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If Google Eats Dutch Sandwiches, Can You?

By Robert W. Wood

Reports from Dutch regulatory filings say that Alphabet Inc.'s Google saved $3.6 billion in taxes in 2015 alone by moving $15.5 billion offshore via a so-called Dutch Sandwich. The reports about the $3.6 billion savings--in just one year--aren't flattering. Yet the move is legal and is decades old.

In Google's case, this layering of tax-advantaged companies has been in place since 2004. And Google isn't the only one in Silicon Valley's elite that use it. Facebook flipped more than $700 million to the Cayman Islands as part of a "Double Irish" tax reduction strategy. How do these exotic sounding tax structures work?

Google moved money through Google Netherlands Holdings BV, and then on to a Bermuda 'company.' The filings were reported by the Dutch newspaper Het Financieele Dagblad. Google Netherlands Holdings BV reportedly has no employees, yet Google moves the bulk of its non-U.S. profits through it.

Since 2004, it has been a key part of Google's tax structure known as a "Double Irish" and a "Dutch sandwich." The tax-driven shell game enabled Google to slash its effective tax rate outside the U.S. to 6.4 percent in 2015, according to Alphabet's filings with the SEC. But Google defends its practices.

"Google complies with the tax laws in every country where we operate," a Google spokesman said in a statement. There has long been discussion of the Double Irish and the Dutch Sandwich, and whether they are abusive. The Double Irish involves forming a pair of Irish companies. The idea is to turn payments on intellectual property into tax-deductible royalty payments.

The U.S. parent company forms a subsidiary in Ireland. The parent signs a contract giving European rights to its intangible property to the new company. In return, the new subsidiary agrees to market or promote the products in Europe.

Thus, all the European income—income that previously would have been taxed in the U.S.—is taxed in Ireland instead. Next, the Irish company changes its headquarters to Bermuda. No Irish tax, no Bermuda tax, and no U.S. tax.

Finally, the parent forms a *second* Irish subsidiary that elects to be treated as disregarded under U.S. tax law—by filing a one-page form. The first Irish company (now in Bermuda) can license products to the second Irish company for royalties. The net result is one low 12.5 percent Irish tax compared to 35 percent in the U.S. Even this tax can be reduced, since the royalties going to the Bermuda company are deductible.

Plainly, some of these steps are circuitous, but tax treaties allow them. And the fabled Dutch Sandwich is even more complex. The Dutch Sandwich starts with a Double Irish, and then adds a third subsidiary in the Netherlands. This is Google's model.

Instead of licensing the parent's products directly to the second Irish subsidiary, the Bermuda-based subsidiary grants them to the Dutch subsidiary. That Dutch sub then pays the third subsidiary. Fortunately, Ireland does not tax money as it moves between European countries.

The Netherlands collects a small fee on monies moving from the Netherlands company to the Bermuda subsidiary. In the end, though, there is virtually no tax. It can create a kind of stateless income, that seems ever on the move.

Google and Microsoft have cut their overseas tax rates to single digits by establishing Dublin-registered subsidiaries, which they have designated as tax resident in Bermuda. Google and Apple have Irish-registered and tax resident subsidiaries that make sales to customers. They pay large, tax-deductible royalties to their Bermuda tax-resident affiliates.

In the end, profits wind up in zero-tax jurisdiction. Just how much longer all of this will continue remains to be seen. The OECD advises the G20 on tax and economic policy, and it says existing national tax enforcement regimes just don't work. The OECD doesn't like the situation, and neither does the IRS.

The OECD claims that companies like Apple and Google avoid billions in taxes. Twitter is in the mix too. And as the IRS seeks new ways to pursue "stateless" income, Ireland has its own worries over whether it is effectively enabling tax cheats. The concerns have been brewing for years.

Back in May 2013, the Senate Permanent Subcommittee on Investigations said Apple avoided $9 billion in U.S. taxes in 2012 alone via offshore units with no tax home. Apple's CEO Tim Cook testified it was nothing illegal. But Ireland hates being called a facilitator of tax cheats and says it's pulling up the ladder on tax gimmicks. The Senate claimed Apple saved billions by claiming companies registered in Ireland are not tax resident in any country.

So, can you do any of this on a small scale? Not really, although it is hard not think about it. If Apple, Google, and many other companies stash money offshore, why not us? With Dutch Sandwiches and other devices keeping tax bills in the pennies, how about individuals? The answer is that individuals are subject to quite different rules.

For individuals, the last seven years of IRS crackdowns show that Americans must pay U.S. tax on their worldwide income. Public companies can keep money squirreled away offshore, as a tax-protected hoard. Meanwhile, individuals are paying up to 39.6 percent in federal tax and struggling with global reporting issues.

Individuals better be sure that they declare their worldwide income on their U.S. tax returns. Individuals are even attributed offshore income that is not distributed to them. It makes you want to be a company, especially one of the Fortune 500.

Offshore tax loopholes used by big U.S. corporations cost America $90 billion every year. More than a few big U.S. companies with far-flung operations go to extreme lengths to situate income offshore where it's taxed at a fraction of the U.S. 35 percent corporate tax rate. Can individuals do that? Not hardly.

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