NEXIA GLOBAL INSIGHT

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Still open for business

Central and Eastern Europe continue to provide attractive inward investment opportunities – even if the region is expected to record the slowest growth among world emerging markets in 2011.

Growth may be sluggish, but incentives remain, with governments across the region responding to recession with a range of policy moves aimed at foreign investors. The result is that inward incentive packages generally remain intact and, in some cases, there are now improved opportunities for companies to set up and do business in the region.

The benefits of outsourced finance functions

Outsourced finance functions are increasingly used by international groups to improve the quality and timeliness of their management information.

Major changes to Chinese income tax will impact expatriates

Foreign companies operating in China will need to take account of income tax changes that will hit their expatriate employees.

Plan ahead for IFRS convergence

IFRS is coming – embrace it and shape up for the future.

Revenue recognition and leasing transactions

Two of the more wide-reaching IFRS issues.

Red tape burden of US foreign account rules for offshore investors

The new FATCA legislation in the US will create an additional administrative burden for offshore funds and financial institutions investing in US capital markets.

Guidelines on new M&A scheme in Singapore

Foreign companies looking to invest in Singapore have a window of opportunity to take advantage of changes in the rules governing mergers and acquisitions.

UK tax regime aims to attract multinationals

A significant shift in UK tax policy in recent years has been designed to encourage more overseas businesses to relocate to the country.

Concern over EU e-invoicing rules

'Substance requirements' a threat to overseas subsidiaries' tax breaks

Liechtenstein overhauls its tax regime

Nexia International is a leading worldwide network of independent accounting and consulting firms.

Central and Eastern Europe

Still open for business

Central and Eastern Europe continues to provide attractive inward investment opportunities – even if the region is expected to record the slowest growth among world emerging markets in 2011.

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The result is that inward incentive packages generally remain intact and, in some cases, there are now improved opportunities for companies to set up and do business in the region.

For example, in Hungary the government is pursuing a policy of economic reform, which includes cutting personal income and corporate tax rates to increase the country's competitiveness for inward investment. Romania has introduced a tax exemption for reinvested profit, while Russia has established a private equity fund to act as a co-investor to direct foreign investment in industrial projects.

New report highlights key issues

A new report from Nexia International, Doing Business in Central and Eastern Europe, urges potential investors to do their homework and 'shop around' to identify incentive packages that will be of benefit to your business.

The report also highlights a range of issues to consider when doing business in the region. These include the ease and speed of establishing a legal entity, access to credit for foreign investors and availability of tax incentives, for example, corporate tax relief for newly established or expanding companies, capital gains tax exemptions, tax allowances for SMEs and tax reliefs for research and development.

Other matters to bear in mind are the existence of withholding tax on employment income, dividends, interest payments, royalties, rent or even the sale of property, as well as incentive packages for setting up a business in an enterprise zone or business park.

Companies should seek to discover if there is access to business expertise and support, quality of infrastructure and services to help overseas businesses set up.

Also important to know are the options to enforce outstanding debts and the ease and speed of winding up a legal entity, including the ability for foreign investors to remit profits and investment capital to their home country.

Local help critical

It's also vital to use local advisers when doing business in the region. Local professionals who speak the language and have experience in the relevant areas of interest are crucial. They can help foreign investors get to grips with the legal, tax and regulatory environment, as well as deal with red tape – increasing their chances of success.

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Asia Pacific

Major changes to Chinese income tax will impact expatriates

Foreign companies operating in China will need to take account of income tax changes that will hit their expatriate employees.

The new income tax arrangements, which are effective from 1 September 2011, are aimed at shifting the tax burden from low-income earners to higher-income earners.

Current inflation rates are taking a big bite out of workers' paychecks, so the changes will come as a welcome relief to mid-level and low-level earners.

Fair share

The changes are also aimed at ensuring that wealthier taxpayers in China pay their fair share of income tax. The Chinese tax authorities have until now mostly focused on salary income because it is easy to track and easy to collect. They are now turning their attention to high-level earners receiving income from property, trusts, securities and private equities – all of which are more difficult to track. Bonuses and dividends, home sales, consulting work and the like are in a similar category.

