How Apple Group Succeeded to Avoid Billions of Euros in Taxes by Shifting Profits into Subsidiaries from Ireland

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Abstract

The paper explores a subject that is getting more and more popular, namely how companies use loopholes to report domestic profits as being earned by subsidiaries in a tax haven, with the purpose to avoid paying taxes. I have chosen to present the case of the largest tech company in the world: Apple Inc.

Apple Inc., for two subsidiaries created in Ireland, benefited of a tax ruling agreement that was in force between 1991 and 2014, attributing the profits to a head office with no tax residency and therefore not taxable in Ireland or anywhere.

The European Commission performed an in-depth investigation on the State Aid implemented by Ireland to Apple, and while it revealed the undue tax benefits that Ireland granted to the company, amounting 13 billion euros, that should be recovered, Apple claims that it does not owe a single euro in any country around the world.

Key words: tax haven, subsidiaries, state aid, corporate tax
J.E.L. classification: H26

1. Introduction

Tax havens are a modern phenomenon, whose origins lie at the beginning of the twentieth century, being commonly associated with tax avoidance, which is considered as old as taxation itself.

Very often a discrepancy can be noticed between where companies report their profits and where they actually establish their personnel and assets.

Most of the World's largest corporations established subsidiaries in different offshore tax havens, from the Fortune 500 not less than 366 companies operating at least one subsidiary in a tax haven country. This is a clear indication on how commonly used are tax havens among large companies (Phillips et al, 2017, p.8).

2. Theoretical background. The practice of companies to use tax haven subsidiaries

According to OECD, to determine whether a jurisdiction is a tax haven, four key factors should be considered. First, a jurisdiction that offers to non-residents or foreign controlled legal entities taxes at a very low level, or even nonexistent, might be a tax haven. Nevertheless, this criterion is not enough, by itself, to conclude that a jurisdiction is a tax haven. More than that, OECD recognizes the right of every jurisdiction to determine whether to impose direct taxes and, if so, to determine the appropriate tax level. Therefore, some other factors should be acknowledged:

- local administrative or legal arrangements that prevent the exchange of information for tax purposes with other jurisdictions regarding taxpayers that benefit from taxes at a minimal rate
- legal, legislative or administrative practices that are not transparent
- absence of a clear requirement that the activity be substantial, as the lack of such activities may suggest the attempt of a jurisdiction to attract investments and transactions that are purely tax driven. As it is often the case, the operational presence of a company in a tax haven is limited to a post office box.

According to Phillips et al (2017, p8), as of 2016, almost 3/4 of the Fortune 500 companies report maintaining at least 9,700 subsidiaries in jurisdictions considered tax havens. From the remaining 1/4 of companies, while some might be only domestic, others might not operate tax haven subsidiaries or simply choose not to disclose the subsidiaries that they have.

During recent years, most of the Fortune 500 companies decided to establish their subsidiaries for tax purposes in jurisdictions outside the Caribbean area, as islands like Bahamas or British Virgin Islands are widely known as tax havens.

Some authors, including Phillips et al (2017, p8), consider this as a change of strategy, due to the fact that, in the public opinion, island tax havens are more likely to be illegitimate that the ones located in Europe. In fact, more than half of the major 500 companies in the world actually established at least one subsidiary in Europe, the Netherlands being the most preferred tax haven country, followed by Luxembourg, Switzerland and Ireland.

The research performed by Phillips et al (2017,p2) revealed that those companies are holding, for tax purposes, almost 3 trillion euros in accumulated profits offshore, four of them Apple, Pfizer, Microsoft and General Electric, accounting twenty-five percent of the total.

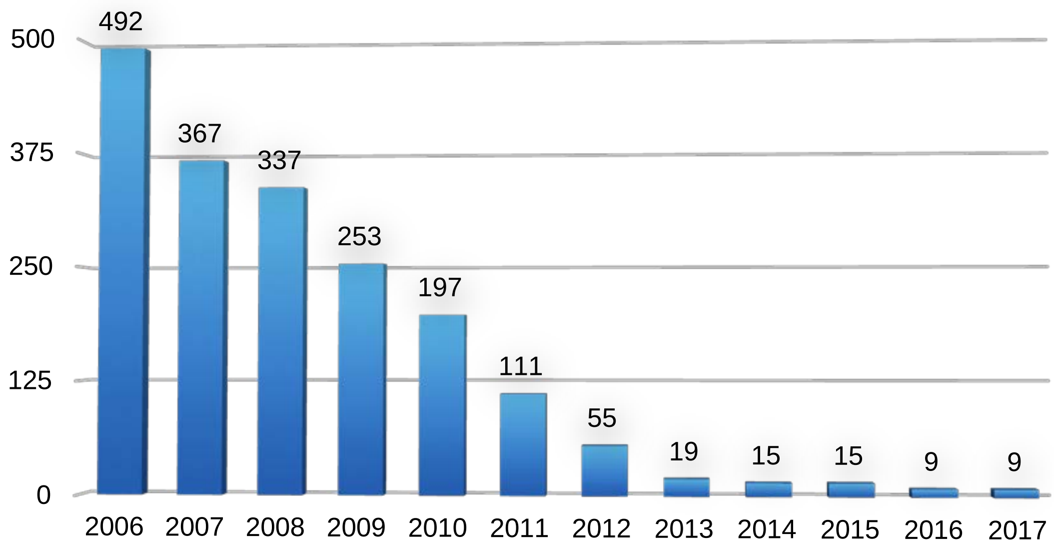
3. Apple - the largest tech company worldwide

