Comment

The EC's state aid ruling on Apple: an Irish perspective

Speed read

All eyes will be on the General Court of the European Union when it hears case T-778/16 which pits Ireland against the European Commission in a tax dispute. The amount at stake makes this one of the largest ever tax disputes to be heard by a European Court, indeed one of the largest tax cases ever. It is regretful that even at this late stage, neither the Commission nor Ireland, nor Apple, appear clear on what Irish tax law requires here. While Irish tax law is not entirely clear here, what is reasonably clear is that it was not applied by Ireland to Apple, creating prima facie selectivity and a state aid.

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In June 2014, the European Commission made public the fact that it was investigating whether Ireland had provided state aid to Apple via a 'sweetheart tax ruling'. At the end of August 2016, the Commission shocked the tax world by concluding that not only had Ireland granted Apple an illegal state aid, but that the aid amounted to €13bn, plus interest.

As an Irish tax professional with an interest in EU law, I find this case immensely frustrating, pitting as it does the European Commission (with no knowledge of Irish tax law) against the Irish state, which appears resolute in obfuscating the law that it is charged with enforcing.

I will begin by apologising for the Irish tax technical nature of this article. I felt it was necessary to understand the strength of the Commission's case. And I think that there was a 'selective' (and ultra vires) application of Irish tax law to Apple, but not necessarily for the reasons which the Commission has found.

I think neither Ireland, nor the Commission, is correct in their arguments at this time as to what Irish tax law requires; regretfully, though, Ireland appears to be further away than the Commission in this regard.

The correct starting point

As I read, and reread, the Commission's publications on alleged aid to Apple (SA-38373), including the non-confidential decision published on 19 December 2016 (see www.bit.ly/2hQns0J), I am struck by the question as to what is the correct starting point. I am not yet sure that the Commission has addressed this question. Neither, unfortunately, have Ireland, Apple, Apple's tax adviser or the Revenue Commissioners (the Irish government agency responsible for customs, excise and tax).

In order to prove that a tax ruling constitutes a state aid, the Commission must prove that Ireland, via the medium of the Revenue Commissioners, did not apply its own tax law correctly, thus offering a selective tax advantage to Apple.

So the first question must be: what did Irish tax law require here? The answer to that question – vexing as it is for a tax professional to admit – is that I am not entirely sure.

There are two, if not three, distinct parts of the Irish tax code which appear to apply here. Their interaction is entirely unclear, is based on ambiguous legislation, and has never been tested in the Irish courts.

The general rule

The general rule, broadly copied from the UK when we introduced corporation tax, is that corporation tax on trading income is based on the accounting profit with specific tax adjustments. If the general rules relating to corporation tax were the only issue, then the only basis in Irish tax law for producing the tax computation is the accounts, based on s 76 of the Taxes Consolidation Act (TCA) 1997 and its associated case law (for example, *Odeon Associated Theatres v Jones* (1972) 48 TC 257) and, since 2005, TCA 1997 s 76A.

It would always have been common practice for foreign companies with a branch in Ireland to produce branch accounts, in accordance with Irish GAAP, from which to produce their tax computation. Indeed, since 2005, tax legislation introduced to deal with the transition to the international financial reporting standard (IFRS) expressly states that the profits or gains taxable as trading income must be calculated from a set of accounts produced under Irish GAAP or IFRS. This appears not to have been done in this case.

The reason given for this by the Revenue to the Commission is that Irish companies are under an obligation to produce Irish GAAP accounts under the Irish Companies Acts, so they have no Companies Acts obligations to produce branch accounts. Which is true. This apparent breach of the 1991 agreement, under which the taxpayer committed to produce branch accounts, appears to be of no concern to Revenue; nor does the fact that, without branch accounts, Apple manifestly cannot comply with s 76A since 2005.

The absence of branch accounts is inherently problematic

Paragraphs 54 to 59, 61 and 69 of the Commission's decision might cause some eyebrows to be raised, in relation to what might have appeared in the branch accounts, had they been produced.

