The Implications of the EU vs. Apple Case

The European Commission is taking a gamble with its case against Apple’s tax arrangements in Ireland.

Ever since the European Commission (EC) declared that Ireland “granted undue tax benefits of up to €13 billion to Apple” and ordered the company to pay it back, both sides have appealed against the ruling. The fact that Ireland said it isn’t owed any money has raised awkward questions about who the victim is in this case. It also raises uncertainty about who has the right to decide how member states treat their corporate guests: the member state or the European Union (EU).

The fact that the case was raised by EU Commissioner for Competition Margrethe Vestager and not the commissioner for taxation makes the case a particularly fascinating one and could present countries in the union with a challenging situation in their arrangements with foreign companies.

But why?

The biggest question in all of this, then, is why is the commission going after Apple and Ireland in particular?

In our recent case study on this topic, “Did Apple Pay Ireland Too Little Tax? Appealing the EU Ruling on Illegal State Aid”, co-written with Brian Henry, we note that the EU has not claimed that Apple broke any laws, but that its “sweetheart” deal from Ireland was in fact illegal because their tax arrangement meant unfair competition and therefore “state aid”.

As we detail in our case, the issue centres on an arrangement Apple had with Ireland. In 1991, Apple created an Irish subsidiary, Apple Sales International (ASI), which records all profits for Apple in Europe, the Middle East, Africa and India. When someone in Italy buys an iPhone, for example, the profit is recorded by ASI in Ireland, not in Italy. ASI paid annual tax rates between 0.005 percent and 1 percent in Ireland until 2014, due to an agreement negotiated between Ireland and Apple. Ireland has a low corporate tax rate for an EU country – 12.5 percent. Most other member states have corporate tax rates over 16 percent; Belgium’s is 33.9 percent. ASI paid far less than the already low corporate Irish rate, according to the EU.

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The previous image from the EU report shows how other European countries were affected by Ireland’s sweetheart deal with Apple. Showing these links wasn’t necessary for the case itself, but it seems that the EU wants to alert its members not only about the concept of low corporate tax as state aid and how it could be unfair to other companies in that country but also to inform other countries how some tax revenue may be slipping through their fingers.

It’s the first case that really links national tax affairs to competition policy. The result of the EU vs Apple and Ireland case will set out the rules of competition. But no other countries in the EU, except perhaps Luxembourg, have been so aggressive on tax deals for multinationals as Ireland. The whole perspective of how countries can attract companies without violating competition agreements or competing unfairly is something to be considered.

The case also raises the fact that even if the EU is successful in having Apple pay the taxes back, Ireland still has a lower rate of tax than anywhere else and the EU. There is also the issue of realising all these sales in a country where the sale is not actually being made.

Harmonised tax rate

Managers reading this case will notice the inefficiencies, inequities, and implications for how to think about where to locate a company or subsidiary or how to realise profits. It might expose small business owners who don’t have access to tax deals or other legal tax avoidance to the inequalities that are going on between firms.

The EU is considering a harmonised corporate tax, which is a tall order. Remember that even in federalist states, like the U.S. or Canada, they haven’t achieved an across-the-board, within-states tax. In the U.S., states have different corporate tax regulations compared with the other states; as do Canadian provinces. Businesses do pick up and move from one state to another, based in part on tax rates.

However, a harmonised tax rate across the EU may face other hurdles. It is well known that businesses regularly pass tax on to consumers and workers. Corporate taxes are necessary, but denying states the right to decide how they attract and retain foreign investment could impact their ability to compete.

The outcome

Now that the case is heading to the court in Luxembourg, there are two possible results: If the EU loses and Apple does not have to pay Ireland or any other member state these taxes, it confirms that countries have considerable independent power within the union. If the EU wins, member states will be restricted in their competition. One outcome we may expect from this case is that it will clarify the rules and practices for member states designing corporate tax arrangements.

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