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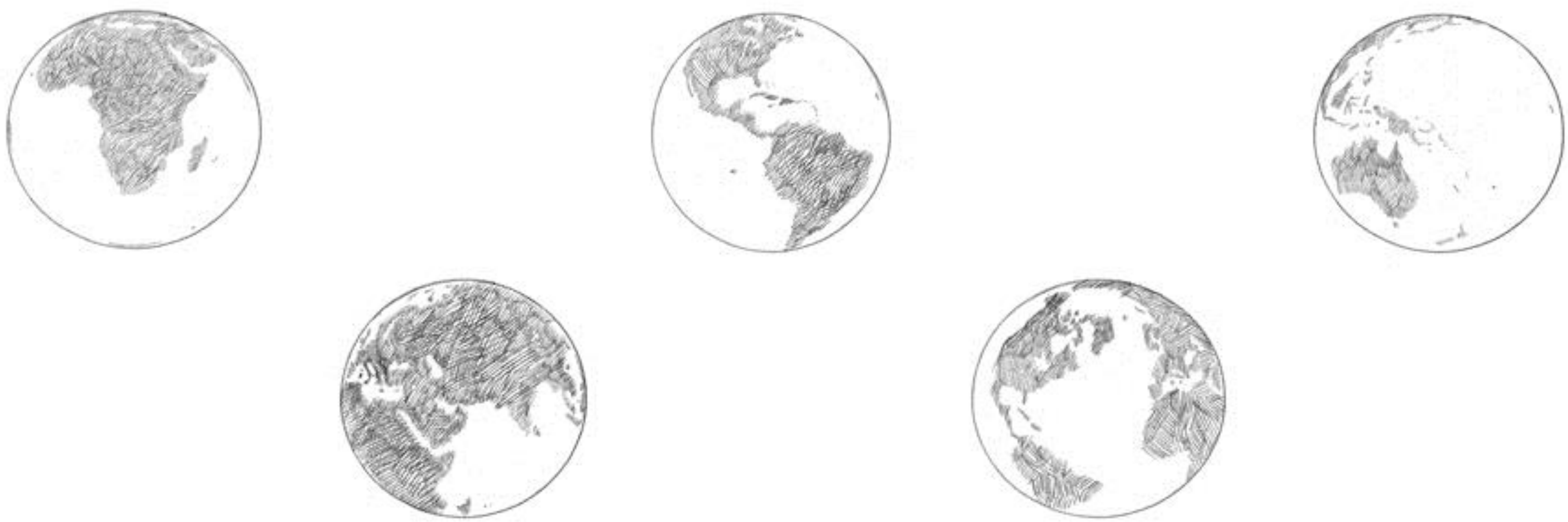
Growing overseas



What are we going to discuss today?

- Why might you want to do business overseas and what are the typical models?
- Initial research and planning phase
  - Are you ready?
  - Do you understand the market?
  - Do you understand the challenges and have you planned for them, and costed them?
  - Cultural considerations and negotiation
- Route to market
  - Operating without a presence
  - Sending staff abroad
  - Forming a taxable presence
  - Setting up a local entity
  - Working with partners and customers
- Tax considerations
  - Which taxes will you encounter
  - Supply chain, withholding and indirect taxes
  - Developing intellectual property
  - Sending staff overseas and employing people
  - Compliance
- **Help is out there!**

What is the opportunity?

Why Go Global?

- It is increasingly important for companies to grow overseas to stay competitive in a globalising market place
- New markets offer increased scale and growth opportunities
- Demand in many markets is burgeoning
- Finance in some markets is more readily available
- Increase your credibility and profile
- Go global for the sake of the UK economy! Its vital that we increase exports, and address our trade deficit

- Its not easy, but it may be easier than you think
  - Barriers include understanding the market, the regulations, tax and finding partners and customers.
  - However, there is help at hand from accountants, lawyers, consultants, trade associations and the Government.

