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In this article, Vern Krishna uses the recent EU ruling that would retroactively reclaim U.S $14.5 billion (plus interest) in back taxes from Apple to give readers insight into the matter by discussing the two variables that determine the amount of revenue that a tax system raises: taxable base and tax rate.

Bureaucrats and Taxing Powers (Vern Krishna)

Date: September 21, 2016

Bureaucrats and Taxing Powers

By Vern Krishna

Benjamin Franklin said that nothing in this world is certain, except death and taxes. The European Union is out to prove him wrong on the second count. The EU is challenging Ireland and Apple Sales International and Apple Operations Europe over its taxes that the company paid in 2014 in compliance with two Irish tax rulings enacted twenty-five years ago.

The EU wants to retroactively reclaim U.S $14.5 billion (plus interest) in back taxes, which they assert was a form of “state aid” to Apple. They ignore the fact that the tax incentives resulted in Apple creating 6000 jobs in Ireland.

The decision by EU bureaucrats to pursue Apple undermines the fundamental principles of the rule of law, and infringes upon the right of sovereign nations to determine their own tax structures. Retrospective tax legislation offends the rule of law and creates legal uncertainty, all the more so when taxpayers comply with the rules enacted by a sovereign state. Apple could reduce its profits because we have moved from a bricks and mortar to a technological economy, where profits from intellectual property can be easily relocated to low tax jurisdictions, such as Ireland.

There are two variables that determine the amount of revenue that a tax system raises: taxable base and tax rate. Statutory tax rates are not the same as effective rates, which can be lower because of special concessions, credits, exemptions, incentives, and exclusions granted for economic reasons.

The “effective rate” of tax is the total tax payable divided by income, before exclusions, credits, and exemptions. The following table illustrates the variations in some OECD countries between statutory corporate tax rates and effective tax rates in 2015.

Country	Statutory corporate rates (incl. subnational taxes) %	Effective marginal tax rates (incl. subnational taxes) %
Canada	26.3	12.5
France	34.4	24.0

Country	Statutory corporate rates (incl. subnational taxes) %	Effective marginal tax rates (incl. subnational taxes) %
Germany	30.2	21.2
Italy	31.3	5.2
Japan	32.1	24.5
United Kingdom	20.0	19.0
United States	29.6	19.4

Source: OECD and U.S. Department of the Treasury, Office of Tax Analysis.

Statutory tax rates do not tell the full story in international comparisons because they do not take into account the differences in calculating the taxable base to which one applies the rate. For example, Canada's corporate statutory tax rate in 2015 was 26.3 per cent, but its effective rate was only 12.3 per cent. Similarly, the statutory tax rate in the United States was 29.6 per cent, whilst its effective tax rate was 18.1 per cent.

The differences in corporate rates arise because of special allowances, exemptions, credits or deferrals, which vary between countries. For example, assume that Country A taxes net income at 30 percent, whereas Country B taxes net income at 20 percent. On the surface, it appears that Country A has the higher tax rate. If, however, Country A allows more generous deductions for depreciation or interest expenses in computing income than Country B, the effective rate of tax in Country A may actually be lower than in Country B. We see this in the deduction for personal mortgage interest and property taxes, which the United States allows individuals, but that Canada does not.

In political terms, raising top marginal rates is more impressive than adjusting effective tax rates, because it gives the impression that the government is hitting the rich (the so-called 1 per cent) hardest, which appeals to the remaining 99 per cent. Conversely, eliminating an exemption or credit for middle income earners is a subtle way of increasing taxes, because it increases the taxable base and the effective rate of tax, without actually adjusting rates. Apple's effective tax rate of 0.005 percent was considerably lower than Ireland's statutory rate of 12.5 percent. In exchange for the tax concessions, however, Apple created 6000 jobs in Ireland, which was good for the domestic economy.

Ireland is quite right to say that it will defend the integrity of its tax system. Canada should be concerned in its trade negotiations with the EU that it does not get entangled in the state aid rules, which we gave to companies such as Bombardier and General Motors to salvage employment disasters. The EU's intrusion into Ireland's sovereign domestic tax system underscores British concerns about the bureaucracy in Brussels, which stimulated its decision to Brexit the Union. There are few things as powerful as the arrogance and insularity of bureaucrats with power. Rather than trying to enforce rules retrospectively, which will create uncertainty for all taxpayers, the EU should reform its own tax systems, which have widely disparate effective tax rates that cause corporate migrations.

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