Capturing value, keeping value

Non-U.S. investors use U.S. Inbound International Tax and Transfer Pricing Services for U.S. tax planning

Thinking is one thing no one has ever been able to tax.

— Charles Kettering

Planning to win starts with planning to preserve

More foreign direct investment flows into the United States than into any other country. There is more than $2 trillion in capital in the U.S. that originated somewhere else – equal to about 16 percent of U.S. gross domestic product.[1] About 4.6 percent of privately employed people in the U.S. work for American affiliates of overseas companies.[2]

Having invested so much, non-U.S. companies clearly intend to prosper and profit in the American marketplace. No organization plans to pay higher taxes. But surprisingly, few organizations plan as well as they could to address that expense.

Planning for multinational enterprises is subject to many external inputs – changing tax laws, treaty provisions, currency fluctuation, to name a few. These external influencers, along with ever-changing business performance, may limit predictability. It becomes harder to confirm that a multinational's worldwide corporate tax burden and related cash flow challenges are being maintained at an acceptable level while helping to manage tax risks.

That's why an organization's tax planning should consider current and future investments in the U.S.

[1] http://www.investamerica.gov/home/iia_main_001155.asp, accessed Feb 4, 2011

[2] http://www.investamerica.gov/home/iia_main_001154.asp, accessed Feb. 4, 2011

Quick choices, lingering consequences: Planning from the outset

Decisions that a company makes when first investing in the U.S. are very important. Once made, they are difficult to change. This means that it is important to define and create an opportune way to structure a group's initial U.S. investment. Such initial tax planning should be as flexible as possible.

For example, what form should the investment take? Many foreign investors set up a U.S. corporation without giving close examination to the alternatives. In some cases, setting up a U.S. branch of a non-U.S. company may offer more advantages. A branch and a main office may be able to transfer intellectual property back and forth without creating the taxable events that arise when the intellectual property (IP) changes hands between legally distinct entities.

Similar considerations apply to the placement of IP, the location of debt, and the location and utilization of assets. Instead of creating a U.S. corporation to build a plant, for example, a parent company may realize a lower tax burden by building the plant itself (or in a special purpose entity) and leasing the plant to a U.S. subsidiary.

These considerations encompass the discipline of investing in the U.S. the way an entity's basic structure influences its financial performance. There are as many right answers as there are companies who seek them.

Navigating through the complexity of investing in the United States: A plan for every stage

Sometimes a foreign parent needs a path out of the U.S. – either for part of its business or for the entire operation. That's when it pays to have thought in terms of cycles: from profit to loss and back again, through upturns and downturns, and through the life stages of an enterprise:

Initial investment
Expansion
Continued profitability
Repatriation of capital
Disposition

At every stage an organization needs a plan for those that will follow, and the flexibility to take on changing conditions. Those conditions can arise outside your company – or in your own boardroom. What will be important to you tomorrow that hasn't already occurred?

Planning from the start: Changes in U.S. tax law

A variety of attitudes influence American tax policy: the desire to influence trade, the hope to promote growth and jobs, the need to collect revenue. Policies designed to encourage foreign investment and policies designed to "protect" the domestic economy seem to trade places with regularity.

Keeping up with U.S. tax law, from base compliance to master planning, is up to you. When a foreign company invests in a U.S. enterprise, it plays on a field where it doesn't reside – but it does have an interest. Protecting that interest is a matter of awareness and planning.

Treaties between the U.S. and a parent company's country of origin can also change the tax equation, and the nature of those treaties is also subject to pressure both in Washington and abroad.

In its advisory to Americans planning to travel abroad, the U.S. Department of State advises, "If the drivers in the country you are visiting drive on the left side of the road, it may be prudent to practice driving in a less populated area before attempting to drive in heavy traffic."[3] When you make a significant business investment in the U.S., there is no low-risk practice area. You're in the fast lane from Day One.

