

Tax Considerations of Forming a Foreign Company



Doing business on an international basis is practically a necessity in order to survive in today's competitive environment. Many businesses have found that forming a foreign entity can help overcome many of the challenges of doing business in a global economy. There are many tax considerations that must be addressed when forming and operating a foreign company. Here are a few of the areas to be aware of.

Foreign Tax Credits

U.S. taxpayers are allowed a foreign tax credit against U.S. tax for income taxes paid to foreign jurisdictions. Limitations exist that may delay or prevent the use of this credit. Proper planning can help maximize the utilization of the foreign tax credit to lower world-wide taxes.

Anti-Deferral Regime (Subpart F)

Typically, income earned by a foreign corporation is not subject to U.S. tax until the profits are repatriated back to the U.S. However, certain types of tainted income and transactions will result in current U.S. income tax.

"Check-the-box" Election

The IRS allows some flexibility in choosing how the foreign entity is treated for U.S. tax purposes.

Making a "check-the-box" election will result in current income/loss inclusion for U.S. tax purposes, but will likely maximize foreign tax credit utilization, especially for S corporations and LLC's.

Transfer Pricing

The prices charged between a U.S. company and its foreign affiliates must be at an arm's length amount. Transfer pricing rules apply to the exchange of goods, services, and intellectual property. These rules are complex, but they do offer opportunities to lower a company's worldwide effective tax rate.

Value-Added Tax

Value-Added Tax ("VAT") is a consumption tax levied on the "value added" to goods and services as they pass through each stage of the production process. Typically, businesses are able to recover VAT on the

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materials and services that they buy to make further supplies or services sold to the end-users who ultimately bear the VAT tax liability. Proper compliance is required in order for businesses to collect and remit VAT tax and to apply for the proper refunds or credits.

Compliance Requirements

Expanding overseas often means increased tax compliance, including transfer pricing documentation, foreign bank account filings, and foreign entity reporting forms. Failure to comply with these requirements can result in either costly IRS adjustments and/or penalties.

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