



INSIGHT

HAS THE COMMISSION TAKEN TOO BIG A BITE OF THE APPLE?

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ABSTRACT: On 30 August 2016, the European Commission concluded that Ireland granted undue tax benefits of up to Euro 13 billion to Apple and ordered the recovery of the – allegedly – illegal State Aid. This Insight criticises the Commission's approach in the Apple case as well as in other recent State aid cases. The Commission's approach is problematic and premised on a novel interpretation of EU State aid law. This not only violates the principle of legal certainty, but also the legitimate expectations of the undertaking concerned. It is concluded that, instead of the solution adopted by the Commission, a more appropriate approach would be to show deference to the competence of Member States in the field of taxation.

KEYWORDS: state aid – transfer pricing – tax recovery – legitimate expectations – legal certainty – field of taxation.

I. INTRODUCTION

On 30 August 2016, the European Commission (the “Commission”) decided that under the EU State aid rules Ireland must recover Euro 13 billion euros plus interest from Apple to remove the alleged distortion of competition created by two Irish tax rulings issued to Apple in 1991 and 2007 respectively. The Commission alleges that Ireland granted illegal State aid to Apple from 2003 to 2014.¹ While this article specifically focuses on the Apple decision, the principles and theories discussed are also relevant to the Commission's other recent State aid and tax decisions in the Fiat² and Starbucks³

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¹ Commission State aid case SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP), on alleged aid to Apple by Ireland.

² Commission Decision of 21 October 2015 on State aid SA.38375 (2014/NN) (ex 2014/CP), on State aid which Luxembourg granted to Fiat.

cases and its ongoing investigations in the Amazon⁴ and McDonalds⁵ cases. The Apple decision has not yet been made public. Thus, this Insight can only analyse the European Commission's decision to open an investigation of the alleged State aid to Apple and its recent press release relating to State aid and tax.⁶ From the gist of the press release, however, the Commission appears to have departed from its opening decision consequently, the latter decision seems less relevant as of this writing.

II. STATE AID, TAX AND THE RISKS

Only certain forms of taxation are harmonised at the EU level, and direct taxation falls within the competence of the Member States. The Commission has no powers of its own under the Treaties to legislate on tax. That said, taxation is subject to the Commission's State aid control and the Court of Justice of the European Union ("CJEU") has recognised fiscal aid in its jurisprudence since 1973.⁷

The recent decisions and ongoing investigations in the area of State aid and corporate taxation mostly concern advanced pricing arrangements ("APAs") whereby transfer pricing of related party transactions is confirmed by tax administrations. It is undisputed that APAs can constitute State aid under Art. 107 TFEU since any relief from tax is inevitably financed by the State or granted through state resources if they confer an economic advantage on a selective undertaking/group of undertakings/goods that distorts competition and effects interstate trade.

The risk to be avoided however is that State aid policy may mistakenly identify a State aid where one does not exist; or fail to remove a State aid causing distortions to competition where one does exist; or go too far and impose a State burden that distorts competition.⁸ The latter risk of excessive taxation may be very real psychologically, given the temptation to co-opt State aid policy to address a pervasive and popular general concern that companies are being aggressive in their tax planning, leading to tax evasion and base erosion, where companies avoid tax by "locating expenditure" in high tax countries and "moving profits" to low tax countries. To avoid this, the international tax system is changing rapidly as a result of coordinated actions by governments and of unilateral measures designed by individual countries, both intended to tackle concerns

³ Commission Decision of 21 October 2015 on State aid SA.38374 (2014/C) (ex 2014/NN) (ex 2014/CP), on State aid implemented by the Netherlands to Starbucks.

⁴ Commission State aid case SA.38944 (2014/C), on alleged aid to Amazon by Luxembourg.

⁵ Commission State aid case SA.38945 (2014/C), on alleged aid to Mc Donald's by Luxembourg.

⁶ Commission Decision of 11 June 2014 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP), on Alleged aid to Apple by Ireland; Commission, *State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to €13 Billion*, Press Release, 30 August 2016, europa.eu.

⁷ Court of Justice, judgment of 2 July 1974, case 173/73, *Italy v. Commission*.

