A legitimate tax plan that minimizes a multinational technology companys taxes re...

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Abstract

This paper intends to show the tax avoidance strategies which can be used by a tax lawyer or an accountant to reduce a multinational technology company’s taxes. Furthermore, this paper intends to show the difference between tax evasion and tax avoidance, as defined by specific scholarly articles. The strategies which will be mentioned include: the “ Double Irish,” the “ Dutch Sandwich,” and the “ Check-the Box Rule”. Each strategy will be defined and examples of companies which have used such strategies will be given. This paper, which is essentially a tax plan which will instruct a multinational technology corporation (MNC) on how to reduce its taxes, will be created with the assumption that such a company holds intellectual property rights (IP) in the United States. Additionally, this company should be willing to hold subsidiary companies in the Netherlands and Ireland. Furthermore, the paper will assess the economic advantages (by the multinational technology company and other entities) which can be gained as a result of implementing such tax avoidance strategies.

Keywords: Multinational Corporation, permanent establishment, intellectual property

Introduction

“ The difference between tax avoidance and tax evasion is the thickness of a prison wall.”—Denis Healey

Plato noted that a just man will pay his fair share while an unjust one will pay less while earning the same amount. However, from the shareholders' of

multinational corporations (MNC) perspective, the heads of these corporations have the responsibility to ensure that shareholders receive value on their investments in these organizations by using tax avoidance strategies. Both proponents and opponents of the use of tax avoidance strategies have plausible arguments which support their perspectives. Some argue that tax avoidance strategies used by multinational technology corporations represent some of the worst examples of corporate irresponsibility since these companies take advantage of a country's infrastructure and welfare programs. While proponents of the use of tax avoidance strategies focus companies attentions on not only providing value to their shareholders' investments, but also on creating more job opportunities. Nevertheless, still critics of these strategies posit that MNC's, especially those within the tech industries, no longer have a plausible argument as it pertains to job creation since most of the low- and semi-skilled work in these companies are done by computers and robots or are outsourced to citizens living outside of the U. S. On the other hand, supporters of these tax avoidance strategies contend that in the U. S., these strategies are not illegal although they might be socially irresponsible. Indeed, this is where noting the difference between tax avoidance and tax evasion is important. In Jasmine Fisher’s “ Fairer Shores: Tax Havens, Tax Avoidance, and Corporate Social Responsibility,” the author indicates that “‘ tax evasion’ typically refers to illegally reducing tax payments” while “‘ tax avoidance’” is defined as “ legally reducing tax payments” (2014, p. 339). Therefore, it is possible for an accountant or tax lawyer to create a legitimate tax plan for a multinational technology corporation which minimizes its

taxes, assuming that that corporation has intellectual property rights in the U. S. Consequently, it is the purpose of this paper to show how tax avoidance strategies such as “ Double Irish,” “ Dutch Sandwich,” and the “ Check-the-Box rule” can be utilized to create a legitimate tax plan which can reduce a multinational technology company's taxes.

Tax Avoidance Strategy 1: Double Irish

Definition of Double Irish

In Jesse Drucker’s “ Google 2. 4% Rate Shows How $60 Billion Lost to Tax Loopholes” in Bloomberg, describes “ Double Irish” as a “ method” which “ takes advantage of Irish tax law” which move profits in and out of Irish subsidiaries of a company largely “ escaping the country’s 12. 5 percent income tax” (2010, para. 5). Additionally, Lee Sheppard in the article, “ How Does Apple Avoid Taxes?” in Forbes Magazine highlights the point that Ireland allows “ some Irish companies to claim non-residence if they are related to a [foreign] company that is doing business there” (2013, para. 9). Therefore, this allows a MNC to “ pay tax nowhere” (Sheppard, 2013, para. 9). However, Anne Schafer and Christoph Spengel assert that “ it would be necessary for a non-resident company to have a physical presence in the source country” (2002, p. 14). Therefore, if a U. S. based multinational technology company desires to use that tax avoidance strategy then it would have to prove that it has a permanent establishment (PE) or “‘ bricks and mortar’ presence” at the source country (Schafel& Spengel, 2002, p. 15). Furthermore, the “ Double Irish” tax avoidance method is suitable for tech

companies because these companies usually own intellectual property rights at their source countries.

Google, Inc.: Case Study of a Tech Company which Used the Double Irish

According to Cyrus Farivar's " Silicon Valley Fights to keep its Dutch Sandwich and Double Irish Loopholes" in ArsTechnica noted that Google had two subsidiary companies, Google Ireland Limited (which operates in Dublin, Ireland) and Google Ireland Holdings (which operates in Bermuda, a tax haven like Ireland) (2014, paras. 10& 11). Google Ireland Limited in Dublin paid "$5. 4 billion in royalties [for the use of Google's intellectual property rights] to Google Ireland Holdings," which owns Google Ireland Limited (Farivar, 2014, para. 11). However, in order for Google's earnings to reach its subsidiary which is based in Bermuda from Ireland, these monies need first to be diverted to the Google's Netherland's subsidiary, Google Netherlands Holding B. V. (Farivar, 2014, para. 13). (The diversion of funds from Ireland to the Netherlands alludes to the tax avoidance method called " Dutch Sandwich" which will be explained in more detail later on.) Therefore, Google uses three tax havens which allowed this multinational technology company to " cut its taxes by $3. 1 billion" (Drucker, 2010, para. 1).

