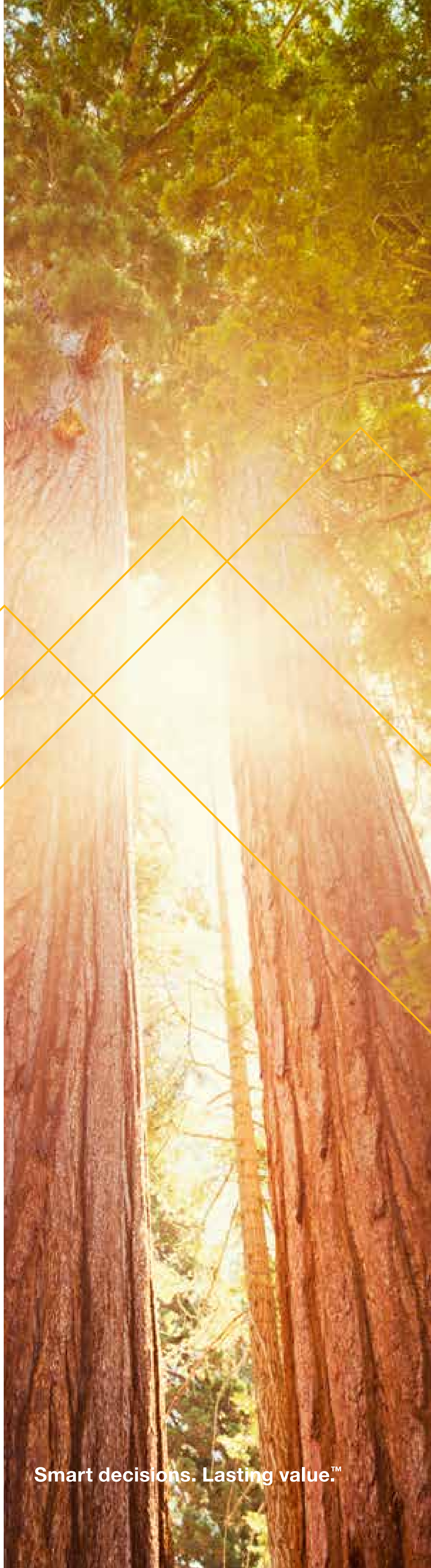
Checklist

Is Your Technology Company Ready for Global Growth?

Five Key Accounting and Tax Considerations to Weigh



When expanding globally, most technology companies do not consider how best to structure the business from an accounting and tax standpoint. Growing businesses need to understand that what has been working in the domestic market may not work internationally. Diving headfirst into the international business waters without an understanding of the accounting and tax implications can affect financial performance and increase business risk.

But with careful planning early on, fast-growing technology companies can optimize their business structures to help maximize cash flow and minimize risk.

Use this checklist to determine if your technology company is prepared to go global in a digital economy.

1. Tax Jurisdiction: Where Do Business Transactions Actually Take Place?

Many jurisdictions have not caught up with the reality of technology businesses. When you provide software as a service, where should it be taxed? Where the services are performed – which could be on a server in a country different than where the customer is? Or where the customer is? Until now, many businesses were taking advantage of this lack of clarity to minimize and, in some cases, avoid taxes.

Companies may be able to take advantage of lower tax rates for R&D – typically somewhere between 5 percent and 15 percent – in countries with "innovation boxes."

In response to this, the Organisation for Economic Co-operation and Development announced the Base Erosion and Profit Shifting (BEPS) initiatives to try to reduce some of these profit-shifting activities. More than 100 countries continue to work together developing the BEPS framework to implement tax planning strategies that will help ensure "the fairness and integrity of tax systems" that currently give multinational companies a competitive advantage over businesses operating only in their own countries by allowing these multinationals to shift certain activities to lower-tax locations.[1] To comply with BEPS, your company will need to determine exactly where business occurs. In one example, BEPS changes will allow companies to take advantage of lower tax rates for R&D – typically somewhere between 5 percent and 15 percent[2] – in countries with "innovation boxes," as long as the R&D is physically located in the country.

✓ 2. Characterization and Sourcing of Income: Is it Software, or Is it a Service?