[3] http://travel.state.gov/travel/tips/safety/safety_1179.html, accessed Feb. 7, 2011

Your global tax force by your side: Getting started with Deloitte

Knowing the leading way to plan, structure, and operate an inbound U.S. investment is too complex to determine in the heat of a pending transaction. Decisions that seem secondary today may introduce costly constraints in the future. When a company's global business strategy takes it into the U.S., its tax planning approach should already be in place.

At Deloitte, we recognize that addressing foreign investment is a specialized area of tax. To focus on this important area we have created our U.S. Inbound International Tax and Transfer Pricing Services group which practices within our worldwide tax practice network. It specifically addresses the issues that non-U.S. investors' face when they do business here, and includes more than 100 tax specialists around the world who focus on inbound tax planning. U.S. Inbound International Tax and Transfer Pricing specialists can help you explore potentially tax-efficient structures for acquisition, financing, repatriation, and disposition. We can also help you understand current and planned changes to U.S. tax laws and offer tax guidance during your investment life cycle. Furthermore, the group draws upon the knowledge of colleagues who are specialists in the various tax rules within their geographic locations. The result is that we offer our clients "home country" knowledge, "target country" knowledge, and industry experience through a single engagement.

Our teams ask tough questions, develop an understanding of each client's goals and strategies, and provide advice and assistance based on a deep knowledge of federal, state, and local tax codes. From that basis, we work together to overcome barriers and explore opportunities.

Financing the U.S. investment choice: Prior to initial investment, structuring an acquisition or expansion

Companies that plan a U.S. investment will doubtless consider multiple ways to fund their U.S. operations. Lending money from the home country parent to a wholly owned U.S. subsidiary may be the straightforward answer.

If the organization structures the transfer as a loan, the subsidiary will owe interest to the parent company. Paying interest creates deductions that may reduce the company's U.S. tax liability. This may create a net benefit for the organization as a whole, especially if the home country tax rate on the incoming interest payments is lower than the U.S. rate on the same amounts.

While the principle is simple, executing this maneuver takes specialized experience with technical compliance. Debt equity provisions in the U.S. address whether these transactions are permissible, and in what amounts. The relevant laws can change in the U.S. and other countries.

Often, a deep understanding of tax rules in the parent company can lower the tax rate on the interest payments coming back from the U.S. entity, which in turn can increase the net savings to the entire organization.

While it's important not to overreach with planning, it's also possible to be overcautious. Some organizations don't use enough reciprocal leverage to realize potential benefits. A close look – and the willingness to make frequent adjustments – may result in a debt equity structure that provides tax relief.

Owning knowledge: Intellectual property

Intellectual property (IP) generates value. It is value. You can never hold it in your hand, but it can be a major component of the tax planning that goes into a U.S. investment.

Some generalizations apply: The U.S. currently has high corporate tax rates that may make it favorable to locate IP outside its borders. For the same reason, many organizations place their IP in Ireland. But generalizations spawn exceptions. And even if “not here” is the answer, the question remains: where?

Circumstances may define your range of options. For example, if you acquire a company in one place, you acquire its IP – in that tax jurisdiction. Moving it out may involve a phased migration or a shift in R&D operations. Inbound investors may find they have tax advantaged IP transfer opportunities.

Remember than when you relocate the profits generated through the application of IP, you’re implicitly moving the IP itself.

