



An Roinn Airgeadais
Department of Finance

EXPLANATORY MEMORANDUM

For the Information of Members of the Oireachtas

Dáil debate of Government motion on the Apple State aid case

7 SEPTEMBER 2016

That Dáil Éireann:

- (i) supports the Government decision to appeal the European Commission's decision that Ireland provided unlawful State aid to Apple;*
- (ii) commits itself to the highest international standards in transparency in the taxation of the corporate sector;*
- (iii) resolves that no company or individual receives preferential tax treatment contrary to the Tax Acts and calls on the Revenue Commissioners to continue to observe this principle; and*
- (iv) affirms its commitment to the 12.5 percent Corporation Tax rate, the Research and Development Tax Credit and Knowledge Development Box and affirms its view that taxation is a competence for Member States as set out in the EU Treaties.*

Background to the initiation of the Apple State aid investigation

1. By letter of 12 June 2013, the Commission requested Ireland to provide information on the practice of tax rulings in Ireland. In particular, the Commission requested information on any rulings granted in favour of Apple Operations International, Apple Sales International (“ASI”) and Apple Operations Europe (“AOE”). By letter dated 9 July 2013, Ireland submitted the requested information to the Commission.
2. On 21 October 2013, the Commission requested additional information relating to Apple Inc., in particular, it requested information regarding all companies related to Apple which are tax resident in Ireland, all rulings in force and all elements essential to support the tax ruling as provided by the addressee of the tax ruling to the Irish tax authorities, the Office of the Revenue Commissioners and, in particular, the underlying tax advisor’s report and, specifically, the rulings granted in 1991 and 2007.
3. On 21 November 2013, the Irish authorities submitted the requested information. By letter of 24 January 2014, additional explanations regarding Apple Inc. were requested, in particular, on turnover figures. On 5 March 2014, the Irish authorities provided the requested information.
4. By letter of 7 March 2014, the Commission informed the Irish authorities that it was investigating whether the tax rulings in favour of Apple constitute new aid and invited the Irish authorities to comment on the compatibility of such aid. Noting that the Commission had already requested, in its request of 21 October 2013, all essential elements underlying the tax rulings, the Commission invited Ireland to provide any additional information related to the profit attribution methodology on which the Irish tax authorities provided a positive opinion in the tax rulings of 1991 and 2007.
5. On 25 March 2014, the Irish authorities replied to that request for information by submitting all the tax returns of Apple-related companies in Ireland since 2004.

6. On 29 May 2014 the Irish authorities informed the Commission by letter that the turnover figures provided in their letter dated 5 March 2014 regarding Apple Operations Europe were not correct and provided corrected figures.
7. On 11 June 2014, the Commission gave its preliminary view that the tax ruling of 1991 and 2007 in favour of the Apple group constituted State aid according to Article 107(1) TFEU.

The beneficiary: the Apple Group

8. The European Commission decision concerns tax rulings on the attribution of profits to a branch granted by Ireland to ASI and AOE, members of the Apple Group, composed of Apple Inc. and other companies controlled by Apple Inc.
9. Apple is headquartered in the United States of America. Apple designs, manufactures and markets mobile communication and media devices, personal computers and portable digital music players. It sells different related software, services, peripherals, networking solutions and third-party digital content and applications.
10. Apple sells its products worldwide through its retail stores, online stores and direct sales force, as well as through third-party cellular network carriers, wholesalers, retailers and value-added resellers. In addition, Apple sells a variety of third-party products compatible with Apple products, including application software and various accessories, through its online and retail stores.
11. Apple sells to consumers, businesses and governments worldwide. Apple manages its business primarily on a geographic basis. The reporting geographic segments are Americas, Europe, Japan, Greater China, and Rest of Asia Pacific.
12. Apple includes a number of companies incorporated in Ireland; of these, Apple Operations International, ASI and AOE are not tax resident in Ireland.

13. In 2013, Apple had worldwide net sales of USD 170 910 million and a net income of USD 37 037 million. In 2012 and 2011, net sales amounted to USD 156 508 million and USD 108 249 million respectively.
14. According to data provided by Apple, ASI's sales revenues for fiscal years 2009, 2010, 2011 and 2012, were USD 12.4 billion, USD 28.8 billion, USD 47.5 billion and USD 63.9 billion respectively . This represents a 415% increase of sales revenues over the period 2009 to 2012.
15. The European Commission notes that the taxable income set out in its opening decision was taxed at 12.5%, except for limited components taxed at 25% mainly represented by interest payments received.

