MOSSADAMS

Global Tax Strategies

EXPANDING YOUR BUSINESS

IGNITING GROWTH

OVERVIEW

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

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

The goal is to establish an 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.

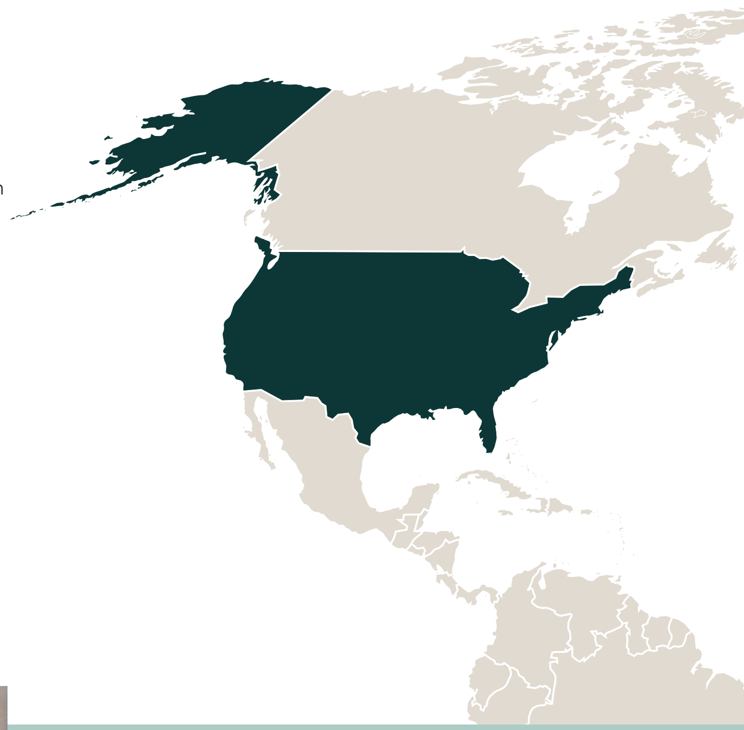
Part of that planning process includes strategic and tactical considerations tailored to your specific situation. These decisions ideally should find the right balance between implementation and cost benefit.

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, 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 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 uncertainty surrounding corporate income tax rates and the 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.

IRELAND

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

CHINA

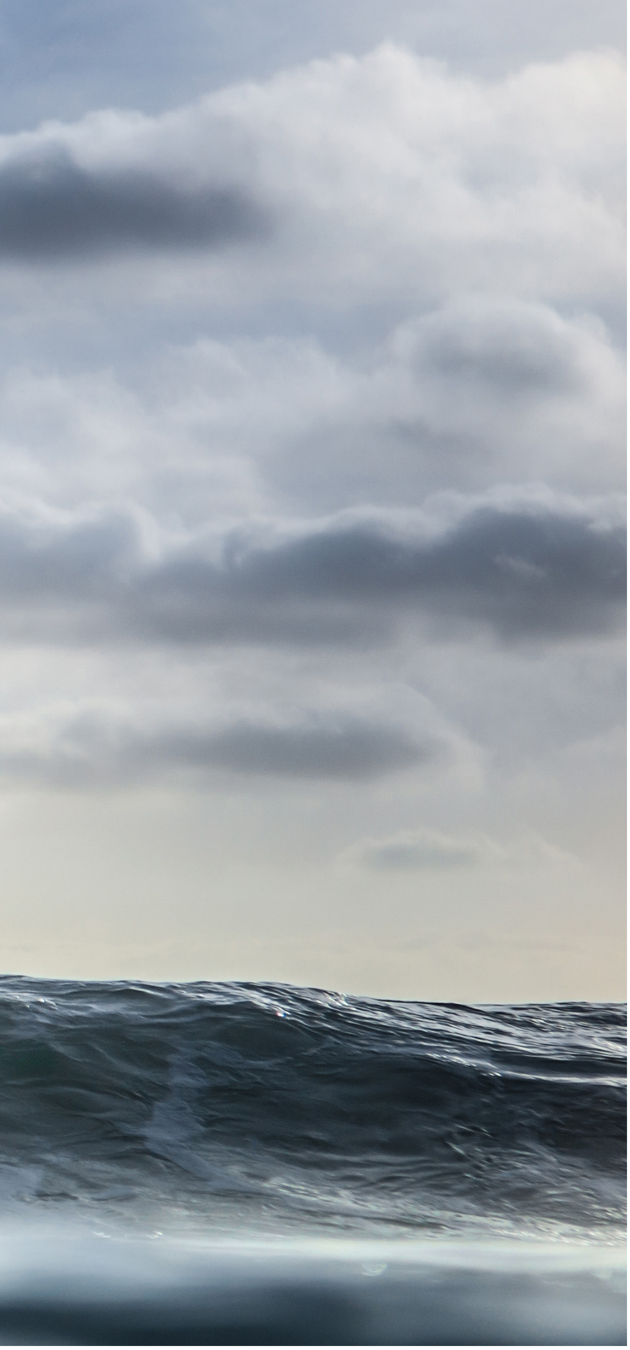
offers a huge market and tax incentives to certain industries, but this also comes with inconsistent regulatory practices and unclear laws, which make it a tough business environment for foreigners. Our China Practice can help guide you through the process.

