Internationalising Your Business
Look before you leap!

By Siobhan Baldwin

While there are a number of key issues that need to be considered when you are thinking of expanding your operations abroad, be it through acquisition or through organic growth, one of your primary objectives should be to ensure that you have structured your expansion in a tax efficient manner. Although the tax regimes in different jurisdictions can be broadly similar, you always need to ensure that you are fully informed about the jurisdiction into which you are expanding.

Start-up losses

When expanding abroad, you need firstly to establish whether your operations will result in you having to pay tax in the new jurisdiction by virtue of having a tax presence there. If this is the case, the question will arise as to whether you should set up a branch of your existing Irish company, or locate the new operations in a new subsidiary company. Your decision may be influenced by the likelihood of incurring losses in the start-up phase. Losses of a branch can be utilised against profits of the head office company, therefore it may make sense to operate as a branch for the first few years. It is generally possible to claim relief and incorporate a foreign branch into a foreign subsidiary company on a tax free basis at a later date if required.

Business modelling

If you anticipate that your new venture will be profitable from the outset, you should consider which activities you will be carrying on abroad and establish whether there are any opportunities to exploit intellectual property and know-how that you have already built up through your existing operations in Ireland.

Reviewing your business model and taking the appropriate steps can substantially reduce your effective tax rate

The corporation tax rates in most jurisdictions are higher than here and it is important to review your business model. It may be possible to limit the risk that is taken on board by the new entity in order to reduce the amount of the profit that it will earn. For example, if you have set up a distribution company abroad, you should consider whether it needs to be a fully fledged distribution company, or whether there is an opportunity to set it up as a limited risk subsidiary in order to allow for some of the distribution profits to be attributed to the head office Irish company and taxed at the lower Irish corporation tax rate of 12.5%.

In the context of manufacturing activities, it may be possible to set up a new plant abroad and have it manufacturing for the Irish company under a tolling contract. As the tolling company would not take title to the goods, all risks associated with the product would remain with the Irish entity. Under this model it would be appropriate to remunerate the tolling company for its costs and allow it to make a small margin. This would provide the opportunity to attribute more of the profit from the manufacture and sale of the product to Ireland, with significant potential for tax savings.

Reviewing your business model and taking the appropriate steps can substantially reduce your effective tax rate. With the recent introduction of transfer pricing legislation in Ireland, it is important to ensure that the appropriate documentation has been put in place in respect of all trading transactions between connected companies.

Deduction for finance costs

An important consideration will be the availability of a tax deduction for any finance costs incurred to fund

your expansion or acquisitions abroad. In most cases you will want to get a deduction for any interest costs against the profits of your new venture. The rules regarding deductibility of interest costs vary from jurisdiction to jurisdiction and can be very complex.

Some jurisdictions have 'thin capitalisation' rules which require that you have a certain amount of equity invested in your company before you can get a full tax deduction for interest that may be incurred on debt. Other jurisdictions only allow a tax deduction in respect of interest incurred on third party bank debt and do not permit a deduction for interest paid to a related party. Certain jurisdictions don't allow for the group relief of losses between tax resident group companies. It is therefore necessary to establish precisely what interest is deductible and ensure that the financing is structured in the most tax efficient manner.

In some cases when acquisitions are made abroad, a foreign holding company may be set up to borrow in order to purchase shares in the target company. If the interest in the holding company cannot be set against profits of the target subsidiary company by way of group relief, it may be necessary to carry out a merger of two entities in order to ensure the deductibility of the interest expense. In some jurisdictions, care must also be taken to ensure that all regulatory aspects are adhered to.

Repatriation of funds

By planning at the outset and structuring your expansion in the right way, you can avoid incurring unnecessary costs in the future.

Investments abroad should be held by a company operating in an appropriate holding company location. You should ensure that your investment is structured using a location which gives you the ability to reduce or eliminate the rate of withholding taxes applied to interest and dividends on repatriation and also gives the ability to allow for profits be to be repatriated without incurring incremental taxes.

In certain circumstances, it may be necessary to consider inserting an intermediary holding company between Ireland and the jurisdiction into which you are expanding in order to allow for the repatriation of profits back to Ireland with lower withholding tax rates. Many jurisdictions have holding company regimes which provide for 'participation exemption'. This allows profits from operations abroad to be paid back to the holding company without being brought within the charge to tax.

Ultimately, you will need a structure which will allow for the profits made abroad to be repatriated to Ireland without incurring incremental taxes in the process.

VAT & employee liabilities

While VAT and employee tax liabilities should not give rise to a cost for the company, careful planning is always required to ensure that the relevant taxes are operated correctly.

Caution is also required if acquiring a business abroad. A rigorous tax due diligence should ensure that you avoid any unwelcome surprises.

Exit strategy

Before you even consider expanding abroad, you need to think about an exit strategy. Typically, it is possible to structure your investment in such a manner as to allow you to sell without incurring either Irish or foreign capital gains tax on a future sale. If you can structure your investment and allow for a sale at different levels on a tax free basis, it will afford more flexibility in the future.

In addition, if you are a private or family company you will want to structure your expansion or investments abroad so as to protect against an attribution of income or gains back to Irish shareholders. The relevant anti-avoidance provisions can be managed but do need attention at the outset.

Conclusion

In summary, when internationalising your business you should be cautious and plan carefully. You should manage your effective rate by ensuring that profits are generated in low tax jurisdictions whenever possible. You should ensure you get the maximum tax deduction for finance costs. Finally, you want a structure that allows for efficient repatriation of profits back to Ireland and which ensures that you can sell on a tax free basis in the future.

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