

State Aid and Tax Rulings update: Commission orders recovery of aid to Apple

In Brief

- > On 30 August 2016, the European Commission (“Commission”) **announced** the conclusion of its investigation into unlawful State aid granted by Ireland to Apple in the form of transfer pricing rulings which reduced Apple’s taxable profits in Ireland, with the Commission ordering the recovery of illegal aid valued at a record-breaking figure of up to EUR13 billion (plus interest).
- > The decision follows similar findings against Luxembourg and Netherlands in the Fiat and Starbucks cases, respectively, and a decision against Belgium in relation to the excess profit exemption regime. The Commission is also investigating tax rulings in favour of Amazon and McDonald’s and it is likely that other cases which are not yet in the public domain will follow.
- > While the decision has important implications not only for Apple but also for other multinational corporate groups with similar tax structures, the Commission’s stance on tax rulings has been challenged before the European courts and the outcome of those appeals is yet to be seen. Uncertainty regarding the legality of tax arrangements between Member States and multinationals therefore continues, and with Apple and the Irish government both expected to appeal the decision this uncertainty will be prolonged.
- > The amount to be recovered from Apple is the largest in a State aid case to date and highlights the importance for companies to be mindful of State aid risk when relying on tax breaks given by Member States through rulings, incentives or other arrangements.

Background

The Commission started looking at tax ruling practices in certain Member States in 2013. It has concluded four State aid investigations into such practices so far, ordering recovery of illegal aid (against Netherlands, Luxembourg, Belgium and now Ireland), with two pending cases still to be

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decided regarding Luxembourg (and involving tax rulings in favour of Amazon and McDonald's). It is likely that additional probes not currently in the public domain will follow.

These State aid probes into tax rulings are not isolated. While the Commission has recognised that the majority of tax rulings do not fall foul of the State aid rules,¹ the EU has been looking at a framework to combat international corporate tax avoidance. This includes the adoption of an Anti-Tax Avoidance Directive providing for six measures to counteract some of the most common types of what the EU considers aggressive tax planning and a Directive on transparency on tax rulings, and considering proposals for public country-by-country reporting for multinational enterprises in each Member State. At a more international level, the OECD base erosion and profit shifting ("BEPS") package (including recommendations relating to transfer pricing) was endorsed by the G20 leaders in November 2015.

Key issues in the Apple investigation

The Commission launched a State aid investigation into tax arrangements between Ireland and Apple in June 2014. While expressly indicating that its decision does not call into question Ireland's general tax system or its corporate tax rate, the Commission concluded that two rulings issued by the Irish authorities in 1991 and 2007 endorsed an allocation of profits between entities within the Apple Group that reduced Apple's Irish-based taxable profits in a manner which had no factual or economic justification. In particular, the Commission took issue with the allocation of profits to a non-Irish "head office" which it found not to have real substance. In the Commission's view, profits within a corporate group must be allocated in a way that reflects economic reality and under the arm's length principle.

The Commission ordered Ireland to recover illegal aid from Apple for the period of ten years preceding the Commission's first request for information in 2013, with the total illegal aid being valued at up to EUR13 billion (plus interest).

According to press reports, the Irish Finance Minister, Michael Noonan, has indicated that the Irish government will challenge the Commission's decision. Similarly, Apple has confirmed its intention to appeal the ruling.

Implications of the ruling

The Apple ruling marks the highest-ever amount to be recovered in a State aid decision by the Commission. The sum Apple has to repay represents about a quarter of its 2015 profits, and is more than 10 times higher than the amount to be recovered by France from Électricité de France ("EDF") pursuant to a 2015 Commission decision in relation to illegal State aid in the form of tax breaks (approximately EUR900 million in tax exemption and EUR500 million in interest). The case also marks the first Commission decision against tax rulings in Ireland following the Commission investigation

¹ See the speech by Johannes Laitenberger (Director-General of the Commission's DG Competition) at the ICF in St. Gallen on 20 May 2016, available [here](#).

of tax rulings in Luxembourg and Netherlands and the Belgian excess profit exemption regime.

