INTERNATIONAL TAX STRATEGIES FOR CROSS-BORDER EXPANSION

Foreign Tax Strategies

Tax planning should be a top consideration for companies managing cross-border expansion activities into foreign countries. Effective tax planning can slash global tax bills by as much as 20% for businesses pursuing expansion in foreign markets. With taxes a top three expense for most companies, all efforts to slash the size of tax obligations directly support business value. Everything from entity selection, managing global tax footprints, strategic transfer pricing and profit repatriation comes into play for companies with cross-border operations.

Entity Selection

The type of entity or legal form of registration available to businesses varies by country. Typically, though, most foreign countries allow United States businesses to form a:

- Branch;
- Partnership;
- Equivalent of a limited liability company (LLC); or
- Corporation.

In selecting the right investment form, businesses should consider the following.

Local taxes

Foreign countries may tax different types of investment forms in different ways. Analyze how the foreign country taxes each type of investment vehicle separately to take advantage of the best local tax rates.

Foreign payment treatment

Take a close look at how each foreign country looks at payments coming out of their country. Different tax ramifications can apply depending on whether funds are paid out of the country in the form of dividends, interest, royalties, management fees, or a return of capital.

U.S. Tax Strategies

A number of U.S. tax implications are driven by how a business structures its overseas investments. The U.S. tax position is affected by both the type of investment vehicle selected in a foreign jurisdiction as well as the legal structure of the U.S. company.

Foreign Entity Taxation

There are two fundamentally different ways that foreign investments are taxed in the U.S. depending on whether the investment vehicle is treated as a corporation or a flow-through entity for U.S. purposes. Generally, if a U.S. shareholder has an investment in a foreign corporation, the earnings of that foreign corporation are not subject to U.S. tax until they are repatriated to the U.S. in the form of a dividend. However, a U.S. shareholder that is an owner of a flow-through entity in a foreign jurisdiction is subject to:

- Immediate taxation on foreign earnings or losses; and
- May be able to utilize a foreign tax credit in the U.S. to offset some or all of that tax paid on foreign earnings.

U.S. Entity Taxation

The structure of the U.S. company significantly affects the desired tax profile of the foreign business. Generally, the following is true.

- Corporate U.S. shareholders prefer to have foreign investments set up as corporations so that they can defer those foreign earnings from U.S. tax until such time as they are repatriated to the U.S.
- Flow-through U.S. shareholders prefer their foreign investment be in the form of a flow-through entity so they can access foreign tax credits. Under current U.S. tax law, U.S. shareholders that are individuals or flow-through entities are not able to access foreign tax credits of foreign corporate subsidiaries. Access to these credits can be achieved by structuring the foreign investment in the form of a flow-through entity or in the form of a corporation that is eligible to be treated as a flow-through entity for U.S. purposes under what are called “check-the-box” rules.

Transfer Pricing Strategy

Any time a new operation in a foreign country is added to the mix, it must be determined how profits and losses will be shared on transactions between related parties. These transactions may include compensation for services, sales of tangible property or the utilization of intangible assets. Properly structuring the transfer pricing on the front-end of the arrangement can reduce global tax and reduce future risk of attack from competing tax authorities.

Deferred Taxation Strategy

The concept of “deferral” is fundamental to international tax planning. Depending on their U.S. tax posture, some U.S. shareholders would prefer to pay taxes on foreign earnings only when they are repatriated to the U.S. while others may want foreign income or loss to flow immediately into their U.S. tax return. This final piece of planning is integral to balancing treasury needs and global tax minimization and should be high on the list of tax planning considerations for businesses expanding overseas.