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# EU's Highest Court Tells U.S. Taxpayers to Pay For a New Marshall Plan

by Mindy Herzfeld

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Former President Donald Trump is often mocked for throwing out grandiose statements about how he intends to make other countries pay for a rebooting of American manufacturing. (See Clark Packard, Scott Lincicome, and Alfredo Carrillo Obregon, "Americans Paid for the Trump Tariffs — And Would Do So Again," Cato Institute blog, Aug. 19, 2024.) But the EU's highest court — the Court of Justice — is already making other countries pay for doing the same for Europe's tech industry. Shortly after the release of a European Commission report about the dire need for a jump-start of European innovation and growth in the tech industry, the Court handed down a decision — nominally against member state Ireland for providing state aid to U.S. tech giant Apple — that would effectively force U.S. taxpayers to pay for the EU's plans to reverse its decades of stagnation in tech (*European Commission v. Ireland*, C-465/20 P).

In remarks last month at the 2024 Michel Camdessus Central Banking Lecture sponsored by the IMF, European Central Bank President Christine Lagarde highlighted parallels between the 2020s and the 1920s, pointing to the rise of economic nationalism, an unraveling of globalization, and the pressures of technological innovation. Lagarde probably wasn't trying to use Court of Justice decisions as an example of the growth of economic nationalism. But if she were, she wouldn't be far wrong.

## *Apple* Timeline

### The Investigation

The Apple state aid saga began in 2014, when the commission first announced its intent to investigate transfer pricing rulings that Ireland granted to Apple in 1991 and 2007. (Prior analysis: *Tax Notes Int'l*, Oct. 27, 2014, p. 295.) The investigation was part of a broader set of tax inquiries taken up by the commission that examined whether several primarily U.S. multinationals that received tax rulings from member states had benefited from an expanded version of state aid (prohibited by the Treaty on European Union). Initial decisions by the commission finding that state aid had in fact been granted via rulings to companies including Amazon, Fiat, and Starbucks were mostly reversed on appeal, with only the Apple case remaining unresolved until recently.

The backdrop to the commission's state aid investigations was an aggressively integrationist Court of Justice that had issued a series of decisions mandating that countries allow for free (that is, untaxed) movement of assets and profits between EU member countries. (Prior analysis: *Tax Notes Int'l*, Jan. 13, 2014, p. 107.) Those decisions, along with EU directives, helped U.S. multinationals shift activities and high-taxed profits generated from European markets into lower-tax jurisdictions eager to attract business. The OECD's base erosion and profit-shifting project developed from these conditions.

### The Commission's Decision

In 2016 the commission's investigation concluded that Ireland had granted state aid to Apple, to the tune of €13 billion (C(2016) 5605 final). Commentators highlighted numerous



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flaws in the decision's legal reasoning, most notably that it superimposed 2016 OECD transfer pricing principles onto Irish domestic law of the 1990s and early 2000s; in so doing, the commission substituted its own idea of what Ireland's tax law should be. Because the commission didn't like Irish law in place at that time — which allowed Apple to shift much of the profits from its European sales to an entity taxable nowhere until its profits were repatriated to its U.S. parent company — it reallocated those profits to two Irish branches that lacked the substance to generate them. (Prior analysis: *Tax Notes Int'l*, Jan. 9, 2017, p. 125.)

Apple placed €14.3 billion in state aid and interest in an escrow account and appealed the decision. The United States requested to intervene as a party in the case, on the grounds that it had a direct interest because Apple could claim the amounts paid to Ireland as a credit to offset its U.S. tax liability. But the General Court denied the request in December 2017 (*Apple Sales International and Apple Operations Europe v. European Commission*, T-892/16), finding that the results of its decision would "have no direct impact on the legal or economic situation" of the United States because there was no evidence that Apple planned to repatriate its profits there and that any Apple claim of a foreign tax credit was hypothetical. (The Court of Justice upheld that decision in 2018, even though the U.S. tax landscape had shifted dramatically in the interim (*United States v. Apple Sales International and Others*, C-12/18).)

## U.S. Developments

In 2017 Congress passed major tax reform in the Tax Cuts and Jobs Act, responding to the widely perceived lack of competitiveness of the U.S. tax system — which, among other things, had been prompting U.S. companies to reincorporate overseas. Included in the TCJA was a provision that imposed tax on a one-time deemed repatriation of U.S. companies' overseas profits, as well as an annual minimum tax on U.S. multinationals' foreign earnings. Those changes — along with broad ones that countries introduced through BEPS reform, including changes to Irish law that had previously allowed companies to shift profits to zero-tax jurisdictions — meant that the planning opportunities that produced Apple's corporate and tax structure at issue no longer exist.

