Double Irish Dutch Sandwich

Introduction

Before understanding the importance of this concept, let us have a look at some supporting figures-

1. By 2017, tech companies which were users of the Double Irish Dutch Sandwich (DIDS) scheme, had saved up to 1 Trillion dollars of tax-free European profits in offshore islands such as the Bermuda Islands, and the Caribbean islands etc.
2. In the period 2004-2014, Apple had collected over 111 Billion dollars of European profits.
3. In 2003, Apple had paid 1% tax on all European profits. By 2014, Apple paid only 0.005% tax on its European profits.

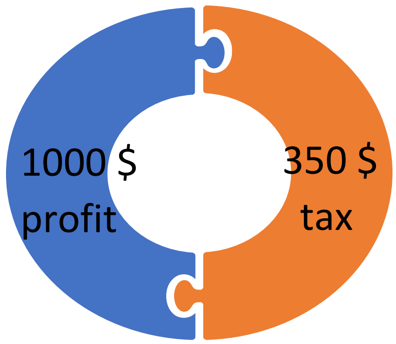
American corporate firms need to pay a high tax rate of 35% but tax evasion schemes like the DIDS help them achieve a <1% effective tax rate (ETR). DIDS in essence is a Base Erosion and Profit Shifting (BEPS) scheme.

BEPS schemes refer to a set of tax saving tool based on profit reallocation developed by tech firms exploiting incoherence in international tax rules. Now a natural question arises, why BEPS? This is because of the worldwide tax system in the US.

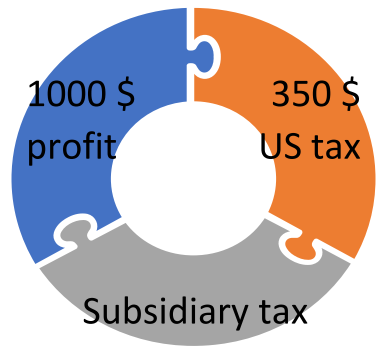
The US Tax System

There are two types of tax systems, the territorial tax system and the worldwide tax system. In the territorial tax system, a firm should pay taxes on whatever income it earns in the territory of the nation. However, in the worldwide tax system, a firm will be taxed on its income earned globally. The first system, promotes free flow of cash allowing companies to expand their reach and perform free trade. However, the worldwide tax system makes free trade difficult by doubly taxing the country's foreign profits. All the present day G7 nations use the territorial tax system. The US used the worldwide taxation system till 2017 and hence it forced MNC's based in the US to use BEPS tools such as the DIDS.

To understand the concept of DIDS, let us take an example of Apple US. Suppose Apple sells an iPhone for 1100$ in the US and achieves a 1000$ profit. Now as per corporate tax rule, it would be supposed to pay 350$ on the profit earned. Now, suppose Apple wants to do business in the European countries. For this it sets up a European subsidiary. The European subsidiary maybe Irish as Ireland has a lot of friendly tax policies that helps companies use BEPS tools. Let's suppose that it sells the same iPhone for 1100$ in Europe as well. Now, as per the old worldwide tax system followed in the US, Apple will have to pay 350$ of tax to the US government. In addition to this, it will also have to pay taxes in the nation where its European subsidiary is located. This will decrease their profits as they are getting doubly taxed.



APPLE US

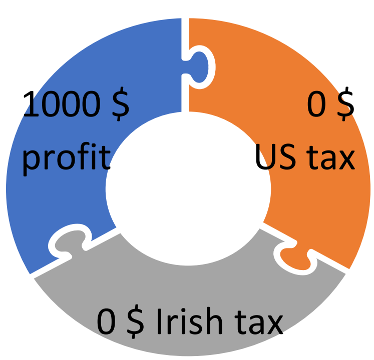


APPLE EU Subsidiary

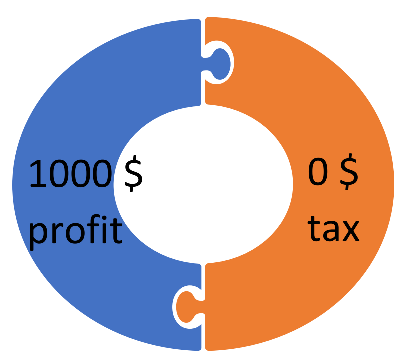
An offshore tax Haven

So, to avoid paying so much tax, we can open a Caribbean islands subsidiary that will control the European subsidiary. This can be done by transferring assets such as IP from the European subsidiary to the Caribbean island subsidiary. Since the major asset of tech firms are intangible in nature such as IP, it is easier for them to transfer assets digitally.

