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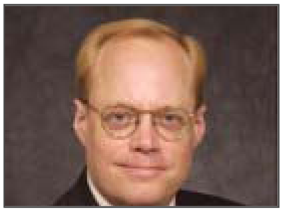

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Italy Claims Apple Is A Tax Cheat--Dolce & Gabbana Look Happy

Image via CrunchBase

No one likes paying taxes, and Apple may not Think Different after all. Italian tax authorities are faced with dwindling revenues and have become more aggressive with domestic and multinational companies. Besides, Apple is a big target. It is alleged to have hidden 1 billion euros ($1.34 billion). Milan Prosecutors claim Apple failed to report 206 million euros in 2010 and 853 million euros in 2011.

Apple has faced scrutiny in the U.S. too. Senators Levin and McCain said Apple skirted U.S. taxes on $44 billion over the last four years. Then CEO Tim Cook testified that Apple doesn't use gimmicks. Perhaps, but Apple's tax strategies do not seem too different from that of many multinational companies. In September 2012, the Senate Permanent Investigations Subcommittee examined tax avoidance strategies of Microsoft and Hewlett-Packard.

The story in Italy is similar. Apple's Italian subsidiary booked profits through the Irish-based subsidiary called Apple Sales International. That meant a lower taxable income in Italy. Of course, Apple places most of its non-U.S. profits in Ireland. Apple Sales contracts to manufacture iPads and iPhones in China.

Apple Sales sells the products to another Irish company. In turn, it then resells them to retail subsidiaries in Italy and beyond. These inter-company transactions are priced so most of the profits end up with Apple Sales in Ireland. In May 2013, the Senate Permanent Subcommittee on Investigations said Apple avoided $9 billion in U.S. taxes in 2012 alone via offshore units with no tax home. Apple's CEO Tim Cook testified it was nothing illegal.

But Ireland hates being called a facilitator of tax cheats and says it's pulling up the ladder on tax gimmicks. Apple isn't the only one to take advantage of what Senator Carl Levin called the "holy grail of tax avoidance." The Senate claimed Apple saved billions by claiming companies registered in Ireland are not tax resident in any country. Google and Facebook use Ireland too.

Facebook sent $700 million to the Cayman Islands as part of a "Double Irish" tax reduction strategy. Google used the Double Irish and the Dutch Sandwich to save billions in U.S. taxes. The Double Irish involves forming a pair of Irish companies to turn payments for intellectual property into tax-deductible royalty payments.

The U.S. parent company forms a subsidiary in Ireland. The parent signs a contract giving European rights to its intangible property to the new company. In return, the new subsidiary agrees to market or promote the products in Europe.

Thus, all the European income—income that previously would have been taxed in the U.S.—is taxed in Ireland instead. Then the Irish company changes its headquarters to Bermuda. No Irish tax, no Bermuda tax, and no U.S. tax.

Finally, the parent forms a second Irish subsidiary that elects to be treated as disregarded under U.S. tax law—by filing a one-page form. The first Irish company (now in Bermuda) can license products to the second Irish company for royalties. The net result is one low 12.5% Irish tax compared to 35% in the U.S.

Not everyone is left out of this equation. The Netherlands collects a small fee on monies moving from the Netherlands company to the Bermuda subsidiary. Still, in the end, there is virtually no tax. And while Ireland's Parliamentary hearings are reviewing Ireland's tax rules, it seems unlikely it will all change overnight.

Irish Finance Minister Michael Noonan has said he plans to make it illegal for a company registered in Ireland to have no tax domicile. Perhaps, but global reforms seem unlikely. The IRS isn't alone in not liking companies that plop income where it can't be taxed.

The Organisation for Economic Co-operation and Development (OECD) advises the G20 on tax and economic policy, and it says existing national tax enforcement regimes just don't work. See G-20 Nations 'Fully Endorse' OECD Action Plan on Tax Evasion. But until something truly changes, we can expect more of the same.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.