Apple Operation Europe (AOE)

16. Apple Operations Europe (AOE), formerly Apple Computer Ltd., was a 100% subsidiary of Apple Operations International (an Irish-incorporated non-tax resident company with no branch in Ireland).
17. AOE was an Irish incorporated non-tax resident company carrying on a trade through a branch in Ireland.
18. The main activity of AOE's Irish branch was the manufacture of a specialised line of personal computers. The company's branch purchased materials from related companies and sold manufactured products to a related company according to specified requirements. AOE's Irish branch also provided shared services to Apple companies in Europe, the Middle East and Africa (EMEA) region, including payroll services, centralised purchasing and a customer call centre.
19. AOE was party to a cost sharing agreement whereby, together with other Apple Inc. subsidiaries, it shared R&D costs and risks of developing certain Apple products. Apple Inc. held the legal title to all Apple IP, while AOE had IP rights under that cost

sharing agreement. No rights in relation to the IP concerned were attributed to the Irish branch of AOE.

Apple Sales International (ASI)

20. ASI, formerly Apple Computer International and originally Apple Computer Accessories Ltd., was a 100% subsidiary of AOE. ASI was an Irish-incorporated non-resident company carrying on a trade through a branch in Ireland. The main activities of the branch related to:

- procurement of Apple finished goods from third-party manufacturers (including a third-party manufacturer in China),
- onward sale of those products to Apple-affiliated companies and other customers, and
- logistics operations involved in supplying Apple products from the third party manufacturers to Apple-affiliated companies and other customers.

21. All strategic decisions taken by ASI, including in relation to IP, were taken outside of Ireland.

22. As with AOE, ASI was a party to the R&D cost sharing agreement with other Apple Inc. subsidiaries under which the total costs of the group's worldwide R&D are pooled.

23. ASI's Irish branch had no authority to make decisions relating to Apple IP or the cost sharing agreement. No rights in relation to the Apple IP concerned were attributed to the Irish branch. In the Commission's opening decision, the territory of tax residency of AOE and ASI was not identified.

What is State aid?

24. State aid is defined as an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities. Therefore, subsidies granted to

individuals or general measures open to all enterprises are not covered by this prohibition and do not constitute State aid (examples include general taxation measures or employment legislation).

25. To be State aid, a measure needs to have the following features:

- there has been an intervention by the State or through State resources which can take a variety of forms (e.g. grants, interest and tax reliefs, guarantees, government holdings of all or part of a company, or providing goods and services on preferential terms, etc.);
- the intervention gives the recipient an advantage on a selective basis, for example to specific companies or industry sectors, or to companies located in specific regions;
- competition has been or may be distorted;
- the intervention is likely to affect trade between Member States.

The contested measure: Tax rulings¹ in favour of AOE and ASI

26. The State aid decision concerns rulings on profit allocation to branches granted by Revenue in 1991 and 2007 in favour of AOE and ASI.

Apple Operations Europe

27. In 1991, a basis proposed by Apple for determining Apple Computer Ltd.'s (subsequently AOE's) Irish branch net profit was agreed by Revenue.

28. According to that ruling, the net profit attributable to the AOE branch would be calculated as 65% of operating expenses up to an annual amount of USD 60- 70 million and 20% of operating expenses in excess of USD 60-70 million.

¹ In Ireland, the term 'advance opinions' is used, but this note reflects the terminology used in the Commission documents re 'tax rulings'.

29. This was subject to the proviso that if the overall profit from the company was less than the figure resulting from this formula, that lower figure would be used for determining net profits of the branch.
30. Operating expenses included in the formula were all operating expenses incurred by Apple Computer Ltd.'s Irish branch, including depreciation but excluding materials for resale and cost-share for intangibles charged from Apple-affiliated companies.
31. In 2007, a revised approach for remunerating the Irish branch of AOE was agreed which was based on:
- (a) a 10-20% margin on branch operating costs, excluding costs not attributable to the Irish branch, and
 - (b) an IP return of 1-9% of branch turnover in respect of the accumulated manufacturing process technology of the Irish branch.