If the only Irish law at issue was the Irish tax law which the Commission has identified, the absence of branch accounts is inherently problematic.

Case law in the absence of branch accounts

If, in 1991, one were to take the view that the production of branch accounts had never been mandated by the Irish Companies Acts (as they weren't under Irish tax law until the 2005 introduction of s 76A), then recourse could be had to older case law, where the Irish Supreme Court held that the profits should be taxed where the true profit generating apparatus of a foreign company was located; see *Cunard Steam Ship Company v Herlihy (Inspector of taxes)* (1931) I ITR 330. In that case, the court found that a UK shipping company, which sold tickets for passage to America in Boston, could not be taxable in Ireland, where the passenger embarked on the ship.

There is some suggestion in para 54 of the Commission's decision that the sales entity Apple Sales International (ASI) conducts this activity in Ireland, but this point would need to be explored.

A solitary decision from our Supreme Court in 1931 does not give great clarity, although it is likely that the Irish courts would follow subsequent decisions of the British courts, such as the decision of the Privy Council in *CIR v HK-TVB International Ltd* [1992] STC 723. However, I struggle to see that the relevant case law clarifies the matter beyond doubt. If the 'true profit making apparatus' of Apple is the IP outside of Ireland, as distinct from sales in Ireland, this might lend some support for the position being taken by Ireland and Apple here.

However, if TCA 1997 s 25 is the appropriate charging provision, then since 2005 Irish tax law, via s 76A, clearly mandates the provision of branch accounts in accordance with GAAP applicable in Ireland. As such, any agreement from prior years, which agreed an alternative basis for producing the tax computation, would have become ultra vires from that date and couldn't have been relied upon by the taxpayer.

Neither Ireland, nor the Commission, is correct in their arguments at this time as to what Irish tax law requires … though Ireland appears to be further away

The Irish courts have consistently held that a taxpayer cannot have legitimate expectations as against the clear wording of a taxing statute; see, most recently, *Coleman v Revenue Commissioners* [2014] IEHC 662. A further ruling, subsequent to the introduction of s 76A in 2005, could not possibly (legally) have agreed that a taxpayer was permitted to ignore an express provision of the Irish tax legislation.

That appears to be the end of the matter, as far as ASI is concerned. Certainly since 2005, branch accounts must be produced in accordance with GAAP; and the profit adjustment, including adjustments of expenses not wholly and exclusively incurred for the purposes of the trade, must be made from there.

On that basis, an Irish branch and an Irish resident company are in directly comparable positions when paying their tax based on GAAP compliant accounts, and there would appear to be limited risk for selectivity.

However, that is not the end of the matter in relation to the manufacturing entity, Apple Operations Europe (AOE). Reference must be had to another part of our tax law not referenced by either the Commission or Ireland in the public communication to date.

TCA 1997 Part 45: the charging and assessment of non-residents

Part 45 of TCA 1997 deals specifically with the charging and assessing of non-residents to tax. It has, as its origins, Finance (No. 2) Act 1915 s 31. Section 31 extended the original charge in the Income Tax Act 1842 s 41, which dealt with non-residents, along with idiots, lunatics and married women!

Corporation tax was introduced in 1976 via the Corporation Tax Act of that year; however, broad exemptions (such as export sales relief) were retained, which meant that inbound investors did not pay any corporation tax on profits they generated here. Export sales relief was determined to be a state aid, and abolished from 1990, which directly led to the Apple discussions with Revenue in 1991.

When the Corporation Tax Act 1976 was introduced, s 8 (the predecessor of s 25 dealing with branches) expressly made itself (via sub-s 4) subject to the Income Tax Act 1967 in relation to this charge on non-residents.

The wording in Part 45 is such that the Irish courts could hold that s 25, with its accounts based approach to calculating profits via s 76 and 76A, can be rendered obsolete, if a taxpayer chooses to apply a more favourable rule in that part (and who wouldn't?).

