Anatomy of a Multi-Government Shakedown

Veronique de Rugy

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I'm slow to defend corporations these days because so many of them have built their business models around government-granted privileges and are free markets' worst enemies. However, for all the perks they get from governments, they also fall victim to their own government. And sometimes the shakedown is done by multiple governing authorities.

A few weeks ago, the European Union's antitrust regulator demanded that Ireland get back $14.5 billion in taxes from Apple Inc. At the heart of the issue are legal tax arrangements between Ireland and Apple passed in 1991 and 2007, which allow the company to pay an annual tax rate of roughly 1 percent on its European profits channeled to Ireland.

According to the European commission, if a country doesn't tax a company as much as the bureaucrats in Brussels want it to be taxed, somehow that's equivalent to giving the company a subsidy or a handout. So even though Apple followed the rules in Ireland and what it did is legal in both Ireland and the United States, the EU retroactively changed the rules and is now demanding lavish sums of cash from the company.

Forget about the Irish government's right to set its own taxes; when the EU wants your cash, tax sovereignty goes out the window. As you can imagine, the Irish government isn't pleased. It said it would appeal the decision in order "to defend the integrity" of its tax system.

Good luck with that, says Dan Mitchell of the Cato Institute. An appeal requires that Ireland persuade one group of European officials to overturn the decision of another. He explains, "Given the long-standing hostility in Brussels to Ireland's tax system, that's an uphill climb — particularly since European bureaucrats have set themselves up to be judge, jury and executioner on these issues." Also, considering the amount at stake through this Apple tax grab and the tax grab looming over other American multinational corporations, the EU is unlikely to change its mind.

Now enter the United States. U.S. Treasury Secretary Jack Lew complained in The Wall Street Journal about the EU's behavior — calling the move "unfair" and "contrary to well established legal principles" and noting that the move "threatens to undermine the overall business climate in Europe." True. But don't be fooled; the only reason Lew has opposed this EU move is that he would rather be the one grabbing that money.

Under the current punishing system, U.S. companies doing business abroad and repatriating their foreign earnings home get tax credits for the taxes paid to other governments before being hammered with a ridiculously high 35 percent tax rate. The more taxes companies pay offshore the less is left for Uncle Sam to grab. So if the tax payments to the EU qualify as a tax credit, that's potentially $14.5 billion less tax revenue in the U.S. tax chest.

The EU shakedown of Apple will soon become the EU shakedown of Amazon.com, McDonald's and many other U.S. companies, so the U.S. Treasury proceeded to put in place its own shakedown mechanism. It's issuing new rules to restrict how corporations can use tax credits on their foreign tax payments to reduce their U.S. tax bills. The explicit goal of these rules is to avoid suffering a huge tax loss as a consequence of U.S. multinationals having to pay billions of dollars in taxes to the EU version of the Soprano family.

In other words, no matter how you look at it, U.S. corporations are in for a large shakedown from the EU and from the United States. It's sad, considering that the best solution to this mess would be for the United States to reform its corporate income tax by lowering its rate and moving to a territorial tax system. Such reform would guarantee that U.S. firms operating abroad would not park so much money abroad and subject themselves to arbitrary tax changes by foreign governments. It would also increase U.S. competitiveness and trigger economic growth. But if you think that scenario will happen soon, don't hold your breath.