IBM Uses Dutch Tax Haven to Boost Profits as Sales Slide

by Alex Barinka and Jesse Drucker
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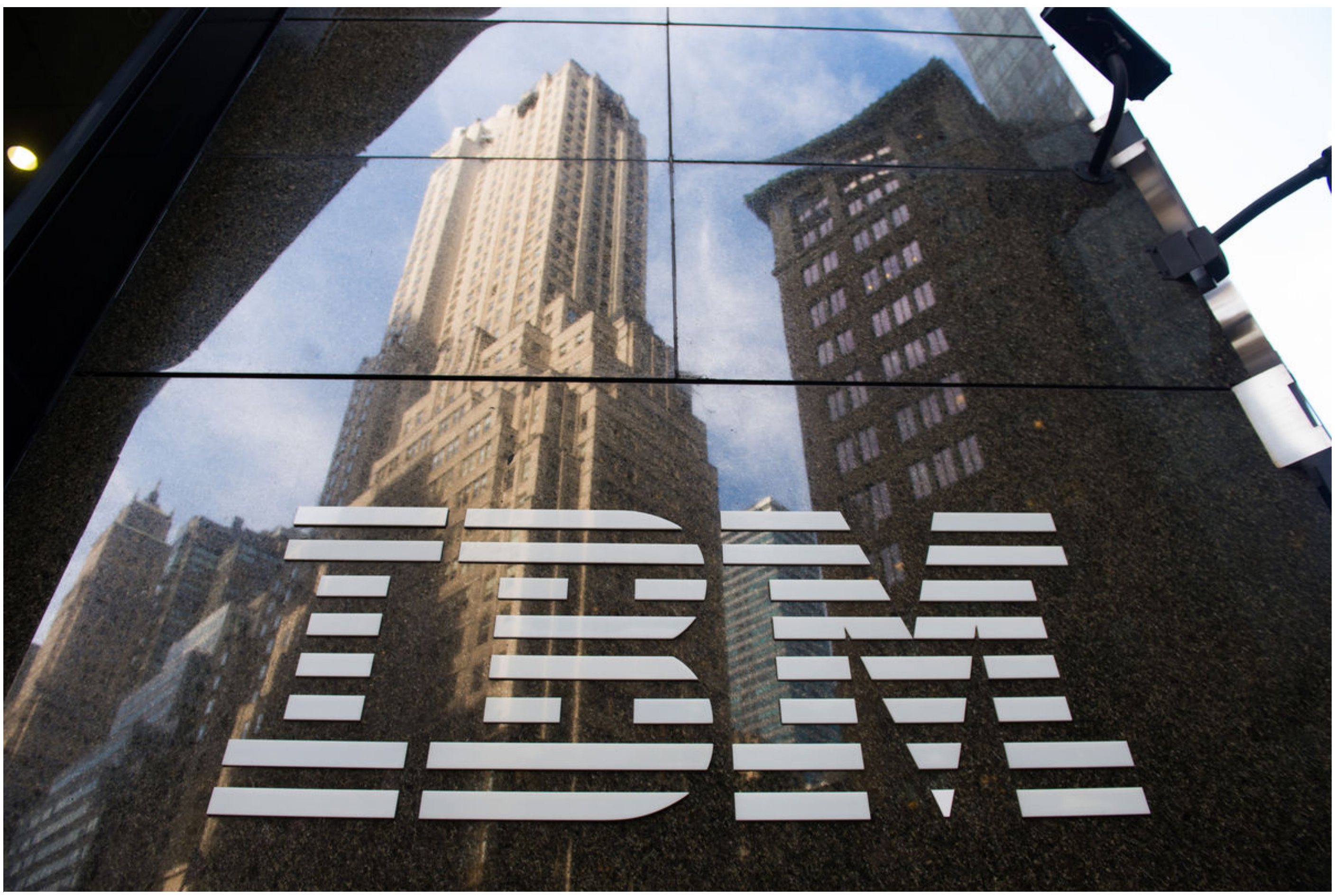

The International Business Machines Corp. (IBM) logo is displayed in front of the company's offices in New York. Photographer: Craig Warga/Bloomberg

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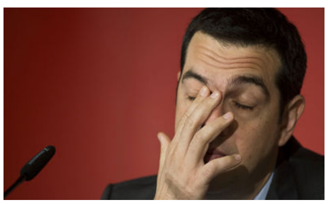

What Is the Worst-Case Scenario for Greece?

Feb. 4 (Bloomberg) -- International Business Machines Corp. has reduced its tax rate to a two-decade low with help from a tax strategy that sends profits through a Dutch subsidiary.

The approach, which involves routing almost all sales in Europe, the Middle East, Africa, Asia and some of the Americas through the Netherlands unit, helped IBM as it gradually reduced its tax rate over 20 years at the same time pretax income quadrupled. Then last year, the rate slid to the lowest level since at least 1994, lifting earnings above analysts' estimates.

