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Is American Multinational Enterprises' Honeymoon with the European Union Over?An Analysis of the European Commission's Investigations into American Multinational Enterprises' Tax Deals with Ireland, Luxembourg and the Netherlands

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I. INTRODUCTION

American multinational enterprises ("MNEs") love Ireland, the Netherlands and Luxembourg, not because of their potatoes, tulips or smoked pork soup, but because these countries' tax policies can reduce American MNEs' corporate tax bills by millions of dollars. However, good times do not last long. American MNEs' love affair with these European Union (EU) countries has been severely challenged by the European Commission in recent years.

In August 2016, in a landmark ruling, the European Commission ordered Apple Inc. ("Apple"), an American technology company, to pay Republic of Ireland up to €13 billion in back taxes.[1] This ruling is only one part of the European Commission's long battle against EU member states' sweetheart tax deals with American MNEs. In 2015, the European Commission ordered Starbucks Corporation ("Starbucks") to pay the Netherlands €30 million in back taxes, and is currently investigating tax deals of Amazon.com, Inc. ("Amazon.com") and McDonald's

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1. European Commission-Press Release IP/16/2923, *State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to €13 Billion* (Aug. 30, 2016) http://europa.eu/rapid/press-release_IP-16-2923_en.htm.

Corporation ("McDonald's") with Luxembourg.[2] To make things worse, recent changes in U.S. Department of Treasury's regulations are backfiring on these tax expatriates.[3]

Behind these three cases is a process called "corporate inversion," also known as "inversion," "tax inversion," "corporate expatriation," and "outbound corporate inversion."[4] An inversion is typically defined as a transaction in which an American corporation's stocks or assets are transferred to a foreign corporation to reduce tax and regulatory costs.[5] This note will first introduce the origins and development of corporate inversions, and then analyze why American MNEs choose these EU countries and how some popular tax avoidance techniques worked. After laying out the groundwork, this note will focus on analyzing how the new legal changes in EU challenge American MNEs' corporate inversions and how American MNEs should respond to changes in their tax strategies.

II. FUNDAMENTALS OF TAX INVERSIONS

A corporate inversion is the process of a U.S. corporation changing its residency to a foreign jurisdiction, often doing so to reduce its tax burden.[6] Before delving into the corporate inversion, it is useful to brief some key features of the United States' corporate tax system to understand the motivation for American MNEs to invert to another country.

A. An Overview of the United States' Tax System

The United States adopts a worldwide taxation system, which taxes American corporations on all income, whether the income is generated domestically or abroad.[7] All income earned within the U.S. borders is taxed the same—in the year earned and at statutory tax rates up to 35%.[8] The income earned outside the United States is also subject to U.S. taxation, though not necessarily in the year earned because U.S.

2. *Id*. at 4.

3. *See generally* DONALD J. MARPLES & JANE G. GRAVELLE, CONG. RESEARCH SERV., R43568, CORPORATE EXPATRIATION, INVERSIONS, AND MERGERS: TAX ISSUES (2016) [hereafter *Congressional Research Report*].

4. Orsolya Kun, *Corporate Inversions: The Interplay of Tax, Corporate, and Economic Implications*, 29 DEL. J. CORP. L. 313, 313 n.1 (2004).

5. Joshua Simpson, *Analyzing Corporate Inversions and Proposed Changes to the Repatriation Rule*, 68 N.Y.U. ANN. SURV. AM. L. 673, 676 (2013).

6. MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568, *supra* note 3, at 3. *See also* Scott DeAngelis, Note, *If You Can't Beat Them, Join Them: The U.S. Solution to the Issue of Corporate Inversions*, 48 VAND. J. TRANSNAT'L L. 1353, 1359-60 (2015).

7. *See* MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568, *supra* note 3, at 7.

8. DeAngelis, *supra* note 6, at 1357.

corporations can defer U.S. tax on active income earned abroad in foreign subsidiaries until it is paid, or until this income is repatriated to the U.S. parent company as a dividend.[9] Furthermore, the United States provides foreign tax credits as a way to alleviate some of the competitive disadvantages brought with a worldwide tax system.[10] But this foreign tax credit is limited to the amount of U.S. tax liability on the corporation's foreign-source income, and the source of income is determined by U.S. tax law.[11]

For example, multinational corporation A ("Corp A") is incorporated in the United States, but also generates $100 million income from its operation in Ireland.[12] Under the worldwide tax regime, this $100 million would be subject to Ireland's corporate tax at a rate of 12.5% and the U.S. corporate taxation at 35% minus any foreign credits received for the initial Irish taxation for any income derived in Ireland.[13] So Corp A would owe Ireland government $12.5 million in corporate tax ($100 million * 12.5%= $12.5million) and another $22.5 million ($100 million *35%-$12.5million=$22.5million) in corporate tax to the U.S. government.[14] The tax credits avoid double taxation of $12.5 million in both Ireland and the United States, however, these tax credits do not change the fact that Corp A ends up owing 35% of its Ireland operation income as corporate tax.[15] Since the U.S.'s 35% corporate taxation rate is one of the highest in the world, the overall tax paid on foreign investments may still be higher for U.S. corporations when compared to that of their competitors.[16]

In contrast, the territorial tax system is the norm in developed countries.[17] The territorial tax regime "imposes tax only on income derived within the geographical boundaries of that country," and exempts income generated from outside of the home country's geographical boundaries from taxation.[18] As of 2016, twenty-six of the thirty-four

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9. *Id.* at 1356
10. *Id.* at 1357.
11. I.R.C. §901(a).
12. DeAngelis, *supra* note 6, at 1358.
13. *Id.*
14. *Id.*
15. *Id.*
16. *See* Kyle Pomerleau, *Corporate Income Tax Rates Around the World, 2014*, TAX FOUND. (Aug. 20, 2014), http://taxfoundation.org/article/corporate-income-tax-rates-around-world-2014 [http://perma.cc/4D4X-RUY4] (archived Oct. 3, 2015) (listing the highest corporate tax rates in the world).
17. JOHN BARRASO, S. REPUB. POLICY COMM. REP.; TERRITORIAL V. WORLDWIDE TAXATION (2012), http://www.rpc.senate.gov/policy-papers/territorial-vs-worldwide-taxation (last visited Nov. 22, 2016).
18. DeAngelis, *supra* note 6, at 1357.

current members of the Organisation for Economic Co-operation and Development (OECD) have adopted territorial tax systems that exempt the majority of the active earnings repatriated from subsidiaries resident in some or all other countries.[19] Moreover, the United States' 35% top corporate income tax is also the highest among all the OECD countries, and only four other OECD member countries have corporate tax rates of 30% or above.[20]

Being subject to a worldwide taxation system where the corporate tax rate is one of the highest in the world may be extremely disadvantageous to American corporations competing globally.[21] Although foreign tax credits may alleviate double taxation in both the United States and another foreign state, the overall tax paid on foreign investments may still be higher for U.S. corporations when compared to that of their non-American competitors.[22] Against such background, the American MNEs are motivated to look for tax breaks elsewhere to alleviate the United States' high corporate tax burdens.

B. The Developments of Tax Inversion and Related U.S. Regulations

1. 1980s: The McDermott, Inc.'s Transaction

In 1982, McDermott, Inc. ("McDermott"), a New Orleans-based construction company, completed a stock exchange transaction with McDermott International, a Panama-registered subsidiary.[23] McDermott then took an unprecedented step in rebuilding its corporate structure by making the Panamanian McDermott International the parent.[24] This

19. PRICEWATERHOUSECOOPERS, REPORT ON EVOLUTION OF TERRITORIAL TAX SYSTEM (2016), http://www.techceocouncil.org/clientuploads/reports/Report%20on%20Territorial%20Tax%20Systems_20130402b.pdf (These 26 countries are: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Iceland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, and United Kingdom. Additionally, Greece and Poland exempt income for EU subsidiaries.); BARRASO, S. REPUB. POLICY COMM. REP., *supra* note 17.

