MOSSADAMS

Global Tax Strategies

EXPANDING YOUR BUSINESS

IGNITING GROWTH

OVERVIEW

Today's digital revolution is making business more complicated as technology companies set up shop outside of the United States.

When it comes to worldwide expansion, even the simplest transactions—adding a customer, employee, contractor, or subsidiary, for example—can be complex, costly, and time consuming.

The goal is to establish the most efficient and cost-effective expansion plan for your business. This will require a good amount of communication and planning in the beginning to avoid what can be an enormous expense to unwind or remediate later on, particularly when considering tax implications.

Part of that planning process includes strategic and tactical considerations tailored to your specific situation. These decisions ideally should find the right balance between implementation costs and your tax exposure.

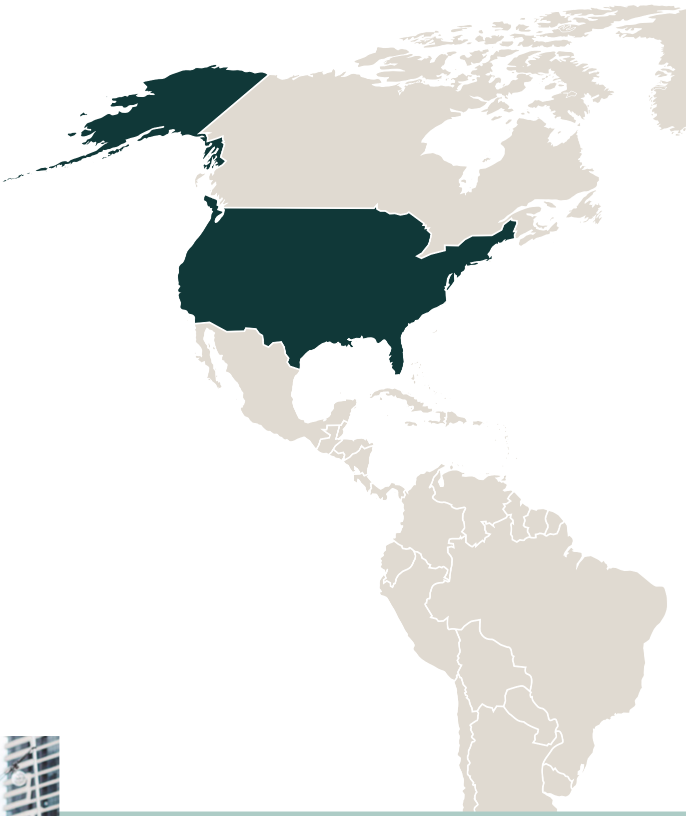
on the cover:
Cappadocia, Turkey
Photo: Mahir Uysal

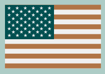
International Locations

Prudent executives focus on overall objectives and long-term strategies that safely expand their overseas business where it needs to go—as opposed to chasing specific tax rates, whether in China, the rest of Asia, India, Mexico, South America, or Western Europe.

Once international locations are determined, technology companies can consider day-to-day tactical approaches that can help them manage tax exposure, administrative expenses, and payroll costs. This requires careful planning that also involves preparing for an effective exit strategy.

Ultimately, key decision makers need to feel confident that the domestic business is strong enough to manage the cost of an international move. This is a particular challenge for start-up and growth-stage technology companies that are often pulled to other continents early in their life cycles, before they have sufficient resources or knowledge to devise and manage a global strategy.



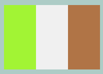


UNITED STATES

has high tax rates and cost of doing business; however, companies can gain access to the US domestic market and have a direct link to the US stock option regime. Contrary to conventional wisdom, you don't need a presence here to access critical funding.

Queen Victoria Market,
Melbourne, Austraila

Photo: Linda Xu



IRELAND

has a 12.5% corporate income tax rate. This means companies with material foreign operations in high-tax jurisdictions, such as the United States, can significantly reduce their effective global tax rates by considering an Irish presence or intangible property migration.