IBM is aiming for $20 a share in adjusted earnings by 2015, up from $11.67 in 2010 -- a goal made more difficult as the company posted seven straight quarters of declining revenue. To stay on target, IBM has bought back shares, sold assets, and fired and furloughed workers. A less prominent though vital role is played by its subsidiary in the Netherlands, one of the most important havens for multinational companies looking for ways to legally reduce their tax rates.

"They've got a lot of ways to beat earnings and they definitely take advantage of it," said Josh

Olson, an analyst at Edward Jones & Co. “It’s part of how IBM operates.”

IBM ended 2013 with a tax provision $1.84 billion lower than it initially projected, thanks to a tax rate of 15.6 percent -- compared with its forecast of 25 percent. Without the lower rate, the company’s earnings per share would have fallen from the previous year instead of rising, and net income would have missed analysts’ estimates by about 14 percent instead of 2.9 percent, according to data compiled by Bloomberg.

Michael Fay, a spokesman for Armonk, New York-based IBM, declined to comment on the company’s tax structure.

Dutch Approach

Attracted by the Netherlands’ policies and extensive network of tax treaties, IBM joins companies such as Yahoo! Inc., Google Inc. and Cisco Systems Inc. that have used Dutch subsidiaries to cut taxes.

Offshore tax strategies like the one used by IBM are coming under increased scrutiny. In the past year, the tax-avoidance techniques of companies including Apple Inc., Google and Amazon.com Inc. have been the subject of U.S. Senate and U.K. Parliament hearings. Meanwhile, the Organization for Economic Cooperation and Development, a government-funded think tank, is developing a plan to fight so-called profit-shifting at the direction of the Group of 20 nations.

IBM International Group BV was incorporated under Dutch laws in 1999, according to filings in the Netherlands. The subsidiary acts as a holding company for more than 40 IBM-owned companies worldwide, including its operations in Ireland, a corporate tax haven where IBM has thousands of employees. The Dutch group had three employees in 2008, a number that has since swelled to about 205,000 as of the end of 2012 -- only 2 percent of whom actually work in the Netherlands. IBM overall has about 430,000 workers worldwide.

Offshore Profits

As of the end of 2012 -- the latest year for which filings are available -- IBM had accumulated $44.4 billion of offshore profits on which it hasn't paid U.S. taxes, the sixth-highest total of any American company, according to data compiled by Bloomberg from securities filings. Since IBM International Group's incorporation, its parent company's tax rate has fallen in 12 of the past 14 years.

"No company is better than IBM at managing their annual effective tax rate," said Ed Outslay, an accounting professor at Michigan State University.

The lower costs have helped IBM free up funds for its $65 billion in share repurchases since 2010. By reducing the amount of stock in circulation, the buybacks increase earnings per share -- even when revenue is falling.

Cloud Stumbles

IBM has stumbled during the technology industry's transition to the cloud, where information is stored online instead of onsite. While the company's sales from cloud services are growing, the trend has spawned a new crop of competitors and eroded demand for traditional hardware and services.

Even as that technological shift affects the business, Chief Executive Officer Ginni Rometty has stuck with IBM's profit goals. To stay on track for her $20-a-share earnings target, the company spent $1 billion last year to restructure its workforce -- shedding 3,300 employees in the U.S. and Canada, according to employee group Alliance@IBM. It also sold businesses, getting $505 million for a customer-service unit last month and agreeing to let Lenovo Group Ltd. buy its low-end server business this year for $2.3 billion.

Last year's tax rate was lower than expected partly because of a "more favorable expected geographic mix" of earnings, the company said in an October filing. The company declined to provide further details. In the last three months of the year, an audit of IBM's U.S. taxes from 2008 to 2010 went in the company's favor, helping reduce the rate to 11.2 percent, the lowest for any quarter since at least 1994. A retroactive 2012 U.S. tax credit for research and development also helped cut the rate last year.

Saving Billions

From 2010 to 2012, IBM attributed $34.1 billion of its pretax income to its non-U.S. operations, according to the most recent data from tax footnotes in the company's annual reports. During that period, IBM consistently cut about a third off its tax rate as a result of those overseas earnings, saving about $6.5 billion compared to what it would have reported if all its earnings had been in the U.S. The company's effective tax rate of 15.6 percent in 2013 was down from 28 percent in 2007.

"They have always looked at the tax rate as a potential lever to drive earnings growth," David Grossman, an analyst with Stifel Nicolaus & Co., said in an interview.

Even with the cost cuts, IBM hasn't been able to convince some investors to hold onto its shares. The stock was the only member of the Dow Jones Industrial Average to decline in 2013, and it trailed the Standard & Poor's 500 Index by 32 percentage points.

Selling Off

Walter Todd, a chief investment officer who oversees about $960 million for Greenwood Capital Associates LLC, said his firm sold all of its holdings after IBM's 2013 third-quarter earnings report.

"We were concerned about the revenue growth slowing," Todd said. "You see this a lot of times with these big companies -- there are a lot of ways to manage earnings."