The Commission's stance on tax rulings has been challenged before the European courts in relation to rulings relating to Fiat, Starbucks and the Belgian excess profit exemption scheme. The outcome of those appeals is yet to be seen and legal uncertainty regarding the legality of tax arrangements between Member States and multinationals therefore continues, and will be prolonged if, as expected, Apple, the Irish government or both also appeal the Commission's ruling.

The U.S. Department of the Treasury has also written to the Commission and published a supporting White Paper, expressing concern at the various State aid investigations that are being conducted into tax rulings granted to multinationals (many of which are U.S.-headed). The White Paper urges the Commission to reconsider the investigations and instead focus efforts on the OECD's BEPS package. There therefore also appears to be political pressure in this area.

Although the appeal process is likely to take several years, any appeal will not suspend the validity of the decision and thus the Irish government must now start the process to recover the aid. The mechanics of how the aid will be recovered is a matter for Irish national law. Technically, a request to suspend the decision of the Commission can be made to the European courts pending a final judgment. However, the President of the EU General Court has recently rejected such a request from the Belgian government in relation to the pending appeal of the Belgian excess profit exemption regime, showing that the threshold for granting such suspension would be high and there must be exceptional circumstances or urgency justifying suspension of the recovery.

Interestingly, the Commission noted in its decision that the amount to be recovered by Ireland could be reduced if other European countries or the U.S. required Apple to pay more corporate tax in their jurisdictions. This seems to invite countries to consider whether, in light of the information revealed through the Commission's investigation, Apple's commercial risks, sales and other activities should have been recorded in their jurisdictions and thus more profits taxed in those countries. If such countries embark on tax-related inquiries into Apple, this could lead to further legal uncertainty and disputes pursuant to national tax regimes, relevant tax treaties and/or the EU Arbitration Convention (and complications may, in particular, arise where the limitation periods to recover unpaid taxes are different from the period covered by the Commission's investigation).

Update on other State aid tax ruling cases

In addition to the Apple case, the Commission has been investigating tax ruling practices in a number of Member States since 2013 and sent an information request to all Member States in December 2014. Of course, not all the cases brought forward by the Commission have the same merits and

there are different fact patterns, however it is useful to understand the picture as a whole.

In October 2015, the Commission concluded that Luxembourg and Netherlands had granted illegal selective tax advantages to Fiat and Starbucks, respectively, and ordered a recovery of EUR20 to 30 million for each company. Although Fiat and Starbucks have repaid the aid, the Dutch and the Luxembourg governments as well as Fiat appealed the rulings in December 2015 (with the date of the hearings yet to be confirmed). For further details of the decisions please refer to the previous Linklaters publication which is available [here](#).

Following on from the Fiat and Starbucks decisions, in January 2016 the Commission ordered Belgium to recover State aid granted to at least 35 multinationals under its excess profit exemption regime which the Commission deemed illegal under the State aid rules. The total value of the aid to be recovered amounted to approximately EUR700 million. The Belgian government and many companies have appealed the decision. The Belgian government also filed a request for interim measures in the General Court seeking a suspension of its obligation to recover State aid until the Court delivers its judgment on the main action. However, the request for temporary suspension was rejected by the Court on 16 July 2016 on the basis that Belgium failed to prove exceptional circumstances or urgency justifying suspension of the recovery of the alleged State aid.

There are two on-going Commission investigations into tax rulings in Luxembourg in relation to Amazon and McDonald's. According to press reports, the Commission is expected to issue its decisions on these two cases in the next 6 to 12 months, and there may be more cases in the pipeline that are not publicly known yet.

Conclusion

The amount to be recovered from Apple is the largest ordered by the Commission in any State aid case. This and other ongoing probes by the Commission (and related appeals) into tax rulings/regimes signifies the increased willingness of the Commission to use the EU's State aid regime as another tool to clampdown on the (perceived) tax avoidance by multinationals in a number of Member States.

Although the length of the appeals process in the EU courts indicates that there is unlikely to be a final ruling on the investigations for months and years to come, the stakes are higher than ever for multinational companies which rely or have relied on tax rulings by Member States. The amounts at stake may intensify the political pressures both within the EU and from outside the EU, and companies must now more than ever carefully assess whether any agreements or rulings they receive from national tax authorities are compliant with the State aid principles.

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This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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