Apple modified its structure accordingly.

## The General Court Decision

The General Court dealt the commission a blow when it ruled against it in 2020 (*Ireland v. Commission* and *Apple Sales International and Apple Operations Europe v. Commission*, joined cases T-778/16 and T-892/16). That court rejected the commission's reasoning, finding that it failed to substantiate that Ireland's actions in granting Apple a tax ruling met the standards for state aid. It concluded that the commission had failed to establish that Ireland had provided a "selective advantage" to Apple because it inappropriately determined the "normal" Irish tax law against which to measure an advantage. It also criticized the commission's reallocation of Apple's non-Irish booked profits to the two Irish branches, noting the limited activities engaged in by those branches and that all strategic decisions of importance were taken and implemented outside them.

## The Other State Aid Decisions

Meanwhile, the commission's state aid tax rulings were faring poorly overall in the courts. In 2019 the General Court overturned the commission's state aid decision as applied to Starbucks (*Netherlands v. Commission*, joined cases T-760/15 and T-636/16), finding that in choosing to rely on one transfer pricing method rather than another, the Netherlands didn't provide the company with a selective advantage.

In *Fiat Chrysler Finance Europe v. Commission* and *Ireland v. Commission*, joined cases C-885/19 P and C-898/19 (2022), the Court of Justice determined that Luxembourg had not provided state aid to Fiat, overturning the General Court and commission decisions. The principle applied by the Court of Justice was that selectivity for state aid purposes could be measured only against a country's domestic law, and not by reference to a legal standard preferred by the commission.

That rule was reiterated in the Court's 2023 Amazon judgment, *Commission v. Luxembourg*, C-457/21 P, upholding the General Court's decision that overruled the commission's finding

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that Luxembourg had provided state aid to Amazon via a tax ruling. In that case (as in *Apple*), the commission sought to superimpose its view of what the law — specifically, the arm's-length standard — should be, rather than looking to what Luxembourg's law was. The Court roundly rejected that approach, stating that "there is no autonomous arm's length principle that applies independently of the incorporation of that principle into national law." (Prior analysis: *Tax Notes Int'l*, Jan. 29, 2024, p. 595.)

## The Advocate General Opinion

Last year Advocate General Giovanni Pitruzzella issued his opinion in *Apple*, finding that the General Court had made a number of errors of law in its analysis and recommending that the Court of Justice remand the decision. Pitruzzella's opinion relied on the authorized OECD approach to find that the profits associated with Apple's European intellectual property rights could be properly allocated to the Irish branches. (Prior analysis: *Tax Notes Int'l*, Dec. 4, 2023, p. 1331.)

## The Court of Justice Decision

The Court of Justice went further than the advocate general, not only remanding the General Court's decision but overturning it. It held that Ireland provided state aid to Apple when it entered into the 1991 and 2007 advance pricing agreements and that the government was obligated to collect €13 billion (plus interest) from Apple.

The Court acknowledged the principle articulated in its prior cases: that the proper reference system for determining whether a state had granted a selective advantage — and thus, state aid — to a company when providing it with a tax ruling could only be the state's "normal" tax regime (citing *Luxembourg v. Commission*, joined cases C-451/21 P and C-454/21 P (2023)).

But it declined to apply that principle in this case, finding that the General Court had committed a series of legal errors in its judgment, and it upheld the commission's approach of substituting a version of OECD arm's-length transfer pricing for the Irish tax authorities' application of Irish law. The Court said that in determining the profits allocated to the Irish branches under the arm's-length principle, it was appropriate to look at more than just the functions of the branches. The Court upheld the commission's conclusion regarding the absence of functions related to IP at the head offices of the Irish incorporated companies and what the commission said was an active role undertaken by the Irish branches.

Contrary to the General Court, the Court of Justice concluded that the commission had succeeded in showing that substantive activities and functions were actually performed by the Irish branches. Even though all the evidence demonstrated that Apple's extraordinarily successful products — and resulting profits — were the result of activities undertaken in the United States, rather than in Ireland, the Court of Justice determined that the lack of consistent evidence establishing that strategic decisions were made and implemented by the head offices of the Irish incorporated companies outside Ireland supported allocating Apple's European profits to the Irish branches.