HONG KONG

is often used as a financial intermediary with China. In the absence of foreign exchange control, the established British-style banking system in Hong Kong makes it easier for US entities to manage Chinese currency controls via a Hong Kong intermediary holding company.

STRATEGIC CONSIDERATIONS

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 and maintaining your plan.



Cash Repatriation

A common by-product of an international corporate structure, which may have a beneficial tax impact, is the accumulation of cash in foreign jurisdictions. The decision to hold funds offshore or to repatriate them to the United States has both business and tax considerations, and the tax considerations have changed significantly since 2017 when new tax laws passed.

Prior to 2017, a US company could generally defer foreign income from US tax by retaining earnings indefinitely in a foreign subsidiary. Upon repatriation, the earnings would be subject to US tax with an available credit for the foreign taxes that had been paid. The repatriation could result in a net US tax obligation because the US tax rate was often higher than the foreign tax rate.

Post-2017, a US company is more likely to pay US tax on foreign earnings each year. This change has effectively removed a US company's ability to defer foreign income from US tax, and has shifted the timing of the tax burden from when cash is repatriated to when income is earned. However, with careful advance planning and documentation, you can generally achieve a lower US tax impact when repatriating income after it's subject to US tax.

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, the amount of foreign earnings previously taxed in the United States, 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.

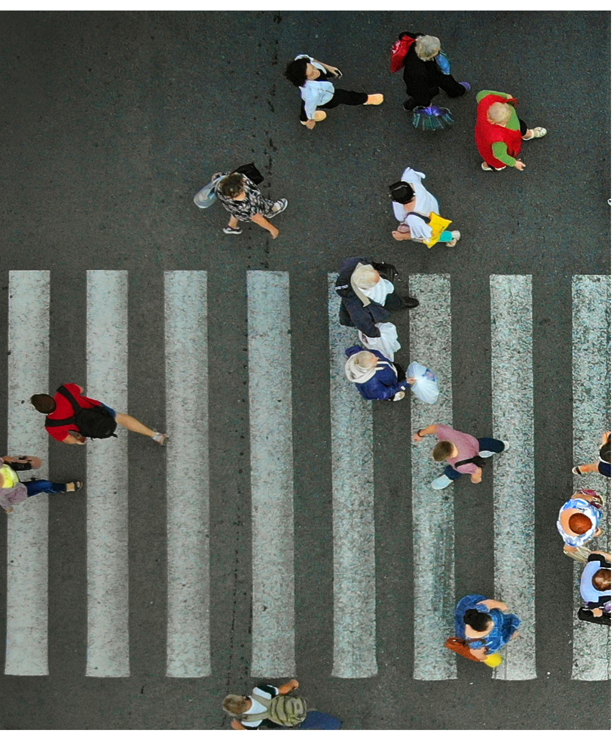
BACKGROUND ON IP

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 IP 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.



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, the location and value of intangibles can have a dramatic impact on the effective tax rate of a multinational business and its enterprise value. This is especially true after new tax laws were introduced in December 2017. Prior to 2017, the U.S. corporate income tax rate could be as high as 35%. However, with the passage of the new rules, the corporate income tax rate was reduced to 21%. This change places the U.S. in comparable tax rates to other jurisdictions with tax rates lower than 20%; for example, the United Kingdom has a tax rate of 19%, and Ireland has a tax rate of 12.5%.

Taxation of intangibles is one of the most volatile areas of international tax and transfer pricing because IP is difficult to define and locate. These transfer pricing arguments can lead to high-profile litigation between tax jurisdictions and corporations that involve large sums of tax and potential penalties. Additionally, countries are starting to impose separate taxes on IP being used in their country. It's also important to analyze the potential implications from the new provisions of Global Intangible Low Taxed Income and Foreign Derived Intangible Income and compare the pros and cons of IP migration strategies.

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

Inversions

The current US tax system treats multinational companies with US parent companies differently than those residing outside of the United States. US-parented multinational companies are subject to a minimum tax on profit above a set rate of return that's accrued by their foreign affiliates. Most other countries apply a territorial tax system that exempts resident multinationals' active-foreign-source income from taxation.