IBM has said it doesn't expect its tax rate to stay at last year's lows, meaning it will probably have to find other ways to keep expanding profits. The company has forecast a 2014 tax rate of 23 percent -- 7.4 percentage points higher than where it ended up last year -- though it's possible other unforeseen items could affect the number, Chief Financial Officer Martin Schroeter said last month.

‘Increasingly Strained’

Revenue growth would help. IBM is increasing its bet on cloud services with a plan to invest $1.2 billion in its SoftLayer Technologies Inc. network-infrastructure business. The company is also spending $1 billion to build a new division around its Watson supercomputer, which can analyze large volumes of data and answer questions in conversational language.

It’s becoming more difficult to find other areas where IBM can cut costs, making it hard to see how IBM can meet its earnings targets, Toni Sacconaghi, an analyst at Sanford C. Bernstein & Co., said in a note to investors.

“The model is increasingly strained,” he said. “IBM risks being tethered to its road map to the detriment of its longer-term financial health.”

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TECHNOLOGY: COMPANIES

‘Dutch sandwich’ grows as Google shifts €8.8 billion to Bermuda

Vanessa Houlder
Thursday, 10 Oct 2013 | 9:06 PM ET

Getty Images

Google

Google funneled €8.8 billion ($12 billion) of royalty payments to Bermuda last year, a quarter more than in 2011, underlining the rapid expansion of a strategy that has saved the U.S. internet group billions of dollars in tax.

By routing royalty payments to Bermuda, Google reduces its overseas tax rate to about five percent, less than half the rate in already low-tax Ireland, where it books most of its international sales.

The figures were revealed in the latest filings by one of Google's Dutch subsidiaries, and means that royalty payments made to Bermuda – where the company holds its non-U.S. intellectual property – have doubled over the past three years. This increase reflects the rapid growth of Google's global business.

(*Read more:* Google pays $55 million tax in Britain on 2012 sales of $5 billion)

The company has been at the center of the international controversy over corporate tax avoidance because it earns "substantially all" its foreign income in Ireland and pays relatively little tax in the countries where its customers are based.

Mapping Google's Future

Thursday, 3 October 2013 | 9:00 PDT | 04:52

Google has transcended its search engine beginnings and is now fully integrated in our everyday life, from our cell phones to our glasses. Maria talks with Google Executive Chairman Eric Schmidt on constantly innovating, technology's impact on the broader economy and why mobile devices are changing everything.

It has also faced criticism for its use of a "double Irish" structure that exploits differences between the U.S. and Irish tax codes to move the profits from Ireland to Bermuda. It also routes the profits through the Netherlands to avoid withholding taxes, using a structure known as a "Dutch sandwich". Google declined to comment.

Revelations about Google's tax planning have stoked widespread public anger, prompting politicians to launch an international crackdown on corporate profit shifting. The problems raised by digital companies is one of the central issues being addressed by the initiative launched by the G20 group of leading economies this summer.

In principle, multinationals such as Google that pay relatively little tax overseas will face big bills in the U.S. when they bring their earnings back to the U.S. But Google has not provided for extra U.S. tax because it intends to permanently reinvest $33 billion of offshore profits outside the U.S.\

(*Read more:* Bono defends Ireland's low taxes)

The new figures come from the accounts of Google Netherlands Holdings, which represents the "Dutch sandwich" part of the tax structure. It received €8.6 billion in royalties from Google Ireland Ltd and €232.8 million in royalties from Google's Singapore operation. All but €10.4 million of this was paid out to Google Ireland Holdings, a company that is incorporated in Ireland but controlled in Bermuda.

Differences between the Irish and U.S. tax codes mean that this dual-resident company is viewed as Irish for U.S. tax purposes but Bermudan for Irish purposes. It acquired much of Google's intellectual property in 2003, which it licensed to Google Ireland Ltd, a Dublin-based business that is at the heart of its global operation. The business, which employed 2,199 people last year, paid €17 million in Irish corporation tax, having reported pre-tax profits of €153.9 on turnover of €15.5 billion.

More from Financial Times:

Google UK paid £11.2m in corporate tax
Google and Facebook face tougher EU tax and privacy rules
Google accused of devious and unethical tax behaviour

Google's U.K. operation, which provides marketing services to the Irish affiliate, paid £11.5 million in corporate tax in 2012, nearly double the bill for 2011 but far less than many MPs and other critics believe it should have paid. The U.K. is Google's second-biggest market, responsible for almost 10 percent of its sales, or almost $4.9 billion last year.

In a stormy parliamentary hearing earlier this year, Margaret Hodge, chair of the Public Accounts Committee denounced Google as "evil" and accused it of "devious, calculating and unethical" behavior by booking sales in Ireland. But Google said this was an unfair representation of the way it operated in which sales activity took place in Britain but only the Irish business had the right to close the transaction.

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Technology

The Tax Haven That's Saving Google Billions

By Jesse Drucker October 21, 2010

The heart of Google's (GOOG) international operations is a silvery glass office building in central Dublin, a block from the city's Grand Canal. In 2009 the office, which houses roughly 2,000 Google employees, was credited with 88 percent of the search juggernaut's $12.5 billion in sales outside the U.S. Most of the profits, however, went to the tax haven of Bermuda.

