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# TEN QUESTIONS ON THE *APPLE* JUDGMENT

CLIENT BRIEFING

September 2024

On 10 September 2024, the CJEU surprised most observers by issuing a final judgment in the Apple State aid case. The judgment endorses the position taken by the European Commission back in 2016, in a way that seems hard to square with other judgments issued recently by the CJEU. This decision has made headlines outside the tax world given the magnitude of the tax at stake. Does this mark a decisive change in the way the court approaches tax State aid cases, or are the principles here confined to the slightly unusual facts in *Apple*?

## 1. What has the CJEU decided in Apple?

On 10 September 2024, the CJEU set aside the judgment of the General Court of the European Union (GCEU) dated 15 July 2020 (*Ireland and others v European Commission* (Case T-778/16 and Case T-892/16)), and upheld the 30 August 2016 Commission decision (European Commission Decision (EU) 2017/1283 on State aid SA.38373 (2014/C)). In its 2016 decision, the Commission determined that rulings granted by Ireland on the appropriate profit allocation to the Irish branches of Apple Sales International (ASI) and Apple Operations Europe (AOE) amounted to €13bn of illegal State aid that Ireland should recover from Apple.

The Advocate General (Pitruzzella) previously advised, on 9 November 2023, that the GCEU judgment should be struck down and referred back to the GCEU to be decided on its facts. The CJEU disagreed, remaking the case in a final judgment which entirely agreed with the Commission's case.

As a result, Ireland is now required to collect around €13bn of tax from Apple. (To put that number in context, it is enough to fund the entire Irish healthcare budget for seven months.)

## 2. On what points did the CJEU disagree with the General Court?

The Apple case centres on two Irish incorporated 'stateless' companies, ASI and AOE. As the issues facing each company are broadly identical, and rather more is at stake in ASI's case (€13bn compared to €50m for AOE), our summary of the facts focuses on ASI.

ASI was incorporated in Ireland but managed in the United States, so that it was resident neither in Ireland nor the US (or anywhere else, for that matter). ASI carried on two different functions:

- It held the economic ownership of Apple's iPhone and iPad IP outside the Americas, under a cost sharing agreement with Apple Inc. in the US (Apple Inc. holding exclusive legal title to all such IP). ASI appeared to be a passive owner of this IP and did not have a significant number of employees (in Ireland or elsewhere) engaged in developing or managing the IP.
- Through a branch in Ireland, ASI purchased Apple products from manufacturers and sold those products to end users across Europe. Therefore, all sales in Europe were recorded in Ireland, rather than in the outlets that physically delivered the products. ASI had a large workforce in Ireland supporting this activity. As the company selling iPhones across Europe, and the economic owner of Apple's IP in Europe, ASI generated very significant revenues and profits.

The Irish Revenue agreed a basis for attributing profits to the Irish branch of ASI, under which the Irish branch was rewarded on a cost-plus basis taking account of the branch's operating costs (excluding ASI's costs under the cost sharing agreement). The remaining profits were attributed to the Apple IP, to which ASI's Irish branch had no claim. As the IP profits were allocated to the head office of a 'stateless' company, they were not subject to any immediate taxation. Under US tax law, those profits would eventually be taxed in the US (at the time, at 35%); however, that charge would have been deferred until the profits were remitted to the US. The US Tax Cuts and Jobs Act 2017 deemed all of ASI's profits to be remitted to the US at a reduced tax rate (between 8% and 15.5%).

The European Commission initially stated:

(i) that the appropriate profit allocation to the Irish branch of ASI under Irish tax law should necessarily be set at arm's length and that the 'authorised OECD approach' (AOA) should be applied to determine the profits allocated to the Irish branches, regardless of whether the OECD arm's length standard or the AOA were transposed into Irish domestic law; and

(ii) that the profit allocation validated by the Irish tax rulings resulted in a lower tax charge for the two branches than the allocation that would have resulted from a proper application of the AOA. The resulting reduction in the Irish branches' tax charge amounted to State aid.

In its 2020 decision, the GCEU rejected the appeals of Ireland and Apple on statement (i) above but upheld them on statement (ii), and consequently annulled the Commission decision. In other words, the GCEU held that the Commission was able to rely on the AOA but that it had not applied it correctly.

The CJEU rejected the GCEU's approach, holding that the GCEU was wrong (a) to hold that the Commission had relied on an inappropriate 'exclusion approach' to allocate by default ASI's profits to its Irish branch because those profits could not be attributed to other parts of that company (regardless of the functions actually performed in the branch); and (b) to have regard to functions in Apple Inc. when allocating profits between ASI's Irish branch and head office.