Highly paid expatriate workers in China are under scrutiny too. As they tend to be high-wage earners, their tax will certainly increase, and foreign companies that take on this burden, for example through tax equalization schemes, should plan accordingly.

Threshold

The first major change is an increase in the minimum earnings threshold for income tax liability from 2,000 RMB per month to 3,500 RMB per month for Chinese workers. It remains unclear how this change will affect the current 4,800 RMB threshold for expatriate workers in China.

While this is a step in the right direction for lower-level earners and will no doubt bring relief to those in smaller cities and rural areas throughout China, many believe that the new threshold of 3,500 RMB is not sufficient to help those in larger high-cost cities like Shanghai.

The second main change is to the progressive tax rates scale. Previously, there were nine tax brackets that ranged from 5% to 45%. Under the new rules, those workers with taxable incomes between 1,500 RMB and 4,500 RMB per month benefit, as they are now in the 10% rate bracket. However, workers with monthly taxable incomes higher than 9,000 RMB will see their tax increase as they move into higher brackets. All taxable incomes greater than 80,000 RMB per month will now pay a 45% tax rate, whereas previously that threshold was 100,000 RMB.

For sole traders and those whose income is from contracting or leasing activities, the threshold is increased to 15,000 RMB per year for the 5% bracket and increased to 100,000 RMB per year for the 35% bracket.

This current tax shift still does not address incomes resulting from capital gains and other such earnings. Interestingly, it's clear that total income tax revenue will drop, since most Chinese workers are low-wage earners.

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Financial reporting

Plan ahead for IFRS convergence

A consistent, worldwide set of international financial reporting standards – IFRS – is coming, and the sooner your company understands and embraces them, the fitter it will be for the future.

The ultimate goal of convergence to IFRS is a single set of accounting standards that companies worldwide will use for both domestic and cross-border financial reporting.

In the US, which has previously been slower to commit to the adoption of IFRS than many other countries, the SEC has recently recommended a "condorsement" approach to incorporating IFRS into the US financial reporting system over time – with far-reaching implications for international companies with US connections. The outline of the standards are already known, and preliminary drafts giving more detail have been released for public comment. The drafts address areas of accounting such as consolidations, derecognition of transferred financial assets, financial instruments, financial statement presentation, financial instruments with characteristics of equity, leases, fair value measurement, revenue recognition and post-employment benefits.

Although concerns over the speed of the consultation process on these standards have led to the proposed roll-out being slowed down, this is still expected to be completed by the end of 2011.

Plotting your organisation's convergence course

Careful planning will make a big difference to how your organisation adjusts to the changes. Although these standards may not come into effect for small and medium-sized (non-public) companies until 2014, keeping up to date on the progress of the proposed new standards will allow you to thoroughly understand the relevant issues long before they are final. By reviewing the issues and educating yourself on convergence topics, it will be easier to map out a course to convergence.

A larger organisation will typically have more complex issues to address, so their management teams should start this process sooner. A smaller company may have fewer issues to wrestle with, but also have fewer resources to devote to convergence.

A general map of the IFRS convergence process might include the following points:

- understand, participate in and influence the exposure drafts
- consider current systems and what resources might need to be added in the future
- identify technical accounting differences
- train internal staff.

IFRS and the real world

Companies should see convergence to IFRS as a positive step. For multinationals with subsidiaries throughout the world, the resources needed to keep each location in compliance with accounting rules are significant. These companies should benefit from lower financial reporting and tax compliance costs following convergence to IFRS.

Although not all businesses have multiple locations in different countries, a uniform standard will be useful if expanding overseas is on your horizon. And the hurdles for doing business in a different country will appear significantly less daunting when compliance standards are the same.

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Financial reporting

Convergence impact on revenue recognition and leasing transactions

Globally harmonized International Financial Reporting Standards (IFRS) will have a huge impact on privately owned companies and two of the more wide-reaching issues will be revenue recognition and leasing transactions.

While many countries continue to question the effect of the proposed convergence of rules, the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) are pressing on with drawing up standards.