Emerging markets

- Scale:
  - China has 274 cities with over 1 million population
- Demand:
  - China's cinema industry has grown 29% per year for 5 years, with $6billion in revenues
- Growth:
  - China poured more cement in the last 4 years than the USA did in the entire 20th century

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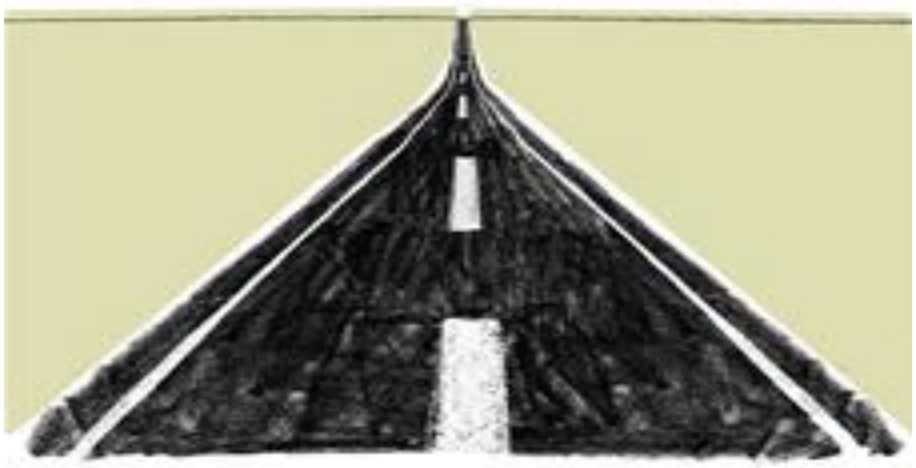
What might you do overseas?

- There is no blue print
- Different activities
  - Distribution
  - Licencing
  - Co-production
  - Joint ventures
- Different markets
  - Language
  - Trends
  - Localisation
  - Partnerships



Research and planning

Are you ready for business overseas?

- Understand your own company
  - What are your aims and objectives?
  - What are your Unique Selling Points? Are these suitable for the market you are targeting?
  - Do you have sufficient resources, including management time and finances to approach the market?
  - Have you budgeted time and money properly?
  - Who will lead the project from your company?
  - Are you willing to spend time travelling abroad?
  - How are you going to approach the language and cultural barriers?
  - Based on your resources, are you going to be opportunity driven, or strategy driven?

Research and planning

Start to understand the market

- Which market (including cities and regions) are you interested in, and may best suit you?
- What are you planning on doing there: distribution, co-production, joint ventures?
- Who are your potential clients, suppliers, distributors?
- Competition - What will your position in the market be?
- Understand your potential clients – customers, culture, language, localisation
- What are the business risks? Do you need any due diligence?
- What is the appropriate model: partners, agents, your own presence
- Pricing, payment and quality?
- Gather information:
  - Secondary sources - UKTI and trade association resources; sector and geographical reports; off the shelf reports
  - Professional support - Bespoke market research; UKTI services; tailored location studies
  - Regulations - are there any legal barriers/ restrictions? Are any licences necessary?
  - Tax advice
  - Identification of counterparts and meeting set up: meeting people and make relationships is vital: clients and customers; partners and agents; government officials
  - Join a trade mission or create your own programme

Research and planning

Detailed planning

- Forecast numbers are likely to be required by external parties, and help your own planning process
- Forecasts are only as good as the information they are based on, and quality research leads to a more realistic business plan
- Forecasting revenue streams gives a more realistic and nuanced picture, and helps you focus on customers and your actual market
- Detailed planning of your route to market helps assess resource requirements, including cash, commitment and time
- Uncover and assess potential challenges and risks and understand costs
- Line by line planning helps you know your unknowns
- Your route to market is the key driver of costs
- Forecast revenues & costs help you to flex budget & strategy during a project