The CJEU then gave a final judgment. To do so, it notably stated that, as the Commission's right to rely on the AOA had not been cross appealed, the CJEU was bound to give its ruling within that framework. It held that, on this basis, all of the profits of ASI had to be split between the head office and branch, based on the functions in each; and that considering the (very) limited functions in the head office and the functions actually performed by the branch, essentially all of ASI's profits had to be taxed in Ireland.

## 3. Is the CJEU position in Apple consistent with its previous State aid rulings?

Not really.

The possibility for the Commission to rely on OECD principles rather than national law had been rejected by the CJEU in its 8 November 2022 *Fiat* decision (Case C-885/19 P and Case C-898/19 P), wherein it stated that the Commission should only rely on the domestic law of the member state to assess the normal level of taxation and could not take into account 'parameters and rules external to the national tax system … unless that national tax system makes explicit reference to them'. This principle was reiterated by the CJEU in its subsequent *Amazon* decision (Case C-457/21 P).

In the *Apple* case, the reasoning of the Commission is mostly built on the AOA even though this was not transposed into Irish law at that time (and indeed did not even exist when the original rulings were granted to Apple). As such, the overall conclusion of the CJEU in *Apple* is at odds with *Fiat* and *Amazon*.

In *Apple*, the CJEU sought to square this circle by saying that it had to reason within the framework validated by the GCEU (see paras 276-281 of *Apple*), given the decision not to cross-appeal the GCEU's reliance on the AOA. In that limited sense, one could argue that *Apple* does not contradict *Fiat* and *Amazon* but is instead a fact-specific decision driven by CJEU litigation procedure.

This argument, however, is not entirely convincing.

Firstly, the CJEU seems to state that the Commission was right to refer to the AOA since the latter 'corresponds in essence' with the PE profit attribution approach required under Irish law. This falls far short of the 'explicit reference' to international principles required in *Fiat*.

Secondly, and more strikingly, a similar procedural issue arose in *Amazon*, in which the CJEU held that the whole of the GCEU's reasoning to annul the Commission decision was based, wrongly, on OECD principles (which the GCEU claimed had been misapplied by the Commission) rather than national law. The CJEU nevertheless held that, as the GCEU's final decision to annul the initial Commission decision was correct on other grounds (because the Commission had itself wrongly relied on the OECD principles - discussed in under a page in the judgment!), it should be upheld. There was no need here for a cross-appeal or respondent's notice from Amazon or Luxembourg. Why should the principle be different in *Apple*?

## 4. Is the CJEU decision consistent with the arm's length principle?

Whether the 'operating cost-plus' profit allocation validated in the Irish rulings is in line with the arm's length principle is, plainly, a valid Irish tax question. It could have been argued, for example, that the significant amount of R&D costs incurred by ASI under the cost sharing agreement with other Apple entities should also have been subject to the cost-plus mark-up.

However, the *Apple* decision means that essentially all of ASI's profits were taxed in Ireland, even though those profits were far above the profits which ASI could have earned at arm's length. In reality, much of ASI's profits were driven by Apple's IP, which was largely developed and controlled by employees of Apple Inc. in the US.

In essence, the CJEU has held that the application of the AOA, when allocating profits between a head office and a permanent establishment (PE), may indeed lead to the branch being allocated 'too much' profit when the amount of profit recognised in the whole company is itself above an arm's length amount. This is consistent with the position we have occasionally seen HMRC adopt

in PE profit attribution disputes in the UK, but the position has been powerfully criticised by Richard Collier in his recent article 'A bad Apple ruling'. Even if the CJEU is right that PE profit attribution can allocate more profits to a branch than that branch could have earned at arm's length, is this the sort of manifest error by the Irish Revenue which, in light of *Engie* (Cases C-451/21 P and C-454/21 P), should amount to State aid?

## 5. Has the CJEU made the European Commission the supreme tax authority on transfer pricing questions?

Not quite. The Commission continues to have the authority to challenge the misapplication of domestic tax law by domestic tax authorities as State aid, but this has been confirmed by the CJEU many times before *Apple*.