Revenue recognition

The proposed standard would apply to companies in all industries entering into contracts with customers, with few exceptions. The underlying principle is that revenue should be recognized to reflect the transfer of goods or services to customers in an amount that reflects the consideration the company receives, or expects to receive, in exchange for those goods or services. While there have been several changes made to the original proposal, and while others continue to be assessed, the recognition process continues to revolve around the following five steps:

- identify the contracts with a customer
- identify the separate performance obligations within the contracts
- determine the transaction price
- allocate the transaction price to the separate performance obligations
- recognize revenue when the entity satisfies each performance obligation.

The process and considerations within each step are intended to remove inconsistencies and weaknesses in existing standards, provide an enhanced framework for addressing revenue recognition issues and improve the comparability of revenue recognition practices across geographic areas and industries.

The following are just a few of the revisions to date:

- multiple contracts are to be combined and assessed as a single contract if one or more of the following exist –
  i) the contracts are negotiated as a package with a single objective
  ii) the amount of consideration in a single contract is dependent upon another contract
  iii) the design, function or technology of the goods and services within the contracts are interrelated
- contract modifications are to be considered a separate contract, subject to assessment if the modification results in a separate performance obligation at a price reflective of the performance of such obligation
- revenue is to be recognized once a performance obligation is satisfied continuously, at which point a method of measuring progress toward complete satisfaction of the performance obligation should be selected.

The proposal should be applied to specific contracts in order to fully understand the implications of the guidance. The IASB and FASB recently decided to re-release their revised proposals for a comment period of 120 days. Therefore, the issue date will be delayed until the second half of 2012 or later.

Leasing transactions

The IASB and FASB continue to work together to ensure that assets and liabilities, arising under leasing transactions, are recognized on the balance sheet. Currently, they have agreed to a one-model approach in accounting for lessee transactions, such that all leases are to be treated as financing transactions. Such an approach results in the recognition of an asset reflecting the right to use the asset, for the term of the lease, and the recognition of a liability for the lease payments to be made over the term of the lease (both subject to present value). The IASB and FASB returned to a one-model approach after temporarily establishing a two-model approach that would have treated short-term leases much like operating leases are currently treated in the statement of income.

The proposal on leasing transactions has seen much debate and the issue date is now likely to be the second half of 2012 or later.

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Offshore investments

Red tape burden of US foreign account rules for offshore investors

The new FATCA legislation – the Foreign Account Tax Compliance Act – in the US will create an additional administrative burden for offshore funds and financial institutions investing in US capital markets on behalf of their owners or account holders.

FACTA essentially targets those who evade paying US taxes by hiding assets in undisclosed foreign bank accounts.

Foreign financial institutions (FFIs) must sign up to a FATCA agreement with the Internal Revenue Service by 30 June 2013 to ensure that they avoid the new withholding tax regime, which will commence on 1 January 2014.

Stick

A 30% withholding tax is the 'stick' the IRS will use to force FFIs to comply with FATCA. Withholdable payments include all US source dividends, interest, rents and royalties and gross proceeds from the sale or disposition of any property that can produce dividends or interest from US sources.

FFIs will generally include banks, securities brokers and dealers, hedge funds, collective and family investment vehicles, private equity funds, trust companies and so on.

Guidance so far

No regulations have been issued, but the IRS has released two lengthy notices that have provided some helpful, albeit incomplete, guidance about how FATCA will operate. Some of the highlights from the notices include the following:

- In order to be a "good" FFI not subject to the 30% FATCA withholding, an FFI must –
  i) belong to a class of institutions the IRS designates as "per se" good
  ii) comply with procedures to ensure that the FFI does not maintain US accounts (but no guidance as to what these procedures are or how to comply with them), or
  iii) enter into an FFI agreement with the IRS with the required obligations to conduct due diligence regarding account holders and report any direct or indirect US owners to the IRS
- Certain non-financial entities, non-US retirement plans and insurance companies will be exempt
- FATCA withholding will not apply to obligations outstanding on 18 March 2012
- The due diligence requirements to document individual and entity accounts are extensive and will be very costly for participating FFIs
- FFIs will have to file an annual report with the IRS with respect to information about US account holders
- FFIs will be required to calculate and document "pass-thru payment percentages" on payments made to recalcitrant account holders and non-compliant FFIs. This will require a quarterly assessment of US assets versus total assets and how such assets "pass thru" to different types of account holders.

