GLOBAL EXPANSION
Top Tax Considerations

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Successful international expansion requires careful planning and understanding of the financial risks and benefits associated with doing business in a new country. As with most major growth opportunities, the CFO will be expected to deliver the information and insights that will inform executive decisions throughout the process.

The tax effect of cross-border growth is one of the most significant variables that CFOs must understand and interpret for the leadership team. Doing business in another country doesn't just add another government's laws into the strategic mix — it also adds complexity and strategic opportunities to the company's U.S. tax planning. To create an efficient, streamlined tax profile for the business, you need to lead executives away from the tendency to view U.S. and foreign taxes as two separate issues and toward a global view of the company's tax position.

At the same time, businesses are still trying to fully understand the impact of the Tax Cuts and Jobs Act (TCJA) and multinationals in decades. CFOs are being challenged to navigate the complexities of international growth while also managing tectonic shifts in the U.S. tax landscape. Businesses that adapt quickly to this new reality will gain ground on their competitors, and CFOs who lead the organization through this period of change increase their value as strategic leaders.

TCJA Changes to Taxation of U.S.-Based Multinationals

The TCJA was widely hailed as the most significant package of tax law changes in the U.S. since the Tax Reform Act of 1986. The international provisions in the new law shift the primary focus of U.S. taxation of multinationals from worldwide income to territorial income. (The nonprofit Tax Policy Center has pointed out that the new law maintains a worldwide tax component in its potential annual minimum tax on foreign income.) CFOs at companies considering expansion into new countries need to be familiar with the foreign tax provisions of the new law.

Deemed Repatriation

For some time now, policy experts have argued that the U.S. misses out on significant revenues from multinationals because the tax impact of transferring profits back to the U.S. is prohibitive. The TCJA imposed a one-time tax on pre-2018 income held in offshore subsidiaries controlled by U.S. businesses. The rates are low by corporate tax standards: Cash and other liquid assets are taxed at 15 percent, while noncash assets are taxed at 8 percent. In addition, some credit is allowed for foreign taxes already paid on these assets, and the law permits the payment of this tax in installments over eight years.

This rule has caused an unusual situation related to overpayments and refunds. Any overpayments related to 2017 non-repatriation taxes are neither refundable nor creditable toward 2018 estimates until the transition tax — including installments due through 2025 — is paid in full.

Affected businesses that prepare audited financial statements also need to consider how this change impacts the reconciliation between financial statement income and taxable income.

Global Intangible Low-Taxed Income (GILTI)

The new law allows U.S. corporations a deduction for dividends received from non-U.S. foreign businesses. The GILTI provision attempts to limit abuse of this exclusion between a controlled foreign corporation (CFC) and a U.S. parent. In short, the GILTI provision subjects to U.S. tax in the current year all income of a CFC in excess of 10 percent of the net tax value of its depreciable (i.e., "tangible") assets. The law presumes that any dividends exceeding this percentage must be

derived from intangible assets such as goodwill. This results in annual repatriation of foreign income, preventing U.S.-based multinationals from accumulating wealth offshore.

Foreign-Derived Intangible Income (FDII)

The FDII rules are intended to create an incentive for U.S.-based multinationals to export to other countries. The provision works by calculating a baseline fixed rate of return on business assets — 10 percent on a company's qualified business asset investment (QBAI), or depreciable assets. Income that exceeds the 10-percent-of-QBAI baseline is then analyzed to determine how much is derived from foreign sources. That amount is the taxpayer's FDII for the tax year, and it is taxed at a favorable rate of 13.125 percent in the U.S., as opposed to the regular corporate income tax rate of 21 percent.

Base Erosion and Anti-Abuse Tax (BEAT)

The TCJA's BEAT rules attempt to reduce the permanent shifting of U.S. income to low-tax jurisdictions. The provision, which applies to domestic and foreign corporations with gross receipts averaging more than $500 million over a three-year period, is intended to keep the U.S. in compliance with international efforts to prevent tax avoidance. If a U.S. multinational has income sufficient to trigger this tax, the computation starts with a calculation of BEAT-specific "modified taxable income." Basically, this is the corporation's taxable income for the current year plus otherwise deductible payments made to related foreign persons.