As the Irish subsidiary uses the IP of the Caribbean islands' subsidiary, we can redirect all the profits made by the Irish subsidiary to the Caribbean islands subsidiary citing royalty payments. In this way, the Irish subsidiary has 0$ of effective profit and hence it won't be subject to any taxes. Meanwhile, as the Caribbean islands have a ~0% corporate tax rate, all of the European profits will now lie untaxed there.



Irish Subsidiary

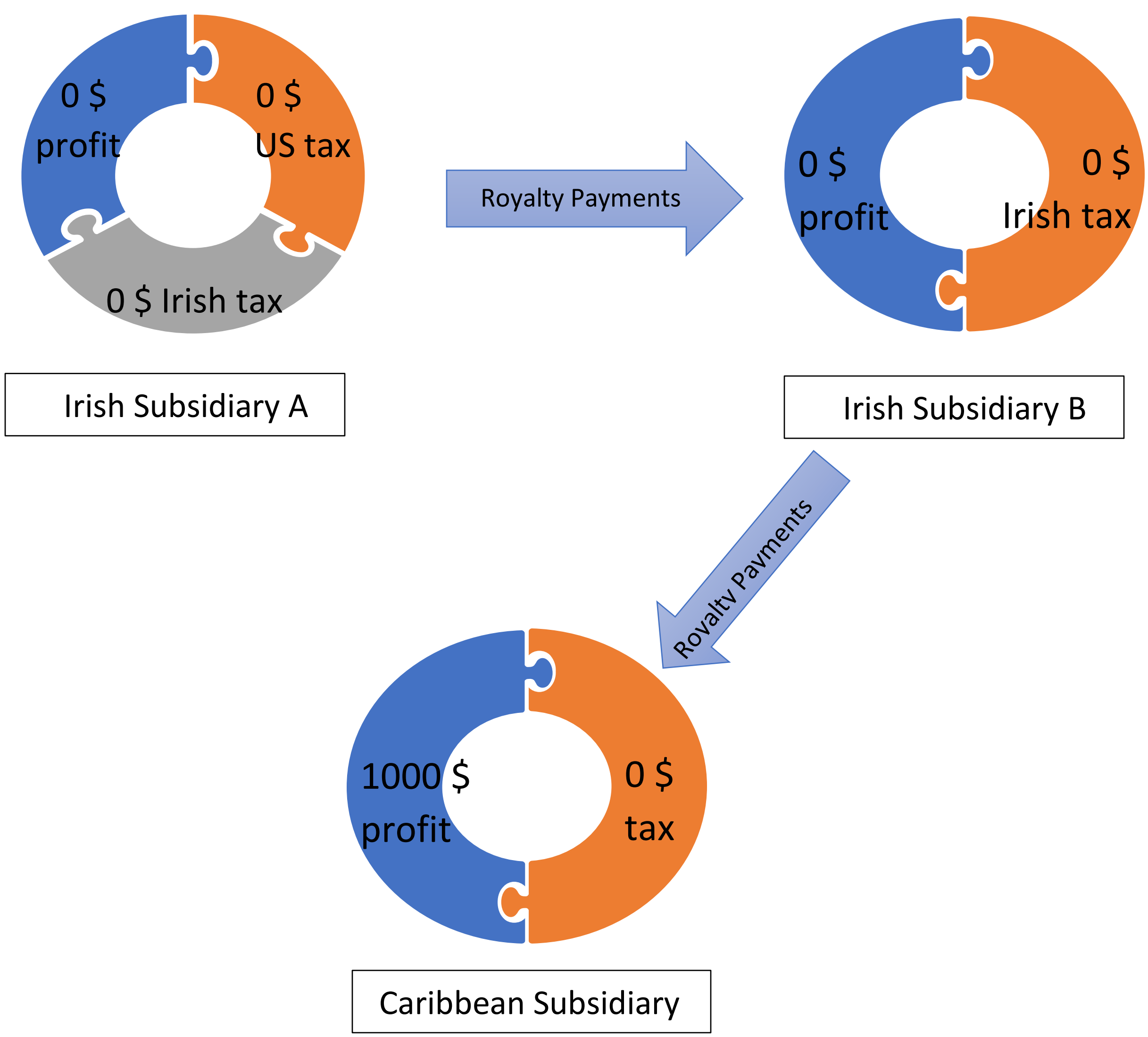


Caribbean Subsidiary

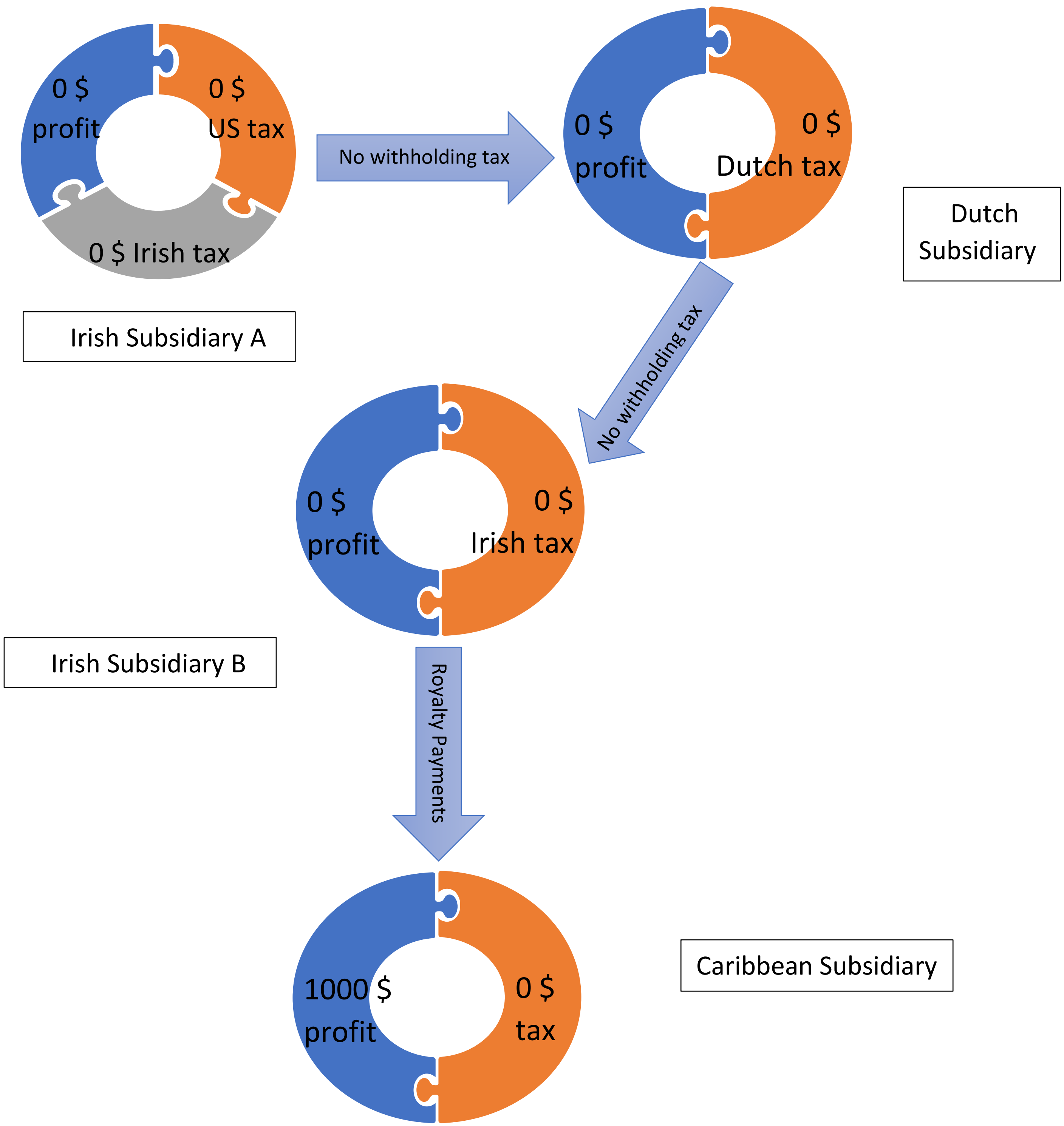
Controlling Foreign Corporations

However, the above system has one problem – CFC. CFC stands for controlling foreign corporations. In the above scenario, if the US authorities find out, they will apply the CFC rule and consider the whole system to be a single unit eligible to pay American tax as it is shielding tax using a controlling firm in the offshore islands.

A workaround this rule would be to introduce another Irish company with control in Ireland itself to prevent the CFC rule from kicking in. So, in the new scenario, we have Apple's EU subsidiary (A) with control in Ireland itself, a second Irish subsidiary (B) which has control in Caribbean islands and a Caribbean island subsidiary. The firm-A distributes goods and earns profits across all European states. A now makes full payment to firm B since B is the controlling corporation of A. Since B has its controlling corporation in the Caribbean islands, it transfers all of its profits there. This is known as a Double Irish arrangement as it involves two Irish subsidiaries A and B for shifting profits and saving tax.