CHINA

offers a huge market and lower tax rates, but this also comes with inconsistent regulatory practices and unclear laws, which make it a tough business environment for foreigners. Our China Practice can help guide you through the process.

HONG KONG

is often used as a financial intermediary with China. The Special Administrative Region of China retained its British-style banking system, which makes it easier for US entities to get cash out of China.

Strategic Considerations

In this section:

Every international expansion plan should be flexible rather than reactive—there's no one-size-fits-all approach. The first step is to consider big-picture strategies that find a balance between your tax exposure versus the cost of implementing your plan.

Guildhall Art Gallery,
London, United Kingdom

Photo: Clem Onojeghuo

INTANGIBLE PROPERTY MIGRATION

In the world of globalized commerce, the geographic location of intangibles—whether determined by planning, default, or by the whim of a governmental tax authority—is often the key in determining where corporate profit is generated and tax is paid. Because tax rates vary widely among jurisdictions (corporate tax rates can range between 40% in the United States to 20% or less in many other countries) the location and value of intangibles can have a dramatic impact on the effective tax rate of a multinational business and its enterprise value.

Taxation of intangibles is one of the most volatile areas of international tax and transfer pricing because intangible property is difficult to define and locate. These transfer pricing arguments can lead to high-profile litigation between tax jurisdictions an corporations that involve large sums of tax and potential penalties.

Strategy

- Determine the location of existing intangibles
- Analyze the alternative locations for future development of intangibles
- Manage that development, document the results, and defend those results against aggressive tax authorities

BACKGROUND

Since the beginning of the industrial revolution, business enterprises have generally derived their perceived value from measurable tangible attributes:

- The value of the land, buildings, and equipment on their balance sheets
- The skill associated with their workforce

In recent years, however, a different type of asset class known as intangible property has begun to dominate the market value of many of the largest corporate enterprises, such as Apple, Google, Microsoft, and Nike.

There are many kinds of intangible assets, but they can be generally grouped into the two broad categories of intellectual property and brand. Technology and life science companies often derive their value from intellectual property; consumer goods companies from brand. Some companies, such as Apple, derive their perceived value from both types of intangible assets.

CASH REPATRIATION

A common by-product of an international corporate structure, which may have an advantageous tax structure, is the accumulation of cash in foreign jurisdictions. The decision to hold funds offshore or to revert them to the United States can be a complicated and potentially expensive decision.

In general, when a company based in the United States repatriates funds back to America, it's entitled to a credit for taxes paid in a foreign jurisdiction. However, the company may be responsible for additional taxes—typically the difference between taxes paid to the foreign country and the US tax rate.

With careful advance planning and documentation, the tax impact for bringing cash back to the United States can be minimized.

Strategy

- Consider repatriating funds to the United States through dividends, royalty payments, intercompany management fees, intercompany advisory fees, or intercompany loans.
- Analyze each method to understand which is most tax efficient for repatriation. This can be based on several factors, including the international structure and the specific foreign jurisdiction housing the cash. The most favorable route may be a hybrid model that involves several options.
- Review options and the associated tax consequences in both the foreign country and in the United States.

INVERSIONS

Inversions have been used as a popular strategy to help US companies trim their US tax bill by relocating their legal domicile to another country where the corporate tax rate is typically lower—a practice the US government is laser-focused on ending. The US corporate income tax rate is the highest in the developed world. The United States also taxes on worldwide earnings, whether they're generated onshore or offshore.

Most other countries have a territorial tax system that only taxes profit from domestic activity. In contrast, even the profit of foreign subsidiaries of US taxpayers aren't beyond the reach of US taxation. They're taxed in the United States when repatriated or deemed repatriated under the comprehensive US antideferral rules.

These characteristics of the US tax system have created an incentive for US companies with overseas markets to change their domicile to a foreign country that offers a lower corporate income tax rate, a territorial system with less comprehensive antideferral rules, and a partial or full exemption for distributed earnings from offshore subsidiaries.