⁸ See L. LOVD AHL GORMSEN, *By Singling out Apple over Taxes, Brussels is Abusing its Own Rules*, in *The Daily Telegraph*, 29 August 2016, www.telegraph.co.uk.

over base erosion and profit shifting (“BEPS”) and perceived international tax avoidance techniques of high-profile multinational enterprises (“MNEs”). The recommendations of the BEPS Project led by the OECD and published in October 2015 are at the root of much of the coordinated activity.⁹

III. NOVEL INTERPRETATION OF THE NOTION OF STATE AID

The Commission’s approach in the cases mentioned is problematic, as it has endorsed a novel interpretation of EU State aid law.¹⁰ This novel interpretation not only violates the legitimate expectations of MNEs, but also legal certainty.

Firstly, the Commission does not distinguish “selectivity” from “economic advantage”, despite the wording of Art. 107 TFEU, and despite specific instructions from the CJEU in *MOL Magyar* and Advocate General Wahl’s Opinion in the case.¹¹ This is all the more important in cases concerning tax, as AG Kokott highlighted in her Opinion in *Finanzamt Linz v. Bundesfinanzgericht*:

“[I]n matters of tax law in particular, however, the decisive criterion is whether a provision is selective, because the other conditions laid down in Art. 107, para. 1, TFEU are almost always satisfied. [...]. The criterion relating to the selectivity of a national provision therefore requires careful handling. If the provision concerns neither one or more individually identifiable sectors capable of being defined by reference to their economic activity, nor individually identifiable undertakings, as the wording of Art. 107, para. 1, TFEU requires, then the provision in question cannot in principle be assumed to be selective”.¹²

In matters of tax law in particular, the decisive criterion is whether a provision is selective because the other conditions laid down in Art. 107, para. 1, TFEU are almost always satisfied. Thus, by presuming in tax cases that an advantage leads to selectivity effectively reduces the first two steps of the analysis to assess whether the arm’s length principle has been applied correctly.

Secondly, the Commission has effectively imposed the arm’s length principle (according to its own interpretation) as the tool to measure whether there is economic advantage in any transfer pricing scenario in the internal market. Transfer pricing tax rules

⁹ OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*, Action 5, 2015 Final Report, Paris: OECD Publishing, 2015.

¹⁰ L. LOVDAHL GORMSEN, *EU State Aid Law and Transfer Pricing: A Critical Introduction to a New Saga*, in *Journal of European Competition Law & Practice*, 2016, p. 369 *et seq.*

¹¹ Court of Justice, judgment of 4 June 2015, case C-15/14, *European Commission v. MOL Magyar Olaj-és Gázipari Nyrt.*, para. 59 and, on the same case, Opinion of AG Wahl delivered on 22 January 2015, para. 47.

¹² Opinion of AG Kokott delivered on 16 April 2015, case C-66/14, *Finanzamt Linz v. Bundesfinanzgericht, Außenstelle Linz*, paras 114 and 115.

are not subject of harmonisation measures at EU level,¹³ and it may well be the case that some Member States either have not implemented this principle in their national laws or that there are divergences in its transposition and application from Member State to Member State. The arm's length principle is not a rule of international law (whether treaty law or customary law) and as such no Member State has a legal obligation to implement it in national law and to apply it consistently with OECD Guidelines. Most modern tax treaties contain Art. 9 of the OECD Model Convention and, in some quarters, the assertion is made that there is an international body of tax rules which contains the arm's length principle as enunciated by the OECD.¹⁴ That said, in order to be a rule of international law, it must be binding on states. Art. 9 is only law to the extent that states give effect to it under domestic law. The Commission seeks to rely on an arm's length principle derived from European State aid law different from that of the OECD Guidelines. Moreover, in the opening decisions in Starbucks, Fiat and Apple, the Commission states that the arm's length principle is "an internationally agreed standard", but it does so without explaining why it should all of a sudden be part of the EU State aid law regime. The Commission seeks to justify its position by relying on the CJEU's judgment in *Forum 187*¹⁵ and it cites a number of decisions from 2001.¹⁶ However, the CJEU's endorsement of the arm's length principle in *Forum 187* is vague. The CJEU does not even refer to the term "arm's length principle" but rather focuses on the application of the "cost-plus method"¹⁷ and it does not clarify whether its endorsement should be read to apply only to the Belgian legal system or to all Member States. More importantly, the CJEU made specific reference to the cost-plus method "as recommended by the OECD", seemingly indicating that its interpretation should be strictly in line with the OECD Guidelines. In the absence of clear case law precedent and given the lack of harmonisation, no such EU arm's length principle can exist. Any assessment must be based on national rules, as not every Member State has implemented an arm's length principle or the OECD Guidelines.

