GUEST EDITORIAL

The Apple Case: Who Wins? What's Next?*

On 15 July the General Court of the EU (GC) passed down its much awaited judgment in cases *Ireland v. Commission* and *Apple Sales International and Apple Operations Europe v. Commission*,[1] annulling a Commission decision on state aid granted to Apple by Ireland. The outcome was expected since much of the relevant principles in the judgment were already established in previous case law (notably but not exclusively, *Starbucks*[2] and *Fiat*[3]).

The *Apple* judgment can be read in different forms: from a tax policy (or maybe politics?) perspective, from a purely state aid standpoint, or from a strictly transfer pricing perspective. Before advancing some conclusions on these different fronts, it is useful to recall the main issue discussed in the case. Due to a well-known, consented to by both sides of the Atlantic, mismatch or gap between the United States and Ireland corporate tax legislation, it was perfectly possible for a US company with an Irish subsidiary managed from the United States to obtain 'ocean profits', specifically, profits that were not taxable either in Ireland or in the United States (the legislation in both countries was reformed later so the scheme, as such, is no longer valid). The Commission's decision in the *Apple* case wanted to correct that perfectly legal, although arguably 'undesirable', outcome by applying Article 107 Treaty on the Functioning of the European Unión (TFEU) in a 'creative new form': there was state aid (selective advantage) if the untaxed 'ocean profits' that were directly linked, in the specific case, with the intellectual property (IP) license controlled by the Irish subsidiaries were not taxed in Ireland. In fact, the Irish companies were treated as non-resident entities in Ireland, and the IP license was managed and allocated to the head office in the United States without the profits linked with the IP being taxed there or in Ireland (the latter only taxed income effectively connected with functions performed in Irish territory).

From a policy perspective, the main effect of the GC judgment is to correct the innovative use of Article 107 TFEU by the Commission as a tool to tax 'untaxed profits' and eliminate international tax planning schemes of multinationals (MNEs). It is true that the judgment seems to begin by (unsurprisingly) rejecting Apple's and Ireland's arguments that Member States and their tax policies are not subject to scrutiny under the state aid rules and that sovereignty is not a valid exception to the application of Article 107 TFEU. However, the judgment makes it very clear that the parameters to analyse whether there is state aid must be defined by taking into account the tax system of the Member States, which severely limits the use by the Commission of Article 107 TFEU as a tool for disguised tax harmonization or to close gaps facilitating international tax planning and tax stateless income.

Paradoxically, however, the defeat for the Commission may also support other of its recent initiatives. First, the GC seems to hint that, if there was 'state aid' for Apple, it was granted by the United States where the relevant functions regarding the licensed IP were conducted and related profits untaxed and not by Ireland. Something should probably be done in a case when a third state is subsidizing MNE groups operating in the internal market, and the Commission has already recently presented a proposal that, albeit indirectly, is strongly backed by the GC judgment, the Commission's White Paper on levelling the playing field regarding foreign subsidies (Brussels 17 June 2020, COM(2020) 253 final). This White Paper is a policy reflection on systems to control state aid-like subsidies granted by third states, which indeed includes 'tax aid' such as Article 107 TFEU.

In addition, the Commission seems to have anticipated the defeat and thought about alternative routes to achieve the same goal. On the same day of the *Apple* judgment, it

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* A first version of this editorial was advanced in EU Law Life and authored by the current author and Jorge Piernas, associate professor of International and EU Tax Law, University of Murcia, Spain.

