

Doing business overseas can be taxing experience

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The complex and oft-shifting minutiae of U.S. corporate tax laws can prove challenging enough for American companies. For American firms doing business overseas, foreign taxation can turn into a veritable minefield.

GUEST COLUMN



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Massachusetts companies contemplating international expansion must arm themselves with information well before they traverse tax borders that have the potential to hurt their bottom lines. Preparation and anticipation are the keys. And it's never too early to begin planning.

Before taking any steps toward foreign growth, U.S. companies must consider long-term business and international goals. Do they plan to expand into just one foreign country, or a dozen? Will they bring their foreign earnings back to the United States, or reinvest the money overseas? Will they move U.S. employees to their foreign offices, or hire local workers?

Issues like these, to name just a few, must be considered well ahead of time to maximize tax benefits and reduce liabilities. But first, some background.

The United States operates under a worldwide tax system, by which domestic corporations are taxed on all income. Under this system, the income is taxed whether that income is derived in the United States or abroad.

By contrast, many foreign jurisdictions tax only on income earned within the country's boundaries. It doesn't matter where the

company is located; it matters only where it is economically active. This is known as a territorial tax system.

If they're not careful, U.S. companies risk double taxation on their overseas enterprises. But with enough preparation and planning, companies can find clever solutions to these rules.

For example, foreign tax credits allow companies to claim foreign taxes paid against their U.S. tax — up to the U.S. tax rate of 35 percent (subject to certain limitations). But what happens when a U.S. firm is operating in, say, Germany, where the tax rate can be as high as 40 percent? Establishing a division in a country with a lower rate — Bermuda or Ireland, for example — can offset that 5 percent difference. Such balancing acts are critical to consider before companies move across multiple borders.

Similar questions should be weighed regarding foreign-earned cash. Does the company need its international cash state-side? If not, then the company can defer paying U.S. tax by keeping the earnings offshore. Even if the answer is yes, there may be planning opportunities that maximize tax efficiency. Refinancing U.S. debt to a foreign lender, for example, allows a company to pay down the overseas loan using the foreign money — and defer foreign taxes at the same time.

Think of these foreign expansion tax issues like a giant puzzle that blends the most advantageous pieces of U.S. laws and foreign laws to achieve a company's business and tax objectives.

There are other tax-related challenges to overseas expansion:

Another country's social, cultural and political norms — not to mention language — can cause unforeseen issues. Take, for example, a U.S. firm with operations in

Denmark. To improve its tax situation, the firm might need to shift from an incorporation to a limited liability company. But in Denmark, a company with an LLC in its name lacks prestige, and the local employees will balk. In the United States such a change would be minor, akin to changing your socks. But in Denmark, you're nobody if your socks are not the right color.

The firm may be required to change to an LLC, but not without a strong internal public relations effort.

Employment laws vary dramatically from country to country, with pronounced effects on corporate bottom lines.

Forewarned is forearmed. In France, employees can only work 35 hours a week by law. In China, the government must give the OK to all hiring. And in Germany, the company CEO must meet in a public forum annually with employees to answer any questions.

Doing business in foreign jurisdictions further complicates domestic compliance reporting requirements.

If the finance department is in Boston, how will they ensure accounting integrity at your European or Asian divisions? Many companies satisfy these issues by sending their domestic tax employees to their foreign divisions several times a year.

Put simply, when it comes to foreign taxation, there is no one-size-fits-all solution. The ideal tax structure must be tailored to the specific business goals of each individual company.

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