Apple, founded in 1977 in California by Steve Jobs and Steve Wozniak, having 116,000 employees, is, according to the Forbes 2017, the largest tech company worldwide.

Apple's core product lines are iPhone - the Company's line of smartphones based on its iOS operating system, iPad - the Company's line of multi-purpose tablets based on its iOS operating system and Mac - the Company's line of desktop and portable personal computers based on its macOS operating system.

Apple is currently not only the most successful tech company worldwide, but also the 9th largest company, according to the Fortune Global 500 list, with a spectacular evolution over the last 12 years.

Figure no. 1: Apple's rank in Fortune Global 500 -2006-2017



Source: Author's processing after Fortune Global 500 statistics

The Apple Group is composed of Apple Inc. and all companies controlled by it, including those established in Ireland. Both Apple Sales International (ASI) and Apple Operations Europe (AOE) are Irish incorporated companies fully-controlled by the Apple group, ultimately owned in US by the Apple Inc.

The corporate tax rate applicable to the profit of companies subject to tax in Ireland is 12.5 %, in the US being at the level of 35%.

4. Data and method

For a comprehensive understanding of the case, a number of written documents from various sources have been analyzed. Data from publicly available financial statements of Apple, reports of the European Commission and the Permanent subcommittee on investigations of the US Senate and also press releases were utilized. The analysis was performed through a process of iterative readings of the texts, the interpretations being further refined during the analysis. In addition to what the Apple stated in it's reports and press releases, what it omitted to mention was also examined, as silence on a specific issue in a corporate report also conveys valuable information about the strategy of a company that attempts to manipulate its public image.

5. The findings of the investigation performed by the European Commission on the State Aid Ireland gave to Apple

In 1991, Ireland granted a tax ruling in favor of both ASI and AOE, replaced by a similar second one in 2007, that produced its effects on the taxable profits of ASI and AOE until 2015, when both changed their structures. The extended state analysis conducted by the European Commission concluded that the taxable profits of the two subsidiaries in Ireland were not correlated to economic reality, having no factual or economic rationale.

Even if the customers of Apple Sales International are buying products from the shops in Europe (but also from countries located in Asia and Africa), from the contractual point of view, the seller used to be ASI in Ireland. As reported by the European Commission, those sales and their corresponding profits were recorded by Apple in Ireland, most profits being internally allocated to a head office belonging to Apple Sales International. According to the European Commission Decision on State Aid implemented by Ireland on Apple, issued in August 2016, both ASI and AOE, in the period the contested tax ruling was producing its effects, even if integrated in Ireland, they were not resident for tax purposes there. The finding revealed that the two companies were not actually resident in other tax jurisdiction either, during that time, having no physical presence or employees for their head offices, therefore lacking the taxable presence in US or somewhere else. To the Irish branch, and taxable in Ireland, was allocated only a part of the profits of ASI, the significant majority of profits being attributed to a head office with no residency and remaining untaxed.

According to Commissioner Margrethe Vestager, responsible of competition policy within the European Commission, the EC findings revealed that Ireland offered illegitimate tax benefits in favor of Apple, that was allowed to settle an effective corporate tax rate at the level of only 1 per cent on its European profits in 2003, down to 0.005 per cent in 2014. She also underlines that under EU state aid rules, Member States are not entitled to grant tax benefits to selected companies and if this occurs, state aid should be reclaimed in order to remove the distortion of competition generated by the aid and to reinforce similar treatment with other companies. However, no fines are foreseen under the EU State aid rules, therefore the recovery does not penalize the company concerned.