## Postscript

Just a week after issuing its *Apple* judgment, the Court of Justice reversed the commission's decision that the United Kingdom's controlled foreign corporation regime violated state aid principles because it provided an exemption for some types of financing activities (*United Kingdom v. European Commission*, joined cases C-555/22 P, C-556/22 P, and C-564/22 P).

The commission had determined that the exemptions constituted state aid. But the Court found that the commission improperly identified the reference framework against which to analyze whether selective state aid was provided. It said the right reference framework in analyzing state aid tax questions is the "normal" tax system applicable in the relevant member state, and that when determining the reference framework for applying the state aid doctrine to tax measures, "the Commission is in principle required to accept the interpretation of the relevant provisions of national law given by the Member State concerned."

If the Court had applied the same principles in the Apple case, it could not have concluded that Ireland had granted a selective advantage to

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Apple based on Ireland's interpretation of Irish law in 1991 and 2007.

## Apple Commentary

It didn't take long for critics to weigh in on the Court's decision. *Tax Notes* contributing editor Robert Goulder called it "a dog of a decision" and "thoroughly rotten," describing as "bizarre" its conclusion that Ireland — providing 4 percent of Apple's global workforce and 1 percent of its global sales — should be attributed roughly two-thirds of its profits. (Prior analysis: *Tax Notes Int'l*, Sept. 23, 2024, p. 2127.) Goulder added that "there can be little doubt the jurists began with a preset conclusion (Apple must not prevail), then worded backwards to plug in whatever guff was necessary to justify the outcome."

*Tax Notes* contributing editor Lee Sheppard called the decision "EU extortion" and "a result-oriented decision that flouts the Court's own precedent and OECD guidance." (Prior analysis: *Tax Notes Int'l*, Sept. 23, 2024, p. 1947.) *Tax Notes* contributing editor Ryan Finley said it "seemingly def[ies] case law that isn't even two years old." (Prior analysis: *Tax Notes Int'l*, Sept. 23, 2024, p. 1961.)

Criticism hasn't been restricted to the United States. Richard Collier, associate fellow at the Oxford University Centre for Business Taxation, referred to the holding as "A Bad Apple Ruling" in a September 13 center blog post. He argued that the Court's decision to rely on the authorized OECD approach transfer pricing method was "highly questionable" and that in any case, "its interpretation by the Court [was] misconceived," resulting in "a colossal failure in complying with the requirements of the arm's length principle." Another U.K. academic criticized a separate aspect of the decision: the Court's "acceptance of the premise that a misapplication of domestic law amounts to State aid" (Steven Daly, "Another Take on the (Bad) Apple Ruling: Is a Misapplication of Domestic Law Enough for a Finding of State Aid?" Oxford University Centre for Business Taxation blog, Sept. 17, 2024). Daly added that if the decision is followed, "tax authorities will have to look over their shoulders as the Commission might find a reasonable and bona fide interpretation of domestic law unlawful, with all the uncertainty that may create."

Tax justice advocates have been more enthusiastic, with Oxfam International crowing that the decision "delivers long-overdue justice after over a decade of Ireland standing by and allowing Apple to dodge taxes" (Oxfam International, "Apple Tax Ruling: EU Tax Havens' Love Affair With Multinationals Exposed" (Sept. 10, 2024)).

In short, the Court issued a politically driven decision, relying on highly flawed analysis, to allow it to conclude that Ireland must collect €13 billion in back taxes from a U.S. company that Ireland doesn't believe it is owed. Given the consensus on the (lack of) legal merits of the holding, what might have motivated the Court to issue the opinion that it did? And what are the broader ramifications of such a flawed decision?

## The CJEU as a Tool of EU Integration

Academics who have studied the role of the Court of Justice in advancing the European integration project emphasize its political nature and the extent to which it's beholden to member states, explaining that the Court "is a strategic actor that is sensitive to the preferences of EU member governments" (Geoffrey Garrett, R. Daniel Kelemen, and Heiner Schulz, "The European Court of Justice, National Governments, and Legal Integration in the European Union," 52(1) *International Organization* 149 (1998)). Each EU member state appoints a judge to the Court for a renewable term of six years. A judge who hopes for an appointment renewal must essentially please the state with his or her decisions.