20. PRICEWATERHOUSECOOPERS, *supra* note 19. (The other four countries are France 34.43%, Belgium 33%, Australia 30% and Mexico 30%).

21. DeAngelis, s*upra* note 6, at 1357. However, although the US's corporate tax rate is 35%, the effective tax rate is lower due to tax breaks. *See* Alexandra Thornton, *The Skinny on Corporate Inversions*, CTR. FOR AM. PROGRESS, (Sept. 25, 2014, 12:35 PM), https://www.americanprogress.org/issues/tax-reform/report/ 2014/09/25/97827/the-skinny-on-corporate-inversions (noting the United States' effective tax rate).

22. Derek E. Anderson, *Turning the Corporate Inversion Transaction Right Side Up: Proposed Legislation in the 108th Congress Aims to Stamp Out Any Economic Vitality of the Corporate Inversion Transaction*, 16 FLA. J. INT'L L. 267, 281 n.21 (2004) ("The U.S. corporations are still paying a full amount of tax on their foreign investments, and foreign corporations are not.").

23. DeAngelis, *supra* note 6, at 1362.

24. *See* Anderson, *supra* note 22, at 275 (discussing the McDermott transaction).

change would allow the company to pass the Panamanian profits to shareholders in the form of dividends without facing U.S. corporate income tax on the payment of dividends.[25] This is regarded as one of the first corporate inversion cases that gained the attention of the Internal Revenue Service ("IRS").[26]

The IRS objected to this transaction and challenged it on the grounds that it constituted a taxable distribution in redemption of McDermott's stock in exchange for the stock of the Panamanian subsidiary under section 304 of the Internal Revenue Code ("Code.")[27] Although the Service was unsuccessful in its challenge, McDermott's inversion provoked Congress to enact section1248(i) of the Code, which requires shareholders of U.S. corporations to recognize gains from these stock exchanges as dividend payments on their individual income taxes.[28] Moreover, section 1248(i) extends to transactions in which a U.S. corporation's shareholders exchange their stock in a U.S. corporation for the stock of its foreign subsidiary.[29] Thus, in transactions similar to the McDermott's inversion, section 1248(i) treats the receipt of the foreign subsidiary's stock like a taxable distribution in redemption of a U.S. corporation's stock.[30] However, the gain recognition treatment under section 1248(i) can still be avoided in a stock exchange transaction, where the U.S. corporation's stock is exchanged for stock in a newly formed foreign subsidiary with no earnings and profits.[31]

2. The Late 1990s and Early 2000s: the Naked Inversions

Corporate inversions became common in the late 1990s, when U.S. corporations actively sought to reincorporate to tax havens such as Bermuda and the Cayman Islands.[32] This period's inversion transactions usually involved little or no shift in actual economic activities and were thus called "naked inversions."[33] One of the leading cases is Helen of Troy Limited's ("Helen of Troy") inversion into a Bermuda corporation. Helen of Troy was a publicly traded cosmetic company established in Texas in the 1960s, which owned several household brands such as Dr.

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25. *Id.*
26. *Id.*
27. Bhada v. Commissioner, 892 F.2d 39, 43 (6th Cir. 1989).
28. *See* I.R.C.§ 1248(i) (2015).
29. *Id*. § 1248(i).
30. Joseph A. Tootle, *The Regulation of Corporate Inversions and "Substantial Business Activities*," 33 VA. TAX REV. 353, 365 (2013).
31. *Id.*
32. MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568, *supra* note 3, at 4-6.
33. *Id.*

Scholls, Honeywell, Revlon and Vicks.[34] Between 1993 and 1994, Helen of Troy engaged in a series of transactions that made a newly formed Bermuda shell corporation the parent corporation.[35] At that time, these transactions had zero tax consequences for both Helen of Troy and its public shareholders.[36] The IRS viewed these transactions as tax-motivated, with the sole purpose of avoiding the U.S. taxation.[37] The IRS later issued Notice 94-46 (1994-1 C.B. 356), which announced new steps to stop corporations from restructuring "for tax-motivated purposes."[38]

This first wave of corporate inversions ended quickly among strong public criticism and the enactment of the American Jobs Creation Act of 2004 ("Act"). The Act denied tax benefits on inverted corporations if the original U.S. stockholders owned 80% or more of the new firm.[39] On the other hand, the Act left two loopholes. First, a company could invert if it had substantial business operations in the country where the new parent was to be located; second, companies could invert by merging with a foreign company if the original U.S. stockholders owned less than 80% of the new company.[40]

3. After 2004: The Recent Wave of Corporate Inversions and the U.S. Department of Treasury's Scrutiny

Eventually, another wave of inversions arose. The post-2004 approach to inversions no longer involved tax haven countries with a small size economy like Bermuda, but larger countries in which U.S. corporations have substantial economic activities, such as the United Kingdom (UK), Canada, and Ireland.[41] For example, one of the world's largest insurance brokers, Aon, was established in Illinois in 1982 and moved to the UK under the substantial business activity exemption in

34. *See generally*, HELEN OF TROY, http://www.hotus.com/about/ (last visited Sept. 12, 2017).

35. Brandon Hayes, *U.S. Anti-inversion Provisions*, INT'L TAX REV. (March 27, 2013), http://www.internationaltaxreview.com/Article/3181949/US-anti-inversion-provisions.html.

36. *Id.* This case is the convergence of several favorable factors: The Company had a net operating loss shielding it from tax on required gain recognition. Its share price was down. A large proportion of its shareholders were either foreign investors or tax-exempt entities, neither of which were taxable in the event the conversion resulted in a gain. *See* Andrew P. Mitchel & Rusudan Shervashidze, *"Helen of Troy" Inversions Continue*, 2 TAX J. OF RUCHELMAN P.L.L.C., no. 4 (2015).

37. Hayes, *supra* note 35.

38. I.R.S. Notice 94-46, 1994-1 C.B. 356.

39. American Jobs Creation Act of 2004 Pub. L. No. 108-357. *See also* MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568. *supra* note 3.

40. *Id.*

41. MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568, *supra* note 3, at 7.

2012.[42] Although Aon had extensive business operations and appearances in the UK including sponsoring Manchester United F.C., Professor Bret Well of University of Houston Law Center analyzed that the real reason for Aon's move was tax savings.[43]

a. Treasury Decision 9592 in 2012

In response to the increased use of the substantial business activities exemption, the U.S. Department of the Treasury ("Treasury Department") provided a bright-line rule for meeting the requirements of "substantial economic activities" which requires that "at least 25 percent of the group employees, group assets, and group income are located or derived in the relevant foreign country."[44] Therefore, the first loophole of the American Jobs Creation Act of 2004 was no longer realistic for many U.S. corporations to meet.[45]

Currently, many companies take advantage of the second loophole, by way of merger with companies in lower-tax countries.[46] Two types of mergers are usually involved: first, a U.S. corporation and a larger foreign corporation merging for business purposes; second, a U.S. corporation merging with a smaller foreign corporations for corporate tax breaks.[47] Under the second scenario, the effective control of the new company stays with the shareholders of the U.S. corporations despite the fact that the corporation is now headquartered overseas.[48]

b. Treasury Notice 2014-52

The issue of corporate inversion drew public attention in 2014 when three household names, Pfizer Inc. ("Pfizer"), the Walgreens Company and Medtronic Inc.("Medtronic"), proposed high-profile inversions.[49] If America's largest drug maker Pfizer inverted to the UK as proposed, the United States would have lost as much as $1.4 billion in tax revenue per year after its conversion.[50] In response to the new wave of inversions, the Treasury Department released a notice of regulatory

42. Brett Wells, *Cant and the Inconvenient Truth About Corporate Inversions*, 136 TAX NOTES 429, 429-39 (July 23, 2012).

43. *Id.*

44. T.D. 9592, 2012-2 C.B. 41.

45. Wells, *supra* note 42, at 429-39.

46. MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568, *supra* note 3, at 5.

47. *Id.*

48. *Id.* at 4.

49. MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568., *supra* note 3.

50. Zachary R. Mider, *Tax Break Blarney: U.S. Companies Beat the System with Irish Addresses*, BLOOMBERG, (May 5, 2014), http://www.bloomberg.com/news/2014-05-04/u-s-firms-with-irish-addresses-criticized-for-the-moves.html.

actions restricting inversions and indicated that other regulations were under consideration.[51] Notice 2014-52 did not prevent inversions via merger and did not address earnings stripping by shifting debt from the foreign subsidiary to the U.S. firm, but the Treasury Department has indicated future action in this area.[52] Following Notice 2014-52, several corporations announced they were canceling plans to merge, and one corporation, Medtronic, announced a change in financing plans (no longer using earnings abroad to pay acquisition costs).[53]

c. Inversions After 2014 and Changes to the Treasury Department's Regulations

After the Treasury Department's notice in 2014 , the pace of corporate inversions slowed down. However, some deals went on and avoided the Treasury regulations by an ownership of less than 60%, which would disqualify the mergers as inversions.[54] The most significant in size was the proposed Pfizer merger. On November 23, 2015, Pfizer announced a proposed merger with Allergan Inc., ("Allergan Irish"), an Irish pharmaceutical company.[55] This merger, which would create the largest pharmaceutical company in the world, would not be covered under the anti-inversion rules of 2015, because Pfizer would own 56% of the value of the new firm.[56] However, Pfizer had to terminate its merger with Allergan Irish after the tax rules changed again in 2016.[57]

On April 4, 2016, the Treasury Department and the IRS proposed temporary regulation T.D. 9761, to formalize rules contained in Notices

51. *See* I.R.S. Notice 2014-52. *See also* Press Release, U.S. Department of the Treasury, *Treasury Announces First Steps to Reduce Tax Benefits of Corporate Inversions*(Sept.22, 2014), https://www.treasury.gov/press-center/press-releases/Pages/jl2647.aspx.

52. *See* Andrew Velarde, *Next Inversion Guidance May Affect Interest Deductions and Debt,* 145 TAX NOTES 490, 490-91 (Nov. 3, 2014).

53. *See* Kevin Drawbaugh, *Factbox: Another U.S. Tax 'Inversion' Implodes, Pending Deals Dwindle*, REUTERS (Oct. 24, 2014, 9:31 AM), http://www.reuters.com/article/us-usa-tax-pending-inversions-idUSKCN0ID1VR20141024.

54. MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568, *supra* note 3, at 11.

55. *See* Jackie Wattles & Heather Long, *Avoiding U.S. Corporate Taxes,"* CNN MONEY (Nov. 23, 2013, 8:28 AM) http://money.cnn.com/2015/11/23/investing/pfizer-allergan-merger/.

56. MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568, *supra* note 3, at 11.

57. Caroline Humer & Ransdell Pierson, *Obama's Inversion Curbs Kill Pfizer's $160 Billion Allergan Deal*, REUTERS (Apr. 8, 2016, 6:40 AM) http://www.reuters.com/article/us-allergan-m-a-pfizer-idUSKCN0X21NV.

2014-52 and 2015-79.[58] In response to these new regulations, the proposed merger between Pfizer and Allergen Irish was terminated.[59]

The most significant change in T.D. 9761 is the "three-year rule."[60] Under this rule, a transaction will be treated as an inversion, if the foreign corporation that acquires a U.S. target has made other acquisitions of one or more U.S. companies in the 36-month period preceding the acquisition.[61] In Pfizer's case, Allergan Irish itself is the product of an acquisition of Actavis plc, a U.S. corporation, by the shareholders of former Allergen Inc., a U.S. Corporation, in 2015.[62] Therefore, the multi-step acquisition rule would apply to both the Actavis's acquisition and Pfizer's acquisition.

Secondly, the temporary regulations target inversion transactions involving new foreign parent corporations that previously acquired one or more U.S. entities in transactions where the new foreign parent issued stock.[63] These prior acquisitions usually can largely increase the value of the new foreign parent, enabling it to subsequently engage in another acquisition or merger transaction with another larger U.S. company while remaining below the 60% or 80% ownership thresholds.[64] The temporary regulations address this possibility by disregarding stock of the new foreign parent to the extent the value of such stock is attributable to its prior U.S. entity acquisitions during the prior three years.[65] According to analysis by Americans for Tax Fairness, the implementation of this rule would have increased Pfizer's share of the merged company to roughly 70% from 56% prior to the rule.[66]

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58. *Fact Sheet: Treasury Issues Inversion Regulations and Proposed Earnings Stripping Regulations*, U.S. DEP'T OF THE TREASURY (Apr. 4, 2016), https://www.treasury.gov/press-center/press-releases/Pages/jl0404.aspx. *See also* Richard Rubin & Liz Hoffman, *U.S. Treasure Unveils New Steps to Curb Tax Inversions*, WALL ST. J. (Apr. 4, 2016, 8:28 PM) http://www.wsj.com/articles/u-s-treasury-unveils-new-steps-to-limit-tax-inversions-1459803636; Velarde, *supra* note 52.

59. Velarde, *supra* note 52*;* Humer & Ransdell, *supra* note 57.

60. PRICEWATERHOUSECOOPERS, TEMPORARY REGULATIONS ADDRESS INVERSION NOTICES, PROVIDE FURTHER RESTRICTIONS (Apr. 11, 2016), https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-temp-regs-address-inversion-notices-provide-further-restrictions.pdf.

61. *Id.*

62. MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568, *supra* note 3, at 11.

63. *Id.*

64. *Id.*

65. T.D. 9761, 2016-20 I.R.B.

66. Frank Clemente, *New Treasury Dept. Anti-Inversion Rule Would Prevent Pfizer's Estimated $35 Billion Tax Break*, AMERICANS FOR TAX FAIRNESS (Apr. 5, 2016), https://americansfortaxfairness.org/new-treasury-dept-anti-inversion-rule-would-prevent-pfizers-estimated-35-billion-tax-break/.

Thirdly, the new temporary regulations requires a Controlled Foreign Corporation (CFC) of an inverted U.S. corporation to recognize all realized gain with respect to certain post-inversion §351 exchange.[67] This would address situations where a CFC of an inverted U.S. company engages in a post-inversion exchange that could dilute a U.S. shareholder's indirect interest in the exchanged asset, allowing the U.S. shareholder to avoid U.S. tax on any realized gain in the asset that is not recognized at the time of the transfer.[68]

III. EXPLAINING IRELAND, THE NETHERLANDS, AND LUXEMBURG'S CHARM: EU'S PATENT BOX, THE "DOUBLE IRISH DUTCH SANDWICH," TAX RULINGS AND THE NON-TAX FACTORS

As the following table shows, a significant portion of corporate inversions since 2012 have involved companies in the medical and pharmaceutical industries, and almost all of these companies' inversion destinations were United Kingdom, Ireland, Netherlands and Luxemburg.[69] The main reason for this phenomenon is these EU member states' favorable intellectual property taxation, which is often called "patent boxes".[70]

Table 1 A Decade of Inversions and Re-incorporations [71]

Year	U.S. Company	Industry	Foreign Acquisition Target	New Corporation Residency
2015	Steris	Medical Products	Synergy Health	UK
2015	Cyberonics (now LivaNova)	Medical Devices	Sorin	UK

67. T.D. 9761, 2016-20 I.R.B.

68. *Id.*

69. The only exception is Valeant, which was inverted to Canada. *See infra* Table 1A; Nicholas V. Praet, *Doubts Mount About Valeant Pharmaceuticals' Tax Structures*, FINANCIAL POST (Sept. 8, 2014, 9:50 AM), http://business.financialpost.com/investing/valeant-pharmaceuticals-under-threat-from-tax-audit-analysts-say.

