Practical aspects of structuring a multinational

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Introduction

Tax is an important factor for any multinational corporation (MNC) and is critical to the issue of shareholder return. As a result, the tax strategy adopted by an MNC has traditionally been quite one-dimensional. Recently, as the global economy has modernised and jurisdictions attempt to attract business with competitive tax regimes, structuring MNCs has become much more complex.

Although managing the effective rate of tax (ERT) is a priority, there must be personnel in each jurisdiction with the skills and experience to carry out the day-to-day management. Without focussing on such practical considerations, "mind and management" would not be present in the desired jurisdiction creating unwanted tax exposures. Gone are the days of brass-plate companies; substance over form is a well-entrenched doctrine of international tax.

Managing ERT

Basic commercial issues aside, it cannot be ignored that managing global ERT is critical to optimising shareholder return. To this end, the transfer pricing policy of the MNC is as pivotal as the locations selected for financing, intellectual property management and purchasing functions. Likewise, identifying jurisdictions with favourable tax regimes, rates, capital expenditure regulations and other investment incentives play an important role. In addition, reputational risk will invariably be high on the tax policy agenda as Starbucks, IKEA, Google, Facebook and many others have only recently found out.

For instance, the Netherlands is the original international headquarters jurisdiction of choice, having designed its corporate tax system particularly for MNC use. It offers a range of tax incentives for holding companies, finance and treasury functions, intellectual property management and other benefits. This model has not, unsurprisingly, been widely emulated, particularly across Europe where tax competition is fierce. Luxembourg has an equally attractive tax system and flexible ruling policy coupled with the reputational cache that the likes of Cyprus and Malta are striving for.

The UK has also taken great steps to modernise its tax system - the most recent development being the wholesale rewrite of the Controlled Foreign Company (CFC) regime. Most developed jurisdictions have specific CFC rules to prevent the sheltering of profits in low tax/no tax jurisdictions. However, this has caused considerable problems (see Cadbury Schweppes and Vodafone for example) with domestic anti-avoidance rules often drafted well before globalisation as we now understand it.

Another critical consideration in managing global ERT is the withholding tax exposure on dividends, interest, royalties and business profits. In this regard application of double tax agreements (DTA) and EU Directives provide significant opportunity.

Further, the way in which a MNC finances its local operations also has a significant impact on its tax footprint. Invariably, funding with debt rather than equity will be the preferred option and in some instances the use of hybrid debt will allow a double dip (deduction in the paying state but exemption in the recipient). Such arrangements will, however, need to be carefully considered from a tax risk and reputational standpoint.

That said, there has been a tightening of rules across Europe limiting interest deductibility on intra-group financing. For instance, France has recently proposed new changes that restrict the ability of a French tax resident company to deduct more than 85% of net financial expenses. Germany too has introduced a bill limiting interest deductibility (although the original proposal that net interest expenses would be deductible to the extent that they do not exceed 30% of the result of business, plus interest expenses etc) has been watered down.

The paradox of all of this for high tax jurisdictions is that a balance has to be struck between erosion of the tax base on the one hand and on the other the attraction of foreign business. An example of this is the growing number of patent box regimes in and around Europe; the fact that the UK has jumped on the bandwagon speaks volumes not so much in terms of the businesses it is seeking to attract but the businesses it is seeking to stop from relocating potentially hugely profitable functions overseas.

Managing the business

While it is undoubtedly critical to manage ERT in a way that optimises shareholder return, the global economy has changed considerably from a one-dimensional approach of looking at a MNC's best tax strategy. The economy and local laws have changed to such an extent that the substance takes significant priority over form. As a result, without having personnel or management (in the least) in the chosen jurisdiction, the authorities can look behind the structure and ascertain its true place of management elsewhere.

On a practical level therefore, geographical location, visa requirements, travel and transport links, language barriers and living costs are essential factors as to whether a certain jurisdiction is appropriate. Take Geneva, for example; as the regime for non-doms in the UK has slowly been eroded, Geneva has positioned itself as the go-to jurisdiction of choice for hedge fund managers, commodity traders and so on. However, the costs of living in Geneva and the ability to recruit or relocate staff there should not be underestimated, nor should the difference in business culture.

Conclusion

The success of any tax strategy and structuring of an MNC (while bearing in mind the important aspects of managing ERT) now boils down to whether the business can be practically run on a day-to-day basis. In a global economy where there is such increased flexibility to travel and reduced trade barriers, there are significantly more aspects to consider which make an attractive jurisdiction for an MNC.

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