Such a potentially more favourable rule exists in TCA 1997 s 1038, which provided at the relevant time that:

> '*Where a non-resident person is chargeable to income tax in the name of any branch*, manager, agent, factor or receiver *in respect of any profits or gains arising from the sale of goods or produce manufactured or produced outside the State by the non-resident person*, the person in whose name the non-resident person is so chargeable may, if that person thinks fit, apply to:
> (a) the inspector; or
> (b) in case of an appeal, to the Appeal Commissioners;
> to have the assessment to income tax in respect of those profits or gains made or amended on the basis of the profits which might reasonably be expected to have been earned by:
> (i) a merchant; or
> (ii) where the goods are retailed by or on behalf of the manufacturer or producer, by a retailer of the goods sold;
> who had bought from the manufacturer or producer direct and, on proof to the satisfaction of the inspector or, as the case may be, the Appeal Commissioners of the amount of the profits on that basis, the assessment shall be made or amended accordingly.' (emphasis added)

If you consider TCA 1997 Part 45 to be the correct starting point for AOE, as this author likely does (although we don't entirely have sufficient facts), the Irish tax law provided for some, albeit primitive, version of transfer pricing.

ASI is not a manufacturer according to paras 54 and 55 of the Commission decision, and as such must be taxable under ss 25 and 76A. AOE is a manufacturer, and as such may be within the ambit of s 1038 in respect of some or all of its activities. Presumably, one could seek to treat the manufacturing trade in Cork as a distinct and separate trade from the manufacturing activities, outsourced and other, outside of Ireland.

It is regrettable that no one among Apple, Apple's adviser in its communication with Revenue, or Ireland in its communication with the Commission, has made any reference to the provisions of Part 45.

While s 1038 is not unproblematic, it does appear to place the burden of proof on the taxpayer to introduce evidence as to what margins might reasonably be expected to have been earned by a merchant or retailer.

While there has been no Irish case law on the issue, other cases are instructive. One recent case dealt with minority oppression and the correct valuation method for ordering the purchase of a minority holding by the majority. The Companies Act, like s 1038, is silent on the specifics.

In the case of *Donegal Investment Group v Danbywiske* [2014] IEHC 615, the High Court expressed a strong preference for a market based approach based on comparables, to more subjective methodologies such as discounted cash flows. Much like the Commission here, the High Court criticised the inclusion and omission of certain comparables by the respective expert valuers. The Court of Appeal did not disturb this finding. It would seem to this author that it would take the same approach in relation to s 1038 if a case were to reach the Irish courts in 2016; and that, regardless of the current status of the OECD guidelines in Irish tax law, a transfer pricing study would need to be produced.

Whether that would have been the case had the matter been litigated in 1991 is a different matter.

Conclusion

As a matter of Irish tax law, ASI was absolutely mandated to produce GAAP accounts for the branch, from 2005 at the latest. If this did not occur, ASI did not comply with Irish tax law, and the Commission's case that there was an aid seems to be solid, albeit for slightly different reasons. The quantum of the aid cannot be known until such accounts are produced.

In relation to AOE, one might infer that s 1038 was invoked, and thus it is possible that accounts were not required. However, s 1038 requires the taxpayer to evidence the margins which might reasonably have been made by a merchant, or retailer, and there is no suggestion in what the Commission has released, that Apple or its adviser ever provided any such evidence to Revenue.

The reversal of the burden of proof in state aid cases, once the Commission has concluded that there is an aid, puts Ireland on the back foot. Ireland cannot defend the position Revenue agreed with Apple as a matter of Irish law, because those agreements did not comply with Irish tax law.

Next steps

As with all tax state aid cases, it is critical to ensure that any agreements are in compliance with local tax law, and that if they rely on Fisc discretion that it is within a margin of appreciation of that discretion. Apple and Ireland, appear to have missed this point. This author can offer no views as to the likely quantum of any aid which will end up being a matter for Revenue and potentially the Irish courts on appeal. But, in the opinion of this author, Irish tax law was not complied with here, by ASI from 2005 at the latest, and by AOE by failing to produce evidence to support its chosen margins. ■

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