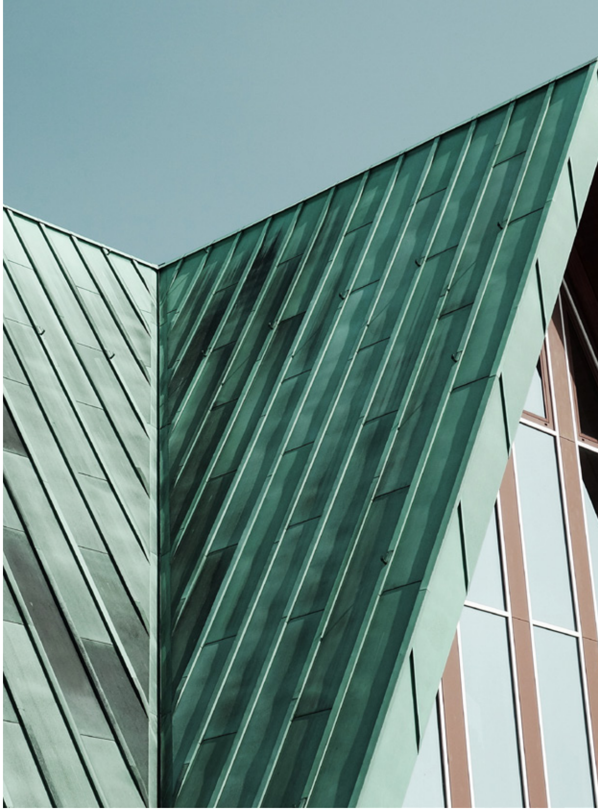
Strategy

Inversions put a new foreign parent company on top of the corporate structure. This happens one of two ways:

- The US company combines with a smaller company in the desired foreign country.
- The foreign company acquires the shares of the US company.

Combined with certain post-inversion structuring efforts designed to further reduce the US tax base, including intercompany pricing strategies, successful inversions can shift significant profit out of reach of US worldwide taxation and antideferral rules, thereby reducing the overall effective tax rate of multinational companies.

Consider the impact of the new rules prior to implementing a new structure with inversions or other foreign mergers and acquisitions transactions.



BACKGROUND ON ANTI-INVERSION RULES

In order to curb inversions, the US Treasury and the IRS proposed regulations in 2016 that would further tighten the anti-inversion rules and limit potential tax benefits of post-inversion structuring. These regulations were yet to be finalized at the time of this publication.

The guidance establishes extensive documentation requirements that must be satisfied for a debt instrument to qualify as debt for US federal tax purposes. It may re-characterize certain related-party corporate interests as capital rather than debt.

Payments in excess of capital are now consistently characterized as nondeductible dividends rather than interest payments, which would generally be deductible within limitations. Inversions can still be completed, but the potential pricing and mix of cash and equity will likely change.

Hängeseilbrücke Geierlay, Mörsdorf, Germany

Photo: Jonathan Klok

Tactical Considerations

Once your strategy is set, then you can focus on day-to-day decisions.

TRANSFER PRICING

A growing number of countries have rules and laws associated with transfer pricing—and tax authorities around the world have intensified their focus on the issue. The key is whether a globally expanding technology company has set its transfer pricing appropriately and efficiently with its foreign related party.

Three-Phase Approach

PHASE ONE

Identification and Planning

Determine the level and type of transactions currently performed. This assessment will address the following:

- The need for intercompany contracts
- Benchmarking to determine the range of prices or profit levels
- Levels of documentation needed

It's imperative to put in place an intercompany contract for every related party transaction to preserve the validity of the transaction.

PHASE TWO

Implementation

Complete transactions in the books and records according to the contacts and benchmarking where necessary to determine the appropriate transfer price. To be respected by tax authorities, transactions between related parties may require the following:

- An actual cash payment
- Payment before the year closes to ensure current deductibility

PHASE THREE

Documentation and Management

Many countries, including the United States, have direct or indirect requirements for transfer pricing documentation, which tests and concludes that the transfer pricing is applied according to the arm's length standards.