The Commission is entitled to request recovery of illegitimate state aid only to the extend of ten years before the moment it began requesting information on the subject, which was 2013. Therefore, the EC stated that Ireland is entitled to recover from Apple the unpaid tax beginning with 2003, amounting up to €13 billion, to which interest should be added. Anyhow, in 2014, Apple decided to change its structure in Ireland after it consulted the firm of lawyers called Appleby, one of the leading players in the offshore world, specialized in setting up and administering tax-haven companies, to which addressed, in writing, a set of questions, looking for the confirmation that a company in Ireland is allowed to run management activities without being subject to taxation in that jurisdiction. With the support of tax advisers, in late 2014, Apple decided to settle in Jersey, as there no tax on corporate profits are charged for most companies, just like in many Caribbean Islands. The result was that Apple has continued to benefit from tax rates at a very low level on most of its profits.

The Permanent subcommittee on investigations of the US Senate also performed analysis on Apple's tax avoidance and concluded, in May 2016, that the company, each year, used to attribute profits amounting billions of dollars, to the two subsidiaries in Ireland that reported tax residency in no jurisdiction.

6. Apple's statement about tax payments

On the other hand, according to the Apple's statement dated November 2017, the company describes itself as the most important taxpayer in the world, with almost 40 billion euros paid in corporate income taxes for the period 2014-2017, claiming that it does not owe a single euro in any jurisdiction around the world.

In the same statement, contrary to what the European Commission concluded, Apple is trying to convince the public that when an Apple product is bought outside US, that profit is first taxed in the country where the sale occurred, then taxes are paid also in Ireland at the level of 12.5 percent, as more than 5,000 employees are performing there activities regarding sales and distribution. Also, when profits are brought back to US, 35% tax rate on investment income from its overseas cash apply. More than that, Apple officially reported it's worldwide effective tax rate at the level of almost 25%.

According to company's 2017 10-K reports that are annually requested by the US Securities and Exchange Commission, from the total Cash, cash equivalents and marketable securities amounting $269 billion, Apple reported $252 billion (93.7 %) as being held by foreign subsidiaries, becoming the Fortune 500 company with the most money officially booked offshore. Apple mentions that it has cash outside US for the simple reason that it sells most of its products overseas.

Apple mentions in its 2017 official report about the European Commission decision that Ireland granted state aid and requested Ireland to count and reclaim additional taxes from the Company for the period from 2003 to 2014. Apple does not recognize the State Aid Decision and claimed for a resolution from the General Court of the Court of Justice of the European Union. More than that, Ireland has also appealed the State Aid Decision. Nevertheless, Apple explicitly mentions in the report that, even if the process performed by Ireland in computing the recovery amount is ongoing, the Company estimates that the amount will be similar with what the European Commission announced - €13 billion and the corresponding interest of €1 billion, from which we may conclude that it recognizes and accepts the amount to be recovered. More than that, beginning in 2018, Apple declared that intends to fund the recovery amount, including interest, and expects to place the amounts into escrow until the conclusion of all appeals.

With reference to the changes to its corporate Irish structure, after Ireland changed its tax laws in 2014 and the two subsidiaries of Apple became resident in the UK Crown dependency of Jersey, Apple stated that since then, all of Apple's Irish operations have been conducted through Irish resident companies and tax was paid at Ireland's statutory 12.5 percent. Although the iPhone producer claims that there was no benefit from this change, that did not reduce Apple's tax payments or tax liability in any country, it forgets to mention that the reason for which it settled tax residency in Jersey for the two subsidiaries was that Jersey charges no tax on corporate profits.

7. Conclusions

With the support of very experienced tax advisers, many large companies succeed in paying income taxes at very low rates, this being the result of the obscured corporate arrangements they manage make in tax havens. Apple Inc. is leading this field, reporting 93.8% of its worldwide profits as being held by foreign subsidiaries.

According to the Irish law, for companies incorporated in Ireland, taxes on profits shall be paid locally, the companies managed and controlled abroad being excepted. For more than twenty years Apple management constantly avoided Irish tax residency by controlling the two Irish subsidiaries from the US headquarters. They could not be subject to US tax residency either, because, under US rules, only a company incorporated there qualifies for American tax residency.

Therefore, an official analysis performed recently by the European Commission and the US Senate subcommittee on investigations came to the same conclusion, that Apple was attributing significant profits to Irish subsidiaries with no tax residency, that remained untaxed.

On the other hand, Apple, while claiming that it pays taxes that it owes in every country around the world, will have to pay back taxes in Ireland amounting €13 billion, after both European and US regulators decided that Ireland had authorized illegal state aid by accepting the Apple's tax structure. Even if both Apple and Ireland appealed the State Aid Decision, on one hand Apple recently declared that it intends to fund the recovery amount, plus €1 billion interest and on the other, Ireland's minister for finance, Michael Noonan, at first defended his country's policies, but after the reactions at the international level, he declared that the Irish companies will be required to declare tax residency somewhere in the world.

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