70. JOINT ECONOMIC COMMITTEE, PATENT BOXES: A BRIEF HISTORY, RECENT DEVELOPMENTS, AND NECESSARY CONSIDERATIONS (2016), https://www.jec.senate.gov/public/_cache/files/02a2a18a-1e08-42ce-8c14-72b6138b54dd/031016-patent-boxes.pdf.

71. *Decade of Inversions and Re-incorporations*, BLOOMBERG, https://assets.bwbx.io/images/users/iqjWHBFdfxIU/i0iB.OFB4l2U/v0/1400x-1.png.

2015	Wright Medical	Medical Devices	Tornier	the Netherlands
2015	Civeo	Oil and Gas	—	Canada
2015	Mylan	Pharmaceuticals	Abbott's Generics Unit	the Netherlands
2015	Medtronic	Medical Devices	Covidien	Ireland
2014	Burger King	Fast Food	Tim Hortons	Canada
2014	Horizon Pharma	Pharmaceuticals	Vidara Therapeutics	Ireland
2014	Endo International	Pharmaceuticals	Paladin Labs	Ireland
2013	Perrigo	Pharmaceuticals	Elan	Ireland
2013	Actavis	Pharmaceuticals	Warner Chilcott	Ireland
2013	Liberty Global	Telecommunication and Television	Virgin Media	UK
2013	Tower Group	Insurance	Canoplus Holdings Bermuda	Bermuda
2012	Stratasys	Printing and Manufacturing	Objet	Israel
2012	Eaton	Industrial Manufacturing	Cooper Industries	Ireland
2012	DE Master Blenders 1753	Tea and Coffee	—	Ireland
2012	Tronox	Chemical and Mining	Exxaro Resources	Australia
2012	Rowan	Driller Manufacturing	—	UK
2012	Aon	Insurance	—	UK

2012	Jazz Pharmaceuticals	Pharmaceuticals	Azur Pharma	Ireland
2011	Alkermes	Pharmaceuticals	Elan's Drug Technologies	Ireland
2010	Valeant	Pharmaceuticals	Biovail	Canada
2009	Altisource Portfolio Solutions	Real Estate	—	Luxembourg
2009	Ensco International	Drilling	—	UK
2009	Tim Hortons	Fast Food	—	Canada
2007	Western Goldfields	Mining	—	Canada
2007	Argonaut Group	Insurance	PXRE	Bermuda
2005	Lazard	Financial Advisory	—	Bermuda

A. An Introduction to the EU Member States' "Patent Box"

Tax incentives for intellectual property are usually provided in two periods of time: at the front end of the innovation value chain, in the years when the research and development ("R&D") expenditures incur, or at the back end of the value chain, in the years when income is generated from using intellectual property.[72] Front-end tax incentives include deductions and tax credits for qualifying R&D expenses, such as the U.S. R&D tax credit under section 41.[73] By contrast, the EU's tax incentives are mainly back-end incentives that provide a reduced income tax rate for certain income arising from the exploitation of the intellectual property.[74]

72. Peter R. Merrill et al., *Is it Time for the United States to Consider the Patent Box?*, 65 TAX NOTES 1665, 1666 (Mar. 26, 2012).

73. I.R.C. § 41.

74. *Id.*

A Patent Box generally refers to a tax incentive that grants a lower tax rate to income earned from qualifying intellectual property.[75] Patent Box can also refer to a deduction or exemption for qualifying income that reduces taxable income.[76] The scope and tax rates under each jurisdiction are different, but they generally are in the range of 5% to 15%.[77] The Netherlands currently has the lowest rate at 5%, and the U.K. sits in the middle, with a rate of 10%.[78] "Patent Boxes are generally legal under EU law as long as they do not amount to illegal state aid.[79]

B. The "Double Irish Dutch Sandwich" Technique

The extensive bilateral tax-treaty networks between the United States and Ireland, the Netherlands and Luxemburg eliminate almost any worry of being taxed twice in these countries.[80] Specifically, these three countries have tax treaties with the United States that are favorable for companies who own intellectual property.[81] There are three common characteristics of these treaty agreements: (1) 0% withholding tax, (2) low corporate tax rate on royalties, and (3) less restrictive limitation on benefits provisions than newer treaties.[82] As a result, these three countries were able to attract American MNEs, especially those in technology and pharmaceutical industries, using tax incentive techniques such as "Double Irish Dutch Sandwich" to reduce their tax bills.

The common tax avoidance technique here is the "Double Irish Dutch Sandwich," which also has a Luxembourg equivalent. Apple Inc. was a pioneer of this tax technique and many household American MNEs followed its example, including Facebook, Inc. ("Facebook"), Google Inc. ("Google"), Microsoft Corporation ("Microsoft"), Oracle Corporation ("Oracle") and Pfizer.[83]

The "Double Irish Dutch Sandwich" technique used to be effective in saving these MNEs tax bills. In 2014, Google moved 10.7 billion euros ($12 billion USD) through its Netherlands shell company to its Bermuda accounts, and reported "an effective tax rate of just 6% on its non-U.S.

75. W. Wesley Hill, *The Patent Box as the New Innovation Incentive for the Several States: Lessons from Intellectual Property-Tax Competition*, 42 AIPLA Q.J. 13, 16 (2014).

76. *Id.*

77. *Id.*

78. Ireland's, Netherlands' and Luxembourg's rates all fall between 5% and 10%. *Id.*

79. DeAngelis, *supra* note 6, at 1367.

80. *Id*. at 1366.

81. *Id.*

82. *Id.*

83. Charles Duhigg & David Kocieniewski, *How Apple Sidesteps Billions in Taxes*, N.Y. TIMES (Apr. 28, 2012), http://www.nytimes.com/2012/04/29/business/apples-tax-strategy-aims-at-low-tax-states-and-nations.html?mcubz=0.

profits" from its parent company Alphabet, Inc.[84] According to a study released by the Center for Tax Justice and the U.S. Public Interest Research Group Education Fund, "Apple has booked $181.1 billion in offshore profits in their financial statements", "more than any other company," while only paying IRS a 2.3% effective rate on its offshore profits.[85] According to European Commission's investigation, Starbucks had allegedly "cut its tax burden by up to €30 million since 2008," paying the Netherlands "€2.6 million in corporate tax on a pretax profit of €407 million, a rate of less than 1%."[86]

This combined technique of "Double Irish" and "Dutch Sandwich" takes advantage of some EU members' low corporate tax rates and their tax incentives for intellectual property due to the implementation of "Patent Box," differences in tax residence rules between the United States and Ireland and between different EU countries' withholding tax rules.[87] The following is a step-by-step walkthrough of the technique:

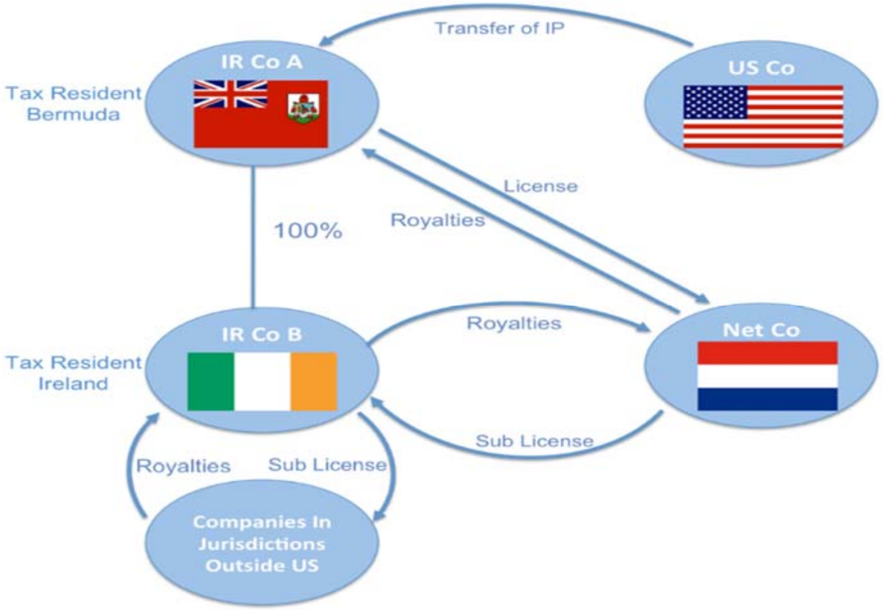
84. Jonathan Chew, *7 Corporate Giants Accused of Evading Billions in Taxes*, FORTUNE (Mar. 11, 2016), http://fortune.com/2016/03/11/apple-google-taxes-eu/.