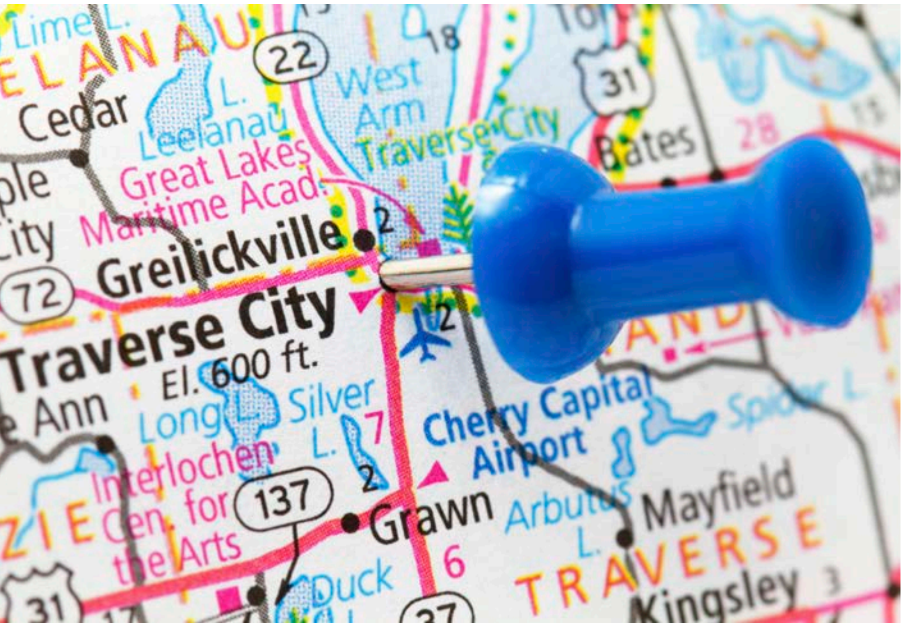
Seeing value to its destination: Transfer pricing and supply chain

Supply chain transformation and realignment is justly regarded as a science of its own, and many companies use it as a way to speed processes, reduce inventory commitments, improve productivity, and boost customer service. But it's common for companies to overlook the tax implications of supply chain structure.

The supply chain can influence both pre-tax gains and after-tax returns. As profits rise, a plan that's attuned to the current reality may allow too much tax exposure as the company grows. When applying these concerns to foreign investment in the U.S., organizations should include customs compliance, warehousing locations, and transfer pricing in their supply chain calculus.

Similarly, transfer pricing is now a legal issue in dozens of nations that was addressed little, if at all, 15 years ago. International Financial Reporting Standards include significant transfer pricing requirements and corporate accounting officers can be held personally liable for inaccuracies and shortfalls.

When capital is flowing across borders, changes in one jurisdiction ripple into others, and a country-by-country analysis may not produce the best result. A global issue calls for a global plan.



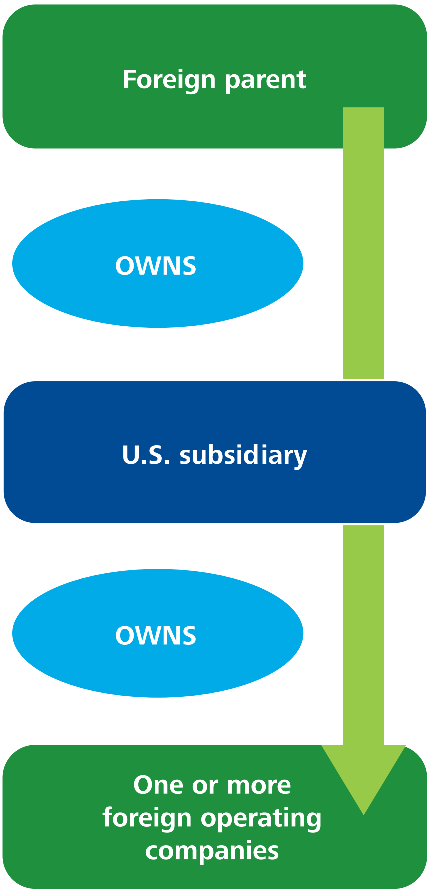
Mergers and acquisitions: The right combination

Like any merger or acquisition, a cross-border transaction rises or falls on the basis of total value. Value influences the price. Considering how taxes will affect the long-term value of the transaction is important to knowing a fair price.

It's not an area in which surprises are welcome. It's not something you can shrug off and save for later. As with other planning considerations, the likely outcome improves when tax is part of the early-stage discussion. Target screening is a good time to start talking about it. The due diligence phase may even be too late.