To reduce its overseas tax bill, Google uses a complicated legal structure that has saved it $3.1 billion since 2007 and boosted last year's overall earnings by 26 percent. While many multinationals use similar structures, Google has managed to lower its overseas tax rate more than its peers in the technology sector. Its rate since 2007 has been 2.4 percent. According to company disclosures, Apple (AAPL), Oracle (ORCL), Microsoft (MSFT), and IBM (IBM)—which together with Google make up the top five technology companies by market capitalization—reported tax rates between 4.5 percent and 25.8 percent on their overseas earnings from 2007 to 2009. "It's remarkable that Google's effective rate is that low," says Martin A. Sullivan, a tax economist who formerly worked for the U.S. Treasury Dept. "This company operates throughout the world mostly in high-tax countries where the average corporate rate is well over 20 percent." The corporate tax rate in the U.K., Google's second-largest market after the U.S., is 28 percent.

In Bermuda there's no corporate income tax at all. Google's profits travel to the island's white sands via a convoluted route known to tax lawyers as the "Double Irish" and the "Dutch Sandwich." In Google's case, it generally works like this: When a company in Europe, the Middle East, or Africa purchases a search ad through Google, it sends the money to Google Ireland. The Irish government taxes corporate profits at 12.5 percent, but Google mostly escapes that tax because its earnings don't stay in the Dublin office, which reported a pretax profit of less than 1 percent of revenues in 2008.

Irish law makes it difficult for Google to send the money directly to Bermuda without incurring a large tax hit, so the payment makes a brief detour through the Netherlands, since Ireland doesn't tax certain payments to companies in other European Union states. Once the money is in the Netherlands, Google can take advantage of generous Dutch tax laws. Its subsidiary there, Google Netherlands Holdings, is just a shell (it has no employees) and passes on about 99.8 percent of what it collects to Bermuda. (The subsidiary managed in Bermuda is technically an Irish company, hence the "Double Irish" nickname.)

Transfer Pricing

All of these arrangements are legal. "Google's practices are very similar to those at countless other global companies operating across a wide range of industries," says Jane Penner, a company spokeswoman who declined to address the particulars of Google's tax strategies. Irving H. Plotkin, a senior managing director at PricewaterhouseCoopers' national tax practice in Boston, says that "a company's obligation to its shareholders is to try to minimize its taxes and all costs, but to do so legally."

The setup lowers Google's overseas tax bill, but it also affects U.S. tax revenues as the government struggles to close a projected $1.4 trillion budget gap. Google Ireland licenses its search and advertising technology from Google headquarters in Mountain View, Calif. The licensing agreement allows Google to attribute its overseas profits to its Irish operations instead of the U.S., where most of the technology was developed. The subsidiary is supposed to pay an "arm's length" price for the rights, or the same amount an unrelated company would. Yet because licensing fees from the Irish subsidiary generate income that is taxed at 35 percent, one of the highest corporate rates in the world, Google has an incentive to set the licensing price as low as possible. The effect is to shift some of its profits overseas in an arrangement known as "transfer pricing."

This, too, is legal. In 2006 the IRS approved Google's transfer pricing arrangements, which began in 2003, according to Google's SEC disclosures.

Transfer pricing arrangements are popular with technology and pharmaceutical companies in particular because they rely on intellectual property, which is easily transportable across borders. Facebook is preparing a structure similar to Google's that will send earnings from Ireland to the Cayman Islands, according to company filings and a person familiar with the arrangement. Microsoft and Forest Laboratories (FRX), maker of the blockbuster antidepressant Lexapro, have used a similar Irish-Bermuda transfer pricing arrangement. Facebook, Forest, and Microsoft declined to comment.

Ethical Questions

Even if the tax avoidance structures are legal, not everyone considers them ethical. Google is "flying a banner of doing no evil, and then they're perpetrating evil under our noses," says Abraham J. Briloff, a professor emeritus of accounting at Baruch College who has examined Google's tax disclosures. "Who is it that paid for the underlying concept on which they built these billions of dollars of revenues? It was paid for by the United States citizenry," Briloff says, referring to the fact that Google's initial technology was based in part on research done at Stanford University and funded by the National Science Foundation. Profit-shifting arrangements such as Google's cost the U.S. government as much as $60 billion in annual revenue, according to Kimberly A. Clausing, an economics professor at Reed College in Portland, Ore.

The government has made halting steps to change the rules that let multinationals shift income overseas. In 2009 the Treasury Dept. proposed levying taxes on certain payments between U.S. companies' foreign subsidiaries, potentially including Google's transfers from Ireland to Bermuda. The idea was dropped after Congress and Treasury officials were lobbied by companies including General Electric (GE), Hewlett-Packard (HPQ), and Starbucks (SBUX), according to federal disclosures compiled by the nonprofit Center for Responsive Politics. In February the Obama Administration proposed measures to curb companies' ability to shift profits offshore, but they've largely stalled.

