

Taxation News

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President's Message

by Tiffany R. Gorton

The 2016-2017 term has been quite busy.

On January 9, 2017, a memorandum was circulated to WSBA members regarding the proposed expansion of the Limited License Legal Technician ("LLLT") program into the areas of Estate Planning and Health Law. The proposed expansion would directly affect our members whose practices focus on trusts and estates. The Taxation Section was not invited to participate in the development of the LLLT estate planning program prior to the proposed expansion. Anna Cashman, the Estate and Gift Tax Committee Chair, and I worked closely with the Real Property Probate and Trust ("RPPT") Section to provide comments to the Washington Supreme Court Justices, namely requesting elimination of estate planning from the immediate expansion of the program or, alternatively, the narrowing the expansion of the program and providing an opportunity for the Taxation Section to be involved in any future developments regarding the program. On April 7, 2017, we learned that the Washington Supreme Court does not intend to move forward with the expansion of the program at this time, but may do so in the future. If there are additional future developments, the incoming executive committee will inform Section Members via the Taxation Section listserv.

In other news, we have added an additional tax CLE this term, which will be held on May 5, 2017 at the Gonzaga University School of Law. The Section is hosting a networking lunch onsite that day as well. I would like to give a special thanks to Jennifer Gellner and our incoming CLE Chair, Stephanie Taylor, for their hard work in coordinating this program. The program will be webcast for those who are unable to attend in person. Additional details about the program are provided in this edition of our newsletter.

Each year for the last several years, the Section has donated an academic scholarship to a deserving Taxation LL.M student who has strong ties to the practice of law in Washington. The scholarship is a combination of a donation from the Section and law firm donations. We are procuring the scholarship funds for our 2017 Taxation Section Scholarship recipient, who will be announced at our annual luncheon on May 19, 2017. Please consider donating

to the scholarship fund. Donations can be made online using this link <https://co.clickandpledge.com/?wid=66955> or by check, which should be made out to

Washington State Bar Foundation (or WSBF)
1325 Fourth Ave., Suite 600
Seattle, WA 98101

Our section continues to have wonderful practitioners serving on the Executive Committee. I encourage you to serve on the Executive Committee, to become more involved in the Section and utilize the benefits available to you as a Taxation Section member. I welcome any feedback you may have as well. I can be reached at 206-382-4414 or tgorton@khbblaw.com.

WSBA Taxation Section Annual Luncheon

Mark your calendars for the WSBA Taxation Section Annual Luncheon and Election of Officers on **Friday, May 19, 2017** at the Columbia Tower Club. Networking begins at 11:30 a.m. and the program begins at 12:00 p.m.

The WSBA Taxation Section is pleased to announce the keynote speaker will be Dino Rossi. Mr. Rossi ran for governor twice and lost both times to Christine Gregoire, the first election by only 133 votes. He has served in the State Senate from 1997 through 2003, where he focused on balancing the state budget without raising taxes. Mr. Rossi is currently serving as State Senator for the 45th District. After the death of the elected State Senator, Andy Hill, Mr. Rossi was asked to take his seat, mainly to assist in the budget and education requirements imposed on the legislature by the *McCleary* decision.

WSBA Taxation Section CLE

Tax Updates for the Washington Practitioner

Friday, May 5, 2017 at
Gonzaga University School of Law
Courtroom

Join us for a compelling discussion of the current developments in the federal and state tax arena which will impact the advising and planning for our clients. This all-day seminar will focus on new and pending legislation, both nationally and on the state-wide level as well as court cases which impact the way we practice. Of special interest will be a discussion with a Washington Department of Revenue Agent on the hot tax topics affecting Washington residents. This seminar will focus on the practical approach to planning, utilizing the most current key tax issues that affect tax practitioners and their clients.

Ethics for Tax Planning – An analysis of the ethical considerations of advising your clients in an ever-evolving tax environment. Ms. Taylor will review the tightrope that practitioners must walk between advocating for a client's best interest while still complying with tax authorities and their own ethical and professional codes.