Once tax obligations are built into a deal, it's critical to execute as planned. M&A tax planning can include steps such as using foreign tax credits to offset tax on offshore earnings or realigning legal entities to consolidate filings. It's not unheard of for the corporate tax burden to spike if focus shifts after a deal and those plans aren't carried out.

The sandwich



Lines of ownership that cross and re-cross tax jurisdiction borders can introduce inefficiency, administrative burdens – and multiple tax liabilities.

Form and function: Post-acquisition restructuring

In simple cases, the foreign parent that takes over an entity in the U.S. may inherit a target entity's existing structure and the tax obligations that go along with it.

The way a foreign company structures its relationship with the U.S. entities it owns may have a large impact on the efficiency of its tax burden and on the way it does business.

One phenomenon that adds complexity is the "sandwich." For example, a non-U.S.-based multinational might purchase a U.S. multinational that in turn owns operating companies outside the U.S. In this case, assets of the U.S.-based component can get taxed both on the way in and on the way out. What if the foreign parent owns one operating subsidiary in the United Kingdom and another U.S. unit that also owns a U.K. subsidiary – and wishes to combine them? Even if the companies are operating with a common purpose on the surface, they may involve multiple jurisdictions and costly layers of extra taxation.

What are the remedies? The foreign parent may buy components out from under the U.S. group. It may try to limit the future appreciation of assets subject to U.S. tax in order to contain at least one element of the tax cost. It may benefit from a participation exemption from one or more governments to avoid double taxation.

But the better remedy is to see situations anticipate these – and to structure a multi company ownership appropriately.

Borders within borders: Operating in multiple states

Most foreign companies that operate in the U.S. focus their tax planning on the federal government – yet it's not uncommon for them to pay more state tax than federal tax.

"Incorporate in Delaware" may be popular shorthand, but it's hardly a complete approach. Imagine a European tax advisor telling an American millionaire simply to "bank in Zurich!" State-imposed corporate taxes are based on where a company operates and not necessarily where it creates its profit or where it files its paperwork. A company might operate a plant in one state and see sales activity in several others, only to find it has a significant tax bill in each.

The burden of state tax can shift over time. It's common for a new U.S. investment to pay more state tax early in its lifespan, when it isn't generating large profits, and then to incur a greater percentage of federal tax obligations when the company is more profitable.

The fragmented nature of American taxing authorities, from the federal level all the way down to state, county, and municipal governments, may be unfamiliar to business leaders based in countries that operate more centrally. To address this exposure within the scope of your planning, it's important to understand the requirements of every jurisdiction where you'll do business – or to get help from people who do.

The credit you're due

Working effectively with state and local taxing authorities is about more than just writing checks. There are strategies – some negotiated, some not – that can yield credits and incentives that add value to your investment and may reduce cost.

These can include quicker and fuller tax refunds, reductions in locally originating operating costs (think utilities), and even a potential reduction in the overall tax bill.

Many states offer tax credits or grants to companies that bring business and employment to their borders. Training programs, site improvements, and even free land have all been part of past deals.

The necessary skill is realizing where to look for these opportunities, whom to ask, and how to keep track of it all – because the complexity of credits and incentives multiplies as you operate in more and more locations within the U.S.

The fine print: Compliance as a discipline

Given the frequent changes in U.S. tax law – and the way taxing authority is distributed across multiple levels of government – the act of complying is a significant job in itself which results in significant costs and risks, and a foreign investor should obtain the requisite information.

Based upon sales and other activities, a company may be required to file dozens of tax returns even if it operates in only one or two discrete locations. The cost of paperwork alone may be a shock, even to officers of sophisticated corporations.

Creating a compliance strategy requires a broad view backed up by fast, scrutinized, accurate reporting. In addition to rapid changes in U.S. tax laws across multiple jurisdictions, it's important to consider factors specific to overseas investors, such as:

- U.S. earning stripping limitation rules, for example, Internal Revenue Code Section 163(j)
- Approaches to address, and perhaps transfer, IP at periods of low valuation and/or when tax changes are approaching
- Legislative changes that affect the applicability of U.S. income tax treaties

Compliance is not merely a check box. It's a discipline and a process that has significant bottom-line effects. In other words, it matters not only that you do it, but also how well you comply.