"The system is broken, and I think it needs to be scrapped," says Reuven S. Avi-Yonah, director of the international tax program at the University of Michigan Law School. "Companies are getting away with murder."

The bottom line: *Google has built a complicated international structure that sends most of its overseas profits to the tax haven of Bermuda.*

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Drucker is a reporter-at-large for Bloomberg News.

Yahoo, Dell Swell Netherlands' $13 Trillion Tax Haven

by Jesse Drucker
9:01 PM PST
January 22, 2013

Jan. 23 (Bloomberg) -- Inside Reindert Dooves's home, a 17th-century, three-story converted warehouse along the Zaan canal in suburban Amsterdam, a 21st-century Internet giant is avoiding taxes.

The bookkeeper's home office doubles as the headquarters for a Yahoo! Inc. offshore unit. Through this sun-filled, white-walled room, Yahoo has taken advantage of the law to quietly funnel hundreds of millions of dollars in global profits to island subsidiaries, cutting its worldwide tax bill.

The Yahoo arrangement illustrates that the Netherlands, in the heart of a continent better known for social welfare than corporate welfare, has emerged as one of the most important tax havens for multinational companies. Now, as a deficit-strapped Europe raises retirement ages and taxes on the working class, the Netherlands' role as a $13 trillion relay station on the global tax-avoiding network is prompting a backlash.

The Dutch Parliament is scheduled to debate the fairness of its tax system today. Lawmakers from several parties, including members of the country's governing coalition, say they want to remove a stain on the nation's reputation.

"We should not be a tax haven," said Ed Groot, a parliament member from the Labour Party, which along with the People's Party for Freedom and Democracy took power in November. Both ruling parties are "fed up with these so called PO Box companies," he said. "If they go somewhere else we are not sorry at all because they spoil the name of Holland. Otherwise you can wait for retaliation measures and this we don't want."

War Declaration

Last month, the European Commission, the European Union's executive body, declared a war on tax avoidance and evasion, which it said costs the EU 1 trillion euros a year. The commission advised member states -- including the Netherlands -- to create tax-haven blacklists and adopt anti-abuse rules. It also recommended reforms that could undermine the lure of the Netherlands, and hurt a spinoff industry that has mushroomed in and around Amsterdam to abet tax avoidance.

Attracted by the Netherlands' lenient policies and extensive network of tax treaties, companies such as Yahoo, Google Inc., Merck & Co. and Dell Inc. have moved profits through the country. Using techniques with nicknames such as the "Dutch Sandwich," multinational the country. Using techniques with nicknames such as the "Dutch Sandwich," multinational companies routed 10.2 trillion euros in 2010 through 14,300 Dutch "special financial units," according to the Dutch Central Bank. Such units often only exist on paper, as is allowed by law.

'Harmful Role'

The EU's 27 member states had accumulated an annual 519.5 billion euro budget deficit as of the second quarter of 2012, according to Eurostat. In response, Spain is slashing teacher salaries and Greece is cutting funding for public hospitals and prescription drugs. The Netherlands had a deficit of 24.9 billion euros.

"Governments around the world have to cut budgets and at the same time multinational companies are avoiding taxes," said Arnold Merkies, a Dutch parliament member from the Socialist Party.

Merkies recently sent questions to the state secretary for finance about the Netherlands' role in enabling a tax-avoidance strategy used by Google, after Bloomberg News reported in December that the company had funneled almost $10 billion through a Dutch shell company en route to Bermuda in 2011. The move cut the company's worldwide tax bill by $2 billion that year.

"We connect the tax havens here," Merkies said. "We have a harmful role in the world and have a responsibility toward the rest of the world."

OECD Proposal

Profit shifting into tax havens by corporations costs the U.S. $90 billion a year, according to Kimberly Clausing, an economics professor at Reed College in Portland, Oregon. The U.S. faces a projected budget deficit of almost $1 trillion in fiscal 2013.

The Paris-based Organization for Economic Cooperation and Development -- which sets standards for how multinational companies allocate taxable income around the world -- is standards for how multinational companies allocate taxable income around the world -- is also tackling the issue. It's discussing a proposal that could make it harder for companies to move profits through the Netherlands into island tax havens.

Anger over corporate tax avoidance is spreading throughout Europe. On Jan. 31, the U.K. Parliament is scheduled to hold its second hearing on the issue. At a November hearing, members of Parliament quizzed executives from Google and Starbucks Corp. about their use of Netherlands subsidiaries to cut taxes.

'Applicable Taxes'

Yahoo's offshore operations cut its taxes by $42.8 million in 2011, U.S. securities filings show. Last February, the company reported a dispute with the U.S. Internal Revenue Service regarding its overseas arrangements. It didn't disclose the amount at stake.

"Yahoo! pays all applicable taxes in every jurisdiction where we operate," said Sara Gorman, a spokeswoman for the company, based in Sunnyvale, California. She didn't respond to a detailed list of questions about Yahoo's Dutch tax-cutting arrangements.