The Commission's economic claim that the Irish tax rulings in Apple created a distortion of competition hinges on its claim that:

¹³ Other than in the Arbitration Convention, which aims to resolve disputes and double taxation that results from application of the arm's length principle differently by different Member States.

¹⁴ See for example R. AVI-JONAH, *International Tax as International Law*, Cambridge: Cambridge University Press, 2007.

¹⁵ Court of Justice, judgment of 22 June 2006, joined cases C-182/03 and C-217/03, *Belgium and Forum 187 ABSL v. Commission*.

¹⁶ M. HOCINE, *Aides fiscales: la Commission procède à l'examen approfondi du critère de la sélectivité dans le domaine de la fiscalité directe des entreprises*, in *European Commission Competition Policy Newsletter*, February 2002, ec.europa.eu.

¹⁷ *Forum 187 ABSL*, cit., paras 93-94.

“[t]he rulings endorsed a way to establish the taxable profits for two Irish incorporated companies of the Apple group (Apple Sales International and Apple Operations Europe), which did not correspond to economic reality: almost all sales profits recorded by the two companies were internally attributed to a ‘head office’... that these ‘head offices’ existed only on paper and could not have generated such profits”.¹⁸

Furthermore, the Commission claims:

“[t]hese profits allocated to the ‘head offices’ were not subject to tax in any country under specific provisions of the Irish tax law, which are no longer in force. As a result of the allocation method endorsed in the tax rulings, Apple only paid an effective corporate tax rate that declined from 1% in 2003 to 0.005 per cent in 2014 on the profits of Apple Sales International”.¹⁹

The problem with these conclusions is that the Commission does not appear to have conducted the kind of detailed analysis of the controlled transaction required in a proper application of the arm’s length principle. To do this the Commission needed to:

- a) Identify the relevant associated parties,
- b) Identify the relevant transactions that are being challenged and identify the key features of these transactions that determine prices at which transactions are consummated, and
- c) Consider the appropriateness of the transfer pricing method adopted by the parties and their assessment of whether the arrangements are arm’s length.

Only the actual Apple decision, when it is published, will show whether the Commission has gone through these steps and how.

IV. LEGAL CERTAINTY, LEGITIMATE EXPECTATIONS AND RETROACTIVITY

The principles of legal certainty, legitimate expectations and retroactivity are particularly important in the Apple case due to the enormous recovery and the amount of years Apple has had APAs with the Irish revenue. The principle of legal certainty requires intense scrutiny where the violation of a law leads to sanctions,²⁰ for example in State aid cases. As regards the principle of clarity and definiteness, the CJEU even established a rule of interpretation stating that vague laws are to be interpreted in favour of the addressee.²¹ According to the CJEU, the Commission is obliged to act in a timely manner to

¹⁸ Commission Decision SA.38373, cit.; Commission, *State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to €13 Billion*, cit.

¹⁹ *Ibid.*

²⁰ S. REINER *et alia* (eds), *Europarecht*, Baden-Baden: Nomos, 2015, p. 299.

²¹ Court of Justice, judgment of 9 July 1981, case 169/80, *Administration des Douanes v. Gondrand Frères*, para. 17 *et seq.* See also T. TRIDIMAS, *The General Principles of EU Law*, Oxford: Oxford University Press, 2006, p. 244.