In addition, prior to tax reform, the United States had one of the highest corporate tax rates in the world. The benefits of foreign residence led some US-based multinational companies to use inversion—a process by which an existing corporation changes its country of residence—as a strategy and incorporate their parent companies overseas without impacting the location of business activities.

STRATEGY

The United States generally bases its definition of corporate residence on place of incorporation and doesn't consider other factors, such as location of production and sales or residency of shareholders or management. Thus, a US company looking to invert could either merge with or transfer its assets to a foreign entity.

Together with certain post-inversion structuring efforts designed to further reduce the US tax base, including intercompany pricing strategies, inversions have been an attractive tax-planning strategy for US-based multinational companies looking to shift significant profit out of reach of US worldwide taxation and anti-deferral rules.

However, with anti-inversion legislation and changes brought about under the tax reform reconciliation act of 2017—commonly referred to as the Tax Cuts and Jobs Act (TCJA)—the benefits of an inversion must now be weighed against penalties imposed on companies that choose to invert.

BACKGROUND ON ANTI-INVERSION RULES

The American Jobs and Creation Act of 2004 introduced the first anti-inversion provisions to the US tax code. These rules primarily taxed domestic corporations that migrated internationally based on the level of ownership maintained by shareholders before and after an inversion took place. There was also the potential for the inverted foreign parent company to be taxed as if it were still a US corporation. A toll tax could also be imposed on transfers of assets to the new entity while disallowing any offset by foreign tax credits or net operating losses.

However, inversion transactions continued to persist. US companies used mergers with existing foreign companies to satisfy the ownership thresholds set out by the 2004 inversion rules.

The United States Treasury and IRS responded by tightening the anti-inversion rules in 2014, limiting the ability of US companies to access accumulated deferred earnings of their foreign subsidiaries. Certain techniques used in inversion transactions that allowed companies to meet the ownership requirements under the 2004 inversion rules were restricted as well. Additional regulations issued in 2015 and 2016 resulted in a decline in inversion transactions.

The TCJA adopted several additional provisions to discourage inversions. There are a few possible outcomes if, during the 10-year period following the enactment of tax reform, a US corporation undertakes an inversion transaction. These outcomes include:

- The US corporation being retroactively subject to a 35% tax rate on the full one-time repatriation amount and the use of foreign tax credits is prohibited.
- Dividends paid by the foreign acquiring corporation being taxable to US non-corporate shareholders and increased to a 37% tax rate.
- An exception to the exclusion under base-erosion anti-abuse tax (BEAT) for cost of goods sold, whereby firms that invert after November 9, 2017 must include payments to a foreign parent or any foreign firm in the affiliated group for cost of goods sold.

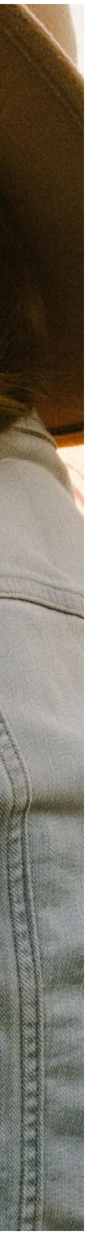
The TCJA also reduced the corporate tax rate and revised the existing world-wide tax system to tax income from foreign subsidiaries at a lower rate, with an exemption for a deemed return on tangible assets, in hopes of keeping more companies in the US.

TACTICAL CONSIDERATIONS

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 and demanded increased transparency in international planning through compliance requirements. The key is whether a globally expanding company has set its transfer pricing appropriately and efficiently with its foreign related party.

In addition to increased scrutiny, the reductions to corporate tax rate, foreign-derived intangible income (FDII), and global intangible low-taxed income (GILTI)—as a result of tax reform legislation in 2017—have caused many taxpayers to reconsider their operations and historical transfer pricing.



THREE-PHASE APPROACH

1 IDENTIFICATION AND PLANNING

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

- Historic transfer pricing documentation and intercompany agreements, if available
- Preferred jurisdictions for operations modeled on the multinational tax structure
- 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. Additionally, it may be worthwhile to revisit what transactions are taking place and being charged to take advantage of the new FDII deduction. It will also be important to analyze foreign branch activity to ensure foreign tax credits are utilized.

2 IMPLEMENTATION

Complete transactions in the books and records according to the contracts 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

Operations between the related party entities must reflect the terms of the intercompany agreements; failure to do so may negate supporting documentation.

3 DOCUMENTATION AND MANAGEMENT

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

In some countries, transfer pricing information must be lodged annually with the tax authorities. In other cases, transfer pricing documentation is recommended because it's often requested during a tax authority review or audit.

