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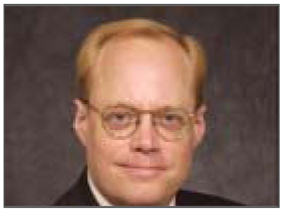

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THE TAX LAWYER

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How Can Companies Skirt U.S. Tax?

In common parlance, a tax shelter is something that allows you to pay little tax even though you are making money. The shelter protects ***other*** income from tax. Many are legal, but the "shelter" term has generally come to mean something you buy that is somehow sleazy. Just look at all the investigations—and prosecutions—of aggressive tax shelters over the last decade.

But often tax driven transactions are legal and are manipulations of complex tax rules, sometimes a blend of U.S. and foreign tax rules and tax treaties. A big company may hire fancy tax lawyers to come up with ways for the company to reduce its effective tax rate from 35% to 10 or 15%. This is especially true for multinational companies that have diverse roots. There have been recent reports that U.S. corporate tax rates are among the highest in the world. However, some suggest the study is skewed and that U.S. tax laws allow for all sorts of plays that make the top rate inapplicable for many. There's even controversy about how much multinational companies contribute to the U.S. system. But there is no question that companies can and do plan around tax rules.

Take Google, which reportedly used two legal strategies labeled 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 exchange for marketing help in Europe.

In this way, all the European income–that previously would have been taxed in the U.S.—is taxed in Ireland instead. In return, the new subsidiary agrees to help market or promote those products in Europe. Then the Irish company changes its headquarters to Bermuda–a true tax haven. That means 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 all 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.

Eating Your Lunch. The Dutch Sandwich has been around for decades but involves another layer of complexity. You basically start with a Double Irish but add 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.

Once again this sounds circuitous (it is). The trick 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.

These tax strategies may sound aggressive, but they are the kind of sophisticated tax planning that big (and increasingly global) companies can do.

For more, see:

How Offshore Tax Havens Save Companies Billions

Google's recipe for tax-rate cut: Double Irish and a Dutch Sandwich

Report: Offshore tax havens cost U.S. $100B

A look at the world's new corporate tax havens

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