85. *See also* CTR. FOR TAX JUST., OFFSHORE SHELL GAMES (2015), http://ctj.org/ctjreports/2015/10/offshore_shell_games_2015.php#executive.

86. *See* Liz Alderman, *European Inquiry Focuses on A Mysterious Starbucks Business*, N.Y. TIMES (Oct. 22, 2015), https://www.nytimes.com/2015/10/22/business/international/european-inquiry-focuses-on-a-mysterious-starbucks-business.html.

87. *US Companies & Their Use of the Double Irish Dutch Sandwich*, PEARSE TRUST BLOG (June 13, 2012), http://www.pearse-trust.ie/blog/bid/86105/US-Companies-Their-Use-Of-The-Double-Irish-Dutch-Sandwich.

Graph 1: An Illustration of the "Double Irish Dutch Sandwich" Technique[88]



The first step is for the U.S. corporation ("US Co") to transfer some intangible property rights, such as intellectual property, to an Irish subsidiary ("IR Co A") that is incorporated in Ireland but has its headquarters located in Bermuda or other tax havens with no income tax.[89] This company is not designed like this by accident, but with the intention of making the best of the differences in tax residency determination rules between the then Ireland tax law and the U.S. tax law.[90] Irish tax law provides that a company is a tax resident where its central management and control is located, not where it is incorporated.[91] So, IR Co A is a Bermuda resident (or a tax resident of other tax havens), and not a tax resident in Ireland.[92] However, the IRS treats IR Co A as an Ireland company since it is incorporated in Ireland, which allows it to

88. *Id.*

89. *Id.*

90. *Id.*

91. As of January 1, 2015, companies incorporated in Ireland will be considered tax residents in Ireland. *See* Sam Schechner, *Ireland to Close "Double Irish Tax Loophole*, WALL ST. J. (Oct. 14, 2014), https://www.wsj.com/articles/ireland-to-close-double-irish-tax-loophole-1413295755.

92. Debasish Kaushik, *Tax Evasion Strategies: The Double Irish & The Dutch Sandwich*, TELL ME YOUR VIEW. (Feb. 3, 2013), https://tellmeyourview.wordpress.com/2013/02/03/the-double-irish-the-dutch-sandwich.

make full use of all the U.S. treaties with Ireland and Ireland's 12.5% corporate tax rate, which is one of the lowest corporate tax rate in the world.[93] Additionally, according to U.S. tax law, IR Co A must pay the US Co the arms-length value of intellectual property, and this royalty income is exempted from US corporate taxes under U.S. - Ireland Treaty for US Co, because an Irish company, IR Co A, is in control of the intellectual property.[94]

The next step is to create another Irish subsidiary ("IR Co B"), which is wholly owned by IR Co A and is a tax resident of Ireland. IR Co A then licenses intellectual properties to IR Co B in exchange for royalties.[95] IR Co B then sub-licenses the intellectual properties to some companies outside of the US, and report royalty income to Ireland, but thanks to Ireland's low corporate tax rate and the ability to deduct the royalties paid to IR Co A, IR Co B ends up paying only a "nominal amount in taxes."[96] On the other hand, IR Co A also only pays "a low or nil rate of taxation in Bermuda" for its royalties received from IR Co B.[97]

Ultimate ownership of both IR Co A and IR Co B is located in the United States and therefore they are subject to the IRS's Controlled Foreign Corporation regulations.[98] The payments between the two related Irish companies might be non-tax-deferrable and subject to current taxation.[99] However, this could be avoided if IR Co B is not a corporation, but a pass-through entity like a partnership, so that it can hide its finances from the IRS.[100] This is possible because a company may choose either to be treated as a corporation or a pass-through entity for tax purposes

93. Stephen C. Loomis, *Recent Development: The Double Irish Sandwich: Reforming Overseas Tax Havens*, 43 ST. MARY'S L.J. 825, 838-39 (2012). I.R.C. §7701(a)(3),(4) and (5). *See also* Joseph B. Darby III & Kelsey Lemaster, *Double Irish More than Doubles the Tax Savings: Hybrid Structure Reduces Irish, U.S. and Worldwide Taxation*, PRAC. U.S./INT'L TAX STRATEGIES 2, 12 (May 15, 2007), ("Ireland's flat tax rate … is one of the lowest in the world.").

94. Treas. Reg. § 1.482-1(b)(1) (as amended in 2009) ("In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer."). Convention Between the Government of the United State of America and the Government of Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, Ir.-U.S., art. 12, ¶ 1, Jul. 28, 1997, S. TREATY DOC. NO. 105-31 ("Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State may be taxed only in that other State.")

95. Loomis, *supra* note 93, at 839.

96. *Id.* at n. 56.

97. *US Companies & Their Use of the Double Irish Dutch Sandwich*, *supra* note 87.

98. Kaushik, *supra* note 92.

99. *Id.*

100. Loomis, *supra* note 93 at 838.

through the "check the box" rules.[101] If the subsidiary elects to be a pass-through entity, it is treated as a branch of the parent company for tax purposes.[102] Therefore, the payments between IR Co A and IR Co B are not subject to current taxation.

Many American MNEs adopt another step to further reduce tax burdens. This step is usually called the "Dutch Sandwich," or the "cheese" on the "bread" of the "Double Irish."[103] Irish law makes it difficult for U.S. Co to send the money directly to IR Co A without incurring a large tax bill, so the payment makes a brief detour through the Netherlands.[104] Under the "Dutch Sandwich," a Netherland company ("Net Co") is established to funnel income from IR Co A to IR Co B.[105] IR Co A licenses its intellectual property rights to Net Co, which then sub-licenses the intellectual property rights to the rest of EU and pays royalties to IR Co A. Ireland doesn't tax certain payments to companies in other EU member states.[106] Therefore, Ireland does not tax the transfer from Net Co to IR Co B, and the royalty payment from Net Co to IR Co A is "subject to a minimal amount of tax under Dutch law."[107]

US Co's payments receive this important tax benefit by a brief detour through a third country, but such transactions could incur extra cost, the withholding tax—sometimes as high as 33% — on royalties leaving for zero-tax jurisdiction , such as Bermuda and the Cayman Islands.[108] But, luckily, , the Netherlands doesn't impose withholding taxes on royalties leaving the country, regardless of their destination.[109] Similarly, on a "Luxembourg Sandwich", Luxembourg does not impose withholding tax on royalties either.[110]

101. Treas. Reg. § 301.7701-3(a) (as amended in 2006).

102. Joseph B. Darby III & Kelsey Lemaster, *Double Irish More than Doubles the Tax Savings: Hybrid Structure Reduces Irish, U.S. and Worldwide Taxation*, PRAC. U.S./INT'L TAX STRATEGIES 2, 12 (May 15, 2007) (defining a controlled foreign corporation as "any foreign corporation" with a U.S. taxpayer holding of more than 50% of the total value of the shares or voting interest (emphasis added)).

103. *US Companies & Their Use of the Double Irish Dutch Sandwich*, *supra* note 87.

104. *Id.;* Loomis, *supra* note 93, at 839.

105. Loomis, *supra* note 93, at 839.

106. *Id.*

107. *Id.*

108. *Id.;* Kaushik, *supra* note 92.