Apple Sales International (ASI)

32. In 1991, a basis proposed by Apple for determining Apple Computer Accessories Ltd.'s (subsequently ASI) Irish branch net profit was agreed by Revenue.
33. According to that ruling, the net profit attributable to the ASI branch would be calculated as 12.5% of all branch operating costs, excluding material for resale.
34. A modified basis for determining net profit was agreed for the ASI branch in 2007 with an 8-18% margin on branch operating costs.

Points made by the Irish authorities on the rulings

35. Under the relevant Irish tax law, non-resident companies are chargeable to Irish corporation tax only on the profits attributable to their Irish branches by reference to the facts and circumstances.

36. The profits of non-resident companies that are not generated by their Irish branches – such as profits from technology, design and marketing that are generated outside Ireland – cannot be charged with Irish tax under Irish tax law.
37. As regards the agreements in the rulings in favour of AOE, the Irish authorities expressed the view that AOE’s Irish branch was essentially a contract manufacturer and provider of shared services for related Apple entities.
38. The 10-20% margin on the Irish-based costs of those low-risk functions, together with the 1-9% of turnover return on manufacturing knowhow developed by the Irish branch, delivered an aggregate attribution of profit to the Irish branch that would have been commensurate with the activities undertaken in Ireland.
39. As regards the agreements in the rulings in favour of ASI, the Irish authorities expressed the view that ASI’s branch was considered to carry out routine, albeit important, functions in the procurement and onward sale and supply of goods for Apple. It would therefore have had no special valuable assets. Although the Irish branch arranged the procurement and onward sale and supply of goods (which did not pass through the Irish branch), the goods concerned derived their value largely from IP created in the US. There were also no indications that the Irish branch bore significant risks in relation to the activities of ASI.
40. Furthermore, Revenue was satisfied that the agreed margin on operating costs delivered a net profit commensurate with the value added by the Irish branch. On the basis of a branch-focused analysis of the operations undertaken in Ireland, it would have been clear that the main profit-generating functions and assets were not located in Ireland. All significant risks and all intellectual property would have been borne and economically owned elsewhere in the ASI enterprise or the Apple group and the profit attribution to the Irish branch would have represented full remuneration of its role in that process.

41. No selective advantage was given o Apple in these rulings.

Commission's final decision

42. Following an in-depth state aid investigation launched in June 2014, the European Commission concluded that two tax rulings issued by Ireland to Apple have substantially and artificially lowered the tax paid by Apple in Ireland since 1991.

43. The Commission stated that the rulings endorsed a way to establish the taxable profits for two Irish incorporated companies of the Apple group (Apple Sales International and Apple Operations Europe), which did not achieve, in the Commissions terms, a "market based outcome" as almost all sales profits recorded by the two companies were internally attributed to a "head office".

44. The Commission's assessed that these "head offices" existed only on paper and could not have generated such profits.

45. These profits allocated to the "head offices" were not subject to tax in any country.

46. The Commission found that the selective tax treatment of Apple in Ireland is illegal under EU state aid rules, because it gives Apple a significant advantage over other businesses that are subject to the same national taxation rules.

47. The Commission can order recovery of illegal state aid for a ten-year period preceding the Commission's first request for information in 2013. On foot of the Commission's decision, Ireland must now recover the unpaid taxes in Ireland from Apple for the years 2003 to 2014. The Commission estimates that this could be up to €13 billion, plus interest.

48. The Commission also stated that if other countries were to require Apple to pay more tax on profits of the two companies over the same period (2003-2014) under their national taxation rules, this would reduce the amount to be recovered by

Ireland.