In some countries, transfer pricing information must be lodged with the tax authorities annually. In other cases, transfer pricing documentation is recommended as it's often requested during a tax authority review or audit. Actively managing the transfer pricing is recommended by revisiting the first two phases as well as updating documentation on a regular basis.

SNEAK PEEK:

HOW THE IRS LOOKS AT TRANSFER PRICING

The IRS released two training tools for IRS staff in 2016 that focus on US transfer pricing rules under Internal Revenue Code (IRC) Section 482. This section applies to international transactions as well as those between two US organizations, trades, or businesses.

For the IRS to apply the US transfer pricing rules:

- There must be two or more organizations, trades, or businesses.
- There must be common ownership or control, either direct or indirect.
- The allocation must be necessary to prevent evasion of taxes or clearly reflect income.

EMPLOYEE VERSUS CONTRACTOR

Building a successful global technology company requires utilizing top talent from across the world, which can require keeping payroll in multiple countries.

A key question from a tax perspective is whether the company is hiring employees, contractors, or consultants. This is a significant distinction because having employees in countries apart from the location of the employer can establish a taxable presence for the employer in that location. Additionally, some countries view contractors as employees, which may inadvertently create a tax presence for the company in those foreign jurisdictions while also potentially affecting ASC 740 and ASC 450 assessments.

Approach

Establish a Framework

Expanding technology companies should be mindful of who's hired offshore, how he or she is compensated, and what duties he or she perform.

A framework looks at those job duties abroad and helps align them with how the activities are viewed locally. Specifically limiting functions for employees or contractors can be the difference between creating a taxable presence for the company, or not.

Always remember that the definition of an employee, contractor, or consultant in Silicon Valley or Seattle may be very different overseas where the person resides.

Manage Risk Up Front with Due Diligence

If the United States has a treaty with a country where you have employees, the corporate income tax issues may be covered. However, treaties don't necessarily cover local employment law issues, and there's always the possibility of a new foreign government assuming power and changing the law.

To manage global payroll risk, some technology companies use professional employment organizations (PEOs) or administrative services organizations (ASOs) to handle the daily administration as well as payroll tax and returns for team members working abroad. While employees are contracted with the PEO rather than the client company, PEOs or ASOs don't solve the problems that arise when an employee creates a tax presence for a company in a particular country.

PERMANENT ESTABLISHMENTS

A company can be considered a permanent establishment with a taxable presence in a foreign country and subject to income tax in that country based on the following:

- Types of activities being conducted
- Profit attributable to that activity
- Income tax treaties between the United States and foreign countries

For example, the location of a server may or may not create a taxable presence in a foreign country. The Organisation for Economic Co-operation and Development (OECD) Model Tax Convention, which many income tax treaties are based on, looks at specific questions when determining whether a taxable presence has been created. When it comes to servers, the following questions are considered:

- Is a server at its own disposal of a company?
- Is the purpose of the server used for an integral part of the business—such as concluding contracts of sale with the customer? Or is the purpose of the server merely to host a website for advertisement?

Some countries, such as the United Kingdom, have stated that the location of the server won't constitute a permanent establishment under any circumstances. For most other countries, however, facts and circumstances are analyzed on a case-by-case basis to determine if the server will create a taxable presence.

While the OECD Model Tax Convention on e-commerce refers to the tax treatment of servers and websites, it doesn't necessarily address cloud computing. However, the concept of permanent establishment does apply to cloud computing—software as a service, known as SaaS, for instance. The facts need to be analyzed by each country to understand if permanent establishment is triggered. Many countries won't attribute a permanent establishment to a company that's storing or providing content via a server that's leased or rented from third parties.

Approach

- Mitigate exposure to foreign tax systems by understanding when a taxable presence is triggered
- Determine an appropriate structure as your technology company expands globally with front-end planning and detailed analysis.

WITHHOLDING TAXES

A withholding tax represents an obligation on behalf of the payer of an item of income to withhold tax from a specific payment made to a nonresident recipient. Thereafter, the payer is required to remit such amount to the corresponding local country tax authority on behalf of the nonresident recipient.