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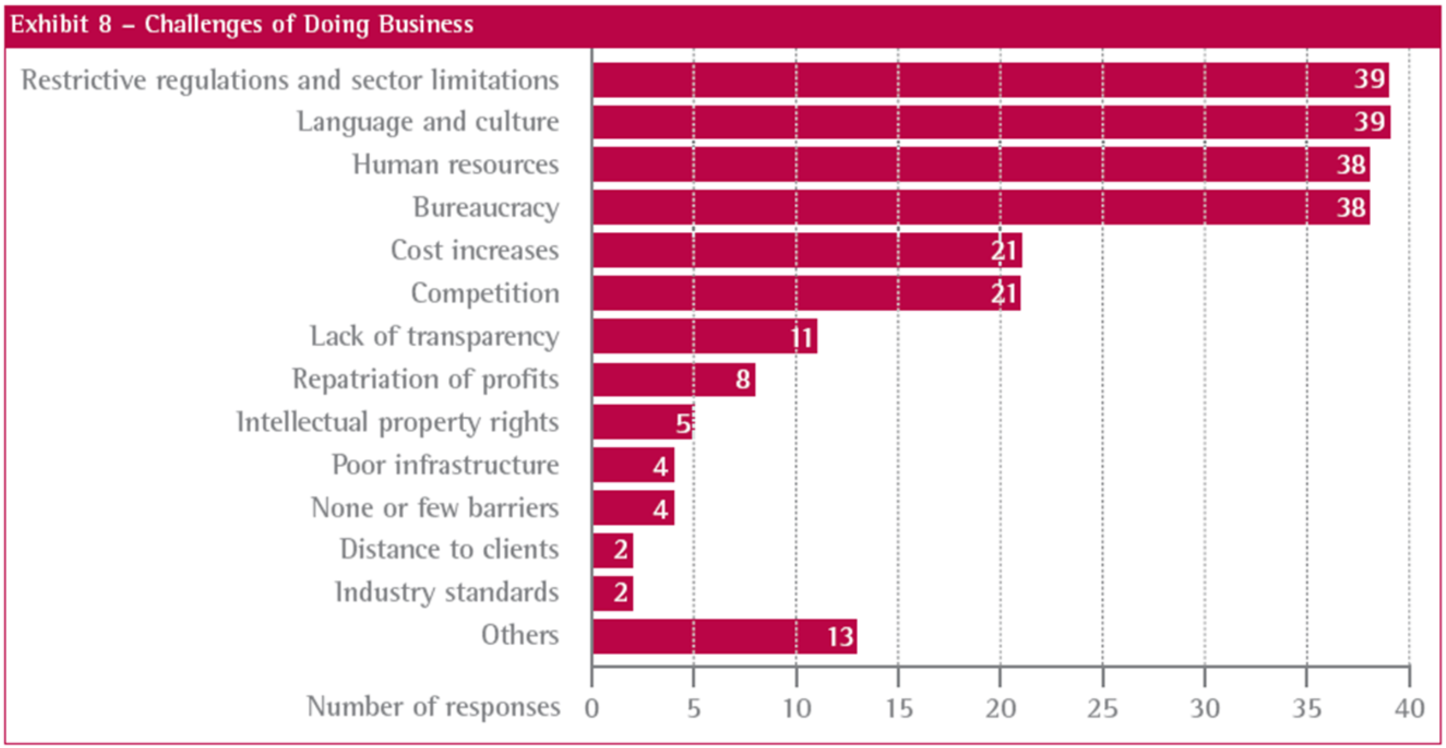
Research and planning

Understand the challenges for your plans

- Some of the common challenges that companies face abroad:



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Research and planning

Planning for language and cultural issues

- **Tailor for the local market:** product and approach
- **Negotiation and contracts**
  - Highlight clients/track record
  - Subtext, the audience
  - Don’t rush, return visits
- **Face**
  - Manners: respect, reputation and hierarchy
  - Praise, recognition of importance
  - The right people, toasting, seating
- **Relationships** – guanxi

Example: China

- Mandarin, Cantonese
- Traditional, Simplified
- Using Interpreters
- Marketing Materials
- Localisation!
- Symbolism
- Translating Contracts
- Pronunciation
- Employ a Chinese Speaker?
- **Top tips:**
  - business cards;
  - marketing materials;
  - interpreters;
  - follow up

Route to market

Distribution without boots on the ground

- Sales can be made through short visits, remote communications, or through agents and distributors
- Pros: cheaper, quicker, lower risk in some respects, less commitment
- Cons: less control, reliance on other parties, someone else may take a big slice of the profits, less ability to drive sales

Selling overseas without an entity:

- If services – withholding tax and indirect taxes, and what credit is available in the UK?
- If licence fee – withholding tax and VAT
- If goods – consider customs duties and VAT.
- If people need to be on the ground – how will you manage the Permanent Establishment risk**?**

Route to market

Sending staff abroad & creating a taxable presence

Commercial questions:

- Do you need people on the ground to drive distribution?
- Do you need people on the ground for a co-production?

