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The General Court of the European Union has annulled the decision of the European Commission that had declared that the tax rulings issued by Ireland in favour of Apple in 1991 and 2007 constituted illegal State aid contrary to Article 107 of the TFEU and had ordered Apple to pay EUR 13 billion in unpaid taxes.

The General Court considers that, while the Commission may legitimately examine from a State aid point of view the application of national tax legislation in accordance with the principle of free competition and the rules on transfer pricing, in the *Apple* Case the institution has not proven that the tax rulings issued by the Irish Treasury gave Apple a selective advantage. In the General Court's view, the Commission did not properly substantiate the alleged methodological errors relating to transfer pricing rules and the comparability analysis of the Apple group entities that benefited from the tax rulings.

The judgment —which is subject to appeal to the European Court of Justice— is in line with the judgments of the same court in the *Starbucks* and *Fiat* Cases, accepts the Commission's general framework of analysis but imposes a rigorous standard of proof to show that the elements of a State aid measure are present.

The judgment of the General Court of 15 July 2020, *Ireland and Others v Commission*, T-778/16 and T-892/16, EU:T:2020:338 (the "**Judgment**") can be consulted here.

TAX RULINGS AND THE EUROPEAN COMMISSION

Since 2012 the European Commission ("**Commission**") has been investigating the tax rulings issued by Member States to multinational companies and their compatibility with State aid rules. A tax ruling or tax agreement is an agreement between taxpayers and tax authorities which determines, prior to the assessment of the tax, how transactions with other entities of the same group of companies are to be valued over a certain period of time.[1] In this context, the Commission has already issued eight decisions declaring that several tax rulings issued by the United Kingdom, Luxembourg, Ireland, Belgium and the Netherlands constitute illegal State aid and is keeping four other formal investigations open. The decision in the *Apple* Case was the fourth issued by the Commission, and stands out for being the largest: the Commission estimated the amount to be recovered by Ireland at approximately EUR 13 billion.

THE COMMISSION'S DECISION IN THE APPLE CASE

In its Decision no. 2017/1283 of 30 August 2016 in Case SA.38373 *Apple Ireland* (the "**Decision**"[2]), the Commission assessed two tax rulings of 1991 and 2007 issued by the Irish tax authorities in favour of two companies of the Apple group. These companies –Apple Sales International ("**ASI**") and Apple Operations Europe ("**AOE**")– were both subsidiaries of the parent company Apple, Inc. incorporated under Irish law. Despite being incorporated in Ireland, they were not tax residents in Ireland as their effective place of management was in the United States. However, precisely because they were incorporated in Ireland, they were also not resident in the United States under US tax law. These two subsidiaries had branches or permanent establishments in Ireland which had business activities in Ireland (channelling manufacturing and distribution into Europe and other markets). These branches, unlike ASI's and AOE's central offices or headquarters, were considered to be corporate taxpayers in Ireland. It is important to clarify, therefore, that these subsidiary companies took two distinct forms, one as a central office in the United States, and another as a branch in Ireland. The issue addressed by the

[1] Under Spanish tax law, tax rulings would correspond to "prior valuation agreements" on related-party transactions generally provided for in Law 27/2014 of 27 November on Corporate Income Tax (*Ley 27/2014, de 27 de noviembre, del Impuesto sobre Sociedades*).

[2] For a more complete analysis of the Decision, see VIDAL MARTÍNEZ, Patricia, CANALEJO LASARTE, Guillermo and LAPRESTA BIENZ, Ana Raquel: "La decisión de la Comisión Europea en el asunto Apple - los tax rulings y las ayudas de Estado", *Actualidad Jurídica Uría Menéndez*, no. 45, 2017, pp. 68-75 (available here).

tax rulings relates to how each subsidiary's income and expenditure is attributed between the central office and the Irish branch for Irish corporation tax purposes.

In essence, the two companies' profits were not taxable in the United States, and in Ireland they were only required to pay corporation tax on profits generated exclusively in Ireland by their branches. The profits made by these companies from their activity of channelling after-sales services and sales of Apple products in the rest of Europe (which were activities carried out locally but invoiced from the Irish branches) were not subject to corporation tax in Ireland. In fact, the Apple group's contractual system – which is confirmed by the tax rulings in question– allowed the vast majority of income to be attributed to the companies' parent company (without effective taxation), while a significant proportion of its expenses were attributed to the Irish branches.

The Commission's criticism relates essentially to the fact that the tax rulings had approved a methodology for allocating costs and profits to the Irish branches of the two Apple subsidiaries that was incorrect from a transfer pricing and a comparability analysis perspective (both factual and functional), and in so doing had given them a selective advantage that was incompatible with State aid rules.