Tax Avoidance Strategy 2: Dutch Sandwich

Definition of Dutch Sandwich

Cyrus Farivar in his article describes the " Dutch Sandwich" method as a means by which " companies move money through the Netherlands" via their subsidiaries located there (2013, para. 1). This process involves a

company selling or licensing its intellectual property rights developed in the United States to a “ subsidiary in a country with lower tax rates” (Farivar, 2013, para. 11). This tax avoidance technique is often used alongside the “ Double Irish” technique which was described previously. Multinational technology companies will often license their intellectual property (IP) to their IP holding companies, which are often based in Ireland, “ whose profits will then stopover in the Netherlands” (Farivar, 2013, para. 11). Finally, these profits will then be placed in a holding company in Bermuda, for instance (Farivar, 2013, para. 11).

It is important to note that Xuan-Thao N. Nguyen in the article, “ Holding Intellectual Property” confirms the fact that many companies “ maximize their revenues” through the “ licensing of intellectual property assets for new fields of products and services in existing or new territories” (2005, p. 1163). Additionally, Nguyen notes that although income obtained from “ licensing intellectual property assets” is subject to taxation at the federal and state levels, companies recently have devised methods and strategies, as indicated previously, to “ minimize state taxation of royalty income” (2005, p. 1163). The author goes to describe in detail the process which allows companies with a “ large intellectual property portfolio” to legally create an IP holding company in a tax haven (Nguyen, 2005, p. 1163). Nguyen explains that the IP which was transferred to the parent company to the IP holding company is then licensed back to the parent company (Nguyen, 2005, p. 1164). The parent and sister companies pay the IP holding company royalties for using the IP, which “ does not pay state taxes on that royalty income in the jurisdiction where the IP holding company was formed” (Nguyen, 2005,

p. 1164). This IP holding company's royalties can be used for " loans to the operating companies and receives interest from those loans" (Nguyen, 2005, p. 1164). In addition, Nguyen mentions that MNC's outside of the tech industry which have used the creation of an IP holding company to gain tax exemption status include the Limited Stores, Inc., the Kmart Corporation, Gore Enterprise Holdings (2005, pp. 1165-1166).

Dell, Yahoo, Google and Twitter: Examples of Multinational International Companies which Have Used the " Dutch Sandwich"

Farivar's article notes that the multinational technology company, Dell, Inc., " uses the Netherlands to avoid paying taxes at either the United States or foreign soil (2013, para. 14). The article explains further that Dell, Inc. created a subsidiary based in Holland which is named Dell Global BV (Farivar, 2013, para. 14). This subsidiary allowed Dell to pay only " 0. 10 percent on profits of 2 billion in 2011" (Farivar, 2013, para. 14).

Likewise, Yahoo has a Dutch subsidiary which allowed this multinational technology company to report only $1. 7 million in out of the $135 million it earned during 2009 (Farivar, 2013, para. 13). This article notes that this is a "' small price to pay'" for the corporation as it allows it to transfer taxes from any location without paying a "' withholding tax'" (as cited in Farivar, 2013, para. 13).

Similarly, Vanessa Houlder in her article, "' Dutch Sandwich' grows as Google shifts €8. 8bn to Bermuda" reports that the MNC was successful in routing €8. 8 billion in royalty payments in 2012 to Bermuda through its Dutch subsidiaries (2013, para. 1).

Sam Biddle in his article, “ Like Everyone Else, Twitter Hides from U. S. Taxes in Ireland” reports that Twitter has created a subsidiary company by the name of Twitter Netherlands B. V. which allows it to transfer royalty payments from its Irish subsidiary company (T. I. Sparrow I) through to another Irish company (T. I. Sparrow II) which is based in Cayman Islands (2013, paras. 7& 8). This strategy is correctly referred to as a “ Double Irish with a Dutch Sandwich” (Biddle, 2013, para. 7). This tax avoidance strategy as the name implies involves the use of two Irish subsidiaries (one based in Ireland and one based in Bermuda or the Cayman Islands) and another subsidiary company based in the Netherlands (Biddle, 2013, para. 7).

Tax Avoidance Strategy 3: Check-the-Box Rule

Definition of Check-the-Box Rule

According to Lee Sheppard’s article, “ How Does Apple Avoid Taxes?,” under the check-the-box rule a taxpayer can choose to treat a foreign corporation as though it is non-existent in U. S. law (2013, para. 17). Jeremy Scott in his article, “ Check the Box for Tax Avoidance” explains further that the check-the-box rule permitted MNCs to create subsidiaries which are perceived one way on foreign soil and another by the United States (2014, para. 2). The check-the-box rule allow MNCs to use “ disregarded loans” to take earnings out of “ high-tax jurisdictions and relocate those profits” to tax havens (Scott, 2014, para. 3). Scott reveals that a MNC based in the United States can borrow a loan from a unrecognized entity in a low or no-tax country (2014, para. 3). When this happens, the United States does not recognize the loan repayment or the interest paid on it (Scott, 2014, para. 3). However, the

