A U.S. Perspective on BEPS and the State Aid Cases

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Tax Cooperation vs. Tax Competition:

Cross-Atlantic Perspectives

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A story I’ve never quite understood

Aesop’s “The Man & the Satyr” perplexed me as a child - & still does.

“On a cold winter day, as a man & a satyr sat together in friendship, the man put his fingers to his mouth & blew on them. When the satyr asked why, he said he did it to warm them, as they were so cold.

“Then steaming hot food arrived. The man raised a dish towards his mouth & blew on it. When the satyr asked why, the man said he needed to cool it, as it was so hot.

“The Satyr sprang angrily to his feet, saying: ‘Begone! I’ll have nothing to do with a man who can blow hot & cold with the same breath!’”

But … but …

A modern update?: Apple’s “Irish” income from the EU state aid case.

Underlying facts from the *Apple* 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%.

The IRS/Treasury blow hot & cold

IRS agrees with Apple: under U.S. “cost-sharing” rules, this is foreign source income.

But U.S. Treasury (White Paper) tells the EC: you can’t tax it either!

Not formally saying the income is U.S. source (although in substance it is under an “origin-based” view), but is that the underlying thought?

Can income be at an “intermediate temperature,” like the breath of the Satyr’s guest?

It’s hard to argue, especially post-BEPS, that countries can’t reasonably take note of double non-taxation.

4 underlying international tax policy ambiguities

Controversiality of BEPS/state aid issues (on both sides of the Atlantic) reflects unresolved underlying disputes.

1) What does “source” mean? – Origin vs. destination concepts; relevance of artificial conventions.

2) How define optimal policy re. taxing “outbound”? – And how achieve it politically / administratively once defined?

3) How define optimal policy re. taxing “inbound”? (E.g., given intra- vs. extra-EU tax competition).

4) How evaluate foreign-to-foreign profit-shifting? (Note CFC rules)

U.S. international tax policy dissensus

2 warring sides: anti-tax (MNEs, Republicans, some academics) vs. anti-tax avoidance (some Democrats, some academics).

On BEPS & (especially) state aid, much more was heard from the anti-tax side.

This reflected U.S. companies' prominence as targets, & retroactivity concerns.

(The latter despite U.S. case law on tax avoidance, & reflecting U.S. tax advisors' red faces.)

What to expect next from the U.S.

Had the 2016 U.S. presidential election gone as most expected, more of the same was highly likely.

That is, from the Treasury, some (but limited) BEPS cooperation, some voicing of State Aid concerns, but no significant retaliation.

And from Capital Hill, little or nothing given the partisan divide.

The actual 2016 U.S. presidential election outcome makes prediction harder, as we're in less charted waters.

But based on what we've seen so far…

The Trump Administration, regardless of its views on BEPS & State Aid, has bandwidth issues. (E.g., are they capable of considering the application of §891?)

The bandwidth issues reflect, not just temperament & the degree of expertise at the top, but light staffing throughout the Executive Branch.

Republican Congressional majorities have generally been embarrassing themselves – & this is likely to continue.

Very large rate cuts, plus territoriality (but without Dave Camp-style safeguards), remain a good bet. But beyond that??

Encouraging (?) final words

The U.S. is going through a self-absorbed period.

Impulsive, ill-considered war-making is possible, but this would most likely be in Asia or Africa.

Whether ideal or not, U.S. self-absorption is not the worst possible outcome under existing parameters.

EU countries therefore can, but in any event probably must, chart their own courses, both re. BEPS & State Aid, and more generally.