Once your company determines the countries in which it is being taxed, the next step is to structure the business for the greatest tax efficiency. Preplanning can help optimize cash flows by lowering both the tax burden and the entity's annual expenses.

Something to consider is the characterization and sourcing of income. Your business needs to take a hard look at what type of transactions occur and how those are going to be taxed. For example, goods and services bundled together may need to be recognized separately when it comes to taxes. For the greatest tax efficiency, the business may want to restructure how it packages its services. It also needs to consider the implications of sales tax and value-added taxes (VATs), property taxes, and the regulatory burden that may come with them, such as a statutory audit requirement.

✓ 3. Foreign Currencies: How Do Exchange Rates Affect Transaction Settlements?

One issue surrounding dealing in foreign currencies is, logistically, how to bill the customer if your business will receive payments in a foreign currency. Then, how should the company use that foreign currency? Immediately exchanging it for U.S. dollars may not be the best answer.

It is generally advantageous to settle liabilities in the foreign currency. For instance, if your liabilities are in British pounds and your cash is in British pounds, then no matter what happens to the exchange rate, you would be able to settle the liability without a currency exchange gain or loss. This is also less complex from a tax standpoint.

Repatriated foreign earnings may be subject to tax under certain circumstances.

However, there are other factors. If you bring money back into the U.S., your company may have to pay taxes on it. Repatriated foreign earnings are taxed if the original earnings were not consolidated into the U.S tax return. It is wise to have a well-thought-out strategy concerning foreign earnings that considers tax implications and repatriation timing issues.

✓ 4. Legal and Regulation Issues: What Are the Rules and the Penalties for Noncompliance?

While moving toward common international accounting and tax rules, the reality is that different countries still have different rules. Some examples include required statutory audits or audits of only the subsidiaries located in that country, restrictions on minimum capital structure, and withholding requirements associated with treaties.

If you do not follow the rules of the countries in which you conduct business, your company may be subject to severe noncompliance penalties. For example, in the United States, there is a $10,000 fine *per return* on a failure to file an informational document with the IRS, even when the form does not require a tax payment. Further complicating matters, the deadline for filing this form has changed as of 2017.

Treaties are also an issue when going global. For example, you may have a situation in which your business could use a U.S. treaty to help get a lower withholding rate on a royalty.

✓ 5. The Supply Chain: What Happens When Transactions Cross a National Border?

One of the most critical activities your internationally expanding technology company needs to undertake is to understand the business' supply or value chain. Whenever a transaction crosses a national border, there is an opportunity to optimize accounting processes or tax efficiency while reducing risk.

If you do not have the financial expertise in-house, your business may try to fix a transfer pricing issue without addressing the consequences of moving human capital or VAT. Consequently, rather than fixing one issue, you have created two or three more.

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Your Next Steps

Global expansion means moving into an environment loaded with potential land mines in terms of accounting, tax, currency, and legal issues. Technology companies in the digital economy especially need to be aware of the potential risks and consequences and begin planning before they go global. Working with a firm specializing in this area can help your business prepare strategically.

How Crowe Can Help

Crowe has extensive experience serving the accounting and tax needs of global technology companies. Our specialized technology industry team can assist management in identifying factors it needs to consider when expanding into new markets. With offices in more than 130 countries, Crowe has local experts in most major markets and countries of the world. Crowe has developed custom software to help technology companies manage their global businesses – including software that helps manage international filings and coordinates the exchange of information between subsidiaries and parent companies throughout an audit.

Connect With Us

Kevin Wydra
Technology, Media, and
Communications Services Leader
Partner
+1 630 586 5242
kevin.wydra@crowe.com

Jim Parker
Partner
+1 404 442 1652
jim.parker@crowe.com

[1] Organisation for Economic Co-operation and Development, "About BEPS and the inclusive framework," (2016); http://www.oecd.org/ctp/beps-about.htm

[2] Congressional Research Service, "A Patent/Innovation Box as a Tax Incentive for Domestic Research and Development," June 13, 2016 https://fas.org/sgp/crs/misc/R44522.pdf. Used with permission.

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