Actively managing the transfer pricing is recommended by revisiting the first two phases annually as well as updating documentation on a regular basis.

SNEAK PEEK: HOW THE IRS LOOKS AT TRANSFER PRICING

In 2018, the IRS released the Transfer Pricing Examination Process (TPEP) as a training tool for its staff and a guide to assist taxpayers during the process.

For the IRS to apply the US transfer pricing rules, there must be:

- Two or more organizations, trades, or businesses
- Common ownership or control, either direct or indirect
- A necessary allocation to prevent evasion of taxes or clearly reflect income

The TPEP provides guidance on US transfer pricing rules under Internal Revenue Code (IRC) Section 482. The result of new tax laws, this section applies to international transactions including transactions with a foreign branch as well as those between two US organizations, trades, or businesses.

Employee Versus Contractor

Building a successful global 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 companies should be mindful of who's hired offshore, how they're compensated, and what duties they 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, for example, 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 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

The analysis differs depending on what kind of activity takes place in a specific country and if an income tax treaty is in force. As a result of new tax laws, it's possible that many treaties will need to be renegotiated due to various international tax provisions such as GILTI, FDII, and BEAT.

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 if a taxable presence was 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 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. Tax treaties and legislation are trying to keep up. This might put a company in an area of uncertainty where the tax policy doesn't match with the current technology being employed.

The facts need to be analyzed to understand if a permanent establishment is triggered in each country. 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 company expands globally with front-end planning and detailed analysis
- Stay up-to-date with newly negotiated treaties passed by the Senate

After passage by the Senate Foreign Relations Committee, affirmative votes from two-thirds of the Senators present are required for a treaty resolution to be approved. While many treaties were negotiated between 2009 and 2014, they were at a standstill until 2019 when resolutions were approved by the Senate. As a result of these Senate actions, the treaties for Japan, Luxembourg, Spain, and Switzerland have been modified.

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

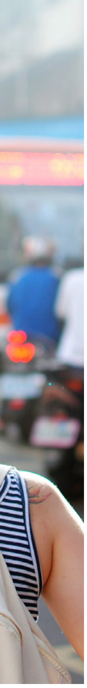
Each country has a domestic or standard rate of withholding tax established for payments of income to nonresident recipients. The domestic or standard rates of withholding tax vary by jurisdiction and often may be reduced or completely eliminated under a local statute or an applicable income tax treaty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

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. US withholding agents rely on the IRS Form W-8 in order to document nonresident aliens from all countries.



PREPARE IN ADVANCE

If anticipating a transaction with a nonresident, determine whether there is a tax treaty in place to reduce withholding, and obtain the documentation necessary to substantiate a reduced rate under the local law of the payer.

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. Note 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 information reporting, tax return filing obligations, or both 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.

ABOUT OUR INTERNATIONAL TAX PRACTICE

Our International Tax group can support all tax aspects of your international businesses, including foreign taxation, financing arrangements, sourcing, import-export considerations, and new markets. Following are some other areas where we can help.

ACQUISITION AND POST-ACQUISITION INTEGRATION

The tax process around an acquisition and how that acquisition is integrated into your existing business must start before an agreement is signed. It's important to understand indemnities related to tax issues and project effective tax rates.

DISPUTE RESOLUTION AND ADVANCE PRICING AGREEMENTS

As it turns out, not every company is fully compliant with the various reporting and disclosure laws for the jurisdictions in which they operate. When under audit by a taxing authority, most make the assumption that valuations are understated and start down the path of making adjustments and asserting penalties. There is no evidence that this will slow in the coming years. Once under audit, you must follow appropriate audit and appeals procedures. Additionally, it's important to understand all of the options available to mitigate the global tax impact of adjustments and penalties.

GLOBAL HUMAN CAPITAL STRATEGY

One of the challenges of competing in a global marketplace is optimizing your international workforce. This includes issues such as expatriate benefits, federal and state taxes, tax equalization calculations, payroll compliance, and compensation reporting. You need a custom strategy that provides a return on the investment you make in people.

GLOBAL RESTRUCTURING AND RATIONALIZATION

There are tax consequences to your operational business decisions—whether you extract an underperforming business unit for disposition, acquire a company, or rationalize your current organizational structure. Technical and hands-on experience evaluating restructuring or business rationalization and determining the resulting tax implications is essential.

We're Here to Help

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

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About Moss Adams

With 3,400 professionals across 25-plus locations in the West and beyond, Moss Adams provides the world's most innovative companies with specialized accounting, consulting, and wealth management services to help them embrace emerging opportunity. Discover how Moss Adams is bringing more West to business.