There will also be a networking luncheon. More details to follow soon.

Apple and Ireland v. Commission: What Will the Scope of the European Commission's State Aid Assessments be in the Tax Ruling Context?

by Kyle Richard, J.D.

On August 30th, 2016, the European Commission (EC) ordered Ireland to collect approximately € 13 Billion from Apple Group (through its subsidiaries Apple Sales International (ASI) and Apple Operations Europe International (AOE)—hereafter referred to collectively as “Apple”). Although the amount at issue makes this case one of the largest tax controversies on record (in comparison, the widely reported 2006 IRS settlement with Glaxo SmithKline, at the time reported as the “largest tax dispute in the history of the IRS” was over a mere \$3.4 billion), and has generated much press as a result, in a rare moment of consensus between regulators and taxpayers, Treasury, Irish Revenue, the President of the United States, and numerous corporate taxpayers have each argued that the assessment represents a serious overstep by the EC. At present, the assessment is under appeal by both Ireland and Apple, and the stage appears set for the European Court of Justice (ECJ) to rule on the permissible scope of the EC’s investigation of Member State tax ruling practices.

Background and European Commission Assessment

In 1991 and 2007, the Irish tax and customs administration agency (“Irish Revenue”) issued tax rulings to ASI and AOE regarding the appropriate allocation of profit to their Irish branches. Central to the Commission’s assessment, and likely to be at issue in the ensuing litigation is the lack of tax residence by ASI and AOE, and the fact that under each of those rulings, none (or an insignificant percentage) of the income derived from Apple intellectual property was attributable to ASI and AOE’s Irish branches, despite their prominence in manufacturing and selling Apple products outside the U.S.

In May 2013, the U.S. Senate held hearings regarding the taxation of U.S. multinationals to begin investigating whether the U.S. tax code provides for adequate taxation of those entities during which Apple executives, including CEO Tim Cook and Head of Tax Operations Phillip Bullock testified,

and ASI’s and AOE’s lack of tax residence came to light. In short order, on June 12, 2013, the EC opened an investigation to determine if Ireland had granted state aid to Apple in contravention of the Treaty. After a lengthy investigation, the EC entered a Decision requiring Apple to pay approximately € 13 in taxes.

The EC presented two rationales for its finding of selective advantage and resulting assessment, both of which rest upon a claim that Ireland improperly failed to apply the arm’s-length principle to the profit allocation methodologies proposed by Apple which Irish Revenue endorsed in ruling. In the Commission decision, it presents those theories in the alternative. The first rationale was that the method for profit allocation to ASI’s and AOE’s Irish branches, based primarily on branch operating costs or expenses, reduced their tax burden compared to non-integrated companies, providing them with a selective advantage over other companies. The second was that the profit allocation methodologies endorsed by Irish Revenue in those rulings granted a selective advantage to Apple even as compared to other similarly situated Irish nonresident companies operating through a branch.

This decision came less than a year after Commission issued two decisions finding that the Netherlands and Luxembourg had granted illegal state aid under the Treaty to Starbucks and Fiat (EC Decisions on State Aid SA.38374 and SA.38375, respectively). In Commission Decision SA.38374, the EC found that the Netherlands had granted state aid to a member of the Starbucks Group because Dutch law incorporated the arm’s-length principle and an “advance pricing agreement” (a tax ruling) entered into between a Starbucks subsidiary and the Netherlands provided for a measure of taxation that was not in accord with that principle, as it provided for transfer pricing which did not approximate the tax liability arising from a similar transaction between unrelated parties. Similarly, in Commission