By routing profits through the Netherlands en route to island havens, companies receive an important benefit: They generally don't have to pay taxes on payments leaving or entering the country.

Technology and pharmaceutical companies often seek to reduce their tax bills by paying royalties to license patent rights from offshore subsidiaries.

Withholding Tax

Such transactions could incur a cost: many developed nations impose a withholding tax -- sometimes as high as 33 percent -- on royalties leaving for zero-tax locales with which they don't have tax treaties, such as Bermuda and the Cayman Islands. By contrast, the Netherlands doesn't impose withholding taxes on royalties leaving the country, regardless of their destination.

their destination.

Countries often either eliminate or reduce those taxes when such payments head to a treaty partner. The extensive Dutch treaty network thus protects payments on the way into the country as well.

The Netherlands' role in facilitating tax avoidance began in force in the late 1970s, when it started so-called advance-pricing agreements to attract multinational companies, said Francis Weyzig, chair of Tax Justice Network Europe, who is finishing a Ph.D. thesis at Radboud University on Dutch tax policy.

Under such agreements, multinational companies agree to leave a tiny amount of income in the Netherlands to be taxed in exchange for being permitted to route profits through the country. This remainder left for the revenue authorities in the Netherlands is known to tax planners as "the Dutch Turn."

'All Upfront'

Yahoo, for instance, has an agreement to pay taxes equal to about 1.35 percent of the unit's total revenue, said the soft-spoken Dooves, who has run the Yahoo unit since 2007. He previously worked as treasurer for a Dutch packaging company for almost 15 years.

"The benefit of the Netherlands is that you know all upfront," Dooves said in his high-ceilinged home office in the town of Koog aan de Zaan, overlooking a placid commercial street with a scooter store, bakery and Thai restaurant.

Records show that the Yahoo unit reported Dutch income taxes in 2009 of 1.28 million euros -- out of the 101.5 million euros in royalties it funneled through the subsidiary that year.

That's a small price to pay. In return, Yahoo can move profits to virtually any destination without paying a withholding tax.

Nothing Illegal

Tax avoidance has fostered a sizable industry in the Netherlands of so-called trust firms, generating about 1 billion euros in annual tax revenues and about 3,500 jobs, according to a 2009 study by SEO Economic Research. Local companies such as Intertrust Group Holding SA and TMF Group set up high-priced mailboxes for multinational companies, often by providing them with an address at their gleaming, high-rise office buildings near the Amstel River and Amsterdam's massive soccer arena. Trust firms also provide non tax-related services, such as bookkeeping and payroll administration.

Jan Reint de Vos van Steenwijk, managing director of TMF Holding BV, said he expects the Dutch government to wait until the release this spring of a research report on the economic impact of the corporate services industry before taking any action.

"The benefits to Holland are employment, high-level tax advisers," said Jos Peters, tax director for Merlyn Tax Solutions & Royalty Conduit Services in Rotterdam. "They come to us and why should we refuse this? We are not doing anything illegal or immoral."

Blackstone Purchase

In December, Blackstone Group LP, the New York-based private equity giant, announced it would buy one of the biggest such firms, Intertrust, for $833 million, according to a person with knowledge of the deal.

Merck, the maker of diabetes drug Januvia and asthma treatment Singulair, lists 54 subsidiaries in the Netherlands. From 2002 to 2010 the company routed more than 7 billion euros in royalties, mostly from European sales, to Bermuda via an Amsterdam subsidiary called Crosswinds BV.

The unit -- which had no employees -- was named Crosswinds to conjure the image of royalties crossing in and out "like wind blowing," said a person familiar with the matter.

In late 2010, after Merck acquired Schering Plough Corp., it stopped using Crosswinds to route royalties. Merck cut $1.9 billion off its tax bill that year because of its offshore arrangements, securities filings show.

Ronald Rogers, a spokesman for Merck, based in Whitehouse Station, New Jersey, declined to discuss its tax strategies.

"Merck files its income tax returns in accordance with all applicable laws and regulations," Rogers said.

Double Non-Taxation

One purpose of tax treaties is to prevent companies from paying tax twice in two different countries on the same profit.

Dell, however, uses the Netherlands to avoid paying income taxes in either place. The world's third-largest personal-computer maker has avoided about $4 billion in income taxes since 2004, thanks partly to its use of a Dutch unit.

The subsidiary, called Dell Global BV, paid income taxes at a rate of 1/10 of 1 percent on profits of about $2 billion in 2011, the most recent year for which records are available. That means the unit took credit for almost three quarters of Dell's worldwide income. That subsidiary had no actual employees in the Netherlands as of 2009, filings show.

The Dutch company conducts its business through a branch in Singapore, where it designs and sells laptops and other equipment for the U.S., European and Asian markets.

Singapore Business

For tax purposes, Dell says the unit's profit is generated in Singapore, where it obtained an income-tax holiday in 2004. Although the company pays almost no income taxes in

Singapore, the Netherlands doesn't impose any significant income taxes either because "avoidance of double taxation can be claimed with respect to the" profit earned in Singapore, according to the Dutch subsidiary's 2011 annual report.

