$4.794	$12.0	$22.0	n.a.
Tax charge in	$2.1	$3.9	$6.5	$8.9	$14.9	$3.653	$7.0	$10.0	n.a.
Effective Tax Rate	0.78%	0.54%	0.55%	0.48%	0.48%	0.08%	0.06%	0.045%	0.005%

Source: - PSI, (2013), p. 21, Apple Sales International Accounts filed with the Australian Securities and Investment Commission, European Commission (2016a),

The Commission Case

- In the Commission Apple decision, the Commission (European Commission 2016b) state:-
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- “Specifically, Revenue endorsed a split of the profits for tax purposes in Ireland: Under the agreed method, most profits were internally allocated away from Ireland to a "head office" within Apple Sales International. This "head office" was not based in any country and did not have any employees or own premises. Its activities consisted solely of occasional board meetings. Only a fraction of the profits of Apple Sales International were allocated to its Irish branch and subject to tax in Ireland. The remaining vast majority of profits were allocated to the "head office", where they remained untaxed”.
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- Apple have replied to this point (third plea in law) by stating :-
- “The Commission made fundamental errors by failing to recognise that the applicants’ profit-driving activities, in particular the development and commercialisation of intellectual property (Apple IP), were controlled and managed in the United States. The profits from those activities were attributable to the United States, not Ireland.
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- The Commission wrongly considered only the minutes of the applicants’ board meetings and ignored all other evidence of activities”.

- Effectively Apple argued that the subsidiaries registered in Ireland could be split into two parts or branches
- One branch made all the profits and was not located anywhere, the other part was located in Ireland and made minimal profits.
- Note the subsidiary in Ireland had no fixed assets and no employees.
- The Branches had no fixed assets and no employees.
- Revenue agreed with this analysis.

Why should ASI and AOI be regarded "as non-resident companies" ?

- ASI and AOI were regarded by Revenue as not tax resident in Ireland (European Commission, 2016a, par. 50) because:-
- "ASI and AOE had a trading activity in Ireland through their respective branches and were managed and controlled outside Ireland".

- The 'central management and control test' is applied on "the basis of fact and precedent" (Revenue, 2013, p. 1).

- These "facts" cannot be the location of fixed assets or employees.
- Board meetings were mostly conducted in the U.S. (Senate subcommitte Report (2013, p. 22, 24), but board meeting minutes do not indicate that the Board of directors performed 'active and critical roles'.
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- One difference between Apple tax strategy and companies using a 'double Irish tax strategy' is that the latter group of companies had an identifiable address, for example in Bermuda.

- But the Apple address was always in Ireland

Country of Incorporation

- It is interesting that the Department of Finance summary of the basis of Ireland's appeal does not refer to the fact that ASI and AOI are registered companies in Ireland, but rather refers to the 'Irish branches' of ASI and AOI.

- There are several important legal requirements for an Irish incorporated company, as distinct from a branch.
- The auditor must be located where the firm is registered;
- Books of Account must be located where the firm is registered;
- The country of incorporation has ruled that the registered office, (the place of incorporation) was the 'centre of main interests' (CoMI), and where the firm should be liquidated even though this subsidiary had no employees and no fixed assets (Judgement of the Court of Justice in Case C-34/04 Eurofood IFSC 2 May 2006).

The Issue of Legal Certainty

- The U.S. Treasury (24th August 2016) published a White Paper which was highly critical of EU Competition Directorate decisions on State Aid.
- U.S. Government (and Apple) have argued that the Apple decision (11^{th} Plea in Law) violates "the principles of legal certainty and non-retroactivity" and in (Plea 14) that the commission violated legal certainty by ordering recovery under an unforeseeable interpretation of State aid law".
- Perhaps as a result of the U.S. position, tax certainty has become a focus of policy makers, for example at the G20 meeting in China in September 2016, and at the G20 meeting to be held in Hamburg this year.
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Uncertainty and State aid cases

- Both the OECD and EU have produced research papers as a contribution to this debate (EU, 2017; OECD, 2017).
- However despite the very extensive literature review, the evidence for a relationship between tax certainty and investment is mixed.
- The EU paper notes (p. 3) that
- “The theoretical literature shows that the effects of tax uncertainty depend on many factors” and that (p. 20) “ Given the ambiguities in the theoretical literature, whether tax uncertainty matters and in which direction are ultimately empirical questions”.
- Nevertheless several solutions to the problem of uncertainty are proposed.
- There are several references in the EU Working Paper to the desirability of a mandatory binding dispute resolution.
- Similar sentiments have been expressed by the OECD (2017).
- Binding arbitration is often linked to the doctrine of ‘legitimate expectations’.

Proposed Solutions to Uncertainty could help undermine State Aid Cases

- Reducing tax uncertainty, through binding arbitration, and legitimate expectations all feature in criticism and appeals of the Competition Directorate State Aid Cases.

- The US Treasury White paper states that the U.S.:
- "has been a strong proponent of binding mandatory arbitration to more efficiently resolve disputes, and has worked with a group of countries, including Belgium, Ireland, Luxembourg, and the Netherlands, over the past year on developing a multilateral instrument to incorporate it into existing treaties".

- The U.S. White paper (p. 14) states ".. .. retroactive enforcement runs counter to one of the fundamental principles of EU jurisprudence: the principle of legal certainty".

- Similarly the summary statement of the Irish Government case states the Commission has "infringed the principles of legal certainty and legitimate expectations" .

- The summary statement of the Apple case states that the Commission decision violates "the principle of legal certainty" and "non-retroactivity".

- One of the most important drivers of reform of taxation of multinational enterprise in recent years has come from State aid cases taken by the Competition Directorate.

- It is of concern that reasons given for changes to tax administration and the proposed changes advocated would help undermine State aid cases taken by the Commission Directorate.

Conclusions

- Industrial policy in Ireland emphasises low tax rates to attract FDI, in particular U.S. FDI.
- This policy is fequently described as the “cornerstone of industrial policy”.
- This industrial policy model is risky.
- It is important to note that the most attractive aspect of tax incentives offered by Ireland is not the tax rate but the tax regime.
- Ireland has been ranked 6^{th} in the world in terms of corporate tax havens.
- An industrial policy for Ireland that is less dependent on tax incentives needs to be developed and implemented.
- Balanced growth requires a greater empahasis on indigenous firms.