Once modified taxable income is determined, the BEAT is applied at a rate that changes over the life of the provision. BEAT is calculated at 5 percent in 2018, 10 percent from 2019 to 2024, and 12.5 percent beginning in 2025. While BEAT rates are still lower than the U.S. corporate rate, prior to the TCJA this income would not have been subject to any tax in the U.S.

Tax Impact to International Business Decisions

These new provisions are just one part of the complicated global tax landscape. When evaluating expansion into new markets, businesses look to their CFO to identify the key decision points and provide valuable insights to the leadership team. The issues described below are just a few examples of the opportunities available to CFOs looking to step into a leadership role in the international growth process.

Entity Choice

Before a company can begin operations in a foreign country, it needs to decide how it will operate in that country. CFOs need to keep in mind not only tax rates at home and abroad, but also the tax impact of classifications of workers employed in the new country, and the impact of various choices related to the physical and legal structure of the foreign venture.

U.S. tax rates. In addition to the tax effects of transferring money from the foreign jurisdiction back to the U.S., a critical part of the equation to determine the best entity choice for a foreign subsidiary includes the new flat 21 percent corporate income tax rate in the U.S., as well as the new personal income tax brackets and the creation of a 20 percent deduction for income from a pass-through entity.

Hiring choices. For many businesses, the first step toward international operations is simply a person on the ground in a foreign country. If that person qualifies as an "employee" under the laws of the U.S., the foreign country, or both, that status can trigger certain tax and employment law obligations that need to be factored into any calculations of costs and benefits.

One way to limit exposure in this area is to use an independent contractor as your first in-country representative. Relying on contractors can help to minimize tax obligations in the new country, although you still may have information-reporting obligations relating to the worker. This structure also helps to avoid investing in physical infrastructure that can trigger tax liabilities in the new country.

Be sure you understand the rules regarding independent contractor classification in the U.S. and abroad, as misclassifications can result in significant charges for unwithheld taxes and penalties.

The "representative office." Some countries allow an intermediate step between workers in-country and a true physical location. Businesses may be able to avoid tax obligations triggered by a physical presence if they opt for a "representative office." These locations won't trigger tax liabilities if the activities performed there are limited to those permitted under the law, such as market research or liaison activities with the U.S. parent.

Physical presence. If operations in the new country succeed and the company's presence grows, it will eventually reach the point where a physical location is needed. This more substantial footprint in the country may trigger new tax obligations, including but not limited to property taxes on the physical plant and employment taxes if your contractors begin to meet the standards for classification as employees. Depending on the country, your business may also be required to set up and fund some form of pension plan.

When the time arrives to establish a physical presence in a foreign country, CFOs often need to advise the executive team on choosing between opening a "branch" or a "subsidiary." Here's a quick look at some of the key differences:

- A **branch** does not qualify as a separate legal entity because it functions as an extension of the U.S.-based parent company operating directly in the foreign location. This structure offers relative simplicity at formation, but the downsides include subjecting the parent to taxation in the local jurisdiction as well as the risk and liabilities of operations in the branch office. If the growth trend that is causing you to consider a physical presence in the first place is expected to continue, a subsidiary is probably your preferred structure. (However, the transition from a branch to a subsidiary is relatively easy and typically tax free, with the possible exception of U.S. "recapture" of branch losses.)
- A **subsidiary** can more effectively protect the U.S. parent from liability issues in the new country. However, the business may spend additional time and money dealing with infrastructure issues, and some countries impose a statutory audit requirement on businesses operating as subsidiaries.

The bottom line: CFOs studying options for an international expansion should focus on alternatives that allow the business flexibility to support growth as operations succeed.

Mobile Workforce Issues

CFOs who manage international expansions face a variety of human resource considerations when deciding how to staff new or growing operations in a foreign country. We'll cover some of the tax implications at a high level here, but issues such as immigration, residency and work permits all factor into the evaluation process.