Permanent Establishment risk

- 'Permanent Establishment' means a taxable presence. This can be formed through:
  - Fixed place of business – physical presence – recurring visits/events can still create PE
  - Dependant agents – agents concluding contracts or without significant other clients
  - Having staff in country for a certain period of time – for example in China you can create a PE by furnishing services for over 183 days (cumulative) in 12 months
- Activities that are preparatory or auxiliary in nature can be exempt
- If a double tax treaty is in place, business profits may only be taxable to the extent the income is attributable to the PE.
- Once a PE is formed, an entity may be required to employ the staff. This may be a legal requirement or a sensible option to manage other implications. Analysis should be untaken based on the particular facts.

Route to market

What are the options for a local entity?

Branch

- Operation/activity of an overseas company
- May need formal registration as a 'representative office'
- Scope of activities may be limited

Pros

- Use losses in home country
- Foreign income not taxed
- Changing from a branch to a corporate can be done tax free but to change from a corporate to a branch triggers a taxable event

Cons

- No choice on payment date for WHT
- Can be complex branch tax rules
- Can be local tax even though a cost centre

Subsidiary

- Some markets will require a local partner or local directors
- Some markets may limit activity in the media sector
- Usually a subsidiary is the preferred option

Pros

- Simpler, with clearer record keeping
- Choosing payment dates gives more control over WHT

Cons

- Often taxed on subsidiaries' worldwide income, so foreign sourced income can be taxed
- Foreign parent subject to withholding tax on dividends (eg 30% from US unless double tax treaty applies)

Partnership

- Partnerships can often be transparent for tax purposes
- Check liability!
- In the US an LLC can be treated as transparent for tax purposes, and are popular
- In China most partnerships are unlimited liability so are very rare

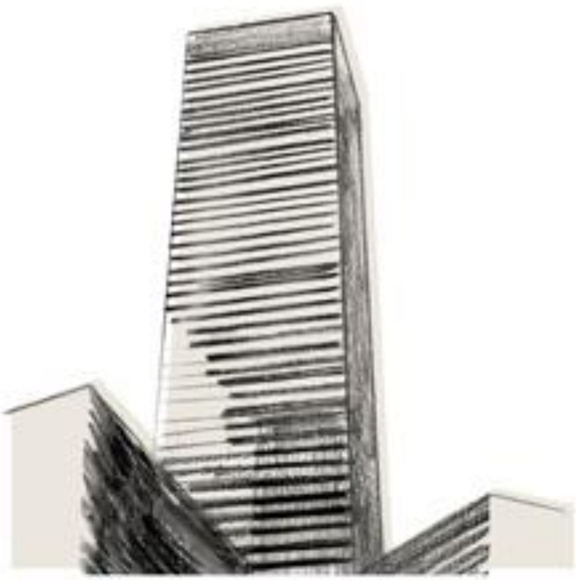
Joint venture

- Commercial or regulatory motivations
- Equity (ie take shares in a new company)
- Contractual (ie formed through contracts and operated through existing companies
- The joint venture agreement

Route to market

Other considerations for setting up a local entity

- Implications and implementation different depending on whether using a subsidiary, branch, representative office, or joint venture
- Timeframe – it can take a considerable amount of time to form a company in some territories
- Cost – what are the fixed costs and professional fees?
- Where to set up – practical factors, different provinces/regions, incentives
- How much investment might be required – equity v debt v market support payments
- How should you hold the entity – directly or via a holding company?
- Do you have non-dom shareholders? What are the individual income tax issues?
- What will my supply chain look like?



Route to market

Working with partners and customers

- **Understanding each other**
  - *"Same bed, difference dreams"* - Chinese idiom
  - Short term, mid term and long term plans – are you on the same page?

- **Know your counterparty**
  - Formal and informal process
  - Due diligence

- **Planning for divorce and dispute resolution**

Tax considerations

Which taxes will you encounter?

- **Corporation tax**
  - charged on profits
- **Withholding taxes**
  - charged on cross border payments
- **Indirect taxes**
  - charged on sales
  - includes VAT and customs duties
- **Individual taxes**
  - Employees may be subject to overseas taxes as well as UK taxes
- **Miscellaneous local taxes**

- Remember - every market is different!

