

Is the EC's State Aid Position Reasonable from a US Standpoint?

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The question presented

I'm *not* asking whether the EC is correct as a matter of EU law – that's for people in the EU to judge!

Nor, whether it advances the EU's collective self-interest – ditto!

But rather: Should we in the US view the EU, through the EC, as acting within reasonable bounds?

Our view of their reasonableness may affect how we should respond.

The Apple-Ireland case

Apple's US employees developed technology for products sold WW.

Apple used in-house cost-sharing agreements to create FSI, for US legal purposes, on its EU sales (its Irish sub owns the IP for such sales).

Under Irish law, >99% of "Irish" income (in 2011) went to a phantom "head office" that continues to elude non-paranormal investigators.

EC: Irish tax concessions amounted to illegal state aid, improperly reducing Irish taxes by \$14B.

If sustained, this will raise Apple's WW tax rate on the "Irish" income from under 1% (for some years) to 12.5%.

Global & national tax politics & policy

Results like those Apple was getting may no longer be politically sustainable.

They are also quite bad from a global tax policy standpoint.

But let's also think about it from a US and EU standpoint.

Suppose we start by asking: Does the income have a “true” source?

After all, the US might think differently about the EU's taxing clearly US source income than clearly EU (whether or not Irish) source income.

What does “source” mean?

A term with limited, but not zero, economic content.

E.g., clearly Apple’s Irish affiliates didn’t have *Chinese* source income.

One fundamental question is whether one adopts an origin-based or a destination-based conception of source.

Income from Apple’s EU sales was economically (whether or not legally) US-source under an *origin*-based concept.

But it was economically EU-source (in sales jurisdictions) under a *destination*-based concept.

Origin vs. destination basis

Is one of these 2 concepts actually “right,” & the other “wrong”?

E.g., if origin-basis is the canonically proper way to determine source, then the EC is proposing to tax US source income.

As it happens, income – the tax base in an income tax – is theoretically an origin-based concept. It’s about production.

By contrast, consumption – the tax base in, say, a VAT – is theoretically a destination-based concept.

Does this mean the EC is improperly trying to tax US source income?

In a word, NO.

Is o-basis “correct” in an income tax?

Despite the intellectual congruence between taxing “income” & using the origin basis, there’s no reason of logic or history to privilege it.

Source in international tax is basically just a coordinating device.

Favoring an income tax (e.g., due to a view about currently taxing residents’ saving) \neq committing to a particular cross-border coordinating device.

The US source rules mix & match between o-based and d-based.

E.g., §861(a)(4): royalties from US use of patents, etc. are US source, without regard to where the IP was created.

Proposals to use sales-based formulary apportionment are good or bad on their merits – but not out-of-bounds for being destination-based. ⁷

What about cost-sharing?

Cost-sharing is an origin-based concept. It purports to determine where the research costs (& associated risks) were “really” borne.

But even under today’s (marginally) improved US cost-sharing regs, it’s completely bogus – &, under Apple’s grandfathered cost-sharing deal with the IRS, even more so.

A US parent gives \$\$ to a foreign sub, then the sub gives the same \$\$ back to the US parent.

Neither costs nor risks are truly being shared – nor can they be shared within an affiliated group.

Cost-sharing and the Apple case

At best, under cost-sharing, reduced US deductibility of expenses is the US tax price for effectively exempting rents from foreign sales.

It mainly applies to rents because companies get to choose when they will elect it.

In a case such as Apple, it's hard for the US to tell the EC with a straight face: “Even though *we* classified the profits from Apple's EU sales as non-US source, *you* can't legitimately do so.”

Nature abhors a vacuum (whether or not it endorses the “single tax principle”).

More on the EC decision (as viewed from a US perspective)

The EC's calling what Ireland did "state aid" is coherent under tax expenditure analysis.

While economically a bit "retroactive," that's how agency & judicial findings generally work!

Famous U.S. anti-tax avoidance cases, such as *Gregory v. Helvering* & *Knetsch v. United States*, were similarly "retroactive."

"The EC could have been more gracious & accommodating" ≠ "The EC is acting improperly."

Some of the carping may come from red-faced tax advisors to US companies who egregiously failed at their job of risk evaluation.

Is this bad for the US?

To a degree, yes – but not mainly due to the FTCs that Apple & other firms may generate ...

... even leaving aside the fact that we deliberately (although in my view foolishly) offer 100% reimbursement for foreign tax costs via the FTC.

Absent tax planning tricks that the US Treasury already (& wisely) is addressing, how likely is Apple to repatriate income taxed @ 12.5%?

Deemed repatriation may lie in our future, but surely will be applied at a greatly reduced rate.

So the main issue is: We'd rather have \$\$ belong to Apple SHs who are US individuals, than to non-US individuals who inhabit EC countries.

How should the US respond?

“Who gets the \$\$?” is a zero-sum US vs. EU question.

But it arises within a broader relationship that’s amicable, cooperative, & positive-sum.

This is why it matters that one could view the EC as acting reasonably.

Suppose we might have wanted to do exactly the same thing, in their shoes.

Then, while no harm done by (amicably) urging them to back off – or addressing our own inbound tax avoidance issues – apoplexy is probably best limited.

The age of Brexit and Trump

These are dangerous times in the world. Nationalist rage & grievance-mongering seem to be rising wherever one looks.

The Brexit vote threatens to hurt the UK a lot, & others to a degree.

It verges on bad taste even to mention the toxic Trump candidacy in the US.

This is a background against which I'd be cautious about unduly raising the US temperature regarding the EC state aid cases.