PERSPECTIVE

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Double Irish Dutch Sandwich on the menu, for now

By Robert W. Wood

No one likes paying taxes. Fortunately, it is perfectly legal for individuals and companies to plan their affairs to reduce their tax burden. But despite what the Internal Revenue Service might say, differentiating between planning which is above reproach and planning which is dicey can be tough. Even defining what is downright cheating can invite vigorous debate: one person's clever planning is another's tax evasion scheme. Bewildering applications of tax law and regulations don't help to alleviate the confusion.

For example, it's a generally accepted principle that you can't keep money in offshore accounts to avoid paying taxes on them. However, Apple, Twitter, Google, Facebook, Starbucks, Hewlett Packard and many other companies do exactly this. And despite the recent criticism, what they are doing isn't illegal.

Let's start with Apple, which doesn't quite live up to its "think different" slogan when it comes to taxes. Italian tax authorities claim that the company failed to report 206 million euros in 2010 and 853 million euros in 2011. Stateside, in May 2013, the Senate Permanent Subcommittee on Investigations claimed that Apple avoided $9 billion in U.S. taxes in 2012 via offshore units with no tax home. Apple CEO Tim Cook vehemently defended the company and its tax planning before Congress last year and did a superb job of deflecting the issues. He is certainly not alone in saying that our tax system itself is to blame.

Apple famously uses Ireland as its sort-of-but-not-really-tax-home. And Apple isn't the only multinational company to do so. Google, Facebook, Microsoft, Hewlett Packard, LinkedIn and many others take advantage of Ireland's business-friendly tax laws. Twitter's Irish outpost added 100 Dubliners to its workforce in late 2013, and LinkedIn's Dublin office just hit 300 employees this February.

Often, other countries are involved in such efforts, and it can look like a shell game. For example, Facebook reportedly relocated more than $700 million to the Cayman Islands as part of a "Double Irish" tax reduction strategy. Google also used strategies generally referred to as the "Double Irish and the Dutch Sandwich," saving billions in U.S. taxes.

Double Irish

As the shorthand name for the tax strategy suggests, the Double Irish involves forming a pair of Irish companies. The general idea is to turn payments on intellectual property into tax-deductible royalty payments. The U.S. parent company forms a subsidiary in Ireland, which in turn establishes its tax residency in a tax haven like Bermuda. The new subsidiary typically agrees to market or promote the company's products in Europe. With a few moves on paper, European income — that previously would have been taxed in the U.S. — is taxed in Ireland instead.

Then the parent company may form a second Irish subsidiary that elects (by filing a one-page form) to be treated as disregarded under U.S. tax law. The first Irish company (in Bermuda) can license products to the second Irish company (in Ireland) for royalties. The net result is one low 12.5 percent Irish tax compared to 35 percent in the U.S. But this can often be reduced even further, since the revenue going to the Bermuda company is deductible as royalties. With optimal planning, there is little or no Irish tax, no Bermuda tax, and no U.S. tax. Some of these steps are circuitous, but tax treaties currently allow them.

Dutch Sandwich

The Dutch Sandwich is even more complex: Take a Double Irish setup, then add a third subsidiary in the Netherlands. But instead of licensing the parent's products directly to the second Irish subsidiary, the Bermuda-based subsidiary grants them to the Dutch subsidiary, which pays the Ireland-based subsidiary. This works because Ireland does not tax money as it moves between European countries. The Netherlands collects a small fee on monies moving from the Netherlands company to the Bermuda subsidiary. In the end, companies can face a tax rate of as little as 3 percent.

Not surprisingly, this kind of tax-free shell game makes some people mad. The U.S. recently criticized Ireland over its status as an enabler of corporate tax shenanigans. In response, Ireland's Parliament is conducting hearings to review Ireland's tax rules. Yet many observers think that the liberal Irish rules are unlikely to change in the near future. Some changes, though, might occur. Irish Finance Minister Michael Noonan has said he plans to make it illegal for a company registered in Ireland to have no tax domicile. But even if this is implemented, companies will likely be able to list any country as their tax residence, including zero tax jurisdictions such as Bermuda.

The IRS isn't alone in bristling about companies plopping income where it can't be taxed. The Organization of Economic Cooperation and Development (OECD) advises the G20 (the 19 leading world economies plus the EU) on tax and economic policy. The OECD says existing national tax enforcement regimes do not work and that companies like Apple and Google avoid billions in taxes. In July 2013, the OECD put forward a 15-point "action plan" to support a fundamental reassessment of the rules on taxing multinational companies.

In the meantime, the IRS is seeking new ways to pursue so-called stateless income. But that will not advance overnight, and it remains to be seen how successful it will be. Even if regulators do find a way to close this loop hole, there will almost certainly be a country wishing to take advantage of multinational corporations' desire to reduce their tax burden as much as possible. Indeed, it seems unlikely that the IRS, OECD and other enforcement efforts will be able to address large scale tax avoidance strategies without a complete overhaul of international tax treaties.

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