109. Kaushik, *supra* note 92.

110. DELOITTE, TAXATION AND INVESTMENTS IN LUXEMBOURG 2016, 13 § 4.3, *https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/international-business-support/deloitte-cn-ibs-luxembourg-tax-invest-en-2016.pdf.*

C. An Introduction to the Tax Ruling Practices in EU Countries

As we can see from the above walk-through of the "Double Irish Dutch Sandwich" technique, it is not easy to navigate through different countries' tax codes, and one small mistake or one uncertainty in the technique may cost the American MNEs millions of dollars in tax bills. The widespread use of tax rulings in the EU countries may help the American MNEs rest assured in implementing complicated tax planning techniques.

Tax ruling, or "advance tax ruling," is a procedure that allows taxpayers to achieve certainty regarding the tax consequences of a proposed transaction.[111] Before implementing a transaction, the taxpayer can turn to the tax authorities for a binding ruling on the tax consequences of the transaction. In light of the binding ruling, the taxpayer decides whether the transaction should be implemented or changed.[112] As one tax law professor described it, "it's like taking your tax plan to the government and getting it blessed ahead of time."[113] Therefore, seeking a tax ruling before launching a complicated tax planning technique can effectively prevent controversy and mitigate the risk of double taxation.[114]

However, there are also some limits imposed on each EU countries' tax rulings. The most popular topic in tax rulings is price transferring.[115] Such tax rulings "have historically been the province of the individual Member States [of the EU]" and are legal in all Member States.[116] However, if transfers amount to illegal State aid —with the potential to distort competition within the EU—these agreements are subject to European Commission's scrutiny.[117] The Treaty on the Functioning of the European Union ("TFEU") provides that "any aid granted by a

111. Yehonatan Givati, *Resolving Legal Uncertainty: The Unfulfilled Promise of Advance Tax Rulings*, 29 VA. TAX REV. 137, 139 (2009).

112. *Id.*

113. Leslie Wayne et al., *Leaked Documents Expose Global Companies' Secret Tax Deals in Luxembourg*, THE INT'L CONSORTIUM OF INVESTIGATIVE J. (Nov. 2, 2014).

114. *Id.;* Givati, *supra* note 111.

115. U.S. DEP'T OF TREASURY, U.S. DEPARTMENT OF THE TREASURY WHITE PAPER: THE EUROPEAN COMMISSION'S RECENT STATE AID INVESTIGATIONS OF TRANSFER PRICING RULINGS 1 (Aug. 24, 2016) [hereinafter WHITE PAPER]; Robert Stack, *Treasury Releases White Paper on European Commission's State Aid Investigations into Transfer Pricing Rulings*, U.S. DEP'T OF TREASURY (Aug. 24, 2016), https://www.treasury.gov/connect/blog/Pages/Treasury-Releases-White-Paper-on-European-Commission%E2%80%99s-State-Aid-Investigations-into-Transfer-Pricing-Rulings.aspx.

116. WHITE PAPER, *supra* note 115, at 2.

117. *Id.*

Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."[118] The State aid rules "ensure that the functioning of [the] internal market is not distorted by anticompetitive behavior . . . favoring some actors to the detriment of others."[119]

D. An Overview of the Economic and Social Backgrounds in Ireland, Luxembourg and the Netherlands

There are many countries that have lower corporate tax rates than Ireland, Luxembourg and the Netherlands, like Bermuda and the Cayman Islands.[120] However, as mentioned earlier in this note, the post-2004 inversions usually take place in larger countries in which U.S. corporations have substantial economic activities, such as these EU countries.[121] Although American MNEs have even more economic activities in many Asian and Latin American countries, Ireland, Luxembourg and the Netherlands have a more stable economic and political environment,[122] more predictable tax policies, long traditions of providing financial services to international corporations, and most importantly, an extensive tax treaty network with the United States and other countries.[123] .

Ireland, although the poorest of the three countries, has strong industries, a legal infrastructure similar to that of the United States, and an increasingly competent workforce.[124] Compared to Ireland,

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118. *Id*. *See also* Consolidated Version of the Treaty on the Functioning of the European Union art. 107(1), 2016 O.J. (C 202) 47.

119. *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions*, ¶ 2, COM (2012) 209 final (May 8, 2012).

120. *Corporate Tax Rates 2017,* DELOITTE https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-corporate-tax-rates.pdf (last updated Mar. 2017).

121. MARPLES & GRAVELLE, CONG. RESEARCH SERV., R43568, *supra* note 3, at 7.

122. DeAngelis, *supra* note 6, at 1371

123. *Treaties for the Avoidance of Double Taxation Concluded by Member States*, EUROPEAN UNION (Last Updated Oct. 19, 2017), https://ec.europa.eu/taxation_customs/individuals/personal-taxation/treaties-avoidance-double-taxation-concluded-member-states_en.

124. Vanessa Houlder et al., *Tax Avoidance: The Irish Inversion*, FIN. TIMES (Apr. 29, 2014, 5:47 PM), http://www.ft.com/intl/cms/s/2/d9b4fd34-ca3f-11e3-8a31-00144feabdc0.html#axzz3NnaCKlWO [http://perma.cc/TJ3L-8LQT] (noting the large number of pharmaceutical companies that have inverted to Ireland); GRANT THORTON, A GLOBAL GUIDE TO BUSINESS RELOCATION 77 (2015), https://www.grantthornton.global/globalassets/1.-member-firms/global/insights/article-pdfs/2015/advisory/a-global-guide-to-business-relocation_final4.pdf.

Luxembourg is not only richer with the fourth highest GDP per capita in the world, but has a longer tradition in managing international financial transactions.[125] "In a country that's smaller than the state of Rhode Island," Luxembourg has about 150 banks.[126] Luxembourg also has "a very stable economy and political environment with a pro-business government."[127] Additionally, Luxembourg, as the founding member of European Economic Community, is a well-respected country in the world.[128]

Regardless, Luxembourg is "a far cry from the palm-fringed tropical island tax haven of popular imagination."[129] "Luxembourg Leaks," a major financial scandal revealed in November 2014 by a journalistic investigation conducted by the International Consortium of Investigative Journalists, revealed Luxembourg's large-scale tax engineering to assist MNEs tax evasion.[130] The Luxembourg Leaks' disclosures attracted international attention regarding tax avoidance techniques in Luxembourg and elsewhere.[131] Nevertheless, Luxembourg continues to be a tax and judicial haven:

> Neutering Luxembourg as a tax haven at the heart of Europe requires an overhaul of its corporate tax law and administration. A concerted effort coordinated by the OECD aims to bring many of the tax structures facilitated by Luxembourg to an end. But, even if its proposals are technically sufficient, it will take intense political pressure to force Luxembourg to implement them.[132]

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125. CIA, *GDP Per Capita*, *in* THE WORLD FACTBOOK, https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html; *A Global Guide to Business Relocation*, *supra* note 123, at 80.

126. *8 Things You Didn't and Should Know About Luxembourg*, WORLD ATLAS, http://www.worldatlas.com/articles/8-things-you-didn-t-and-should-know-about-luxembourg.html (last modified Sept. 19, 2016).

127. DeAngelis, *supra* note 6, at 1371.

128. Simon Bowers, *Luxembourg Tax Files: How Tiny State Rubber-Stamped Tax Avoidance on an Industrial Scale*, THE GUARDIAN (Nov. 5, 2014), https://www.theguardian.com/business/2014/nov/05/-sp-luxembourg-tax-files-tax-avoidance-industrial-scale.

129. Richard Brook, *Havens Like Luxembourg Turn 'Tax Competition' into a Global Race to the Bottom*, THE GUARDIAN (Nov. 4, 2014), https://www.theguardian.com/world/2014/nov/05/luxembourg-tax-haven-competition-global-grand-duchy-corporate-law-administration.

130. Leslie Wayne & Kelly Carr, *Lux Leaks Revelations Bring Swift Response Around World*, INT'L CONSORTIUM OF INVESTIGATIVE JOURNALISTS, (Nov. 6, 2014); Matthew Caruana Galiza et. al., *Explore The Documents: Luxembourg Leaks Database*, INT'L CONSORTIUM OF INVESTIGATIVE JOURNALIST (Nov. 4, 2014), https://www.icij.org/project/luxembourg-leaks/explore-documents-luxembourg-leaks-database.

