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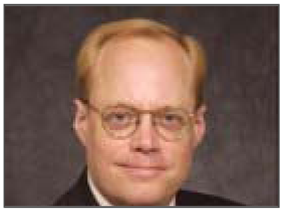

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Facebook Mirrors Google's Offshore Tax Scheme

google+ facebook (Photo credit: Sean MacEntee)

What is a tax scheme and what's legitimate tax planning? It may be a question of opinion. Besides, a "scheme" has different connotations in the U.S. and U.K. But however you slice it, Google and Facebook have something in common.

Both companies have used a kind of sandwich not for sustenance but for tax minimization. Recent reports state that Facebook flipped more than $700 million to the Cayman Islands last year as part of a "Double Irish" tax reduction strategy. See Facebook Defends its 'Double Irish' Tax Reduction Deal. Recall that former Zuckerberg pal and co-founder Eduardo Saverin took considerable heat when he exited the U.S. for Singapore. See Expats Face Steep Exit Tax Courtesy Of Facebook.

Yet Facebook is recently under more fire than Mr. Saverin. See Facebook Paid £2.9m Tax on £840m Profits Made Outside US. From an outsider's perspective, it looks like Facebook Funneled Nearly Half a Billion Pounds Into the Cayman Islands Last Year. Yet Facebook's technique may not be overly aggressive. Big multinational companies can hire tax lawyers to come up with ways to reduce the company's effective tax rate from 35% to much less.

Google reportedly used the Double Irish and the Dutch Sandwich, saving the company billions in U.S. taxes. The Double Irish involves forming a pair of Irish companies to turn payments on 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 help market or promote those products in Europe. Thus, all the European 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–a true tax haven. So far, there has been 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 now license company 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.

Even this tax can be reduced, since the royalties going to the Bermuda company are deductible. Some of these steps may seem circuitous (they are). Tax treaties permit this, yet a deal done directly with Bermuda (and without all the layers) would incur a tax.

Lunch Money? The Dutch Sandwich has been used for decades but involves another layer of complexity. One starts with a Double Irish but adds a third subsidiary in the Netherlands. Instead of licensing the parent's products directly to the second Irish subsidiary, the Bermuda-based subsidiary first grants them to the Dutch subsidiary, which in turn pays the third subsidiary.

The key is that Ireland does not tax money as it moves between European countries. Then the Netherlands takes only a tiny fee on monies going from a Netherlands company to the Bermuda subsidiary. In the end, there is virtually no tax.

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