avoid “a legitimate expectation”²² on the claimant’s side. A particularly important dimension of legal certainty is the notion of non-retroactivity of laws. It was first held in *Ditta A. Racke*²³ that legal certainty prohibits EU legislation which affects situations that were concluded before the publication of the law in question.²⁴ In these situations economic interests of market participants are gravely at risk. Economic actors usually rely on the state of the law at the time a transaction is made.²⁵ However, the courts allow retroactive norms where the purpose of a law requires this effect and where “legitimate expectations of those concerned are duly respected”.²⁶ Thus, retroactivity only appears to be implemented in limited cases where there is a compelling object of Union law.²⁷ The reference to the legitimate expectations of individuals is considered a proportionality test.²⁸ Only where there is no significant individual interest may a public interest justifying retroactivity prevail. The practice of the EU Courts in relation to the principle of non-retroactivity seems to depend on whether or not individuals reasonably relied on circumstances influenced by EU law.²⁹

The principle of legal certainty ensures that laws are “clear, precise and predictable as regards their effects”.³⁰ Hayek stressed the importance of predictability of judicial decisions and their contribution to an overarching impression of justice in society.³¹ Ever since its original development in the nineteenth century, the principle of legal certainty has always had an economic dimension.³² The notion of legal certainty on the level of EU law first appeared in the *SNUPAT* judgment.³³ The Court made clear that the concept is not an absolute one, but a relative one by holding that legal certainty could not in any case prevail over other legal principles.³⁴ A further development contributing to our understanding of the principle of legal certainty was the idea developed in *Inter-*

²² Court of Justice, judgment of 24 November 1987, case 223/85, *Rijn-Schelde-Verolme (RSV) Machinefabrieken en Scheepswerven NV v. Commission*.

²³ Court of Justice, judgment of 25 January 1979, case 98/78, *Ditta A. Racke v. Hauptzollamt Mainz*.

²⁴ *Ibid.*, para. 20.

²⁵ P. CRAIG, *EU Administrative Law*, Oxford: Oxford University Press, 2012, p. 550.

²⁶ *Ditta A. Racke*, cit., para. 20.

²⁷ P. CRAIG, *EU Administrative Law*, cit., p. 551.

²⁸ S. REINER *et alia* (eds), *Europarecht*, cit., p. 300.

²⁹ Court of Justice, judgment of 20 March 1997, case C-24/95, *Land Rheinland-Pfalz v. Alcan Deutschland*, para. 34 *et seq.*

³⁰ Court of Justice, judgment of 16 February 2012, joined cases C-72/10 and C-77/10, *Marcello Costa et alia*, para. 74.

³¹ F.A. HAYEK, *The Constitution of Liberty*, Chicago: The University of Chicago Press, 1999, p. 205 *et seq.* and p. 208 *et seq.*

³² J. VAN MEERBEECK, *The Principle of Legal Certainty in the Case-Law of the European Court of Justice: from Certainty to Trust*, in *European Law Review*, 2016, p. 275 *et seq.*, p. 279; F.A. HAYEK, *The Constitution of Liberty*, cit., p. 208.

³³ Court of Justice, judgment of 22 March 1961, case 42/59, *Société Nouvelle des Usines de Pontlieue-Aciéries du Temple (SNUPAT) v. High Authority*.

³⁴ *Ibid.*, para. 87.

nationale Handelsgesellschaft.³⁵ The CJEU developed the notion of general principles emanating from national constitutions in order to avoid conflicts with national provisions that Member States deemed indispensable.³⁶ This allowed the Court to reconcile the primacy of EU law with the protection of fundamental rights in the EU.³⁷ The Court found that these general principles should apply across all matters covered by the EU Treaties, although the specific application of these principles can be influenced by the subject matter of a specific area of law.³⁸ Art. 6, para. 3, TEU makes clear that the general principles are to be located at the same level as the Treaties of the European Union. The principles are therefore deemed to have “constitutional status”.³⁹ The principle of legal certainty carries even more weight as a sub-principle of the rule of law, which is enshrined in Art. 2 TEU as a core value of the European Union.

According to the principle of clarity and definiteness, laws that lead to detrimental effects for individual legal subjects must be clear and precise so that addressees can deduce their detailed rights and obligations.⁴⁰ This principle applies not only to the legislator but also to administrators where they issue administrative orders.⁴¹ Clarity and definiteness do not only assure predictability for legal subjects, they are also important elements to achieve the effective application of legal rules. This is even more important in the Commission’s decisions in Starbucks, Fiat and Apple, where the Commission is trying to maximise the administrative effectiveness of State aid law by adopting a novel interpretation of “selectivity”, as the individual freedom imparted by the rule of law may be at stake. The CJEU has tried to resolve this issue by combining an interpretation based on the logic of EU-wide uniformity with reasonable individual expectations based on the natural meaning of the words used in legislation.⁴²

³⁵ Court of Justice, judgment of 17 December 1970, case 11/70, *Internationale Handelsgesellschaft mbH*.