foreign jurisdiction where the IP holding property is located will regard the " tax haven entity as a corporation" (Scott, 2014, para. 3). This will then permit the foreign jurisdiction to treat the " interest to be deducted as a business expense" (Scott, 2014, para. 3). Nguyen in his article explains further that can the IP holding company can use the royalties accrued from its intellectual property rights for " loans to the operating company" of the MNC, which may be based in the United States (2005, pp. 1164-1165). The IP holding company then " receives interest from those loans" (Nguyen, 2005, p. 1165). The IP holding company may then choose to " pay dividends to the parent company" (Nguyen, 2005, p. 1165). Scott exposes that the interest deducted being perceived by the foreign jurisdiction as a business expense which is being paid to a corporation rather than a tax haven entity reduces both tax paid in the foreign country and U. S. law governing the subpart F income (Scott, 2014, para. 3).

Apple Inc.: An Example of a Company Which Uses the Check –the-Box Rule

Sheppard explains in his article that the check-the-box rule allows an Apple subsidiary to be treated as a corporation in Ireland whereas in U. S. the subsidiary does not even exist (2013, para. 17). This means that Ireland will " recognize payments paid to and from" the tax entity while the U. S. will not recognize these payments (Sheppard, 2013, para. 17).

When Apple's distribution companies earn from sales made outside of the United States, it then " pays the receipt" to Apple's subsidiary company based in Ireland, which owns the " merchandise and rights to use Apple technology" (Sheppard, 2013, para. 18). After the Apple subsidiary based in

Ireland receives this money then the dividends are then paid to another Irish subsidiary based in Bermuda (Sheppard, 2013, para. 18). These payments will be immediately taxed except both the Irish subsidiaries are checked as non-corporation entities (Sheppard, 2013, para. 18). When the Irish subsidiaries are checked as such on their tax forms then the U. S. is unable to recognize these entities as corporations and, as a result, no tax is based to the United States. This tax planning was so effective for Apple, Inc. that it enabled the MNC technology company to avoid paying "$44 billion" worth of U. S. tax on " foreign sales income for the past three years" (Sheppard, 2013, para. 20).

Some Issues to Consider as it Pertain to the Use of Tax Avoidance Schemes

Some critics of the use of tax avoidance schemes by MNC's argue that governments face " enormous difficulty" taxing MNCs technology companies in an international market " involving intangible assets and transfers accomplished at the push of a button" (Fisher, 2014, p. 342). This means that MNC technology companies such as Google, Amazon, and Yahoo have a distinct advantage as they pose regulatory problems due to the "' intangible nature'" of the goods and services that they offer and the ease with which these transactions can "' cross borders'" (as cited in Fisher, 2014, p. 342). These tax avoidance strategies ultimately cost government billions of revenue, which could otherwise benefit cash-strapped nations, such as developing countries, which are often tax havens for these MNC technology companies (Fisher, 2014, p. 344).

However, as reported by Christopher Matthews's in his article, the United

States had the leading corporate tax rate in the world as of April 1, 2012 (2012, para. 1). It can be argued, therefore, that MNC technology companies based in the United States might see to use tax loopholes to avoid paying the “ burdensome” American corporate tax rates (Matthews, 2012, para. 2). On the other hand, advocates supporting the elimination of tax avoidance schemes posit that wealthy MNC technology companies are paying less than their fair share in taxes and, as result, essential social services are being drastically cut back (Fisher, 2014, p. 347). However, as indicated previously MNC technology companies feel pressured to transfer their profits to tax havens because of the high corporate tax rates, and they believe that they have a right to do so since their shareholders require that these companies’ profits are not reduced because of the exorbitant amount of taxes that they need to pay (Fisher, 2014, p. 349).

Opponents of the use of the abovementioned tax avoidance strategies contend that the use of tax avoidance strategies may potentially damage a company’s reputation (Fisher, 2014, p. 349). Nevertheless, it should be noted that MNC technology firms such as Google, Apple, Dell, Twitter, Yahoo and Adobe which use tax avoidance schemes are still perceived favorably by the general American public where their products are sold widely. Apple, in particular, still creates products (such as the Macbook Air, iPods, iPads) which are still in high demand by the American public.

Conclusion

In conclusion, although some critics of tax avoidance strategies (such as " Double Irish," “ Dutch Sandwich,” and the “ Check-the-Box” rule contend

that companies such as multinational technology corporations are not doing their fair share by using these strategies, especially when their profits are at an all-time high and wages are either stagnant or decreasing, supporters of such strategies argue that it is not feasible to tax corporate profits and then tax shareholders' (of these tech companies) dividends; in addition, MNCs may see the need to use tax avoidance schemes since much of the world's economic growth is happening outside of America's shores, and multinational technology corporations may think it best to keep much of their earnings overseas. Furthermore, the tax avoidance strategies stated above will be best suited for a MNC based on the assumptions that this MNC is a technology company which is based in the United States and owns intellectual property rights there.

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