To improvise the Effective Tax Rate (ETR) in the above scheme, some companies have introduced a Dutch twist. Since Ireland imposes withholding tax for monetary transfers between two Irish firms, company A will have to pay tax to the Irish government while transferring money to company B. But as Ireland has tax agreements with few countries such as Netherlands, it does not impose any withholding tax for monetary transfers between the firms of both nations. In the above example, we can introduce a Dutch company (C) to achieve an even lower ETR. This arrangement is known as the Double Irish Dutch Sandwich.



Discovery & Shutdown

The DIDS scheme was officially discovered by the US in 2014 and it gave a 5-year time period to all tech firms to discontinue the use of this policy. The European Union also pressurized the Irish government to reform its tax policies so that MNC's cannot avoid paying taxes on their profits by means of profit shifting. The US government also decided to switch to territorial tax system in 2017 and brought down corporate tax rates from 35% to 15.5% in 2018 under the Trump tax reforms in order to promote free trade and decrease the use of BEPS tools such as the DIDS. Following these tax reforms, Apple had announced repatriation of 252$ Billion of money in offshore havens. However, the new tax reforms and international tax policy changes did not achieve the expected success and use of BEPS tools continued to increase over time.

Newer Alternatives

After the shutdown of the Double Irish Dutch Sandwich scheme, two BEPS strategies became prominent, namely the CAIA and the Single Malt scheme.

The **Single Malt scheme** is quite similar to the Double Irish Dutch Sandwich scheme with a Maltese/UAE firm replacing the Dutch Sandwich. The use of this scheme increased over time and by 2018, it made Ireland the largest global tax haven. Finally, in 2018, a major amendment was made to the Ireland Malta tax treaty to discourage its use.

The **Capital Allowances for Intangible Assets (CAIA) or Green jersey** is another popular BEPS tool. It is more powerful than the DIDS or Single Malt scheme as it is based on providing capital allowances for intangible assets like IP which companies use to book completely tax-free profits. In Q1 of 2015, Apple booked $600 Billion of tax-free profit in Ireland in the following manner-

- Apple's Irish subsidiary bought $300 Billion of IP from Apple's Jersey subsidiary
- The Irish subsidiary made use of the CAIA rule to write off this amount against future Irish profits, i.e. the next $300 Billion of profits that Apple's Irish subsidiary makes would be subject to $0 tax.
- Further, Apple made use of the Irish interest relief laws to double its tax shield to $600 Billion with an ETR of exactly 0%.

Conclusion

In this article, we primarily focused on the development of the DIDS scheme, its need and workarounds etc. We also shed light on modifications and recent alternatives to the Standard Double Irish scheme such as the Single Malt and CAIA.