To date, the IRS has not published details of the kind of FATCA agreement FFIs will have to enter into to, or the reporting forms for US account holders. It is anticipated that further guidance in the form of proposed regulations will be issued by the end of 2011.

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Mergers & acquisitions

Guidelines on new M&A scheme in Singapore

Foreign companies looking to invest in Singapore have a window of opportunity to take advantage of changes in the rules governing mergers and acquisitions (M&A) there.

M&A costs incurred by companies M&A have traditionally been treated as capital in nature and not deductible for tax purposes in Singapore. But this has changed with the introduction of a new M&A scheme.

The scheme only applies to qualifying acquisitions of ordinary shares in an active target company (local or foreign) made during the period 1 April 2010 to 31 March 2015 – in other words, asset deals are excluded. The scheme does not apply to internal restructuring or reorganisations, the incorporation of new subsidiaries to carry on business activities, or trading transactions.

Under this scheme, an M&A allowance (based on 5% of the cash consideration paid for the acquisition and/or the value of any shares issued as consideration) is granted to a company that acquires the ordinary shares in a target company directly or through a wholly-owned acquiring subsidiary. The allowance is capped at SGD 5 million for acquisitions made in each year of assessment and claimed over five years on a straight-line basis.

Qualifying conditions

The qualifying conditions for the acquiring company under the M&A scheme are:

- The acquiring company and its ultimate holding company (if any) must be incorporated and tax resident in Singapore.
- It must carry on a trade or business on the acquisition date.
- It must have at least three local employees (excluding company directors) throughout the period of 12 months preceding the acquisition date.
- It must not be connected to the target company for at least two years prior to the acquisition date.

In addition, a qualifying acquisition is a share acquisition that results in the acquiring company or its acquiring subsidiary:

- owning more than 50% of the ordinary shares in the target company (where 50% or less of the ordinary shares in the target company was owned before the acquisition date); or
- owning at least 75% of the ordinary shares in the target company (where more than 50% but less than 75% of the ordinary shares in the target company was owned before the acquisition date).

Unabsorbed allowance

Any unabsorbed M&A allowance may be carried forward, provided there is no substantial change in the shareholders of the acquiring company, but cannot be carried back or be available for transfer under the group relief system.

In addition to the M&A allowance, there is also stamp duty relief available to an acquiring company under the scheme, but it is capped at SGD 200,000 per financial year.

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Focus on…

The benefits of outsourced finance functions

Outsourced finance functions are increasingly used by international groups to improve the quality and timeliness of their management information.

This approach has a number of benefits. For established companies, outsourcing the finance function to an established network such as Nexia International can provide a combination of robust and reliable reporting platforms, relevant local knowledge and expertise. In addition, the group concerned does not need to invest in setting up new systems and software or recruit staff in each location where it trades or wishes to do so in the future.

For smaller groups looking to embark on an international development strategy, suitable finance functions can be secured in the countries where the group wishes to operate – again without having to incur significant start-up costs.

In addition to cost savings and reliability, a high-quality, established international network such as Nexia can provide added value by anticipating upcoming issues affecting the business and giving advance notice of matters that need to be addressed.

Nexia International member firms provide outsourced finance functions to many global businesses. For example, we work with an international and well-established group in Brazil with operations in 20 countries around the world on this basis, liaising with the group's central finance function.

We also work with inward investors who do not wish to establish finance functions of their own in the country in which they are investing. In one major recent example, we were appointed to provide regular management accounting services, prepare statutory annual accounts, quarterly VAT returns and manage the working relationship and information flow to the originating investor group.

These services are not only extremely helpful, but represent excellent value for money.

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Europe

UK tax regime aims to attract multinationals

A significant shift in UK tax policy in recent years has been designed to encourage more overseas businesses to relocate to the country.