49. The Commission noted that tax rulings as such are perfectly legal. They are comfort letters issued by tax authorities to give a company clarity on how its corporate tax will be calculated or on the use of special tax provisions.
50. The Commission's state aid investigation concerned two consecutive tax rulings issued by Ireland, which endorsed a method to internally allocate profits within Apple Sales International and Apple Operations Europe, two Irish incorporated companies. It assessed whether this endorsed method to calculate the taxable profits of each company in Ireland gave Apple an undue advantage that is illegal under EU state aid rules.
51. The Commission concluded that the tax rulings issued by Ireland endorsed an artificial allocation of Apple Sales International and Apple Operations Europe's sales profits to their "head offices", where they were not taxed. As a result, the Commission stated that the tax rulings enabled Apple to pay substantially less tax than other companies, which is illegal under EU state aid rules.
52. The Commission rejected Ireland's position that the relevant Irish law only allowed the Irish authorities to consider and tax the profits arising from the activities of the branches in Cork.
53. The Commission stated clearly that this decision does not call into question Ireland's general tax system or its corporate tax rate.
54. Furthermore, the Commission elaborated that Apple's tax structure in Europe as such, and whether profits could have been recorded in the countries where the sales effectively took place, are not issues covered by EU state aid rules. If profits were recorded in other countries this could, however, affect the amount of recovery by Ireland.

Recovery

55. As a matter of principle, EU state aid rules require that incompatible state aid is recovered in order to remove the distortion of competition created by the aid. There are no fines under EU State aid rules and recovery does not penalise the company or the country in question. It is designed to restore equal treatment with other companies.
56. The Commission has set out in its confidential decision the methodology to calculate the value of the undue competitive advantage provided to Apple.
57. In particular, Ireland must allocate to each branch all profits from sales previously indirectly, or implicitly, allocated to the "head office" of Apple Sales International and Apple Operations Europe, respectively, and apply the normal corporation tax in Ireland on these re-allocated profits. The decision does not ask for the reallocation of any interest income of the two companies that can be associated with the activities of the "head office".
58. The Commission can only order recovery of illegal state aid for a ten-year period preceding the Commission's first request for information in this matter, which dates back to 2013. Ireland must therefore recover from Apple the unpaid tax for the period since 2003, which, in the Commission's publically stated view, amounts to up to €13 billion, plus interest.
59. Around €50 million in unpaid taxes relate to the undue allocation of profits to the "head office" of Apple Operations Europe. The remainder results from the undue allocation of profits to the "head office" of Apple Sales International.
60. The recovery period stops in 2014, as Apple changed its structure in Ireland as of 2015 and the ruling of 2007 no longer applies.
61. According to the Commission, the amount of unpaid taxes to be recovered by the Irish authorities would be reduced if other countries were to require Apple to pay

more taxes on the profits recorded by Apple Sales International and Apple Operations Europe for this period. This could be the case if they consider, in view of the information revealed through the Commission's investigation, that Apple's commercial risks, sales and other activities should have been recorded in their jurisdictions. This is because the taxable profits of Apple Sales International in Ireland would be reduced if profits were recorded and taxed in other countries instead of being recorded in Ireland.

62. The amount of unpaid taxes to be recovered by the Irish authorities would also be reduced if the US authorities were to require Apple to pay larger amounts of money to their US parent company for this period to finance research and development efforts. These are conducted by Apple in the US on behalf of Apple Sales International and Apple Operations Europe, for which the two companies already make annual payments.

63. All Commission decisions are subject to scrutiny by EU courts. If a Member State decides to appeal a Commission decision, it must still recover the illegal state aid but could, for example, place the recovered amount in an escrow account pending the outcome of the EU court procedures.

Government position

64. The Government disagrees profoundly with the Commission's analysis. Ireland did not give favourable tax treatment to Apple. Ireland does not do deals with taxpayers. The Government has decided to appeal the Commission decision to the European Courts.

65. No fine or penalty has been levied against the Irish State.

66. The Government notes that the European Commission has explicitly stated that "this decision does not call into question Ireland's general tax system or its corporate tax rate". No other companies are subject to this decision by the European Commission.

Position of the Revenue Commissioners

67. The Revenue Commissioners have stated that in collecting the tax due under the law – whether from individuals or companies – Revenue acts independently and impartially, regardless of the taxpayer concerned. While Revenue cannot otherwise comment on the specific facts of this case because of taxpayer confidentiality, they have stated emphatically that–

- (a) there was no departure from the applicable Irish tax law by Revenue;
- (b) there was no preference shown in applying that law; and
- (c) the full tax due was paid in accordance with the law.

68. Under Irish tax law, non-resident companies are chargeable to Irish corporation tax only on the profits attributable to their Irish branches by reference to the facts and circumstances.

69. The profits of non-resident companies that are not generated by their Irish branches (such as profits from technology, design and marketing that are generated outside Ireland) cannot be charged with Irish tax under Irish law.