131. *Id.*

132. Brook, *supra* note 129.

Technology and pharmaceutical American MNEs rely on Luxembourg's Patent Box to realize an effective rate of 5.76%, making it one of the lowest rates in the world.[133] Moreover, MNEs, which do not have large amounts of intellectual property, can also see a hefty discount in their tax bills from cross-border lending techniques and Luxembourg's tax treaties with other countries.[134]

Finally, the Netherlands has a rich history of international trade, evidenced by its tax treaties with over 100 countries.[135] Koos de Bruijn, of Tax Justice Netherlands, summarized the attractions of the Netherlands to MNEs:

> The Netherlands is an increasingly attractive location for multinationals to place holding companies, because of the tax treaties it has with over 100 countries. Along with these come the Netherlands's famous participation exemption [exemption from taxation for a shareholder in a company on dividends received, and potential capital gains arising on the sale of shares], the absence of withholding taxes on interest and royalties, the possibility of being able to conclude tax rulings [before paying tax], the use of legal co-operation and the so-called innovation box, a special fiscal arrangement designed for research and development. [136]

However, the practice in the Netherlands is also under heavy criticism in the EU. In 2015, Dutch News said that Dutch Finance Minister Jeroen Dijsselbloem admitted that the Netherlands "is too often being used by companies to avoid tax and has so become 'part of the problem'." [137] The Finance Minister added that, "[the Netherlands] must become part of the solution from now on."[138] However, it is worth noting that, later in 2015, Dijsselbloem also said that "the Dutch system has allowed some corporations to pay almost no tax and that was never the

133. DeAngelis, *supra* note 6, at 1371.

134. Bowers, *supra* note 128.

135. DeAngelis, *supra* note 6, at 1371.

136. Simon Goodley & Dan Milmo, *Dutch Masters of Tax Avoidance*, THE GUARDIAN (Oct. 19, 2011), https://www.theguardian.com/business/2011/oct/19/tax-avoidance-in-netherlands-becomes-focus-of-campaigners.

137. *The Netherlands 'Notorious' in EU Tax Evasion Talks: FD*, DUTCH NEWS (Apr. 14, 2016), http://www.dutchnews.nl/news/archives/2016/04/the-netherlands-notorious-in-eu-tax-evasion-talks-fd/. *See also* Francesco Guarascio, *Dutch Say Will Lead EU Fight against Multinationals' Tax Avoidance*, REUTERS (Jan. 15, 2016), http://www.reuters.com/article/us-eu-taxavoidance-netherlands-idUSKCN0UT0YW.

138. *Id.*

intention."[139] It is unclear whether the Netherlands' ambition to cooperate with the EU's battle against tax avoidance was an effort to create a positive image for its rotating presidency or if it really planned to be "part of the solution."[140]

IV. CHALLENGES TO AMERICAN MNES' CONTINUED TAX INVERSIONS IN THE EU

A. The EU's Investigation into Apple's, Amazon's and Starbuck's Tax Deals with EU Countries

Since 2013, the European Commission initiated a series of state aid investigations into a number of U.S.-headquartered companies that had tax rulings against them from various EU Member States.[141] The European Commission set up a dedicated task force in 2013 "to follow up on public allegations of favorable tax treatment of certain companies."[142] To date, the Commission has completed state aid investigations against Ireland to Apple, the Netherlands to Starbucks and Luxembourg to Fiat Automobiles S.p.A ("Fiat"), and found state aid in all three cases.[143] Additionally, the Commission is currently conducting state aid investigations into Luxembourg to McDonald's, Amazon.com and GDF Suez S.A.[144]

B. EU's Messages behind the State Aid Investigations

EU Commissioner, Margrethe Vestager, characterized the ruling against Ireland and Apple "as protecting a level-playing field under rules enshrined in the Treaty of Rome, which laid the foundations of the EU [sixty] years ago."[145] As Vestager stated, the European Commission's decision requiring Apple to pay back unpaid taxes is about "restoring fair

139. *Netherlands Wants to Rein in Tax Avoidance During EU Presidency*, THE GUARDIAN (Nov. 2, 2015), https://www.theguardian.com/business/2015/nov/02/netherlands-wants-to-rein-in-tax-avoidance-during-eu-presidency/.

140. *The Netherlands 'Notorious' in EU Tax Evasion Talks*, *supra* note 137.

141. EUROPEAN COMMISSION, TAX RULING (2016), http://ec.europa.eu/competition/state_aid/tax_rulings/index_en.html.

142. *Id.*

143. *Id.*

144. *Id.*

145. Joe Brenna, *Getting to the Core of Europe's Case against Apple and Ireland*, IRISH TIMES (Feb. 3, 2017), http://www.irishtimes.com/business/economy/getting-to-the-core-of-europe-s-case-against-apple-and-ireland-1.2960870.

competition."[146] However, Ireland thinks otherwise. Ireland's Minister for Finance, Michael Noonan, cast the ruling against Ireland providing state aid to Apple "as encroaching on Ireland's sovereignty and attacking its corporate tax regime and potential for foreign direct investment."[147] Nevertheless, Vestager said, "fighting aggressive tax planning practices should make countries such as Ireland and others an even better place in which to invest."[148]

The EU's ruling against Ireland and Apple is the largest state-aid ruling in EU history.[149] Moreover, the European Commission "has become much more aggressive in its approach to the agreements struck between multinational companies and EU member states."[150] Previously the Commission ordered Dutch authorities to recover €30m (£26m) from Starbucks with a similar amount due to Luxembourg from Fiat.[151] The Commission also has two ongoing in-depth investigations in Luxembourg surrounding Amazon and McDonald's, addressing concerns that tax rulings may give rise to state aid issues.[152]

All these rulings and investigations were major progress made by the European Commission towards fair taxation and greater transparency. The message behind this progress is clear: the European Commission is coming after MNEs, even if it means stirring conflict with its members.[153]

C. The U.S.'s Responses

The U.S. Department of the Treasury immediately issued a white paper following the European Commission ruling against Apple in August 2016.[154] The Treasury noted that the EU's state aid investigations have major implications for the U.S. and the recoveries imposed by the

146. Margrethe Vestager, *Why Fair Taxation Matters*, EUR. COMM'N (Sept. 9, 2016), https://ec.europa.eu/commission/2014-2019/vestager/announcements/why-fair-taxation-matters_en.

147. Brenna, *supra* note 145.

148. *Id.*

149. *Id.*

150. Zlata Rodionova, *Apple Slams European Commission over £11 Billion Tax Ruling*, INDEPENDENT (Dec. 19, 2016), http://www.independent.co.uk/news/business/news/apple-eu-commision-11-billion-tax-bill-ruling-appeal-back-taxes-ireland-a7484216.html.

151. *Id*.

152. European Commission Press Release IP/16/2923, *State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to €13 Billion* (Aug. 30, 2016), http://europa.eu/rapid/press-release_IP-16-2923_en.htm.

153. Joe Harpaz, *With Apple Ruling, European Commission Draws First Blood In Global Tax War*, FORBES (Nov. 3, 2016), http://www.forbes.com/sites/joeharpaz/2016/11/03/with-apple-ruling-european-commission-draws-first-blood-in-global-tax-war/#384ba5712486.