Specifically, the Commission considered that the methodology applied deviated from the general system of taxation of Irish companies' profits and was not consistent with the arm's length principle, which requires that related-party transactions be valued at their fair market value. The Decision found that the criteria for market valuation and the allocation of business, risk and profits to ASI's and AOE's branches in Ireland had not been properly applied and that the methodology used in the tax rulings was therefore not in line with the OECD transfer pricing guidelines. According to the Decision, although Irish legislation at the time did not incorporate either the arm's length principle or the OECD guidelines, these tools should be applied under Article 107 of the TFEU. In the Commission's view, if these principles had been correctly applied, the Irish tax authorities should have considered that all profits from sales activities, other than interest income earned by Irish subsidiaries under normal market circumstances, should have been attributed to the branches for Irish corporation tax purposes and subject to the applicable Irish corporation tax rate.

In sum, the Commission considered that Ireland had granted State aid to the two Apple subsidiaries by selectively reducing their tax burden and ordered Ireland to recover the amounts due (approximately EUR 13 billion).

THE JUDGMENT OF THE GENERAL COURT

Ireland and Apple challenged the Decision before the General Court, which raised both general grounds and pleas in law alleging misapplication of the case-law criteria. In general, it can be said that the Commission has prevailed as regards the general framework of analysis (possibility of invoking the infringement of Article 107 of the TFEU to question tax rulings or transfer pricing agreements entered into by authorities and taxpayers), but has lost in terms of the concrete analysis of the case due to its failure to prove that the tax rulings were incorrect from a transfer pricing perspective.

General analysis of the tax rulings under the State aid rules

Firstly, the General Court rejects (as it did in the *Fiat* and *Starbucks* Cases) the general allegation that the Commission was encroaching on the exclusive competence of the Member States in the field of taxation. It thus recognises without doubt that the Commission can assess tax measures in the light of State aid rules, including tax rulings.

Secondly, the General Court also accepts that the correct reference framework for assessing whether the disputed measure was an unjustified exception constituting State aid was the general taxation of business profits (i.e. Irish corporation tax and not the specific provisions applicable to non-residents). This is important since the existence of a selective advantage has to be assessed in comparison with that reference framework.

Thirdly, the General Court raises no objection to the Commission's joint analysis of the advantage created by the measure and its selective nature. In fact, it recalls that in tax cases it is common for the two steps to overlap: exemption from a general taxation rule may be selective (it is an exception to the general regime applicable in comparable factual and legal situations not justified by the nature of the system) and at the same time confer an advantage on the collective (or individual undertaking, as the case may be) benefiting from that exemption.

Finally, the General Court has also accepted that both the arm's length principle and the OECD transfer pricing guidelines, even if they are not part of national tax law, are appropriate tools for analysing, in the light of Article 107 TFEU, whether a selective advantage has been created by a tax ruling. This does not mean, however, that the Commission can determine what constitutes "normal" taxation irrespective of national law, and then attribute any deviation from this "normal" taxation to a breach of State aid rules.

The Commission must prove the existence of a selective advantage, it is not sufficient to prove a methodological error in the tax ruling

Although, as mentioned, the General Court generally accepts the Commission's framework of analysis, it reminds the Commission that the burden of proving that all the elements constituting State aid exist – (i) the origin of the resources (the State), (ii) the existence of an advantage, (iii) the measure's selective nature and (iv) the distortion of trade and competition– lies with the Commission.

Specifically –and this is essential, as will be seen below– the General Court finds that it is not sufficient for the Commission to simply prove the existence of a methodological error in the tax ruling (for example, that the tax ruling does not correctly apply national legislation, the arm's length principle or the OECD guidelines). The Commission must also prove that this error confers a selective advantage on the undertaking to which the tax ruling is addressed. In other words, it must prove that, in the absence of the error, the undertaking to which the tax ruling is addressed would have been subject to higher taxation than that actually paid, which the Decision fails to demonstrate.

Analysis of tax rulings in the *Apple* Case

The Commission's decision was based on three lines of reasoning on the existence of a selective advantage, which the Court rejects one by one.

Firstly, the General Court rejects the Commission's first line of reasoning, according to which there was a selective advantage since all profits should have been attributed to the branches in Ireland. In this respect, the Judgment finds the Commission applied the State aid rules in a way that ignored the case law of the Irish courts in respect of branches of companies not resident in Ireland, which led the Commission not to analyse the relevant requirements under Irish law. In accordance with those requirements, in order to conclude that the subsidiaries should have been taxed in Ireland on all profits generated by those subsidiaries on a universal basis (i.e. as if they were Irish-resident companies taxed in Ireland on all income, whether generated in Ireland or elsewhere), the Commission should have proved that the income allocated to the subsidiaries corresponded to the activities and functions of the branches based on a comparability analysis (both functional and factual), and not to their US central offices.

That is to say, it is not sufficient under Irish law to state that the central offices had no actual business in order to allocate by exclusion all income to the Irish branch; it must be proven in the affirmative that the income in question corresponds to the business and functions of the branch (and the risks and benefits assumed by the branch). The Commission had made the first assumption (attribution of all income to the Irish branch by excluding any role of the US central office), but had not proved that the income corresponded to the activities of the branch.