Government position on appeal

70. The Government has decided to appeal the Commission decision to the European Courts. This is necessary:

- to defend the integrity of our tax system;
- to provide tax certainty to business; and
- to challenge the encroachment of EU state aid rules into the sovereign Member State competence of taxation.

71. The State has a period of two months and 10 days to bring an appeal. The Government will now study the decision of the European Commission in consultation with its legal advisors to prepare the grounds for an appeal. The appeal process may

take several years.

72. An appeal to the European Courts takes the form of an application to the General Court of the European Union, asking it to annul the decision of the Commission.

73. Apple has indicated that it will exercise its right of appeal.

Government position on recovery

74. Notwithstanding an appeal, Ireland is required by law to recover the alleged State aid from the company. This involves recovering additional tax payments over a ten-year period in accordance with the methodology set out in the Commission's decision. These payments are also subject to an interest rate, set by the European Commission.

75. Ireland is not subject to any fine or penalty arising from the State aid decision.

76. Pending the outcome of any appeal process, the recovery sums may be placed in a ring-fenced escrow account. If an appeal is successful, the money will be repaid to the company; if an appeal is unsuccessful – and the Commission's decision upheld – the sum will be paid to the Irish State.

77. The European Commission has stated that the sums to be recovered by Ireland would be reduced if other countries were to require Apple to pay more taxes or if the US authorities were to require Apple to pay larger amounts of money to their US parent company. This is an entirely unprecedented aspect of the State aid decision – the concept that Ireland would not be judged to have granted illegal State aid if another jurisdiction had exercised taxing rights over the profits concerned is difficult to understand.

78. The recovery sums represent what, in the European Commission's view, is the amount of additional tax that would have been paid over the past ten years had

Ireland applied the European Commission's preferred methodology. The recovery sum also applies interest to those amounts.

Government position on international tax reform

79. Ireland continues to take an active role in global work to reform the international corporate tax system. The issue of aggressive tax planning by multinational companies is a global problem that requires a global solution.

80. In particular, this case centres on a mismatch between the company residence rules in Ireland and the US – the result of which was that the companies concerned were 'stateless' for tax purposes. This arose from a mismatch between Irish and US tax rules on company residency. By definition, being a mismatch of two countries' rules, this was not an issue for Ireland alone. Nevertheless the Irish part of this mismatch has since been addressed through legislative amendments to company tax residence rules.

81. The publication of the OECD Base Erosion and Profit Shifting (BEPS) reports in October 2015 was a significant milestone in this work. From the beginning, the key aim of the BEPS project has been to better align the right to tax with real economic substance and activity and, as such, the key outcomes of BEPS project align with Ireland's own tax strategy.

82. Ireland is actively involved in work towards implementing the key BEPS recommendations. Ireland was among the first countries in the world to implement country by country reporting in our domestic law. The Knowledge Development Box was the World's first such tax measure to comply with the OECD's tough new standards.

83. In June, Ireland agreed the Anti-Tax Avoidance Directive with other EU Member States. This Directive introduces five significant corporate tax anti-avoidance measures including implementing the OECD BEPS recommendations on controlled foreign company rules, interest limitation rules and hybrid mismatch rules.

84. There is now consensus that significant parts of the international tax system are broken and can only be fixed by deep and meaningful reform. This consensus has led to an unprecedented agreement on 15 OECD BEPS reports, which represents a comprehensive global response to the problems identified.
85. The core principle underpinning the ambitious project is that tax should be paid where the economic activity takes place. This aligns with Ireland's long-standing policy of attracting real and substantive operations that bring real jobs and investment into Ireland.
86. Ireland is playing its part in full in implementing the BEPS reports both domestically and at EU level through the Anti-Tax Avoidance Directive. In the Government's view, the way to tackle these difficult problems is through tax policy reform agreed at international level. State aid – which is a competition tool and not a tax policy tool – is an entirely inappropriate mechanism to achieve international tax reform.
87. The US Treasury has stated that: "The Commission's new approach is inconsistent with international norms and undermines the International tax system". The US Treasury White Paper is appended to this document for further information (Appendix I).
88. In the Government's view, the European Commission's decision undermines, impedes and conflicts with the global consensus.

APPENDIX I