In our view, however, the CJEU's earlier jurisprudence in *Fiat*, *Amazon*, and *Engie* indicates that, in tax State aid cases, the Commission can intervene only where the national tax authority departs from domestic law (and administrative practice) on the normal level of taxation. Indeed, this approach was reaffirmed by the CJEU a mere nine days after the *Apple* judgment, in finding that the UK CFC regime did not grant State aid through the finance company exemption (Joined Cases C-555/22 P, C-556/22 P and C-564/22 P). In that case, the CJEU confirmed that 'the Commission is in principle required to accept the interpretation of the relevant provisions of national law given by the Member State concerned'. This reaffirmation of the fiscal autonomy of Member States could suggest that *Apple* is an (outsized) outlier in the CJEU jurisprudence.

## 6. Could the Apple case recur today?

Not really. Various tax reforms, including the US GILTI rules, Ireland's abolition of 'stateless companies', and the creation of substance requirements in offshore territories, have led IP-rich companies to move any offshore IP into an onshore jurisdiction. Ironically, the main beneficiary of this IP onshoring trend has been Ireland, which now has to produce 'modified GDP' figures to remove what the Irish government calls 'globalisation effects' from measures of economic performance. (In 2023, Ireland's actual GDP figure was €95bn higher than the modified GDP figure - or over €18,000 extra a year for every individual living in Ireland.)

The Commission has, naturally, said that its State aid investigations have 'decisively contributed' to this change in tax approach.

## 7. Will the Irish government really recover €13bn from Apple?

Broadly, yes. An amount corresponding to the alleged State aid was placed by Apple into an escrow fund following the Commission's decision in 2016. The aid will now be paid out of this fund to the Irish government.

In its 2016 decision, the Commission suggested that the amount of State aid could be reduced if third countries, expressly including the United States, were able to tax ASI's profits themselves. The Irish Department of Finance noted on the day of the *Apple* judgment, that this had already occurred (although for 'only' €455m) and that no further tax claims were expected.

## 8. How will the US react to the decision?

Badly. Both Democrats and Republicans have seen the tax State aid investigations as unduly focused on US businesses, and as an attempt by the EU to collect tax revenues which should properly belong to the United States. We will likely need to wait for the outcome of the US elections in a few weeks to see what, if any, official response comes from the US.

In the meantime, one unresolved question from *Apple* is whether the IRS will grant a tax credit to Apple for the €13bn of Irish tax against Apple's US tax liability on the deemed repatriation of its foreign earnings under the Tax Cuts and Jobs Act. Apple's accounts say that it expects to receive credit for 'a portion' of the Irish tax.

## 9. How should other businesses react to this decision?

The CJEU's (seeming) willingness to depart from its recent State aid jurisprudence will worry many businesses, which thought that the Commission's tax State aid investigations would largely be rejected based on *Fiat*, *Amazon* and *Engie*. That said, in our view, the Apple case is likely to be limited to its own facts. Although *Apple* is routinely portrayed as a transfer pricing case, it really concerns PE profit attribution. The CJEU will likely struggle to endorse the outcome in *Apple*, under which Ireland is required to tax much more than an arm's length return, in a transfer pricing case. Businesses can also take comfort from the CJEU's rejection of the Commission's decision in the UK CFC case on 19 September (Joined Cases C-555/22 P, C-556/22 P and C-564/22 P).

## 10. What does the decision mean for UK businesses post-Brexit? Does it have any impact on the EU Foreign Subsidies Regulation?

The EU's State aid rules do not, of course, apply in the UK post-Brexit - though they will still be relevant to EU subsidiaries and branches of UK businesses. More recently, the EU has turned its attention to the risk that, owing to subsidies provided by non-EU countries to their own businesses, EU business may be placed at a competitive disadvantage. To combat this, the EU passed the Foreign Subsidies Regulation (FSR) in 2022, which can (amongst other things) allow the EU to block M&A deals unless certain foreign subsidies are repaid. Many of the Commission officials who worked on the tax State aid cases, including the official who led the Apple

investigation, are now working on the implementation of the FSR.

The way in which the FSR applies to tax measures remains work in progress. The FSR allows the Commission to intervene only if a 'foreign subsidy' has been provided: this does require the measure to be 'selective', and for this purpose the analysis in Apple (and the other tax State aid cases) will be relevant. However, for most businesses, the crucial question will be whether, in the context of an M&A deal, they have to notify tax savings to the Commission as 'financial contributions' by a non-EU country. This does not have a selectivity component, so sadly none of the tax State aid cases shed light on this mystery.

*This article was co-authored by Amaury de Galbert, Visiting Lawyer on secondment at Slaughter and May from Bredin Prat in Paris, and was first published in the 27 September edition of Tax Journal.*

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