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Decision SA.3875, the EC found that Luxembourg granted illegal state aid to the Fiat group by issuing a tax ruling which provided for a method for calculating taxable profits attributable to a member of the Fiat group taxable in Luxembourg which did not reflect the taxable profit attributable to that entity under the generally applicable provisions of Luxembourg law. Despite the fact that both assessments dealt with similar issues, and the Netherlands (Case No. T-760/15), Starbucks (Case No. T-636/16), Luxembourg (Case No. T-755/15), and Fiat (Case No. T-759/15) have each separately appealed the Commission's assessments, the far smaller amounts at issue (roughly \$30 million in each case) have attracted far fewer headlines. Similarly, because the questions at issue in those rulings may be construed somewhat more narrowly, those cases may not offer the same opportunity for the ECJ to rule on the full scope of the EC's state aid assessment power in the area of tax rulings.

These assessments, and other recent assessments based on the tax ruling practices of Member States, appear to be based on an EC initiative to align Member State tax policy with the guidelines expressed in the OECD Model Tax Convention on Income and Capital (Model Tax Convention), and the later-published OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Transfer Pricing Guidelines) in particular, the implementation of the "arm's length principle," as expressed in those sets of Guidelines. Although a number of Member States have adopted portions of the Model Tax Convention and Transfer Pricing Guidelines in their tax treaties and national laws, neither set of guidelines represents an enforceable part of Member State law unless properly enacted under the Member State's national legislative system.

Ireland and Apple Appeal European Commission Assessment in Late 2016

Apple and Ireland have each lodged separate appeals to the ECJ (Cases T-778/16, lodged on November 9, 2016, and T-892/16, lodged December 19th, 2016, respectively). Only the Application filed by Ireland has been formally published by the ECJ. In its Application, Ireland outlines nine pleas of law, which fall into four categories—the EC

improperly interpreted Irish law and the facts of the case in finding that Apple was given state aid through a reduced tax burden; that the EC improperly applied the arm's length principle to Apple; that the decision, even if otherwise correct, contravenes the principle of legal certainty and legitimate expectations under European Union law; and that the EC breached various procedural requirements inherent in the Commission's decision-making process.

Unfortunately, the text of Apple's appeal is not yet public. However, Apple has issued several comments in response to the EC assessment which provide some indications that Apple's appeal likely rests on similar grounds—that Apple was not afforded a selective advantage under Irish tax law and the EC exceeded its authority in issuing this assessment.

The ECJ Ruling Will Shape Multinational Enterprise Taxation

Although a full resolution may take years, the ECJ's ruling in this case will have enormous ramifications. A ruling upholding the assessment would have particularly broad consequences in this case, given that it deals explicitly with intellectual property sourcing, a critical source of income and subject of substantial tax planning activities for U.S. and other multinational enterprises. Similarly, a ruling which constrains the European Commission's ability to retroactively inquire into the wisdom of tax rulings, based on later-published or enacted OECD principles or Member State adoption of such principles, would require a fundamental shift in the EC's strategy to increase the consistency of Member State tax law with those principles. In the instant case, although the rationale for the assessment rests on intuitively appealing grounds, there are serious weaknesses with how the EC reached its conclusion that state aid was granted.

Although its assessments are cloaked in the guise of state aid findings resulting from undercollected taxes by Member States, these recent EC assessments appear to be part of a larger attempt to alter the scope of income subject to taxation by an individual Member State in conformance with principles published by the OECD. However, this power does not appear to be granted to the EC under

the provisions of the Treaty on the Functioning of the European Union, which only prohibits the granting of aid "which would distort competition by favouring certain [entities or industries]". Such a rule does not appear to give the EC the power to question a Member State's generally applicable tax policy decision; rather, those rules are designed to prohibit (in the tax context) a Member State from providing a selective advantage to a particular taxpayer through Member State law, regulation, or administrative action. At present, the arm's-length principle is not explicitly incorporated in EU law. Assessments against taxpayers in countries with tax policies that the EC wishes to change do not appear to be the appropriate forum for attempting to incorporate that principle into EU law; rather, if the Commission wishes to make such a change, it should be introduced by the Commission to the Parliament and Council.

