Apple's Global iTax Strategy

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Apple does not use tax gimmicks. Apple does not move its intellectual property into offshore tax havens and use it to sell products back into the U.S. in order to avoid U.S. tax; it does not use revolving loans from foreign subsidiaries to fund its domestic operations; it does not hold money on a Caribbean island; and it does not have a bank account in the Cayman Islands. Apple has substantial foreign cash because it sells the majority of its products outside the U.S.

— Apple CEO Tim Cook, in testimony before the U.S. Senate Permanent Subcommittee on Investigations, 2013.

Apple’s Global iTax Strategy

- Life – or at least your public reputation – is difficult to manage when you are possibly the world’s largest and most profitable company, and you are constantly criticized for not paying enough in taxes. Such is the angst at Apple. Apple has engineered one of the more aggressive tax-saving global tax strategies in global business.

Global Operations

Apple is in many ways organized like any other large multinational company. It is headquartered in Cupertino, California, and is a U.S. incorporated company – Apple, Inc. It is here, that essentially all of its global research and development is conducted, and therefore its intellectual property created.

- Although Apple does use contract manufacturers for most of its product construction and assembly (primarily in China), it does manufacture all of its A5 series of microprocessors – the self-described engine of Apple products – at its production facility in Austin, Texas. Manufactured final product is then shipped directly to Apple’s distribution centers globally.
- Apple’s international sales, all sales outside of the Americas, are booked through its Irish subsidiary ASI, Apple Sales International.

Apple's Global iTax Strategy

- ASI purchases the product from the contract manufacturers, taking title to the goods, and then re-sells to its international distribution company, ADI, Apple Distribution International.
- ASI then enjoys large profitability on the re-sale. ASI, as is typical of much of global commerce today, may take legal title to the goods but the goods never physically pass through Ireland, being shipped directly from Chinese manufacturers to the distribution centers for in-country sales like all of the retail companies listed for Europe.
- Finally, ASI then pays all of its profits in the form of dividends to Apple Operations Europe (AOE), its parent company, also in Ireland.
- Apple's tax management is then based on a series of structures it has established, beginning with the principle of a **cost sharing agreement** on the development and ownership of intellectual property.

Cost Sharing

- Apple has a cost sharing agreement between ASI and Apple Inc, an agreement between the parent company and the Irish subsidiary.
- The two units agree to share in the cost of development of Apple's products, and in turn to share the economic rights of any resulting intellectual property. For example, in 2011, Apple's worldwide spending on research and development (approximately 95% of which occurred in Cupertino, California) totaled $2.4 billion.
- The two units ASI and Apple Inc then split these costs on the basis of Apple's global sales in that year, roughly 40% in the Americas (Apple Inc. paid $1.0 billion) and 60% offshore (ASI paid $1.4 billion of the expenses).
- This sharing of cost and subsequent intellectual property ownership is central to Apple's tax strategy. As a result, the profits accruing to ASI based on its ownership of intellectual property are not immediately taxable by U.S. tax authorities because of its Irish incorporation. Theoretically, ASI or AOE should then be paying taxes in Ireland. Theoretically.

Cost Sharing

Apple's Global Structure

- Apple's global sales are divided between Apple Inc. in the United States and Apple Sales International (ASI) of Ireland. ASI is responsible for the sale of all Apple products in Europe, the Middle East, Asia, Africa, India, and the Pacific.
- The key to understanding both the structure and function of Apple's tax strategy is the incorporation of its major foreign affiliate holding companies – AOI, AOE, ASI, and ADI, and Apple Retail Europe – in Ireland.
- Ireland has a low (by global standards) statutory corporate income tax rate of 12%. Apple, however, has negotiated a lower rate with the Irish government, at just less than 2%, since 2003. This is accomplished, according to Apple, by the way the Irish government has chosen to calculate Apple's taxable income.

Cost Sharing

- Apple Operations International (AOI) is the single legal entity which owns and controls all of Apple's activities outside the Americas.
- AOI itself is testimony to the global and digital structure of global enterprise management today.
  - AOI was incorporated in Ireland in 1980. Apple, however, has been unable to locate any documents which explain why Ireland was chosen as its place of incorporation.
  - AOI has not declared a tax residency in Ireland or any other country.
  - As of 2013, AOI had not paid any corporate income taxes to any government anywhere in the world, in the previous 5 years.
  - AOI has no actual physical presence in Dublin or Ireland; it has no Irish employees.
  - AOI has three directors, all of whom work for other Apple companies while serving as directors of AOI. Two reside in California, one in Ireland.
  - AOI's assets are managed by Braeburn Capital, an Apple subsidiary located in Nevada, U.S.A.
  - AOI's actual asset holdings are held in bank accounts in New York.
  - AOI's general ledger is managed at Apple's U.S. shared service center in Austin, Texas.
  - Apple's tax director, in testimony before the U.S. Senate subcommittee, stated that he believed AOI's functions were managed and controlled in the United States.
  - From 2009 to 2011, roughly 30% of Apple's total worldwide net income came from AOI.
- AOI is clearly a legal entity of a digital construction, but its lack of a tax residence anywhere on earth is obviously curious.

Tax Residency

- Under Irish law, Irish tax residency requires that the company be either managed or controlled in Ireland. Obviously, by the details reported above, AOI is not.
- The United States requirements for tax residency require that the business be incorporated in the United States, which AOI is not. So, in Apple's opinion, AOI has no tax residency anywhere on earth, and the company has therefore never established its tax residency.
- Apple executives, when asked in a U.S. Senate subcommittee hearing whether AOI was actually managed and controlled from the U.S., answered that "... it had not determined the answer to that question."
- Apple Sales International (ASI), like AOI, has no tax residency anywhere.