With a rapidly falling rate of corporation tax, no corporation tax on dividends from certain overseas subsidiaries or withholding tax on dividends paid out of the UK, and an ever-increasing tax treaty network, the UK has become a more attractive jurisdiction for multi-national groups to establish headquarters or international holding companies.

Further incentives have been introduced in 2011:

Corporation tax rates
The top rate decreased from 28% to 26% from 1 April 2011 and will fall by a further 1% on 1 April in each of the next three years, so that, by 1 April 2014, the rate will be 23%.

Taxation of foreign branches
Following the abolition of corporation tax on dividends received from overseas subsidiaries (subject to applicable conditions), a new exemption regime has been introduced for foreign branch profits.

Previously, profits of a UK company's overseas branches were taxed in the UK. An election can now be filed to exempt such profits, but losses will not be deductible. The election is irrevocable (after an initial cooling-off period) and applies to all overseas branches, with claw-back provisions for losses claimed in the previous years.

Patent box regime
The UK Government has confirmed its intention to introduce a "patent box" regime with effect from 1 April 2013, with a 10% tax rate on companies for certain patent income. The legislation should encourage companies to locate high-value jobs in the UK, as well as activity associated with the development, manufacture and exploitation of patents.

Research and development (R&D) reliefs
The level of the R&D relief for small and medium-sized enterprises (SMEs) has been increased from 175% to 200% from 1 April 2011, increasing again to 225% from 1 April 2012 (subject to EU State Aid approval). Therefore, from April 2012 an SME could claim tax relief of £225 for every £100 spent on qualifying R&D.

Loss-making SMEs can surrender the enhanced expenditure for a payable tax credit so that, from April 2012 (when the corporation tax rate will be 25%), for every £100 spent on qualifying R&D, the £125 can be surrendered to trigger a tax repayment of £31.25.

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Europe

Concern over EU harmonization of e-invoicing rules

The EU Commission is expected to issue guidelines later this year to avoid uncertainty over new rules for electronic VAT invoicing.

Since the adoption of the new VAT Invoicing Directive in mid-2010, the Commission has been working hard with EU member states to ensure the directive is implemented as consistently as possible in different countries.

The directive comes into force on 1 January 2013, and will bring changes to VAT invoices, especially e-invoicing, which the Commission hopes will cut down on the formal requirements for invoices and reduce the administrative burden on companies.

Compromise

However, not all EU member states are equally keen to reduce the formal requirements, particularly for e-invoicing. The result is a directive that is clearly a compromise between the quite divergent positions of individual EU member states.

The directive puts equal importance on paper and e-invoices and specifies that their authenticity of origin, integrity of content and legibility can be guaranteed by business controls that create a reliable audit trail between an invoice and the supply of goods or services. It also mentions advanced electronic signatures and EDI (electronic data interchange) as examples of technologies that can be used to secure electronic invoices.

Risk

Unfortunately, the directive has given rise to questions as to what controls are acceptable and what are not. Taking into account the difference of opinion in different countries, there is certainly a risk that the directive will not be implemented in a harmonized way across the EU.

To tackle this risk, the Commission is currently engaged in a close dialogue with member states to ensure harmonization of the rules, and has been drafting guidelines, which are likely to be published in the second half of this year.

Although questions will be raised as to the legal status of the guidelines, clarification will be welcome for the many businesses that are currently going through e-invoicing implementation.

Hopefully, these endeavors will lead to truly harmonized rules for e-invoicing at a national level.

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Europe

‘Substance requirements’ a threat to overseas susidiaries’ tax breaks

Companies operating subsidiaries overseas and benefiting from lower taxes in those countries should take note of new international guidelines on so-called substance requirements.

Many international companies establish subsidiaries in low-tax jurisdictions to enjoy the advantages that this can provide. But substance requirements are becoming important to tax authorities worldwide, and should therefore be high on the agenda of companies operating overseas, or thinking of doing so.

As part of the global fight against tax fraud and a crackdown on ‘treaty shopping”, companies are being challenged to show their overseas operations are genuine subsidiaries being run from the host countries – or risk losing the tax breaks.