Entity simplification

When you do business around the world, it isn't hard to step back one day and find that your "company" – singular – is actually made up of hundreds if not thousands of distinct legal entities. Some may correspond to specific operational or jurisdictional mandates. Some may collect dust long after their usefulness has ended. No matter where they come from, it's the rare company that has built them all into a single, coherent plan.

Every legal entity carries cost, risk, and tax exposure. What drives a company to clean house and simplify its legal structure? Typically, one of four pressure points:

- Strategic realignment
- Acquisition or divestiture
- Pressure from the board
- Tax and treasury review

When a company's entity simplification eliminates redundant cross-border transfers or eliminates a sandwich structure, it has the potential to reap savings. At least one company actually motivated its leaders to pursue simplification by paying a bonus for every entity eliminated, and pared hundreds as a result.

However, it also takes thought and planning to avoid triggering a new taxation. The leading approach is to invest in the analysis it takes to find potential opportunities and avoid pitfalls.

Contacts

For more information, please contact Deloitte's U.S. Inbound Services team:

Leaders

Beth Mueller
Partner, US Inbound Services leader
111 S. Wacker Drive Chicago, IL 60606
+1 312 486 3861
bethmueller@deloitte.com

Michael Steinsaltz
Partner, US Inbound International Tax leader
1700 Market Street
Philadelphia, PA 19103
+1 215 299 4555
msteinsaltz@deloitte.com

John Jennings
Partner, US Inbound Global Employer
Services leader
111 S. Wacker Drive
Chicago, IL 60606
+1 312 486 4306
johjennings@deloitte.com

Gary Perler
Principal, US Inbound Multistate leader
100 Kimball Drive
Parsippany, NJ 07054
+1 973 602 6174
gperler@deloitte.com

James Watson
Partner, US Inbound M&A leader
111 S. Wacker Drive
Chicago, IL 60606
+1 312 486 4917
jamwatson@deloitte.com

Christy Wissemeier
Senior Manager, US Inbound International
Expansion Services leader
250 E 5th Street, Suite 1900
Cincinnati, OH 45202
+1 513 723 3089
cwissemeier@deloitte.com

National Resource

Robert Stricof
Partner
1633 Broadway
New York, NY 10019
+1 212 436 2262
rstricof@deloitte.com

Washington National Tax

Phil Morrison
Principal
555 12th St. NW, Suite 400
Washington D.C. 20004
+1 202 879 4977
pmorrison@deloitte.com

Robert Rothenberg
Director
555 12th St. NW, Suite 400
Washington D.C. 20004
+1 202 879 4923
robrothenberg@deloitte.com

Rich Sciacca
Director
555 12th St. NW, Suite 400
Washington D.C. 20004
+1 202 879 5664
rsciacca@deloitte.com

Gretchen Sierra
Principal, WNT International Tax leader
555 12th St. NW, Suite 400
Washington D.C. 20004
+1 202 220 2690
gretchensierra@deloitte.com

U.S. Locations
Central Region International Tax

Mark Brkljacic
Director
200 Renaissance Center, Suite 3900
Detroit, MI 48243
+1 313 396 2730
mbrkljacic@deloitte.com

Mike Dively
Director
1111 Bagby St., Suite 4500
Houston, TX 77002
+1 713 982 4216
mdively@deloitte.com

Reese Fredrickson
Director
2200 Ross Ave., Suite 1600
Dallas, TX 75201
+1 214 840 1260
rfredrickson@deloitte.com

Todd Izzo
Partner
2500 One PPG Place
Pittsburgh, PA 15222
+1 412 338 7606
tizzo@deloitte.com

