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The Apple Case – Can You Sell What You Don't Own?

Theo Koelman (Taxdirector.nl) · Friday, September 11th, 2020

With the General's Court ruling on July 15, 2020, a first step has been taken in the question whether the Irish government has provided Apple with State Aid. So far, the General Court has ruled that the Commission has not been able to prove that the Irish government has provided State Aid to Apple. The Commission is in the position to appeal to this decision.

Apple's set-up / Supply Chain

With the State Aid case an interesting insight has been provided on how Apple has been able to lower its overall tax rate. Where most companies will ensure that the 'entrepreneur' is included in the invoice flow, Apple provides an alternative insight. The residual value (in the judgement the intellectual property is mentioned – however I have not found that residual value is repatriated to the US) on its EMEA sales is landed in two Irish companies that are not tax resident in any jurisdiction. The operations of these two entities form permanent establishments in Ireland. The Commission has not been able to prove that the residual value should be allocated to the permanent establishments in Ireland to substantiate the State Aid claim. With the residual value being allocated to the head-offices of the Irish companies, residual value is not taxed. Taxation will only occur when Apple will repatriate these profits to the US.

An EU law perspective

With the implementation of ATAD2 – anti-hybrid law – the EU has pushed to combat aggressive tax structures that make use of hybrid structures. Essentially, the two Apple companies that are stateless, don't pay taxes anywhere. The question here is whether ATAD 2 will effectively limit Apple's use of this structure from 2020 onwards. If you buy an Apple Watch – or any other Apple product for that matter – your Apple Store will source this product from Apple Ireland. Since taxation on the residual value of the Apple Watch is absent, the question is whether the payment from the Apple Store to Apple Ireland is (partially) non-deductible. Of course, nothing would have prevented Apple to deal with this potential leakage prior to the implementation of ATAD 2.

A mythical queste

The burden of proof in State Aid cases lies with the Commission. Since Apple allocated its residual value to two stateless companies, it was on the Commission to substantiate that the activities that generate the integral margin took place in the Irish permanent establishments. However, the effective leadership of Apple takes place in the US. So the smoke and mirrors created by Apple led to a situation where the Commission had to prove that the residual value which Apple had

transferred on paper to the Irish companies was also transferred economically, which of course is not the case.

Beneficial ownership

This brings us to another field where the European Court of Justice has shed its light on in the recent past: Beneficial Ownership. Essentially, Apple has not shifted its IP to Ireland. It has merely set-up a cost contribution agreement to offshore the IP for US tax purposes. One could argue that the line stops here. The US and Irish tax authorities are the most appropriate parties to question the construction from a tax perspective. However, one could also argue that Apple has knowingly and wilfully been trying to dissect the IP related part of what is typically glued to the goods in a usual value chain for goods. In doing so, it may have created its own demise in that local tax authorities could argue that the transaction should effectively be split in two, as is the case in a typical services value chain. A payment to Ireland for the cost-price of the goods and a royalty to the US as a remuneration for the IP. This will be a tough cookie, but if the local tax authorities argue that Ireland cannot sell what it does not own, this line of reasoning could hold. On the royalty payment to the US some European jurisdictions will withhold a tax at source, which will typically be reduced on the applicable tax treaty. However, in this case, it is questionable whether the tax treaty can be successfully invoked, given that the royalty is part of a payment to the UK and not the US. And the UK is not a bona fide collecting agent in this flow.

GAAR

With the payment not being picked-up in Ireland, an alternative line of reasoning opens up. Depending on the assembly activities in Ireland, it would make sense to include the US in a triangular invoice flow upon the sale of the goods from Ireland to the local Apple store and allocate residual value to the US accordingly. The local tax authorities could also argue that one of the principal reasons for excluding the US – as an entrepreneur – in the invoice flow is the avoidance of taxes. Therefore, the deductibility of the payment for the purchase of the goods – or the royalty part thereof – could be questioned.

Consequently, the Member States of the EU have gained additional insights on the tax planning efforts of one of Americas largest tech giants. A considerable part of the payments from their local Apple Stores has not been included in the Irish tax base. This could lead to local tax authorities questioning the deductibility of these payments or apply a withholding tax on the royalty part on the payment.

Anyway, the first chapter provides a promise for the future! More is to come in my view.

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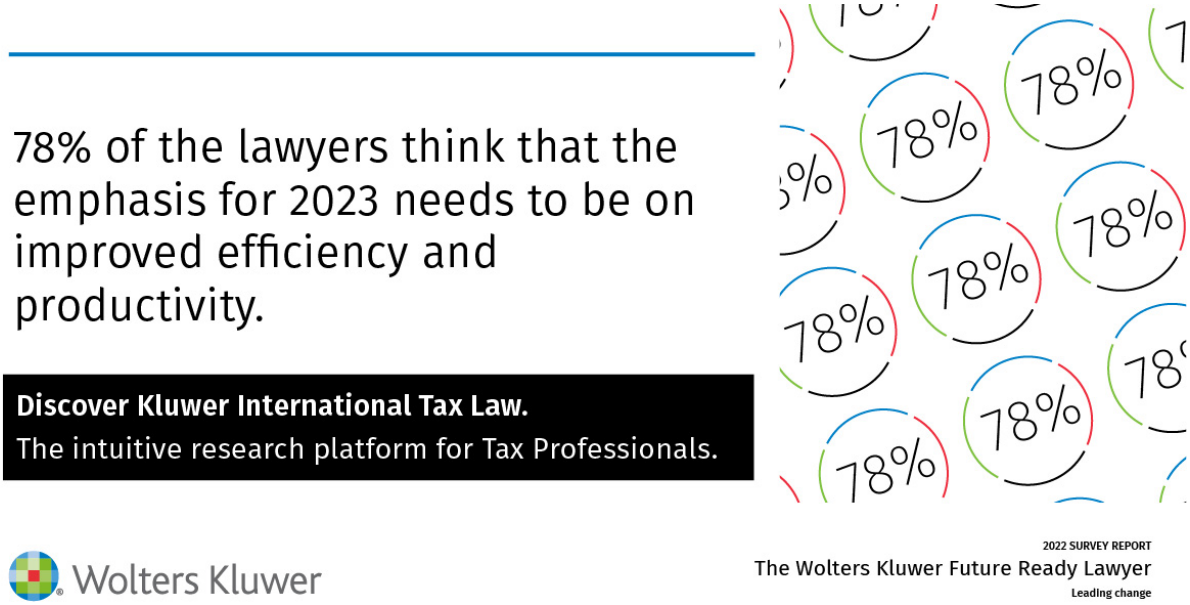

This entry was posted on Friday, September 11th, 2020 at 4:42 pm and is filed under Anti-tax avoidance, Beneficial ownership, EU law, EU/EEA, GAAR, Ireland, Permanent Establishments, State Aid, United States
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