EU Direct Tax Newsalert

General Court of the EU annuls the EC's decision in Apple

On 15 July 2020, the General Court of the European Union (GC) rendered its judgment (T-778/16 and T-892/16) regarding the action brought by Apple Sales International (ASI), Apple Operations Europe (AOE) and Ireland for the annulment of the final State aid decision of the European Commission (EC) of 30 August 2016 on Apple (SA.38373). The GC annulled the EC's decision because the EC did not demonstrate the existence of an economic advantage within the meaning of EU State aid rules.

Background and facts

In its final decision on Apple, the EC concluded that the two rulings granted in 1991 and 2007 on the attribution of profits to the Irish branches of two Irish incorporated, non-resident companies constitute unlawful State aid, and ordered immediate recovery of the aid. Click here for our EUDTG newsalert.

Both Ireland and Apple appealed this EC final decision before the GC challenging the EC's "primary line of reasoning" for: (1) incorrectly identifying the reference framework, inter alia, on the basis of incorrect assessments of Irish law, misapplication of the arm's length principle and the 2010 OECD Transfer pricing Guidelines; (2) having erroneously assessed the activities within the Apple Group; and (3) having erroneously assessed the selective nature of the contested tax rulings. In addition, Ireland and Apple contested the assessments made by the Commission in relation to the EC subsidiary line of reasoning and the alternative line of reasoning.

GC's judgement

The GC noted from the outset that the contested tax rulings form part of the general Irish corporation tax regime, the objective of which is to tax the chargeable profits of companies carrying on activities in Ireland, be they resident or non-resident, integrated or stand-alone. The GC then noted that the EC did not err when it concluded that the reference framework in the present instance was the ordinary rules of taxation of corporate profit in Ireland, which includes the provisions applicable to non-resident companies laid down in Section 25 of the TCA 97.

Next, the GC ruled that the allocation of profits to a branch of a company may lend itself to the application by analogy of the principles applicable to establishing the prices of intra-group transactions within a group of undertakings if it is clear from national tax law that the profits derived from the activities of the branches of non-resident undertakings should be taxed as if they resulted from the economic activities of stand-alone undertakings operating under market conditions. Where this is the case, the arm's length principle (ALP) is an appropriate tool to determine whether the profits allocated to such branches corresponds to the level that would have been obtained through carrying on that trade under market conditions.

The GC ruled Article 107 TFEU does not oblige Member States to apply the ALP in all areas of their national tax law. Accordingly, at the current stage of development of EU law, the EC does not have the power independently to determine what constitutes the 'normal' taxation of an integrated undertaking while disregarding the national rules of taxation. However, in the present case, the GC concluded that since the relevant Irish legislation forming the 'normal' rules of taxation seeks to compute the taxable profits of a branch carrying on a trade in Ireland in the same way as it would compute the taxable profits of an Irish resident company carrying on the trade, the EC has the competence to check whether the profit allocated to the ASI and AOE branches correspond to the level of profit that would have been obtained if that activity had been carried on under market conditions.

Whilst the Authorised OECD Approach (AOA) has not been incorporated into Irish tax law, in the GC's view, it is clear that there is some overlap between the application of Section 25 and the functional and factual analysis conducted as part of the first step of the analysis proposed by the AOA. Therefore, the EC cannot be criticised for having relied, in essence, on the AOA for the purpose of allocating profits to the Irish branches of ASI and AOE. However, according to the GC, the approach followed by the EC in its primary line of reasoning is inconsistent with the AOA and the relevant Irish law. In particular, the GC concluded that, in determining whether the Apple Group's IP licences should have been allocated to the branches as the EC argued, the focus should have been on the actual activities of the branches rather than on the levels of activity (or perceived lack thereof) elsewhere in the companies (e.g. at the head offices).

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The GC then went on to assess the activities of the Irish branches of ASI and AOE within the Apple Group. The Court concluded that the EC has not succeeded in showing that, in the light of (i) the activities and functions actually performed by the Irish branches of ASI and AOE and, (ii) the strategic decisions taken and implemented outside of those branches, the Apple Group's intellectual property (IP) licences should have been allocated to those Irish branches when determining the annual chargeable profits of ASI and AOE in Ireland.

As regards the EC's secondary line of reasoning, namely that even were the IP not allocated to the branches the approaches adopted for determining the branch profits were still inappropriate, the GC ruled that the EC failed to demonstrate the existence of an advantage to ASI and AOE. In this context, the Court noted that the mere non-observance of methodological requirements for the determination of transfer pricing does not necessarily lead to a reduction of the tax burden for the Irish branches of ASI and AOE. In particular, whilst the EC had challenged the choice of the tested party, the choice of the operating costs as the profit level indicator for the Irish branches of ASI and AOE, and the remuneration of the Irish branches accepted by Irish Revenue in the contested tax rulings, in the view of the Court they had not adequately demonstrated that there were more appropriate methodologies that would have given rise to higher taxable profits in the Irish branches of ASI and AOE. The GC went on to conclude that, any defects identified by the EC in the rulings or transfer pricing approaches are not, in themselves, sufficient to prove the existence of an advantage for State aid purposes.

Finally, with respect to the alternative line of reasoning, the Court held that the EC did not prove that the contested tax rulings were the result of discretion exercised by the Irish tax authorities and that, accordingly, ASI and AOE had been granted a selective advantage.

Takeaway
It remains to be seen whether the EC will seek to appeal the GC judgment before the European Court of Justice and what the implications of this judgment are for the other ongoing State aid cases which concern transfer pricing.