Brian Untemeyer
Partner
555 17th St., Suite 3600
Denver, CO 80202
+1 303 312 4168
buntermeyer@deloitte.com

Scott Vickman
Partner
50 S 6th Street, Suite 2800
Minneapolis, MN 55402
+1 612 397 4020
svickman@deloitte.com

Mitch Weiss
Director
111 S. Wacker Drive
Chicago, IL 60606
+1 312 486 9482
mitweiss@deloitte.com

Central Region Transfer Pricing

Shannon Blankenship
Principal
555 17th Street, Suite 3600
Denver, CO 80202
+1 303 312 4778
sblankenship@deloitte.com

Raoul Gonzalez
Senior Manager
111 S. Wacker Drive
Chicago, IL 60606
+1 312 486 4515
raougonzalez@deloitte.com

Central Region Business Tax Services

Tanya Crawford
Director
180 East Broad Street, Suite 1400
Columbus, OH 43215
+1 614 229 4828
tcrawford@deloitte.com

Mary Doehring
Director
100 S. 4th Street, Suite 300
St. Louis, MO 63102
+1 314 641 4356
mdoehring@deloitte.com

Terry Kurtenbach
Partner
555 East Wells Street, Suite 1400
Milwaukee, WI 53202
+1 414 347 6160
tkurtenbach@deloitte.com

Tim Samonds
Partner
111 S. Wacker Drive
Chicago, IL 60606
+1 312 486 3008
tsamonds@deloitte.com

East Region International Tax

Jeff Clegg
Partner
1750 Tysons Blvd.
McLean, VA 22102
+1 703 251 1580
jclegg@deloitte.com

Ed Cloaninger
Principal
200 Berkeley Street
Boston, MA 02116
+1 617 585 5869
ecloaninger@deloitte.com

Miguel Fonseca
Partner
333 SE 2nd Avenue, Suite 3600
Miami, FL 33131
+1 305 372 3274
mifonseca@deloitte.com

Jonathan Goldblatt
Partner
1633 Broadway
New York, NY 10019
+1 212 436 2236
jogoldblatt@deloitte.com

Jared Gordon
Director
1700 Market Street
Philadelphia, PA 19103
+1 215 299 5214
jaredgordon@deloitte.com

Rich Koenenn
Partner
150 Fayetteville Street, Suite 1000
Raleigh, NC 27601
+1 919 546 8111
rkoenenn@deloitte.com

Dan Markiewicz
Partner
1633 Broadway
New York, NY 10019
+1 212 436 4434
dmarkiewicz@deloitte.com

Mike Thompson
Partner
191 Peachtree Street, Suite 2000
Atlanta, GA 30303
+1 404 220 1801
mikthompson@deloitte.com

East Region Transfer Pricing

Matt Berman
Director
333 SE 2nd Avenue, Suite 3600
Miami, FL 33131
+1 305 808 2385
mattberman@deloitte.com

Oliver Bracken
Director
333 Ludlow Street
Stamford, CT 06902
+1 203 708 4140
obracken@deloitte.com

Shanto Ghosh
Client Service Executive
200 Berkeley Street
Boston, MA 02116
+1 617 437 3761
shghosh@deloitte.com

Ivan Gutierrez
Senior Manager
333 SE 2nd Avenue, Suite 3600
Miami, FL 33131
+1 305 372 2639
igutierrez@deloitte.com

Emiko Hashimoto
Director
1633 Broadway
New York, NY 10019
+1 212 436 6854
emhashimoto@deloitte.com

Aydin Hayri
Principal
1001 G Street NW, Suite 1200 West
Washington D.C. 20001
+1 202 879 5328
ahayri@deloitte.com

Peter Meenan
Principal
1919 Peachtree Street, Suite 2000
Atlanta, GA 30303
+1 404 220 1354
pmeenan@deloitte.com

Boris Nemirov
Principal
1633 Broadway
New York, NY 10019
+1 212 436 3351
bnemirov@deloitte.com

