International tax

Q&A: What is the double Irish?

European Commission has threatened to launch a formal investigation

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The European Commission has threatened to launch a formal investigation into a vital aspect of Ireland's tax system, known as the "double Irish". This is a simple structure used by US technology and pharmaceutical companies to route profits to tax havens like Bermuda where they hold intellectual property.

How does the double Irish work?

The double Irish exploits the different definitions of corporate residency in Ireland and the US. Dublin taxes companies if they are controlled and managed in Ireland, while the US' definition of tax residency is based on where a corporation is registered. Companies exploiting the double Irish put their intellectual property into an Irish-registered company that is controlled from a tax haven such as Bermuda. Ireland considers the company to be tax-resident in Bermuda, while the US considers it to be tax-resident in Ireland. The result is that when royalty payments are sent to the company, they go untaxed - unless or until the money is eventually sent home to the US parent company.

Why is it so controversial?

The double Irish and similar structures have allowed US multinationals to park about $1tn of cash in tax havens. That causes frustration for the US Treasury which cannot tax companies' worldwide profits until they are repatriated to the US. It also annoys governments in the countries outside the US where these corporations do business. The ability to send profits to a tax haven has given companies an incentive to report as little profit as they can in the countries where they operate.

What do the companies say?

In their defence, US companies view it as a kind of self-help measure that allows them to compete internationally despite the US's relatively high tax rate on worldwide profits. The companies also stress they are playing by the rules that are set by governments. When politicians attacked Google over its overseas tax rate of just 3.2 per cent in 2011, Eric Schmidt, executive chairman, said the tax structure was "based on the incentives that the governments offered us to operate".

Google employs thousands of people from dozens of countries in Dublin's former docklands, although Ireland only taxes a sliver of profit from Google's overseas sales which are booked in the country. The technology giant justifies shifting billions of dollars away from Ireland to Bermuda using a double Irish structure on the ground that its profits largely arise from the intellectual property generated in the US.

Can Brussels attack the structure?

To show the double Irish breached state aid rules, Brussels would need to show that it gave a selective advantage to certain types of companies, in this case US multinationals. It might be quite tricky to prove but the uncertainty would create a huge headache for business and tarnish Ireland's low-tax brand. The structure's days are generally thought to be numbered anyway, as a result of a planned overhaul of global tax rules initiated by G20 countries.

What would it mean for business?

A successful challenge under the State Aid rules could potentially force companies to pay billions of dollars of extra tax. Even if the double Irish was simply abolished, it would lead to a hike in tax rates and a dent in profits. Although US tax is only deferred – rather than avoided – on the money parked in tax havens, companies usually do not account for the US tax they may ultimately have to pay.

Technology companies are often valued on their growth prospects rather than their earnings but even so, there will be a reluctance to abandon the very low foreign rates – in single digits – generated by the double Irish. So if Ireland closes the structure, the search will be on for other loopholes across the world that have escaped the crackdown. That is why Ireland is so queasy about the prospect of axing the double Irish before other countries have made changes, particularly if it cannot phase in the changes over several years.

So Ireland will get rid of the double Irish in the end?

There is a global consensus that routing profits to tax havens should be stopped. When that happens, many experts think that Ireland can block the use of the structure without too many ill effects. Both technology and pharmaceutical corporations have invested heavily in Ireland, so an exodus is unlikely. And low-tax Ireland is well-placed to compete under planned new global tax rules that will require companies to be taxed where they actually operate.

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