"You don't want companies to pay double tax but you also don't want them to not pay any tax at all," said Merkies, the Dutch parliament member.

The U.S. Internal Revenue Service is seeking back taxes avoided through Dell's intra-company arrangements, according to a company securities filing. Dell is contesting the IRS's proposed assessment. While the company didn't disclose the amount in dispute, it said an unfavorable outcome could have a "material impact" on its financial position.

Cash Overseas

One result of its tax avoidance: Substantially all of Dell's $14.2 billion in cash and cash equivalents is overseas, according to a company filing in December. It may now have to tap that cash pile as it goes private, potentially subjecting the money to U.S. taxes.

"We've always been clear that Dell has a responsibility to pay its fair share of taxes," said Jess Blackburn, a spokesman for Dell, based in Round Rock, Texas. "We operate according to all applicable laws and regulations and in accordance with the letter and spirit of those laws." He declined to respond to a detailed list of questions about Dell's tax arrangements.

Last month, the European Commission recommended that EU members require in their treaties that income be subject to tax in one country before being exempt in another. That could prevent companies such as Dell from avoiding taxes in two countries simultaneously.

Another EU proposal to combat tax-avoidance strategies has moved slowly through the bureaucracy since 2004. It would allocate multinational companies' taxable profits into various countries based on factors such as actual sales or number of employees there.

'Waiting for Godot'

Whether the EU can implement such a change remains doubtful. Under its rules, the move requires unanimous approval from the 27 member states, including the Netherlands. At a December news conference in Brussels announcing the plan to combat tax avoidance, Algirdas Semeta, the EC's commissioner for taxation, avoided answering a Dutch journalist's question about whether the commission would target the Netherlands.

"I regard the Netherlands as the central European hub in corporate tax avoidance," said Sven Giegold, a member of the EU parliament from Germany's Green Party. "The main challenge is you need consensus within the EU, and waiting for consensus on tax matters is like waiting for Godot."

Last year, representatives from the Netherlands fought at least two internal EU proposals to clamp down on tax avoidance techniques, according to a person familiar with the matter.

Other European countries are competing to attract multinational companies with tax inducements. Luxembourg has imitated the Dutch system of conduit companies and advance tax rulings, and Switzerland offers long-term tax holidays and other incentives.

Swiss Generosity

Yahoo is taking advantage of the Swiss tax generosity: In late 2009, the company began shifting profits from its European sales into a small subsidiary in Rolle, Switzerland, a picturesque town 25 miles north of Geneva at the foot of the Alps.

Through Yahoo! Netherlands BV, headquartered at Dooves's suburban home, Yahoo has also routed European and Asian revenues from Web ads to a subsidiary incorporated in Ireland that claims its residency in the tax-friendly Cayman Islands, according to filings.

In 2009, for example, the Dutch unit collected 101.5 million euros in royalties from around the world -- and promptly paid out 98.7 percent of that to the Cayman subsidiary, records show. If those payments went directly from, say, Yahoo's France sales arm to the Cayman unit, they could trigger a 33.3 percent withholding tax in France.

'Beneficial Owner'

In 2011, a Yahoo French sales subsidiary reported 66 million euros of revenue, yet paid just 462,665 euros in income taxes, records show.

A typical Dutch tax avoidance arrangement may violate the tax treaties of various countries, said Peters, the Rotterdam tax adviser. Only a small percentage of royalties stays in the Netherlands in these transactions, records show, yet treaties typically require that, in order to avoid withholding tax, the Netherlands unit must be the "beneficial owner."

"It's clearly visible in the public accounts in Holland that these Dutch entities are not the beneficial owners," said Peters, speaking generally about such arrangements.

Yahoo recently introduced another circuitous path through the Netherlands to cut the taxes on profits from its Asian sales: Royalties travel from Singapore, through Dooves's house, to another subsidiary in Mauritius, a tax-friendly island off the southeast coast of Africa.

In 2011, the Dutch unit collected 110 million euros from Asian sales, according to Dooves -- before paying royalties to the Mauritius subsidiary.

On paper, the cash remains with the Dutch subsidiary, which uses it to finance operations throughout the world outside the U.S., said Dooves. In reality, much of it sits in a HSBC Holdings Plc bank account in London, he said.

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To contact the reporter on this story: Jesse Drucker in Rome at jdrucker4@bloomberg.net

No more “Dutch Sandwich”? The Netherlands reviews its role in tax avoidance

For example, Dell's Dutch subsidiary only paid 0.10 percent tax on $2B profits.

by **Cyrus Farivar** - Jan 23, 2013 5:35pm PST

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Bloomberg has reported: “Multinational companies routed €10.2 trillion ($13.586 trillion) in 2010 through 14,300 Dutch ‘special financial units,’ according to the Dutch Central Bank.”