Tax Residency

- ASI paid just $10 million (million with an ‘m’) in taxes on more than $22 billion (billion with a ‘b’) in pre-tax earnings in 2011. That is an effective tax rate of 0.05% (rounding up, its actually 0.04545%). For the 2009-2011 period, ASI had pre-tax earnings of $38 billion and paid a total of $21 million in taxes.
- Curiously, although ASI is not a tax resident of Ireland, it has filed corporate tax returns in Ireland, which is why we have these numbers.
- Whether businesses like AOI or ASI are really in any functional form separate from Apple Inc. continues to be debated.
- In 2008 Apple Inc, ASI, and AOE signed an amended cost sharing agreement. The signatory for AOE was Apple’s Treasurer. The signatory for ASI was Tim Cook, Apple’s COO. The signatory for AOE was Apple’s CFO. One can only believe negotiations were brief and efficient.

Check-the-box and Disregarded Entities (

- According to the United State's worldwide tax structure, foreign subsidiaries of U.S. companies have the right to defer payment of U.S. taxes on active income (income derived from the active conduct of manufacturing and sales and services provided).
- If, however, the income is passive – such as interest, royalties, dividends – it is subject to immediate taxation by U.S. tax authorities under Subpart F income rules as applied to controlled foreign corporations (CFCs).
- Therefore, according to statute, the income earned by ASI and AOI, which is by all indication passive income, should become immediately taxable in the U.S. by tax authorities. In fact, between 2009 and 2012, AOI reportedly received $29.9 billion in income from its lower-tier subsidiaries in dividends. These dividends would ordinarily be immediately taxable by U.S. tax authorities according to Subpart F statutes.
- Apple, however, has avoided this tax exposure through the use of what is known as **check-the-box**.

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Check-the-box and Disregarded Entities

- In 1996, in an attempt to simplify the U.S. tax code, the Treasury Department adopted a new practice that allowed companies to '**check-the-box**' on a tax form to describe a foreign corporate entity (like ASI or AOE) for tax purposes as irrelevant – a so-called **disregarded entity**.
- This simplified the tax filings for multinational companies dramatically. This **disregarded entity** status allowed U.S.-based multinationals like Apple to set up high-volume profitability subsidiaries in low tax jurisdictions such as Ireland or Luxembourg.
- For Apple, that meant that all of the companies shown in below Apple Operations International (AOI), all being disregarded entities, disappear for tax purposes because U.S. tax regulations do not recognize payments made between units within a single entity.
- The U.S. tax authorities therefore evaluate only AOI, and its income is considered active as it buys and resells Apple products globally. As such, it is allowed to defer U.S. taxes on its profits until that time of repatriation – if ever.

Apple's Global iTax Strategy

Apple is likely the largest corporate income tax payer in the US, having paid nearly $6 billion in taxes to the US Treasury in FY2012. These payments account for $1 in every $40 in corporate income tax the US Treasury collected last year. The Company's FY2012 total US federal cash effective tax rate was approximately 30.5%. The Company expects to pay over $7 billion in taxes to the US Treasury in its current fiscal year. In accordance with US law, Apple pays US corporate income taxes on the profits earned from its sales in the US and on the investment income of its Controlled Foreign Corporations ("CFCs"), including the investment earnings of its Irish subsidiary, Apple Operations International ("AOI").

— Testimony of Apple Inc. before the Permanent Subcommittee on Investigations, U.S. Senate, May 21, 2013.

Apple’s Tax Payments

- Apple does indeed pay a lot of taxes.
- In 2011 alone, according to its 10-K filing, had total taxes payable for the year of $8.283 billion. Yet its effective tax rate in the United States was a combined 22.4% Federal plus State, and its effective tax rate on profits earned outside the U.S. were 1.8%.
- Given that the U.S. statutory corporate income tax rate alone is 35%, Apple’s strategy and structure seems to be working to reduce its taxes – globally.
- One of the principles underlying worldwide taxation and deferral under the U.S. tax system is that company operations and profits earned in other countries are paying taxes in those countries.
- The deferral provision, however, was suspended with the creation of Subpart F income statutes in 1962 to deter the use of tax havens to position offshore profits and permanently defer paying corporate income taxes.
- At this point one must conclude that the complexity of global business combined with changes made to the U.S. tax code over the past 50 years have undermined what was originally intended.

Apple's Global iTax Strategy

Apple supports comprehensive reform of the US corporate tax system. The Company supports a dramatic simplification of the corporate tax system that is revenue neutral, eliminates all tax expenditures, lowers tax rates and implements a reasonable tax on foreign earnings that allows free movement of capital back to the US. Apple believes such comprehensive reform would stimulate economic growth. Apple supports this plan even though it would likely result in Apple paying more US corporate tax.

— Testimony of Apple Inc. before the Permanent Subcommittee on Investigations, U.S. Senate, May 21, 2013.

Apple's Global iTax Strategy: Discussion Questions

1. What is the single most important element of Apple's global tax strategy?

2. Why do most of Apple's businesses in Ireland not have a country of tax residence?

3. Why does Apple Operations International (AOI)—the Irish subsidiary that captures most of Apple's global profits outside the Americas—not pay taxes to Ireland or the United States?