

InternationalTax

A wide world of taxes

As companies go global, so do tax issues >> BY ROGER RUSSELL

As more U.S. firms look toward overseas markets, suppliers or manufacturing facilities, international tax issues have multiplied.

At the same time, international tax is

less understood and more complex than any other area of tax law, according to experts. "One of the greatest challenges we face in tax administration is the rapid pace at which the economy has become global," Barry B. Shott,

deputy commissioner of the Internal Revenue Service's Large and Mid-Size Business Division, told a recent CPA conference. "More than 60 percent of all trade is within

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the international environment.”

That upsurge is seen at the local level as well. “As we’re growing and the Atlanta market grows, we see more of our clients spreading out into other parts of the world,” said Robert Ainsworth, tax manager at HLB Gross Collins PC.

“We’ve experienced a big increase in the firms we do business with,” echoed James Lynch, a CPA and manager at Livingston, N.J.-based Sobel & Co. LLC. He noted that ever-smaller companies are engaging in trade overseas: “Most of our clients are medium-sized, as opposed to large. It’s important for clients to understand the classifications of the manner in which they intend to do business.” For example, he said, “A client that decides to do business in France will experience different tax consequences if they open up a French branch than if they set up a corporation in France.”

Ainsworth advised businesses expanding overseas to plan ahead. “If you don’t, you run the risk of not making the appropriate entity elections. It’s important to choose the correct entity in the foreign country, as well as making the ‘check the box’ election for U.S. tax purposes.”

There are a number of traps

for the unwary, according to Ralf Eschenburg, director of international tax services for CBiz Tax & Advisory Services. “If you have a deal and then go home and draft a contract, you’re viewed as carrying on a trade or business in that foreign jurisdiction. And you have an income tax filing obligation for the company in that country. If you have a filing obligation, you may or may not have a tax obligation there. And since U.S. companies are subject to tax on their worldwide income, you’ll be taxed twice on some of that income.”

“If there’s a tax treaty with the particular country, there’s a higher threshold in the amount of activity or physical presence that will subject you to tax in that country,” he continued. “In a treaty country, you’re not subject to tax unless you have a permanent establishment in the country.”

Other overseas tax traps can involve shipping terms. “Look to the FOB [freight on board] destination,” he said. “If I own the inventory and have risk of loss until goods reach your dock in Vancouver, I’m viewed as selling goods in that country, and therefore I’m doing business and subject to tax. It’s possible to get out of this by changing the shipping terms, and make it FOB the shipping point, so I pass title to

the customer at my dock. A common carrier then ships to the dock in Vancouver.”

Another issue that can arise involves getting the foreign tax credit, particularly in start-up situations. “Profits attributable to a branch will be subject to tax at the corporate income tax rates of a local company,” he said. “Some jurisdictions may not allow you to allocate head office costs to profits of the branch, so that generates greater profit and higher tax in the local [foreign] jurisdiction.”

“In order to claim the foreign tax credit, you have to have taxable income from foreign sources,” he explained. “But when the company just begins, they are likely to have losses in the foreign jurisdiction, since they can’t allocate all their costs there. The company ends up paying tax in the foreign country, but since it has an overall foreign loss under the U.S. method, it doesn’t get a foreign tax credit for the taxes it pays.”

The U.S. company may want to convert the branch to a subsidiary, which raises more issues, he said. He added that only certain foreign entities are eligible or checkable under the “check the box” regime. You also have to be aware of the branch loss recapture rule. “You can have a big income hit in the year

you convert your foreign branch to a foreign subsidiary, so you have to be very careful to calculate the timing of incorporating to avoid the consequences of the branch loss recapture rule.”

EVEN ONE STEP ...

Any taxpayer that has an international transaction has to be concerned, according to David Bukovac, senior director of transfer pricing for CrossBorder, a Thomson Tax & Accounting brand: “Any company can be audited for tax. The company size doesn’t matter as much as the size of the transaction.”

Once a company is involved with related parties overseas, it faces the additional issue of transfer pricing, said Ken Crutchfield, vice president and general manager of CrossBorder. “Transfer pricing refers to the prices established for tangible goods, intangible goods and services exchanged between related parties in different tax jurisdictions,” he explained. “These prices can affect the level of taxable profit recognized in any given tax jurisdiction, so taxing authorities, including the Internal Revenue Service, reserve the right to regulate them. Transfer pricing documentation is necessary to defend transfer prices set by management and demonstrate that these prices are in

line with arm’s-length pricing.”

Another stumbling block for companies expanding into overseas markets is the VAT, or value-added tax, according to Chris Walsh, VAT practice leader at Vertex, a Berwyn, Pa.-based software provider. “If a non-European company sells to consumers in the European Union, it has to register for VAT in the EU, and charge VAT to its EU customers,” he said. “It gets more difficult when the company is selling services, rather than goods. With goods, there’s somebody standing at the other end saying, ‘You have to pay so much,’ but with services, there’s no customs authority to intercept and tell you how much to pay. The taxpayer has to be self-sufficient and self-assessing.”

Walsh advised companies to think very carefully about where they intend to expand and where their potential markets are. “They should get registered for VAT as soon as they can,” he said. “In the VAT system, you charge the tax on sales, but you’re also entitled to a credit on purchases. During initial set-up, you want to be sure you can reclaim the VAT on charges by suppliers. Typically the amount of VAT on your purchases might exceed the VAT on your sales, in which case you’ll be in a refund position.” **AT**