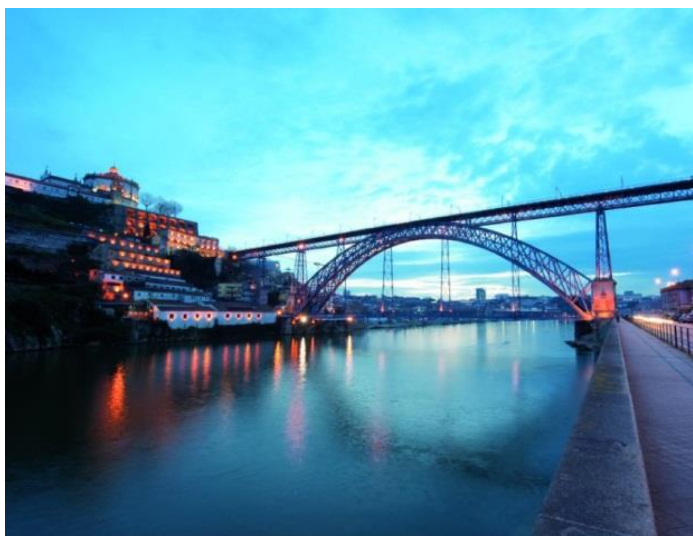


## CONCERNING THE APPLE CASE



## TAX &amp; BUSINESS



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## BACKGROUND

Taxation of multinational enterprises (MNEs) has been subject to debate among civil society and tax administrations. While these voices claim that MNEs shall contribute their fair share of tax, CEOs advocate that they constraint themselves to the legal framework and that they merely optimize their profits, as they are bound to do before their shareholders, further emphasizing that it has never been their purpose to commit tax avoidance.

However, the use of tax rulings has been widespread in order to reduce corporate tax bases. In this context, the European Commission has already brought state aid disputes regarding tax rulings and advance (transfer) pricing agreements against some Member States with a view to ensure a level playing field, such as the *Apple*, *Starbucks* and *Fiat* cases.

If a tax ruling is considered to be illegal state aid, the Member State may be required to retroactively (up to 10 years) recover unpaid taxes from the taxpayer.

## TRANSFER PRICING RELEVANCE IN AN INTERNATIONAL TAX CONTEXT

New business practices have caused a tremendous impact in international taxation. Nowadays, companies doing business abroad might choose between performing an operation with an independent party (an enterprise who does not hold any legal or economic link) or either, with an associated enterprise. In the latter case, it could arise that the associated enterprises agree on a price that deviates from the market prices, leading in this way to an alteration of their taxable base. In order to prevent this outcome, the Organization for Economic Cooperation and Development (OECD) member countries have agreed on an international transfer pricing standard, the so-called “arm’s length”.

The authoritative statement of the arm’s length principle is found the OECD Model Tax Convention, it provides that “where conditions are made or imposed between the two associated enterprises in their commercial and financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be

included in the profits of that enterprises and taxed accordingly”.

The arm’s length principle seeks to adjust profits of associated enterprises by reference to the conditions which would have obtained between independent enterprises in comparable transactions and comparable circumstances. Under this principle, members of a MNE group are treated as separate entities.

## WHAT IS STATE AID?

In order to ensure the optimal functioning of the internal market, the Treaty on the Functioning of the European Union (TFEU) establishes that unless provided otherwise in the EU Treaties, any aid granted by a Member State or through State resources in any form whatsoever shall be prohibited if it distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods.

Mainly, state aid can be granted in two forms. The first encompasses tax measures or regimes that provide a selective advantage. Whereas, the second includes any individual concession granted to a taxpayer i.e. tax rulings.

Tax rulings are “confirmations or assurances that tax authorities give to taxpayers



on how their tax will be calculated". These fiscal instruments are of utmost relevance for MNEs, since they grant taxpayers legal certainty by confirming the fiscal treatment of the requested transaction. For instance, an Advance Pricing Arrangement (APA) might be obtained when it concerns to the prices for services or goods provided by one subsidiary of a corporate group to another subsidiary of the same group.

It shall be borne in mind that there is nothing wrong with tax rulings themselves, as the European Commission acknowledges. The same is true for transfer pricing, which MNEs are required to do and comply with by tax laws across the world.

Nevertheless, a tax ruling may be considered to be illegal state aid if it gives a preferential treatment to a certain company or it artificially reduces a company's tax burden, namely by setting transfer pricing comparability factors and methodologies that deviate from the economic reality or by not regularly revising such transfer prices.

The European Commission has brought several state aid cases against some EU Member States, such as *Starbucks*, *Fiat* and *Apple*, which have already been concluded, and *McDonalds* and *Amazon*,

whose investigations are expected to be concluded by the end of 2016. The main issue under these cases is tightly linked to the selective basis and the advantage conferred requirements.

Starbucks and Fiat cases have provoked controversy due to the new approach of the arm's length principle introduced by the European Commission.

#### RISKS AND CONSEQUENCES OF ILLEGAL STATE AID

If illegally granted state aid is found to be incompatible with the single market, as a rule, the aid will be recovered from the beneficiaries. This means that the amount to be recovered from the beneficiaries will be calculated on the basis of a comparison between the tax already paid out and the amount which should have been paid if the generally applicable rule had been applied, in addition to interests.

The need of a recovery measure relies in the fact that the undue advantage granted of a selective basis to a company shall be removed by restoring the market conditions to its previous status before the aid was granted. Luckily for taxpayers, there is a limitation of ten years for recovery, preventing in this manner an excessive recovery period.

Moreover, according to European case law, taxpayers and tax advisors may be accountable as undertakings could have avoided that risk by immediately opting for operations structured in ways different (and compliant with State Aid) than the one they opted for.

#### ADVANCE PRICING ARRANGEMENTS IN PORTUGAL

Economic substance and non-deviation from economic reality is at the core of most of the European Commission's concerns. Portuguese law formally devotes rules to that aspect and Advance Pricing Arrangements are limited to three year periods, upon which they may be renewed subject to a reassessment to determine whether the facts and circumstances, as well as the comparability and industry margins remain valid.

Since Portuguese law also allows unilateral agreements, that is, with the involvement of just one State, this particular kind of rulings is more prone to increased scrutiny.

A different question lies with actual Member State responsibility on these cases, because, in the end, they benefit from the recovery of illegally granted state

aid, as well as interest payments. As such, Member States are not directly penalized – quite the opposite. However, foreseeing potential mid and long term consequences due to a more fragile legal certainty and eventual decrease in investment, Member States have been appealing such decisions.

#### EXCHANGE OF INFORMATION

Within the framework of the European Union, automatic exchange of advance cross-border tax rulings, including Advance Pricing Arrangements, will be mandatory starting 1 January 2017. A 'secure central directory', which is due to be operational starting 1 January 2018, will be created by the European Commission and Member States will be able to peer review each other's tax rulings.

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