1 GC EU 15 July 2020, Joined Cases T-778/16 and T-892/16, *Apple,* ECLI:EU:T:2020:338.

2 GC EU 24 Sept. 2019, Joined Cases T-760/15 and T-636/16, *Starbucks*, ECLI:EU:T:2019:669.

3 GC EU 24 Sept. 2019, Joined Cases T-755/15 and T-759/15, *Fiat*, ECLI:EU:T:2019:670.

already announced a package that supplemented the cited *White Paper* from a tax policy perspective. First, it announced its will to promote corporate tax reform 'to fit our modern and increasingly digitalized economy … by realigning taxing rights with value creation and setting a minimum level of effective taxation of business profits'; it will afford a first opportunity to the OECD, but the Commission is putting pressure on it by saying that, before the end of the year, 'the Commission will set out the next steps, following up on the global discussions in an Action Plan for Business Taxation for the twenty-first century'.[4] However, its proposal to use Article 116 TFUE and majority voting for these purposes resembles more an element of political pressure than a serious legal move in view of the case law of the CJEU on the legal basis of EU tax proposals. Second, the Commission also strongly reaffirmed its commitment to the principle of minimum taxation at the global level by strongly suggesting the EU Code of Conduct Group to take that principle on board when modernizing its criteria of evaluation of harmful tax competition. Unlike the *White Paper* (and Article 107.1 TFEU), the Commission suggests the new criteria of the Code of Conduct will capture not only selective tax subsidies but also general structures (tax systems as such) and all cases of zero or low taxation, again waiting for the OECD but also beginning to work on that now.[5]

Moreover, the victory of Apple may be taken by some as an (unfortunate) implicit support of another (populist?) measure promoted by the Commission and many Member States: digital service taxes (DST) even if Apple was selling mainly goods (e.g. computers, cell phones, etc.). The problems of these taxes with the rule or law principle and international obligations or their difficult interaction with OECD's current works are well-known and will trigger further conflicts for states applying them. The Commission appears to have abandoned its previous (controversial) adherence to DSTs, although it is also simultaneously proposing measures that, in some aspects, will facilitate their administration by the Member States (at least with regard to platforms and models that help users find other users and interact and transact with them).[6] This appears very much to be a tactical move: it helps the EU Member States who decide to apply DST (at least in respect of some of its taxable events) while avoiding, for the moment, any confrontation and retaliation by the United States. It may also be indirectly attempting to show that the Commission is not only concerned with the digitalized economy and US companies but more with corporate taxes as such and the current international tax rules.

Thus, it appears that the Commission had a (holistic) Plan B to respond in the event of defeat but to also strongly demonstrate to non EU States (e.g. US, but also UK or China) its commitment against third state (tax) subsidies and stateless income with procedures that are more 'orthodox' (not without problems themselves) than Article 107 TFEU.

From a state aid perspective, the judgment is not innovative but still further unfolds already established principles. First, it stresses the relevance for the Commission, which bears the burden of proof concerning the existence of a prima facie selective advantage, of correctly defining the right reference framework (normal taxation) by paying critical attention to the domestic tax system of the specific country, including case law, before deciding that there is a selective advantage. For this purpose, the GC permits the use of some (not all) of the basic features of the OECD's Authorized Approach (AoA, profits follow relevant functions, assets, and risks carried on and controlled within a country) as a benchmark to allocate profits to permanent establishments. However, the GC does not seem to tolerate fictions –the 'exclusion approach' defended by the Commission as a first line of reasoning – leading to linking profits with a country where its tax system does not employ such a fiction or nexus rule. That is to say, if Ireland allocates profits to its companies and permanent establishments based on the functions they perform within Ireland, the Commission's view that profits linked with an IP license should be allocated to Ireland when the functions connected with it are undertaken in the United States does not hold ground even if that means that such an income remains untaxed.

Second, the judgment confirms the soundness of the Commission's joint analysis of the requirements of advantage and selectivity in the tax context and its policy of closely scrutinizing tax rulings although, like *Starbucks*, it places a notably high burden of proof on the Commission to show that those requirements are met. It is not sufficient to identify that there are methodological errors or a defective analysis in the transfer pricing documentation and the ruling (as there were in the *Apple* and *Ireland*

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[4] European Commission, *Communication from the Commission to the European Parliament and the Council an Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy*, COM(2020) 312 final (15 July 2020), at 2.

[5] European Commission, *Communication from the Commission to the European Parliament and the Council on Tax Good Governance in the EU and Beyond*, COM (2020) 313 final (15 July 2020), at 3 ff.