The EC's first rationale is based on a theory that treatment of intellectual property under Irish tax law prior to 2010 (when Ireland adopted the arm's-length principle in its national law) provided a selective advantage to Apple because, as an integrated company, ASI and AOE were able to benefit from Apple intellectual property licenses without the value of such intellectual property being sourced to Ireland, and in the alternative, even if Apple intellectual property licenses were allocated outside of Ireland, that the tax rulings in question undervalued the functions performed by the Irish branches of ASI and AOE. Although the EC correctly cites Joined Cases C-182/03 and C-217/03 (EU:C:2006:416) for the proposition that Member State tax laws are not excluded from the state aid restrictions, it cites no authority for the implicit proposition that the EC is empowered to retroactively modify the results under facially neutral and generally applicable Member State tax laws.

The EC's second rationale—that Apple was granted a selective advantage under the rulings provided to its subsidiaries by Irish Revenue—contains additional inconsistencies. The EC cites a number of Irish tax rulings, and paraphrases eleven of those rulings within its decision. In analyzing those rulings, the EC states that based on the rulings analyzed "the Commission was unable to identify

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any consistent set of rules that generally apply [to allocate taxable profits to Irish branches of non-resident companies]” and “the choice of methods [for allocating taxable profits to Irish branches of non-resident companies] is not systematic even where the activities being described are similar.” Without regard to whether these rulings were considered a part of the reference system against which the rulings granted to ASI and AOE were measured for selectivity and advantage or merely part of the EC’s argument that Irish Revenue did not have consistent principles for issuing tax rulings in the area of profit allocation, they do not appear to support a finding of state aid to Apple without additional evidence; rather, they illustrate the difficult, unique and nuanced tax issues that tax authorities must consider when issuing tax rulings, and the impossibility of comparing or applying tax rulings to even slightly different sets of facts and circumstances.

Furthermore, under ECJ case law, a finding of state aid requires a finding of selectivity and a finding of advantage. A finding of selectivity is a three-step process by which the background tax regime (a

“reference system”) is identified; the policy or measure at issue is compared to that reference system to determine if it differentiates between similarly situated entities; and if such a measure does differentiate between similarly situated entities, whether such differentiation is justified by an underlying principle of the reference system (*see, e.g.*, Joined Cases C-78/08 to C-80/08 *Paint Graphos and Others* EU:C:2011:550).

A finding of advantage requires that the measure provide an economic benefit to an entity that it would not have obtained without governmental intervention (*see, e.g.*, Case C-39/94 *SFEI and Others* EU:C:1996:285; Case C-342/96 *Spain v. Commission* EU:C:1999:210).

In each of the assessments regarding Apple, Starbucks, and Fiat, rather than proving selectivity and advantage separately, the EC appears to conflate the separate requirements of selectivity and advantage into a single concept of “selective advantage,” which it appears to conclusorily state exists based on a lack of adherence to the arm’s-length principle. This failure to prove each element separately could prove to be a significant weakness in the

EC’s defense in front of the ECJ, particularly given recent ECJ case law stating that both selectivity and advantage must be separately proven (Case No. C15/14 P *MOL v. Commission* EU:C:2015:362). In the absence of generally applicable provisions of Irish law sourcing intellectual property such as that used by ASI and AOE to Ireland, it would appear difficult for the EC to prove both selectivity and advantage with regard to the rulings issued to those entities.

On the other hand, if the EC’s state aid assessment is upheld, that decision would provide an unprecedented amount of power to the EC to effectively retroactively modify Member State tax laws to align them with the principles of tax law (such as the Arm’s-Length Principle, at issue in this case) favored by the EC. Such a decision would pose innumerable problems not only for multinational enterprises, but also for their legal and tax advisors, whose advice, based on current tax law, could become entirely inaccurate and incorrect if the laws in effect at the time of the advice may be subject to future modifications with *ex post facto* effect.