Advocates for European integration have long relied on the EU courts to advance an agenda that has limited administrative capacity of its own (Kelemen, "The Court of Justice of the European Union in the Twenty-First Century," 79 *Law and Contemporary Problems* 117 (2016)). According to Kelemen, "Because they cannot deploy vast legions of Eurocrats to monitor and enforce EU policies, EU lawmakers have conscripted private litigants into acting as the eyes, ears, and long arm of Brussels, encouraging the litigants to bring enforcement actions before national and EU courts."

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As Kelemen also notes, the Court has been able to act strategically to "empower itself," extending its mandate in a way that advances the EU cause for greater integration. And as he describes it, the Court's activism is best characterized by setting and imposing standards that are supported by most member states. Viewed from this perspective, a Court of Justice decision that delivers a blow against a U.S. corporate giant makes perfect sense. The more puzzling question becomes why the Court held otherwise in the Amazon case.

### European Uncompetitiveness

The broader context of *Apple* is the depressing state of digital innovation in the EU. A recent report by Mario Draghi, "The Future of European Competitiveness," considered the challenges faced by the industry in the EU single market. Draghi acknowledged the extent to which Europe has "largely missed out" on the digital revolution, noting that the productivity gap between the EU and the United States is largely attributable to differences in the growth of the tech sector in the two regions.

In a bleak assessment, Draghi's report laments that "the EU is weak in the emerging technologies that will drive future growth," and it reflects on the fact that only four of the world's top 50 tech companies are European. Draghi acknowledges that growth in the European tech sector will require investment to rise by about 5 percentage points of GDP — dwarfing prior jump-starts in European investment made under the Marshall Plan.

Those descriptions are all accurate, but Draghi's solutions are mostly nationalistic. He recommends industrial, competition, and trade policies that depend heavily on protectionism. At the same time, he emphasizes the need to attract investment capital to fund start-up growth and suggests maintaining "low trade barriers in digital goods, services and infrastructures" with the United States to encourage growth and innovation in AI.

The Court of Justice's *Apple* decision directly contradicts Draghi's ambitions. It sets a precedent for U.S. companies to question the European development project and whether protectionism will override expectations of growth from investing in any EU country, and in doing so it impedes rather than encourages future investment and growth. But the Court's judges are not alone in creating skepticism about Europe's support for tech growth. The EU Digital Markets Act, effective in 2023, allows a fine equal to 10 percent of a tech company's revenues (not profits) if it's found to be in violation of applicable EU regulations. In that respect, it imposes an effective tax on digital companies that makes it less likely for investors to want to develop the EU tech sector.

### U.S. Recourse?

In its 2017 Form 10K, Apple said that it believed that any incremental Irish corporate income taxes potentially due as a result of the commission's state aid decision would be creditable against its U.S. taxes. (In its 2018 Form 10K, it adjusted that statement, noting its belief "that any incremental Irish corporate income taxes potentially due related to the State Aid Decision would be creditable against U.S. taxes, subject to any foreign tax credit limitations in" the TCJA, a statement it repeated in its subsequent annual filings.) The €13 billion Apple tax bill represents about 4 percent of U.S. corporate tax receipts in 2016. In effect, that means the U.S. government — and by extension, U.S. taxpayers — will be subsidizing the EU's protectionist agenda. The question becomes what, if anything, the United States can do in response.

The government's abilities to retaliate directly are limited. Although section 891 allows the administration to respond to a country's adoption of discriminatory taxes — i.e., to a statutory or administrative measure — it's unclear how it would apply to an EU-wide judicial decision.

Section 301 of the Trade Act of 1974 enables the United States to impose trade sanctions on foreign countries that violate U.S. trade agreements or engage in unjustifiable or unreasonable acts that burden U.S. commerce. But here, too, it's unclear how the United States would impose a measure designed to target a country in response to an act undertaken by an EU court.

The U.S. government might need to get more creative if it wants to respond to this politically motivated decision of the EU's highest court.

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Many U.S. officials — whether members of the administration or Congress — might have little desire to protect a company that has already been profiled as taking liberties with its tax planning and implementing structures that the TCJA was designed to curtail. But even if the target doesn't present a sympathetic case, the extrajudicial reasoning engaged in by the Court could establish a precedent for making the United States pay to fix European failures — a stance the United States would be ill advised to ignore. ■

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