[6] European Commission *Proposal for a Council Directive amending Directive 2011/16/EU on administrative cooperation in the field of taxation*,COM(2020) 314 final (15 July 2020) (so called 'DAC 7' which also includes other interesting proposals, i.e. joint audits, making extensive use of the previous work of the EU Joint Transfer Pricing Forum on this issue). The reporting obligations by platforms, which are in accordance with the more limited OECD proposals (*see* OECD *Model Rules for Reporting by Platform Operators with Respect to Sellers in the Sharing and Gig Economy*, OECD Publishing 2020), are directly addressed to make visible transactions (sales of goods and provision of services within the defined scope) taking place within platforms but also have the 'indirect effect' of bringing within the radar of tax authorities the income obtained by the platform itself in a specific country (as well as, if applicable, the VAT due there).

rulings). The Commission must go beyond that threshold and prove that these mistakes entail the concession of a selective advantage to the beneficiary of the ruling. The analysis proving that an advantage is granted must also be consistent with the facts of the specific case: the (subsidiary) analysis of the Commission reasoning in the *Apple* case (that the rulings did not produce an arm's length result) was permeated by incorrect assumptions and 'side effects' of its primary line of reasoning (allocation of profits of an IP license to the Irish branches to eliminate the advantage). The consequences were that many of its statements regarding the method chosen (TNMM) to allocate profits to the Irish branches and its premises (tested party, choice of operating costs as profit level indicator and levels of return accepted) were flawed.

Third, the judgment also confirms, in accordance with previous case law, that, contrary to the Commission's alternative line of reasoning in the case (the exercise of discretion in the rulings meant granting state aid), discretion of the public authorities as part of a ruling policy cannot be automatically identified with the finding of selectivity. However, this part of the reasoning is a bit difficult to follow because this conclusion was also directly connected with the fact that the Commission was unable to show that an advantage had been granted to Apple by Ireland, and, as mentioned, advantage and selectivity in this case were examined together.

Lastly, from a transfer pricing perspective, the *Apple* judgment makes clear that the Irish rulings and the transfer pricing policy they blessed rested on shaky ground. This is a clear and loud warning for MNEs and Member States that offer 'sweet deals' in the form of tax rulings or advance pricing agreements. This time Apple was fortunate because the commission did not do its job properly, however, there are sufficient indicators in the judgment showing discontent with the outcome. There are also hints that a more refined job by the Commission would have tilted the balance against the MNE group even if the resulting aid amount in that case would have probably been less spectacular and attractive for the public and mass media. The Commission has also been provided with a template for how to do it correctly the next time so weak transfer pricing policies and tax rulings or advance pricing agreements should be reinforced and reconsidered by MNEs and tax authorities.

Whether the case will be appealed by the Commission is not yet known. On initial consideration, the law principles established by the GC are sound although there are some unclear technical and legal issues in part of the reasoning. For instance, the definition of the reference system and the link of the AoA with the Irish non-resident income tax may be regarded as a leap too far (on the other hand, the Commission's attempt to root an alternative view of the arm's length in Article 107 TFEU in comparison with the OECD's version may not have many chances before the CJEU once it has shifted its case law to more carefully take national goals into account). For Apple, the judgment is a major success, however, it is one that may not last long in view of the policy options that this judgment will probably fuel and if the Commission decides to again review Apple's position in line with the indications provided by the GC. For the EU, the victory is no less significant: the state aid legal approach towards tax rulings has been validated even if corrected, the Commission has been shown how to proceed in assessing the effects of tax rulings in future cases, the US arguments regarding discrimination against US companies have been dismantled and, more importantly, the rule of law has prevailed against attempts by the Commission to unduly expand the scope of Article 107 TFEU. Finally, the judgment stimulates new battlefields (for example, over DST, the new Commission's corporate tax policy heralded on 15 June 2020 which may not be palatable for some Member States or even third countries or the application of the EU subsidy control mechanisms and EU tax good governance standards to third countries) where conflicts will be even harder than in this case.

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After this guest editorial went to press, the EU Commission appealed the judgment of the GC on September 25, 2020 (the link to the statement by the Commission is the following: https://ec.europa.eu/commission/presscorner/detail/en/statement_20_1746)