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Estate and Gift Tax Committee Report

by Anna Cashman

The next meetings of the Estate and Gift Tax Committee are April 21 and June 16 at noon at K & L Gates in Seattle.

International Tax Committee Report

by Megan Tahl

Elizabeth Crouse and I are planning to host a meeting on May 3rd at K&L Gates from noon to 1:30 pm for the International Tax Committee. The topic will be "Topics in International Tax Reform." We are planning a short discussion and roundtable format.

IRS Liaison Committee Report

by Claire H. Taylor

We typically have free brown bag lunch CLEs at the IRS building. Our last one was March 29, 2017, and we will plan another one.

Also – **Save the Date** – for a happy hour reception for Judge Halpern when he is in town for the May Tax Court calendar. The event will be on Tuesday May 16th, at 4:30 or 5, downtown, with the location still TBD. I'll share details and send out an invite when we have the location details.

Legislative Committee Report

by Brett Durbin

The Legislative Committee has been working with the WSBA Legislative Liaison to track the tax court bill and proposed constitutional amendment that was recently introduced in the State Senate. The bill had its first hearing today in front of the Senate Law and Justice Committee. The hearing went fairly well and the senators seemed generally supportive.

Also, the Governor's Office recently announced that two out of the three Washington Board of Tax Appeals members will be stepping down over the next few months. The Governor's Office is accepting applications for the open positions until the end of March and will be interviewing candidates in April. The Legislative committee is considering setting up a subcommittee to evaluate the applicants and potentially provide feedback if the Tax Council approves. We plan on working with the WSBA Legislative Liaison to make sure that our evaluation and feedback process is consistent with the WSBA policies.

If you would like to get involved with the Legislative Committee, contact Brett Durbin: brett.durbin@stoel.com

SALT Committee Report

by Miriam Woods

Save the Date! On Thursday, June 1, the SALT Committee is co-hosting a happy hour with the Washington Society of CPAs at Art Marble 21 in South Lake Union. More details to follow.

Transactional Tax Committee Report

by Yesica Hernandez

Andrew Bryant of Wilson Sonsini Goodrich and Rosati and Anna-Rita Wong Terzo of Beacon Law Advisors PLLC led a discussion of "**Section 704(c): Overview and Transaction Examples**," on April 6, 2017 at Riddell Williams.

Andrew and Anna-Rita provided a refresher overview of IRC Section 704(c) and highlighted a few transaction examples regarding allocation method, distribution of 704(c) property, and management rollover issues in partnerships. They welcomed other committee members' shared examples as well.

Pro Bono Committee Report

by Emily J. Yamada

The University of Washington Federal Tax Clinic is looking for volunteer attorneys for the Pro Bono Clinic. Volunteer attorneys give advice to taxpayers who have upcoming Tax Court cases. Volunteers do not represent the taxpayers, but offer advice and take part in a meeting with the IRS. Whether an agreement is reached or not, the attorney's role as adviser ends after the meeting with the IRS. Please contact John Lynch at clyncher@uw.edu if interested.

Young Lawyers Committee Report

by George Munro

I'm working with the Seattle University Tax Club to plan a "Careers in Tax/Estate Planning" panel event. It looks like the event will happen in mid- to late-April. The event will be at Seattle University School of Law. It will be a career panel over the lunch hour.

Also, Kyle Richard, the WSBA Young Lawyer Liaison, is helping me plan a similar lunch panel event at the University of Washington School of Law. Details will be provided as soon as they are finalized.

When you have finished reading this newsletter, please pass it on to someone else in your firm.

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Taxation Section Membership Form

Section membership dues cover October 1, 2016 to September 30, 2017.

- Please enroll me as an active member of the Taxation Section.
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- I am not a member of the Washington State Bar, but I want to receive your Newsletter. My \$35 is enclosed.

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