

Tax Issues for Outbound Investors

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Introduction

- Developing economies, rapid pace of growth
- Shift in world GDP towards emerging markets
- Large number of consumers with excess disposable income
- Financial crisis shakeup and impact on international trade
- Growing exports and export related employment – key focus

Why do companies expand abroad?

- More than one reason
- Find new markets
- Increased global market share
- Reduce reliance on Irish domestic market
- Desire not to downsize operations further

Investing in foreign markets – issues to be addressed

- Operating structure
- Repatriation of profits
- Transfer pricing provisions
- Financing of foreign operation
- Foreign exchange issues
- Exit mechanisms

Investing in foreign markets – issues to be addressed

- Anti-avoidance legislation
- Indirect tax considerations
- Employee secondments
- Miscellaneous taxes

Operating Structure

- Appoint 3rd Party distributor
- Appoint dependent agent
- Appoint independent agent
- Establish a representative office
- Set up a foreign branch
- Incorporate subsidiary, JV vehicle or acquire existing company

“Trading with” v “Trading in” a territory

“Trading with” a territory:

- No taxable presence
- Generally no local country tax issues
- Examples
 - Sale of goods to third party distributor
 - Agent obtains orders for goods and transmits them to Ireland for execution – contracts concluded in Ireland

“Trading with” v “Trading in” a territory

“Trading in” a territory

- Taxable presence
- Liable to local taxes
- Branch, subsidiary etc

Meaning of PE

OECD Model tax treaty includes:

- A Place of Management
- A branch
- An office
- A factory
- A workshop
- A mine, oil or gas well etc
- Building site or construction/installation project etc

Appointment of agents

Dependents agents

- May create a PE
- Has and exercises power to conclude contracts

Independent agent

- Broker, general commission agent etc
- Acting in ordinary course of business
- No PE

Representative Office

- Does not require incorporation of a separate legal entity
- Activities confined to
 - Acting as a liaison with clients and head office
 - Introducing product
 - Market research
 - Collecting information
 - Cannot sign or conclude contracts
- Registration requirements in many territories
- Generally no taxable presence
- Register for payroll taxes

Branch

- Not a separate legal entity
- Creates a PE
- Approval procedures in many territories
- Some territories require appointment of legal representative

Subsidiary

- Options:
 - Incorporate new legal entity
 - Joint venture arrangement
 - Acquire existing legal entity
- Understand residence rules
- Taxing rights if resident abroad i.e. taxed on worldwide profits?
- Tax in Ireland - only on repatriation
- Watch restrictions on foreign ownership - % capped

Residence

- Incorporation test?
- Foreign incorporated company managed and controlled in foreign territory
- Effective place of management test
- Tax treaty tie breaker clause
- Taxable on worldwide income

Repatriation

- Repatriate cash - key objective
- Depends on legal structure
- Repatriation strategies
 - Dividends
 - Interest
 - Royalties
 - Management services agreement

Double taxation treaties

- Agreement between two territories
- Eliminates double taxation of income/gains
- Allocates taxing rights between the two countries in order to ensure that income is not subject to double taxation
- Income/gain should be taxed in one jurisdiction only or
- One country should offer a credit against the tax payable in that country for the tax suffered in another country
- Ireland has extensive treaty network

Foreign Tax Credit relief

- Foreign Tax Credit Relief - Branches
- Foreign Tax Credit Relief – Subsidiary
 - 12.5% v 25% corporation tax

Interest payments

Withholding tax on interest

- Income taxable as Case I Income
- Income taxable as non trading income

Royalties

- Royalties taxable as Case I income
- Royalties taxable as non trading income

Transfer Pricing

- Introduced in Ireland in FA 2010
- Application to trading transactions only
- Arms length pricing between associated persons
- Components of profit and factors in determining arms length price
 - Functions performed
 - Assets utilised
 - Risks borne

Transfer Pricing objectives

- Avoids artificially increasing profits in one jurisdiction vis a vis another
- Designed to prevent profits being booked in a low tax jurisdiction through intra-group charges
- OECD transfer pricing guidelines

Example

A Limited is a manufacturing company. It sells products to a related German company, X Limited. The price charged by A Limited to X Limited is an example of a transfer price. If we assume that X Limited sells the product in Germany for €200, it costs A Limited €40 to manufacture the product and X Limited incurs selling and distribution expenses of €40, the group earns an overall profit of €120 (*€200 minus €40 minus €40*) on the sale of each product.