East Region Business Tax Services

Michael Gaines
Director
100 Kimball Drive
Parsippany, NJ 07054
+1 973 602 6283
micgaines@deloitte.com

Dan Holthaus
Partner
2500 One PPG Place
Pittsburgh, PA 15222
+1 412 338 7890
dholthaus@deloitte.com

Richard Koenenn
Partner
150 Fayetteville Street, Suite 1000
Raleigh, NC 27601
+1 919 546 8111
rkoenenn@deloitte.com

Evan Shea
Partner
1750 Tysons Boulevard
McLean, VA 22102
+1 703 251 1274
evshea@deloitte.com

West Region International Tax

David Cordova
Partner
925 Fourth Avenue, Suite 3300
Seattle, WA 98104
+1 206 716 7527
dcordova@deloitte.com

Eduardo Gonzalez
Director
655 West Broadway, Suite 700
San Diego, CA 92101
+1 619 237 6638
egonzalez@deloitte.com

Vivien Wang
Partner
225 West Santa Clara Street
San Jose, CA 95113
+1 408 704 4537
vivienwang@deloitte.com

West Region Transfer Pricing

Mike Bowes
Director
225 West Santa Clara Street
San Jose, CA 95113
+1 408 704 4750
mbowes@deloitte.com

Andrew Fisher
Director
350 South Grand Avenue, Suite 200
Los Angeles, CA 90071
+1 213 688 3230
andfisher@deloitte.com

West Region Business Tax Services

Diana McCutchen
Partner
695 Town Center Drive, Suite 1200
Costa Mesa, CA 92626
+1 714 436 7702
djmccutchen@deloitte.com

Brad Smith
Partner
2901 N Central Avenue, Suite 1200
Phoenix, AZ 85012
+1 602 234 5146
bradleysmith@deloitte.com

Greg Wichmann
Partner
3883 H. Hughes Parkway, Suite 400
Las Vegas, NV 89169
+1 702 893 4231
gwichmann@deloitte.com

Eigen Yanagi
Partner
225 West Santa Clara Street
San Jose, CA 95113
+1 408 704 4717
eyanagi@deloitte.com

Non-U.S. Locations

Australia

Amin Nosrat
Partner
1111 Bagby Street, Suite 4500
Houston, TX 77002
+1 713 982 4057
anosrat@deloitte.com

Belgium

Marcia Doyle
Partner
Diegem, BE
+32 2 600 69 02
mardoyle@deloitte.com

Robert Stricof

Brazil

Miguel Fonseca

Canada

Dennis Metzler
Partner
Toronto, ON
+1 416 601 6144
dmetzler@deloitte.ca

Beth Mueller

China

Ivan Strunin
Director
Hong Kong, CN
+1 704 887 1881
istrunin@deloitte.com

Vivien Wang

Lili Zheng
Partner
Hong Kong, CN
+852 2852 6769
lzheng@deloitte.com

France
George Gans
Partner
350 South Grand Avenue, Suite 200
Los Angeles, CA 90071
+1 213 996 5778
ggans@deloitte.com

Germany
Dan Markiewicz

India
Bala Rajaraman
Partner
100 Kimball Drive
Parsippany, NJ 07054
+1 973 602 4438
balrajaraman@deloitte.com

Israel
Jeff Clegg

Italy
George Gans

Japan
Tetsuya Ishida
Director
350 South Grand Avenue, Suite 200
Los Angeles, CA 90071
+1 213 553 1337
tishida@deloitte.com

Korea
Don Ryu
Partner
30 Rockefeller Plaza
New York, NY 10112
+1 212 436 7670
dryu@deloitte.com

Mexico
Ed Gonzalez

Netherlands
Jonathan Goldblatt

Nordic countries
Dan Markiewicz

Spain
Mitch Weiss

Switzerland
Dan Markiewicz

United Kingdom
Jonathan Goldblatt

Jeff Wehner
Partner
London, UK
+44 20 7007 0904
jwehner@deloitte.co.uk

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