Local country tax authorities use the withholding tax to ensure a tax payment is collected on specifically identified items of income paid to nonresident recipients. Often, the withholding tax represents a final tax for which the nonresident recipient has no further filing obligations in the payer's home country.

TYPES OF INCOME TYPICALLY SUBJECT TO WITHHOLDING TAX

- Dividends
- Interest
- Rents
- Royalties
- Management fees
- Technical services

Reduced Rates

Each country has a domestic or standard rate of withholding tax established for payments of income to nonresident recipients. The domestic or standard rates of withholding tax vary by jurisdiction and often may be reduced or completely eliminated under an applicable income tax treaty between the payer and recipient home countries.

Generally, the payer of income will follow the withholding tax rules set forth by the payer's home country to ensure the payer isn't liable for any underpayment of tax. When a nonresident recipient claims a reduced rate of withholding tax under an applicable income tax treaty, the onus is on the nonresident recipient, in most cases, to provide the payer with specific documentation certifying the nonresident recipient qualifies for a reduced rate of withholding tax.

However, it's critical the payer request and obtain the required documentation prior to payment from the nonresident recipient claiming a reduced rate of withholding tax under an applicable income tax treaty.

For example, a US company is entitled to a payment for services it provided to an unrelated Indian resident company. As a general matter, the Indian payer is required to withhold 20% on the payment made to the US company and remit that payment to the Indian tax authorities.

In order for the US company recipient to claim a reduced rate of withholding tax at 15% under the United States–India Income Tax Treaty, the US company is required to provide the Indian payer with proof of US residency (in this instance, a Form 6166 letter issued by the IRS), in addition to various Indian forms; otherwise, the Indian payer will likely withhold on the payment to the US company at 20%, the highest domestic withholding tax rate in India for services performed by nonresidents.

Approach

Once the actual withholding tax has been applied by the payer, the following should be determined:

- Whether the nonresident recipient's tax liability was actually less than what the nonresident recipient owed. Then the nonresident recipient should consider whether a refund is available in the payer's home country. It should be noted that several jurisdictions don't provide a withholding tax refund because the withholding payment represents a final tax with no further filing obligation.
- Whether the nonresident recipient may claim a foreign tax credit in his or her respective home country for the withholding tax payment to the payer's home country.
- Whether the payer has any timing requirements related to the deposit of withholding tax with the local country tax authorities upon payment of income to the nonresident recipient.
- Whether the payer has any tax compliance reporting obligations in its home country related to the payment of income to a nonresident recipient and the applicable withholding tax remitted to the local tax authorities.

For help developing or refining your global tax strategy, contact your Moss Adams professional.

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About Our Technology Practice

In addition to our financial statement audit and tax services, our professionals can meet many more operational needs specific to technology companies:

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We provide SOC 1 and SOC 2 assessments and a full spectrum of consulting services in the areas of IT operations, systems, management, security, and organization.

ROYALTY COMPLIANCE

We've performed hundreds of royalty compliance audits for software developers, intellectual property licensors, and patent holders.

TRANSACTION SERVICES

Information is your most important asset in any transaction. We work with more than 200 private equity firms and their portfolio companies, ranging in size from emerging funds to those with more than $1 billion under management.

Our valuation consulting services in particular support mergers and acquisitions, financial reporting, ad valorem tax reporting, estate and gift tax reporting, financial feasibility studies, insurance claims, underwriting, employee stock ownership plans, and litigation.

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- SOC pre-audit gap analysis and readiness assessments
- Coordination among management, user entities, and auditors
- Coaching and review of client-prepared control objectives and narratives
- Independent assistance to document client-defined control objectives and narratives
- SOC 1, SOC2, and SOC 3 examinations (Type 1 and Type 2 audits)
- Dual reporting under SSAE 16 and International Standard on Assurance Engagements (ISAE) 3042 for clients involved in international markets
- Aligning SOC 2 and SOC 3 audits to leverage the CSA's Cloud Control Matrix
- Conversion from 2014 to 2016 Trust Services Principles for SOC 2 and SOC 3

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