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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:

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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.

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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."

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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

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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.

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