

A U.S. Perspective on the State Aid Cases

Daniel Shaviro, NYU Law School
Oxford Summer Conference
June 30, 2017

Illustrative facts from the *Apple* case

Apple's US employees developed technology for products sold WW.

Economically, foreign sales yielded US source income under an "origin" approach; FSI under a "destination" approach.

Existing income tax source rules usually (but not always) purport to rely on origin.

Nonetheless, Apple's EU sales yielded FSI, for US tax purposes, under "cost-sharing" (a *fake* origin-based approach).

While this "FSI" seemingly arose in Ireland under the US tax system's view, about 99% wasn't taxed there either.

The EC steps in; US Treasury responds

EC: Irish tax concessions were illegal state aid, improperly reducing Irish taxes by about €14B.

U.S. Treasury White Paper: says this is novel / contrary to precedents under EU law.

I question its (& my) opinion on EU law, & also disagree with its view on why/how this might be bad for the US.

Effects on future US tax liability vs. wealth effects on US shareholders.

In my view, little ground for US complaint (even if adversely affected) if done pursuant to a good faith view re. EU law & EU policy interests.

U.S. international tax policy dissensus

2 warring sides: anti-tax (MNEs, Republicans, some academics) VS. anti-tax avoidance (some Democrats, some academics).

On state aid, much more was heard from the anti-tax side.

This reflected U.S. companies' prominence among the targets, although I know of no evidence of bias against them.

It also reflected the EC's decision to look far back – & red faces of the companies' tax & accounting advisors, who failed to anticipate it.

But complexity of the underlying policy issues – supporting EC reasonableness, from a US perspective – is often under-appreciated.

Ambiguity #1: the meaning of “source”

US distress may reflect the view that this was “really” US source income (although the Treasury White Paper couldn’t & didn’t say this).

But this depends on whether one takes an origin-based or destination-based view of source.

“Income” is seemingly an origin-based concept – but income taxes don’t always even try to follow it.

And that’s fine. E.g., rationales for taxing income not consumption (based on grounds for taxing the normal return to waiting) turn on distinct issues.

Consider sales-based formulary apportionment (a la Avi-Yonah, Clausing, & Durst 2009). Surely reasonable to evaluate this based on its *effects*.

Ambiguity #2: taxing outbound

Was it a mistake for the US to allow Apple to escape any current US tax on its EU sales?

If so, then the prospect of paying EU taxes might help US tax policy indirectly.

But no consensus answer to this!

In favor of taxing outbound, note (a) ability to pay & US individuals; (b) efficiency grounds for taxing outbound rents.

Against taxing outbound, note corporate residence electivity & source manipulability (underlying, e.g., advocacy of the DBCFT).

Ambiguity #3: taxing inbound

Ireland was smart to grant these deals unless it could have held out for more. But whether it was hurting the EU is ambiguous.

Generally shouldn't tax normal returns on inbound— outsiders won't bear the incidence of the tax.

But (a) Apple may have been earning rents, (b) the EU may collectively have had monopsony power.

No consensus re. when tax competition is collectively beneficial for a given group of jurisdictions.

Ambiguity #4: foreign-to-foreign profit-shifting

Does the US benefit from US companies' foreign-to-foreign tax planning? This is ambiguous.

YES: Why not keep more \$\$ in the pockets of US SHs (or the US fisc)?

NO: Foreign-to-foreign tax planning can encourage domestically adverse base erosion & profit-shifting.

Hence (a) the universality of CFC rules, but with dissensus re. how tough they should be; (b) diverse US & non-US views of check-the-box (quasi-repealing much of the US's subpart F).

Ambiguity #5: retroactivity

Much of the controversiality reflects the EC's aggressively looking as far back as it did (and arguably using novel theories).

This might prospectively increase business uncertainty, even in the absence of impermissible legal “retroactivity.” BUT --

Uncertainty is not the only issue! Inducing business to anticipate future decisions (including under novel theories) can have desirable incentive effects.

There's a huge US tax policy literature on this – e.g., Graetz 1977; Kaplow 1986; Shaviro 2000.

U.S. tax policy writers who favor backward-looking judicial & administrative action to discourage aggressive tax planning include, e.g., Bankman, Shaviro, Weisbach.

What to expect next from the U.S.

The US 2016 presidential election placed us in uncharted waters, making prediction difficult.

The current Administration likes to say “America first,” & has evinced startling hostility to the EU (and to democratic countries generally).

But its policy bandwidth & expertise are unprecedentedly limited.

My guess is that this greatly reduces the likelihood of any significant US response to the state aid cases.