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Google Audited by IRS for Channeling Profits to Ireland

A Bloomberg report states that the IRS is auditing Google on the Search Engine company's strategies in cutting its tax bill by about $1 billion a year by channeling profit to subsidiaries situated in countries with low or non-existent tax rates.

These techniques are known in tax circles as the "Double Irish" and "Dutch Sandwich," named so because it involves moving profits through subsidiaries in Ireland, the Netherlands, and Bermuda, according to the report on Bloomberg News. Apparently, over the last three years, these practices had saved Google $3.1 billion in taxes.

The strategy is simple. By funneling its profits out of the US where tax rates are high, a company is able to reduce its costs. In 2009, Google Bermuda collected about $6.1 billion in royalties from a separate Google subsidiary based in the Netherlands in order to enjoy the tax free environment in the Caribbean nation. On Thursday, Google reported an effective tax rate of about 19% for the third quarter, less than half the average combined US and state statutory rate of 39.2%.

Besides Google, many other big companies like Microsoft, Apple and Cisco Systems employ such strategies. It is estimated that US companies have transferred at least $1.375 trillion in earnings to their foreign subsidiaries that are not subject to income tax. If the earnings had remained or were transferred to the US, they would be subject to a 35% corporate tax rate. Among all the major US companies using these strategies, Google appears most successful in reducing their taxes.

For instance, after Google developed its search engine technology in the US, it transferred foreign rights to the technology to Google Ireland Holdings, an Irish subsidiary managed in Bermuda. In 2006, the IRS signed off on a 2003 intracompany transaction that reflects this transfer, thus approving much of Google's tax arrangements. This arrangement allowed future profit derived from those copyrights to be recognized in foreign subsidiaries rather than in the US, although the technology was developed here.

But according to Bloomberg, the IRS approval covers only rights that Google held as of 2003 and does not cover technology the company acquired since then. Since then, Google has made at least three major acquisitions that include the $1.65 billion purchase of YouTube in 2006, the $3.2 billion purchase of email security service Postini in 2007, and the $3.2 billion purchase of DoubleClick in 2008. These are the transactions the IRS is investigating.

Google does not view the IRS audit as anything to be alarmed over. A Google spokesman told Bloomberg, "This is a routine inquiry."

But he declined to answer a Bloomberg reporter when asked about whether Google was going to assign patents acquired in its $12.5 billion purchase of Motorola Mobility to foreign subsidiaries.