In broad terms, this means companies must show that the management, control and day-to-day decisions concerning business activity are taken in the country where the subsidiary is based.

European Court of Justice

This principle was put in the spotlight by a landmark case involving Cadburry Schweppes, brought by the UK tax authorities. The court ruled that the parent Cadburry Schweppes company would not have to pay UK taxes on the profits of its subsidiaries if genuine activity could be shown to be taking place in the countries of the subsidiaries. The question raised by the case was whether a structure lacking substance can be considered ‘artificial’ and therefore disregarded for tax purposes.

The big question since then has been what constitutes genuine activity, or substance requirements.

New OECD (Organisation for Economic Co-operation and Development) transfer pricing guidelines give useful pointers by referring to the following substance parameters:

- what roles and responsibilities are specifically assigned to what person in what jurisdiction
- does that person have sufficient equity and insurance coverage given the business risks he is exposed to?
- Is there enough skilled staff to carry out a local core business?

From experience, we know that the tax authorities also tends to look at the following:

- are there any local directors and an active bank account?
- are local compliance formalities duly satisfied?
- are meetings physically held locally?
- are the company’s operating expenses recorded in the local P&L?

Be prepared

Bear in mind substance requirements prior to implementing a company structure so that it can successfully pass any tax audit in the host country, the parent company’s country and any other third party countries involved.

In recent years, the importance of substance requirements has also taken hold in the VAT world. Not only as an instrument for the VAT authorities to combat VAT fraud and evasion, but more and more also as an argument for taxable persons to protect them from adverse VAT consequences in case of non-compliance with formal requirements.

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Europe

Liechtenstein overhauls its tax regime

This year has seen a complete redrawing of Liechtenstein's Tax Act, resulting in a single Act regulating the taxation of individuals, as well as corporations.

Under the new Tax Act, which became effective on 1 January 2011, legal persons taxable in Liechtenstein and engaged in economic activities are only subject to tax on income at a rate of 12.5%.

The existing capital tax has been abolished. Income and gains from participations will be tax-free, and losses carried over will no longer be subject to a time limit. In addition, an equity interest deduction has been introduced.

Other important reforms designed to make Liechtenstein attractive as a location for business include group taxation for affiliated companies and provisions for the treatment of patent income. The new Tax Act also contains provisions on the tax treatment of national and cross-border restructurings.

Special Company Taxes and the new 'PVS'

The tax reforms provide for the elimination of Special Company Taxes for domiciliary and holding companies, which is intended to prevent future reproaches for ring-fencing by other countries. However, legal entities may qualify as Private Asset Structures (Privatvermögensstruktur or 'PVS') if they exclusively manage assets according to their purpose and do not engage in any economic activity.

PVS are subject only to a minimal tax of CHF 1,200. Some limits are imposed with respect to asset management. However PVS may acquire, hold, manage and sell only financial instruments, holdings in legal persons, liquid assets and bank account balances. This rules out the acquisition and management of art, real property and precious metals, among others, as well as direct investments in, for example, limited partnerships. In principle, holdings in legal persons are permissible, but the legislative text provides that the domain of asset management is overstepped if the PVS itself, its shareholders or beneficiaries in any way influence the management of the company beyond pure shareholder rights.

Existing entities benefiting from the former Special Company Taxes have a three-year transitional period to adapt to the new rules. If such companies do not become compliant with the rules regarding PVS, they will become subject to flat rate taxation.

Other changes

Trusts having no legal entity are exclusively subject to the minimum corporate income tax of CHF 1,200, if they are domiciled or actually managed in Liechtenstein or receive earnings in Liechtenstein.

The new Tax Act provides for elimination of the coupon tax, with the exception of old reserves. Old reserves can be distributed in the first two years after the new Tax Act came into force at a lower tax rate of 2%. Subsequently, the tax on distributed old reserves will again be 4%.

Individuals looking for tax structures to administer their own assets are advised to look into the possibilities offered by the PVS structure. All existing Liechtenstein holding and domicile companies should also check the tax status that will apply until 31 December 2012.

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