154. Stack, *supra* note 115.

Commission would have an outsized impact on U.S. companies.[155] Furthermore, the Department of the Treasury indicated that it is possible that the settlement payments ultimately could be determined to give rise to creditable foreign taxes, and "U.S. taxpayers could wind up eventually footing the bill for these State aid recoveries in the form of foreign tax credits that would offset the U.S. tax bills of these companies."[156] The investigations have global implications for the international tax system and the G20's agenda to combat Base Erosion and Profit Shifting ("BEPS") projects.[157]

The white paper seems to suggest that the U.S. Treasury is signaling that it is unhappy with the overly aggressive approach the European Commission has taken in the Apple case.[158] The rationale behind the U.S. Treasury's concern is simple. Suppose Apple's total global revenue is a pizza, where each slice indicates a share of that revenue non-apportionable to another State. When a company pays its corporate taxes to the IRS, it is responsible for reporting the whole pizza under the U.S. worldwide tax system. If two slices of that pizza, revenue, were generated in Europe, Apple would claim a foreign tax credit on those two slices so that the two slices would not be double-taxed in both Europe and the U.S.. However, if Europe suddenly claimed that Apple actually owed tax on three slices instead of two, the pizza wouldn't get any larger; the tax revenue would have to come from somewhere else. In the case of Apple, that "somewhere else" is most likely the United States. Although it requires a significant amount of work to calculate the accurate size of the pizza at issue here, it is clear that the U.S. Treasury would not let the one slice of pizza go easily to its European counterpart.

It is worth noting that the U.S. Treasury, the same organization that recently implemented its own anti-inversion rules illustrated in Section II of this note, is concerned that "the manner in which their European counterparts are dealing with same problem is inconsistent with the multilateral standards that U.S. and European authorities have been working toward."[159] The lesson for MNEs here is that they have to analyze the minefield of complex and often conflicting standards of different states in order to navigate global tax codes.

155. *Id.*
156. *Id.*
157. *Id.*
158. Harpaz, *supra* note 153.
159. *Id.*

V. STRATEGIES FOR AMERICAN MNES: LOOPHOLES STILL EXIST FOR TAX AVOIDANCE

There still exists opportunities for the American MNEs to reduce their tax bills through extensive tax planning. First, there still exist inconsistencies in global taxation. The global tax reform has become a game of whack-a-mole: the proposed changes to tax codes intermittently target at specific areas or specific types of companies, but stop short of fixing the problem for good.[160] Corporations caught under the swinging mallet will be bruised, but as long as there are still inconsistencies in global taxation, the smart tax consultants for American MNEs will find new ways to optimize profit for their shareholders. Second, Ireland, Luxembourg, and the Netherlands are still attractive for American MNEs to conduct extensive tax planning, thanks to their extensive tax treaties network, relatively low corporate tax rates and wide use of tax rulings.[161] Third, other than the inconsistencies in the global taxation, the American MNEs should not forget to make best of the loopholes within the U.S. codes, such as the "check-the-box" options, to cut their tax bills.

A. Tax Policy Changes In Ireland: 2020 Deadline To Wind Down The "Double Irish" Loophole

On October 14, 2014, Irish Finance Minister Michael Noonan announced that Ireland would be closing the double Irish loophole.[162] As of January 1, 2015, companies incorporated in Ireland will be considered tax residents in Ireland.[163] As of January 2015, new Irish tax rules state that companies not already operating in the country may not pursue the "Double Irish" technique; those already engaging in the technique have a six-year window to wind down.[164] The closing of the Double Irish loophole is likely the Ireland's response to the pressure from the European Union and the U.S. government.[165]

However, Ireland's 12.5% corporate tax rate remains a settled tax policy for Ireland and "the Patent Box" is still the norm in EU.[166] The Irish government announced it would introduce its own patent box, which will allow companies to pay a lower tax rate on profits from intellectual

160. *Id*.
161. Goodley & Milmo, *supra* note 136; DeAngelis, *supra* note 6, at 1366.
162. Schechner, *supra* note 91.
163. *Id*.
164. *Id.*
165. DeAngelis, *supra* note 6, at 1370.
166. *Id*., at 1370.

property reported in Ireland.[167] Therefore, although technology and pharmaceutical companies may be losing some tax benefits with the closing of the Double Irish, they can still remain in Ireland with Ireland's low corporate tax rates and other attractive incentives.

B. The Possibility of "Double Luxembourg"

Although the Double Irish loophole is closed by the Ireland government, some economists point out that the "Double Luxembourg" still exists to achieve a similar tax avoidance effect as the Double Irish.[168] Irish economist Seamus Coffey took Amazon.com's tax strategy in Luxembourg as an example to illustrate the possibility of the "Double Luxembourg":

> So we have a trading company operating in Luxembourg that records the sales made by Amazon from across the EU – these number[s] [are] in the millions and thus accumulate a large profit. But then the trading company makes a royalty payment to another Luxembourg-registered company but one that is not subject to tax in Luxembourg. Thus the payments to the holding company are not taxable in Luxembourg. These payments will be for the right to use the intangible assets (brand, technologies etc.) that Amazon has developed.[169]

One caveat here is that the European Commission "has its eye on these kinds of loopholes, and is pushing its member states to close them, which is why Ireland shut down the Double Irish."[170] "Luxembourg's tax structure hasn't changed yet, but could very well be next."[171]

C. Ireland, Luxembourg and the Netherlands' Tax Treaty Network and the Patent Box Regimes

Although Ireland, Luxembourg and the Netherlands attracted a great deal of criticism from the European Committee and the OECD, the extensive tax treaties of these countries are still out there – the Patent Box regimes remain the established policies of these countries – thus these

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167. *Id.*

168. Seamus Coffey, *The "Double- Irish" Luxembourg Style*, ECON. INCENTIVES (Oct. 7, 2014), http://economic-incentives.blogspot.com/2014/10/the-double-irish-luxembourg-style.html.

169. *Id.*

170. Shane Farro, *A Popular Irish Corporate Tax Loophole Is Now Dead — Here Are Three Other Loopholes*, BUS. INSIDER (Oct. 4, 2014), http://www.businessinsider.com/double-irish-other-corporate-tax-loopholes-2014-10.

171. *Id.*

countries will remain a popular destination for inversions, especially for corporations holding large amounts of intellectual property.

D. Making the Best of the Loopholes in the U.S. Tax Rules

If a company does not like the United States' high corporate tax rates, it does not have to be considered as a "corporation" if it meets certain criteria. A business entity that is not classified as a *per se* corporation under Reg. section301.7701-2(b) is considered eligible to choose to be treated as a corporation or a flow-through entity, such as partnership, for U.S. tax purposes.[172] The "check-the-box" rules simplify entity classification procedure to permit certain taxpayers to choose to be treated as a corporation or transparent entity for U.S. tax purposes by "checking the box."[173] The "check-the-box" rules allow multinationals to create entities that are treated one way in a foreign jurisdiction and another by the U.S.. These entities, so-called hybrids, are at the core of companies like Apple's tax strategies to realize the Double Irish Dutch Sandwich technique.[174]

The U.S. Treasury promulgated the check-the-box regulations in 1996 and almost immediately regretted them.[175] The "check-the-box" loophole costs the United States about $10 billion per year, according to the White House.[176] President Obama has tried to change the rules, but his "check-the-box" reform has languished in Congress and has never been seriously considered.[177] President Trump did not announce anything relating to reforming the "check-the-box" rules so far. Therefore, the "check-the-box" rules, now almost twenty years old, seem here to stay in the U.S. tax codes.

VI. CONCLUSION

The inconsistencies in global taxations and the loopholes in the U.S. tax codes will not be fixed in the near future. Therefore, although the American MNEs' honeymoon with Ireland, Luxembourg, and the Netherlands is disturbed by the European Commissions' investigations,

172. Treas. Reg. § 301.7701 (2011).

173. Kevin Drawbaugh & Andy Sullivan, *Insight: How Treasury's Tax Loophole Mistake Saves Companies Billions Each Year*, REUTERS (May 30, 2013), http://www.reuters.com/article/us-usa-tax-checkthebox-insight-idUSBRE94T17K20130531.

174. *Id.; US Companies & Their Use of the Double Irish Dutch Sandwich*, *supra* note 87.

175. Drawbaugh, *supra* note 173.

176. *Id.*

177. *Id.*

there still exist opportunities for the American MNEs to continue their love affairs with these countries, thanks to the diligent work by the tax consultants across the globe.