³⁶ P. CRAIG, *UK, EU and Global Administrative Law: Foundations and Challenges*, Cambridge: Cambridge University Press, 2015, p. 334 and p. 337.

³⁷ D. CHALMERS, G. DAVIES, G. MONTI, *European Union Law: Cases and Materials*, Cambridge: Cambridge University Press, 2014, p. 252 *et seq.*

³⁸ P. CRAIG, *UK, EU and Global Administrative Law: Foundations and Challenges*, cit., p. 339.

³⁹ J. VAN MEERBEECK, *The Principle of Legal Certainty in the Case-Law of the European Court of Justice: from Certainty to Trust*, cit., p. 280.

⁴⁰ Court of Justice, judgment of 13 February 1996, case C-143/93, *Gebroeders van Es Douane Agenten BV v. Inspecteur der Invoerrechten en Accijnzen*, para. 27.

⁴¹ General Court, judgment of 27 September 2006, case T-43/02, *Jungbunzlauer AG v. Commission*, para. 72.

⁴² J. VAN MEERBEECK, *The Principle of Legal Certainty in the Case-Law of the European Court of Justice: from Certainty to Trust*, cit., p. 283 *et seq.*

V. CONCLUSION

It is concluded that, rather than intervening in the power of Member States to set taxes within their jurisdiction, a more appropriate legal approach by the Commission would instead be one of *deference to Member State authority and decision making on transfer pricing by multinational enterprises and tax administrations* – at least of those Member States that are members of the OECD.⁴³

Such deference does not mean the Commission would not have a role to play, as it would still have discretion to investigate whether national tax administrations make rulings or issue APAs that may infringe Art. 107 TFEU. These inquiries however should be conducted more like transparency audits, in effect on behalf of other EU Member States, with less associated publicity and no mandatory orders. It is legally and economically undesirable to allow the Commission to order recovery of taxes when it believes there has been an inappropriate transfer pricing by MNEs and tax administrations involving OECD Member States.⁴⁴ This should be left to OECD Member States to address bilaterally and multilaterally.

If instead the Commission is allowed to exercise power to intervene on tax, and retrospectively order recovery of taxes, the likelihood of errors by the Commission appears to be high.⁴⁵ It is not a member of the OECD, but merely a participating observer, and it is not close to the tax affairs of Member States. The consequences of the Commission making errors will also be seriously adverse, and beyond its control.

Given that the Commission has a mixed membership base including non-OECD members, it is inevitably an imperfect agent for OECD members and therefore unlikely to be the OECD members' choice of agent. It would thus seem inconsistent with OECD arrangements to assume that EU Member States would have conferred on the Commission the power to set transfer prices which it has assumed in the Apple case.⁴⁶ The Commission also has no powers of its own under the EU Treaties to legislate on direct taxation. The Commission has not just conducted an audit of State aid rules in relation to tax in the Fiat, Starbucks and Apple cases. In the latter, it has gone so far as to retrospectively order recovery of taxes that are more than 200 times the taxes ordered by an EU Member State – Ireland – leaving it no choice but to appeal to the General Court.

⁴³ Not all the Member States of the EU are members of the OECD. The following EU Member States are not members of the OECD: Bulgaria, Croatia, Cyprus, Lithuania, Malta and Romania.

⁴⁴ L. LOVDAHL GORMSEN, C. MIFSUD-BONNICI, *Legitimate Expectation of Consistent Interpretation of EU State Aid Law: Recovery in State Aid Cases Involving Advanced Pricing Agreements on Tax*, 2016 (forthcoming).

⁴⁵ G. BARKER, L. LOVDAHL GORMSEN, *The Law and Economics of EU State Aids: An Assessment of the Commission's Apple Case*, 2016 (forthcoming).

⁴⁶ Commission Decision SA.38373, cit.