To the extent that most of the Irish subsidiaries' income derived from the licences for the Apple group's industrial property rights, the General Court considers that the claim that ASI and AOE did not have a physical presence and own means (employees) to be able to manage these licences was not sufficient to attribute the income to the Irish branches. The General Court also states that the Commission should have established that the Irish branches were indeed involved in taking decisions on such licences and their management –a fact that is not proved in the Decision– and not merely claim that ASI and AOE lacked the means to do so. The General Court also considers that the Commission wrongly analysed the consequences of the arm's length principle, from the OECD guidelines, and of the distribution of functions and activities within the Apple group.

In conclusion, as the Decision erred as to the criteria to be applied under Irish law, the General Court considers that the Commission did not adequately establish the normal taxation that Apple's two subsidiaries should have faced, and consequently it did not establish the existence of a selective advantage.

Secondly, the General Court rejects the Commission's position in the Decision that a selective advantage was granted as the tax rulings applied an incorrect method to allocate revenues to the branches (i.e. the use of the operating margin method, in accordance with transfer pricing rules, calculated on the basis of operating cost). In general, the General Court accepts that the method used to determine the profits of Irish branches was appropriate. But, according to the Judgment, the Commission was unable to demonstrate that, under the operating margin method, the choice of the branches in Ireland as tested parties, the use of operating costs as profit indicators, and the choice of accepted levels of profitability in tax rulings, would have led to a reduction in the tax burden borne by the two Apple subsidiaries. It is true that the General Court does raise objections to the Irish administrative process that gave rise to the tax rulings as well as some discrepancies in their assessment by the tax authorities. However, as the Commission did not establish that these errors would actually have resulted in lower taxation, the mere

methodological error is not sufficient to prove the existence of a selective advantage; and thus the General Court agrees with the appellants.

Thirdly, the General Court rejects the Commission's last line of reasoning, according to which there was a selective advantage since the tax rulings had been granted on a discretionary basis. In this respect, the Judgment considers that the mere existence of discretion is not sufficient to prove a selective advantage in itself if it is not accompanied by evidence that that discretion had resulted in lower taxation. The Judgment considers that a number of criteria have already been developed to vacate tax rulings by the tax authorities in Ireland. Furthermore, the General Court does not accept that the Commission's comparison with 11 other tax rulings, relating to companies in very different circumstances to those of the Apple group, proves that the Commission has ample discretion.

The General Court therefore concludes that the Commission has not demonstrated that the tax rulings conferred a selective advantage and annuls the Decision.

THE WAY FORWARD

The Judgment, which follows the General Court's general approach in the *Starbucks* and *Fiat* Cases[3], sends an important signal about the Commission's policy in taxation matters.

On the one hand, the General Court has sent a very clear signal to the Commission about the level of scrutiny to which it will submit its decisions. This Judgment joins a series of recent judgments in the field of State aid and competition in which the Court has analysed the Commission's reasoning in detail and required a higher standard of proof for a finding of State aid.

On the other hand, and although the result is adverse, the truth is that the Judgment reinforces the Commission's general conceptual framework and allows it to continue investigating the tax rulings issued by Member States of the European Union. It is of note that the Commission can overcome the obstacles identified in this Judgment by carrying out more in-depth investigations, in which it proves and quantifies

[3] On these two judgments, see LAPRESTA BIENZ, Raquel and BELTRÁN DE LUBIANO, Jokin: "El Tribunal General de la Unión Europea se pronuncian sobre los tax rulings: los casos Fiat y Starbucks", *Actualidad Jurídica Uría Menéndez*, no. 53, 2019, pp. 124-128 (available here).

the advantage conferred by the methodological errors it identifies in the tax rulings. Extreme caution must therefore be exercised with regard to any tax arrangement of this nature.

Finally, the annulment of the Decision may reinforce the notion that the cautious application of the State aid rules is not an appropriate instrument to harmonise corporation tax bases at an EU level. In this respect, the Judgment may result in the European Union offering more tax incentives. In fact, on the same day as the Judgment was issued, 15 July, the Commission proposed a tax action plan to adopt measures at an EU level in this field, under Article 116 of the TFEU.

In any case, the Judgment is subject to appeal to the European Court of Justice, so we will have to wait to see whether it confirms the position taken by the General Court or, on the contrary, supports the Commission's interpretation.

Uría
Menéndez

Contact lawyers

Guillermo Canalejo
Partner
+34915870942
guillermo.canalejo@uria.com

David López
Partner
+34915860582
david.lopez@uria.com

Edurne Navarro
Partner
+3226396464
edurne.navarro@uria.com

Patricia Vidal
Partner
+34915860161
patricia.vidal@uria.com

Ana Raquel Lapresta
Senior Associate
+3226396464
raquel.lapresta@uria.com

Jokin Beltrán
Associate
+3226396464
jokin.beltrandelubiano@uria.com

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