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In recent years, governments have become increasingly aware of the fact that lots of major corporations—notably tech companies including Apple, Google, Yahoo, Dell, and many others—are using shady, albeit legal, techniques to shift income in ways that drastically minimize a company's tax burden. A trick known as the “Dutch Sandwich,” in which companies move money through the Netherlands, has become one of the preferred ways of reducing a firm's financial liability.

On Wednesday, a Dutch parliamentary committee met to consider the fairness of its own tax system and re-evaluate its role as part of a legal financial chain that allows companies to reduce the amount of tax they pay.

In December 2012, Google was found to have moved $10 billion from Ireland via the Netherlands to Bermuda—avoiding huge sums of taxes in Ireland, the Netherlands, and its real home country, the United States.

“We should not be a tax haven,” Ed Groot told *Bloomberg*’s correspondent, Jesse Drucker, who has been reporting on this issue for years and has become the *de facto* expert on the issue. Groot is a parliament member from the Dutch Labor Party, the Netherlands’ ruling faction.

“If they go somewhere else we are not sorry at all because they spoil the name of Holland,” Groot

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added. “Otherwise you can wait for retaliation measures and this we don’t want.”

Experts agree that part of why tax law—usually a fairly dry and obscure issue—is coming to the fore in recent months has to do with austerity measures worldwide, particularly in Europe.

"Everywhere you look, governments are cutting back on spending for teachers, police, fireman—things that the citizenry generally wants more of," Robert Goulder, the editor-in-chief of Tax Analysts' international publications, told Ars. "That's tough for a lot of people to absorb when corporate profits aren't being taxed in a meaningful way."

Moving trillions each year

As these techniques gain more public attention, company executives have faced newfound scrutiny from Ireland, France, the United Kingdom—which is set to hold its second hearing on the issue at the end of January—and now, the Netherlands.

As *Bloomberg* reported on Tuesday, tech companies including Google and Dell employ the Netherlands’ tax laws to their advantage—saving likely billions of dollars for the companies that employ this technique.

“Multinational companies routed €10.2 trillion ($13.586 trillion) in 2010 through 14,300 Dutch ‘special financial units,’ according to the Dutch Central Bank,” the news agency wrote. “Such units often only exist on paper, as is allowed by law.”

Here’s how it works: as *Bloomberg* also reported in 2010, a company sells or licenses its foreign rights to intellectual property developed in the United States to a subsidiary in a country with lower tax rates. That means that in many cases, companies will license their own IP to one of their own foreign subsidiaries (often based in Ireland), whose profits then stop over in the Netherlands. In turn, those profits finally settle in Bermuda, a British overseas territory in the North Atlantic, and a notorious tax haven.

The empty Dutch subsidiaries

Bloomberg also reported Tuesday that Yahoo cut its taxes by $42.8 million in 2011 using such financial shenanigans.

“Records show that the Yahoo unit reported Dutch income taxes in 2009 of €1.28 million ($1.7 million)—out of the €101.5 million ($135 million) in royalties it funneled through the subsidiary that year,” the news agency reported. “That’s a small price to pay. In return, Yahoo can move profits to virtually any destination without paying a withholding tax.”

Dell similarly uses the Netherlands—and its tax treaty with the United States—to avoid paying taxes either at home or abroad. Its Dutch subsidiary, Dell Global BV, only paid 0.10 percent on profits of $2 billion in 2011.

“That means the unit took credit for almost three quarters of Dell’s worldwide income,” *Bloomberg* added. “That subsidiary had no actual employees in the Netherlands as of 2009, filings show. The Dutch company conducts its business through a branch in Singapore, where it designs and sells laptops and other equipment for the US, European, and Asian markets.”

In response to inquiries by *Bloomberg* and others, companies often say they are merely following the law—which is true.

Waiting for Brussels

Despite the newfound pressure from various governments, it seems highly unlikely that national governments—or the European Union, whose proposed Common Consolidated Corporate Tax Base (PDF) continues to languish in Brussels—will pass any meaningful tax reform anytime soon.

"That would end intra-EU transfer pricing by rejecting the arm's length standard and adopting formulary apportionment," Goulder, of Tax Analysts, told Ars by e-mail.

"Ultimately that's the answer, but it's difficult to do unilaterally. It only takes one EU member state to veto the CCCTB. At the end of the day, it will take a major financial crisis to realign the factors that now dictate the status quo. In the meantime Europe will continue to shift the tax burden to VAT and the US will continue to run up huge deficits, so long as the bond market indulges us."

Other tax law experts agree, noting that if there were a better way to reduce tax liability other than via the Double Irish and the Dutch Sandwich, financial wizards would have found it by now.

“Smart people will still work on [tax avoidance], but it will presumably require more work,” Samuel

Brunson, a law professor and tax law expert at Loyola University Chicago, told Ars.

“If there were something more effective out there now, people would be doing that. My guess is that [corporate tax departments] are looking really closely at what their other options would be. They’re not super scared yet, but it could have a real impact on the way they do business and the way they structure. I don’t know that it will create real business change, but it could cause them to pay more taxes in some country—being an American, I would vote for us.”

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