U.S. businesses expanding into foreign countries have three basic options for staffing the new venture:

- U.S.-based staff maintaining a virtual presence in the foreign country
- U.S.-based staff temporarily transferred into the foreign country
- Local staff hired in-country

Of the three, the temporary transfer of U.S. staff seems to be the most popular among expanding businesses. The tax effects of the transfer are generally governed by treaties maintained between the U.S. and the host country. In most cases, those treaties don't impose significant tax

obligations on the business or the employee unless the person spends more than six months out of the year there.

Companies that plan to send employees outside of the U.S. on these types of assignments should consider the following:

- Be clear on the specifics. Define the terms and length of the assignment in writing in order to simplify tax planning at home and abroad.
- Watch the time. Keep the assignments as short as possible and track the number of days in-country carefully. Even one day beyond a statutory limit can trigger significant tax headaches for the employee and the employer.
- Pay relocation costs directly to providers. Whenever possible, pay reimbursable moving expenses directly to movers and other service providers. Expenses reimbursed to the employee may necessitate additional recordkeeping, and the payments may be taxable income to the individual in some countries.

Companies that plan to have staff travel from the foreign country to the U.S. should consider the following:

- Manage visa status to limit tax consequences. Keep assignees on temporary L-1 or intracompany transfer visas to reduce the number who qualify for green card status, as that status triggers additional tax obligations for the employer.
- Plan compensation to manage foreign duties. Determine if assignees will face any significant foreign tax consequences as a result of their time in the U.S., such as deferred compensation. If appropriate, manage the timing of bonuses or performance awards to minimize their tax impact.
- Review tax equalization options. Consider reimbursement agreements with your employees that equalize the burden of taxes. For example, your company might want to reimburse the employee for the amount of taxes that are greater than the amount they would have paid had they remained in their home country.

The bottom line: Planning is essential when staffing foreign operations. The company should have an international assignment policy that spells out how it will manage employment tax obligations, an international assignment letter template, and a tax reimbursement policy that manages the tax consequences for the employer and employee.

Transfer Pricing

Multinational companies must implement transfer pricing policies for nearly all cross-border transactions, including the moving of inventory, the providing of services, licensing, lending and more.

If your company already has international operations and a documented transfer pricing policy, you may want to review the division of work between the U.S. and other countries in light of the lower corporate rates enacted by the TCJA. Depending on what you transfer between countries, the changes might make it worth the effort to redistribute the processes and related costs among the jurisdictions in which you operate.

In order to comply with transfer pricing rules, you will need to document those related-party transactions from the moment operations begin on foreign soil. The following steps should be taken to implement and maintain a transfer pricing policy that complies with international rules:

- Benchmark related-party transactions. Hire an economist to complete an analysis of comparable third-party transactions and recommend what pricing should be assigned to your company's cross-border related-party transfers.
- Document the policy. IRS rules require that the final methodology chosen for specific transfer pricing is the "best available" method for any given related-party transaction. Companies meet this requirement by providing documentation that they are, in fact, using the best possible methodology.
- Draft the intercompany agreement. The agreement should be written to address the arm's-length standard, which states that prices for related-party transfers should be the same as the price between unrelated parties on the open market. It should specify what goods, services, etc., will be transferred between the parties and the pricing that will apply.
- Implement the policy. Create internal accounting policies and invoicing procedures between the related parties to make sure that your processes match those described in the intercompany agreement.
- Monitor and update. Once pricing is established, it will need to be reviewed and revised over time to reflect changes in the broader market.

The bottom line: When a business expands operations into a new country, the CFO needs to invest significant time and resources into the creation of a new transfer pricing policy. If the policy is implemented properly at the outset, its ongoing operation will be significantly less of a burden to the business.

A Leadership Resource During Global Expansion

International expansion can be an exciting prospect for a business. The executive leadership team counts on the CFO to remain attentive and analytical when it comes to evaluating the risks and rewards associated with setting up a new legal entity, workforce and transfer pricing policy. The CFO's contribution to these strategic decisions will help to position the company for continued growth in the new endeavor.

At Armanino, our experts work closely with CFOs, as well as their legal and tax advisors, to ensure that their company implements an international expansion strategy that benefits the business, creates a streamlined global tax profile, and supports the achievement of short- and long-term growth goals. For more information on global expansion best practices, send us a note at info@armaninoLLP.com and we'll connect you with one of our international tax experts.