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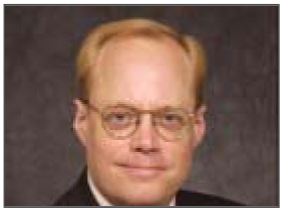

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Legal Offshore Tax Planning? Yes, It Sounds Discriminatory

The last five years of IRS crackdowns on offshore income and bank accounts might make you think anything offshore is illegal. It isn't, although disclosure and reporting are key. Americans must pay U.S. tax on their worldwide income. While they may claim foreign tax credits for taxes paid elsewhere, they still end up with high U.S. taxes even if they pay low rates overseas. See 10 IRS Rules For Stress-Free Foreign Accounts.

But U.S. companies with patents and other intellectual property get a much better deal. Companies with IP often consider where it should be located. For example, the Netherlands, Belgium, France, the U.K., Ireland, Switzerland, Spain and even China can be appropriate jurisdictions for patent entities.

Although patents are the most appropriate type of IP, designs and copyrights can also be eligible. Even trademarks and trade names can work in some cases. Why do this? Think of it as splitting up income. If a company owns IP and produces and sells a product using it, how do you judge whether the revenue is from the IP, from manufacturing, or from sale?

It comes from all of them in most cases, and that invites putting the IP somewhere—quite legally—in which the IP revenue is taxed at a low rate. You want a place that encourages R&D and other activities that will improve the IP. In some cases, the countries encouraging this activity require the R&D to be conducted in their own country.

What are the revenue sources from IP? The owner may derive income from licensing the IP, selling products or providing services using it. Licenses and sales may be to related parties, unrelated parties or both. In related party transactions, valuation is key.

Is the effort worth it? Say your company's U.S. tax rate on its profits is 35%, while the rate on IP profits in country X is 10%. That's a 25 cent savings on every dollar. Even considering fees to set it up and a contingency fund to fight the IRS if need be over valuation, the savings can be huge. The tax incentives are so powerful that IP offshoring is exploding.

To stem the tide a special tax incentive for IP has even been considered in the U.S. One proposal would require R&D activity in the U.S., making it more limited than many foreign countries. Yet this U.S. proposal has not come to fruition.

Intellectual property and taxes go together. In many cases for inventors and flow through entities, IP can produce capital gain rather than ordinary income. See Big Winner In Apple v. Samsung + Other IP Suits? IRS. Plus, IP offshoring to significantly reduce a company's effective tax rate can offer a tax bonanza. Individual Americans paying tax at up to 39.6% on their worldwide income might feel by comparison that they're getting a raw deal.

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