US: Double Irish/Dutch Sandwich

Not an esoteric offering for lunch, but the tax structure used by Google et al that's been the subject of comment and some disapproval in certain quarters.   So what is it all about? Read on below …

First, some notes:

1. I haven't advised Google or any of the other companies that have been reported as using this structure, so I'm discussing this in general tems;
2. this isn't a new structure, it's been around for years – but it's recently hit the business headlines, so I thought I'd explain it here; and
3. this structure only works for US-headquartered groups – it relies on some quirks of US tax law. It's not something that a UK headquartered company could use to any real effect.

Background

The structure starts with a US parent group transferring some its IP to an Irish incorporated holding company that is tax resident in Bermuda (because that's where the company's central management and control resides – Ireland has no override for locally incorporated companies in domestic law, unlike the UK). This transfer may be taxable in the US, so ideally the group would transfer out IP at an early stage when it has low value.

That Irish/Bermudan holding company sublicenses the IP to a Dutch company, which in turn sublicenses the IP back to another Irish company, which is an operating company wholly owned by the Irish/Bermudan holding company. All these licences take place on an arm's length basis because of transfer pricing.

The Irish operating company generates the revenue from the IP, but pays little tax in Ireland because of the tax deduction for the royalty payments paid (on an arm's length basis) to the Dutch company.

There is no withholding tax paid by the Irish operating company on the royalty payments to the Dutch company (the structure is arranged to ensure this under the Interest & Royalties Directive).

The Dutch company than pays a royalty to the Irish/Bermudan holding company (to an account in Bermuda), leaving the minimum necessary profit in the Netherlands for transfer pricing purposes.

The result

The IP income from operations ends up in Bermuda, with little tax suffered along the way. From there, it can be used to finance group operations elsewhere.

So how does this work?
There are various factors that come into play.

First, the Netherlands has no withholding tax on royalties, no matter where they are paid, so the Bermudan residence of the Irish company doesn't make any difference and doesn't result in additional tax being caught in the Netherlands.   The royalties can't be paid direct from the Irish operating company to the Irish/Bermuda company because Irish tax law would require tax to be withheld in Ireland on the royalty.

Second, and the key to the structure, is a mismatch between US and Irish tax laws on tax residence:

1. The Irish/Bermuda holding company is regarded as Irish tax resident under US tax law because it is incorporated in Ireland; however, because management and control are in Bermuda, the holding company is *not* regarded as Irish tax resident under Irish tax law and so is not taxed in Ireland.
2. The US parent could be caught by Subpart F rules on the transactions that follow between the operating company and the holding company. However, because US tax law deems both companies to be in the same jurisdiction (Ireland) the US parent 'checks the box' on the Irish operating company, so that the operating and holding company are regarded for US tax purposes as a single entity, and the transactions between them are (in effect) ignored for US tax and the activities are combined so that the US parent isn't caught by Subpart F/CFC purposes. The check-the-box election has no effect in Ireland (or anywhere else in the world outside the US, for that matter), so the companies are still two distinct entities for Irish tax purposes.

So: the US tax rules think everything is happening in Ireland, so there are no significant US tax complications, but the reality is that the income ends up tax free in Bermuda – very little is left in Ireland/Netherlands, just the minimum necessary for transfer pricing.

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