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The Double Irish Dutch Sandwich finally explained

So Google makes an announcement saying they are going to abandon the Double Irish Dutch Sandwich arrangement and we know what you are thinking. What on earth are they talking about? So here's an explainer that's going to leave you scratching your head for the next 5 hours.

Enjoy!!!

Business

The Story

Say you have a company in the United States that wants to sell cool airpods in the United Kingdom. The problem—when profits on sales of these uber cool airpods make its way into the US, you'll have to pay an effective tax rate of 35%. You think that's too much,

So you consult a tax lawyer. The tax lawyer tells you he has a workaround. But for the plan to be successful, you have to set up another entity in Ireland. Don't ask too many questions. You'll just have to believe him for now. But the promise has been made. This is going to work.

Anyway, you start using the Irish company to sell those airpods in the UK. This way all the income accrues to the Irish subsidiary now. So instead of paying 35%, you only have to pay 12.5% tax according to Irish laws.

But wait. The tax lawyer comes up with another scheme.

According to Irish laws, if the Irish entity is controlled by managers elsewhere, then the profits will be taxed in that jurisdiction. So if this Irish company that you've set up had a controlling presence in say, Cayman Islands, then you only have to pay tax in this small Caribbean territory. And since the effective tax rate here is nil, you won't have to pay anything at all.

So you quickly set up another entity in the Cayman Islands until somebody tells you there's another problem. If US authorities find out you have a subsidiary in Ireland whose controlling owners reside

"Controlling Foreign Corporation" (CFC) rule and force you to pay taxes in the US. So you can't do that.

But there's still hope.

You figure this requires a gameplan straight out of the greatest tax playbook ever. So you go back to the drawing board once again. And you come out with a new strategy.

First, you set up an Irish subsidiary "A", that makes all the sales as usual. This entity will be incorporated in Ireland and will have a controlling presence in Ireland. Not in the Cayman Islands. This way the CFC rule won't kick in and the US won't be able to tax you anymore. But then the Irish will tax you 12.5%. So you set up another Irish entity "B" with a controlling presence in the Cayman Islands and you begin working your magic.

Let's say "A" sells its airpods and makes a total profit of $100. It then contests that the only reason it could make all this money, was because it kept using intellectual property owned by entity "B". So "A" makes a $100 royalty payment to "B". This way the net profit at "A" drops to 0. So "A" doesn't have to pay any taxes. What about "B" though? Since "B" has a controlling presence in the Cayman Islands, the Irish won't tax you.

But here's the kicker. If the arrangement is done right. The US will consider the whole "A" & "B" structure as one single entity originating in Ireland, not subject to CFC rules. And you get away scot-free. Hurrahh!!!

However there is one last problem. When A makes the royalty payment to B, the Irish will walk in and throw a withholding tax on introduce the Dutch angle here. The Irish and the Dutch have an arrangement where they agree to not tax certain kinds of payments flowing between the two nations.

So now you'll have "A" make a royalty payment to a dutch subsidiary "X". No tax here.

And X will make another royalty payment to "B". No tax once again.

And before you know it, your income is finally tax-free.

The US authorities finally plugged the loopholes in 2015 and offered tech companies like Google a 5-year window to abandon this shoddy practice. And as part of that long-standing agreement, Google has finally decided to comply. So now they are moving on from the Double Irish Dutch Sandwich.

That's all folks.

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