The transfer price charged by A Limited to X Limited will determine how the €120 profit is split between the companies.

Scenario A:

- A Limited charges X Limited a price of €150 per unit

	A Ltd	X Ltd	Group
• Sales	150	200	200
• Cost of sales	(40)	(150)	(40)
• Selling & dist	<u>(0)</u>	<u>(40)</u>	<u>(40)</u>
• Profit	110	10	120
• CT rate	12.5%	35%	
• Tax	13.75	3.5	17.25

Effective tax rate 14.38%

Scenario B:

A Limited charges X Limited a price of €50 per unit

	A Ltd	X Ltd	Group
Sales	50	200	200
Cost of sales	(40)	(50)	(40)
Selling & distribution	<u>(0)</u>	<u>(40)</u>	<u>(40)</u>
Profit	10	110	120
CT rate	12.5%	35%	
Tax	1.25	38.5	39.75
Effective tax rate	33.12%		

Transfer Pricing

- Many approaches to determine appropriate price
 - comparable uncontrolled price
 - resale price
 - cost plus
 - transactional net margin
 - profit split method

Transfer pricing cont.

- Documentation needed to record/justify arrangements
- Exclusion in Ireland for SME's:
 - Fewer than 250 employees and either turnover less than €50m or assets of less than €43m
- SME exclusion not available in every jurisdiction
- Overall objective: transfer/leave residual profit in Ireland
- => transfer pricing risks when transacting with high tax territories
- DTA can be relied upon to obtain correlative adjustments
- Advanced pricing arrangements
- Understand local rules re documentation, filing with local tax authorities etc

Financing of foreign operation

- Optimum capital structure
 - Debt
 - Equity
 - Capital contributions
- Taxation of interest income v deduction for interest paid

Debt financing

- Profit repatriation
- Thin Capitalisation provisions – debt: equity ratios limit deductibility of interest on debt finance
- Excess interest not deductible
- Ireland does not have extensive thin capitalisation legislation

Debt financing

- Locate debt in Ireland?
- Interest relief on loans
- Anti-avoidance legislation

Foreign Exchange and Tax Issues

- Operating outside the EU
- FX differences will arise
- Trading transactions vs Investment transactions
- Trading transactions: accounting & tax treatment are the same

Example

X Ltd is a trading company.

Purchases goods in UK in July 2009 for £100K.

Exchange rate €1: £0.6

Balance unpaid at y/e

Exchange rate: €1:£0.8

Creditors July 2009 : €167

Creditors y/e €125

Gains included in P&L account - no adjustment for tax purposes

Non trading transactions

- Foreign currency borrowings
- Foreign currency assets
- Foreign currency debt
- Foreign currency deposit account

Exit strategies

- Capital gains tax exemption on disposal of shares in foreign subsidiaries - S626B TCA 1997
- Min 5% shareholding - OSC, profits & assets
- 12 Month holding period
- Trading company or member of trading group
- Resident in EU/DTA country

Exit strategies cont.

- Gains not taxable, losses not allowable
- Dividends from foreign subsidiary not treated as investment income for close companies surcharge purposes where s626B applies

Exit strategies cont.

- Gains outside the scope of S626B TCA 1997
- Gain taxable in country of residence of subsidiary?
- Relief under DTA?
- Some DTA's do not cover Capital Gains Taxes
- Insert intermediate holding company?
- Qualify for s626B TCA 1997
- Minimise withholding taxes on dividends, interest and royalties

Indirect tax considerations

- VAT
- Customs duty
- Correct documentation critical

Employee Secondments

- Residence and ordinary residence
- Domicile
- Irish and foreign taxing rights

Short term assignment

- May not affect residence position
- Irish PAYE/PRSI continues to be deducted
- Taxes payable in foreign territory?
- Tax free subsistence payments - IT 54

Longer term assignment

- Leaving with intention - non resident in following year
- Post departure employment income not taxable

Social Insurance - PRSI

- Employees working abroad – continue to pay Irish PRSI
- Three Regimes
 - EC regulations
 - Bilateral social security agreements
 - No regulations or agreements in place

Collection of USC

- PAYE exclusion order – DTA Country – No USC
- PAYE exclusion order – Non DTA country- USC payable

Other Issues

- Foreign net wealth taxes
- Real estate taxes
- Capital Duty
- Stamp Duty
- Local Practices

Tips if expanding abroad

- Explore all the options
- Put tax on the agenda
- Take advice from outset
- Both in Ireland and abroad
- Speak to others who have already taken similar steps



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