Tax considerations

Corporate tax is different in every country

For example: Corporate taxes in the US

- Companies pay federal taxes (similar to corporation tax) to the Internal Revenue Service
- Charged on income from overseas made by a US company and US related income earned by a foreign entity
- 35% headline rate contrasts with UK long term rate of 20%, but progressive
  - <$50k is 15%
  - $50k-75k is 25%
  - $75k-10m is 34%
  - >$10m is 35%
- Companies also pay state taxes to the state treasurers in each individual state they have 'nexus' in. This is subjective and includes a place of business or employed staff, or sales of over $500k or more than £50k of property. State income tax rates are 1-10% depending on the state (highest rates in New York, California and Illinois).
- Any state taxes paid are a deductible expense in the computation of federal taxes.

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Tax considerations

Supply chain, withholding taxes and indirect tax

Supply chain:

- What is the local entity doing?

- How will you extract profits back to UK:
  - Should sales be from local entity or the UK
  - Tax efficiency
  - Withholding taxes and credit in UK
  - Indirect taxes and customs duties
  - Remittance strategy and approvals required
  - Satisfying local transfer pricing rules and contemporaneous documentation.

Withholding taxes

- Royalties
- Services
- Interest
- Dividends

Indirect tax

- VAT, GST, Business Tax, Customs Duties

- China - BT, VAT, Duties

- USA - Sales tax (VAT equivalent) by state
  – doing business/ have a physical presence/ presence of employee negotiating contracts
  – Consider if the type of activity is taxable:
    - Information and entertainment services are taxable
    - Law is evolving around live streaming and internet delivery, and the location of the server delivering the 'services'

Tax considerations

Developing intellectual property

- Cross border charges for IP will depend on its location
  - Will you retain IP in the UK?
  - Should you avoid IP generation and ownership in the overseas territory?
- Consider what rights the overseas operation needs to be able to trade or to make sales.
  - E.g. are they a sales agent only, or are they a sub-licensor?
- What sort of agreement is there between the UK and overseas entity for the use of IP
- Transfer pricing and anti-avoidance
  - for tax purposes all transactions between associated companies should be on an arms length basis.
  - Some territories apply TP rules irrelevant of company size
  - Various anti-avoidance legislation to consider

Tax considerations

Sending staff overseas and employing people

- Operating with an entity overseas = probably need to deal with employment taxes
- Operating without = your staff still may have local tax obligations
  - **Tax residency** determines main place for tax. Often has complex tests, and often means worldwide income is taxed as well as local income
  - **Local tax liability** - You can face local taxes without being tax resident.
    - Eg. if in country for significant period, if paid by a local entity or paid by permanent establishment.
- For expatriates you need to understand:
  - **Income tax** – when will individuals become subject to local taxes
  - **Social security & National Insurance** – when will individuals become subject to social security
  - **Payroll** – including 52 week rule for National Insurance
  - **Permanent establishment** may impact income tax considerations
- Employment law also needs careful consideration - contracts, hiring and firing, recruitment, local directors, quotas etc

REMEMBER: Rules are different in every country

Tax considerations

Individual taxes are different in every country

For example: In the USA

- Graduated income tax rate from 15% up to 39.6% - so the top rate is lower than the UK.
- Fringe taxes: Social Security (6.2% matched employer and employee) and Medicare 1.45%
- US residents are taxed on worldwide income and capital gains. If resident:
  - immediate liability to US income tax payment and filing requirements (more onerous than the UK)
  - Capital gains made by non-US nationals are taxed when resident in the US; long and short term tax rate, lowest is 20% plus state tax, could total in excess of 30%. Compared to UK capital gains tax – Entrepreneurs Relief at 10%
- You can be US resident if in the US for at least 31 days in calendar year and the sum of the following equals or exceeds 183 days: all days in the US in the current year, plus one third of days in the first preceding year, plus one sixth of days in the second preceding year.
- Care needed if seconding employees to the US, or founders undertake significant visits

For example: In China

- May be liable for Chinese individual income tax if
  - The individual has stayed in China for more than 183 days in any consecutive 12 months. Or,
  - The individual's employment remuneration is paid or borne by a Chinese entity. Or,
  - The individual's employment remuneration is borne by a PE in China.
- Progressive rates range from 3% to 45%, so can be higher or lower than the UK depending on pay band
- Can lead to significant administration, and possibly unrelieved tax, if double tax relief needs to be claimed.
- Social security – rules and implementation can differ

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Tax considerations

Compliance

- Tax filing
  - Each country will have different tax filing rules
  - There are likely to be multiple taxes in each country, and different filing rules for each (eg corporation tax and VAT)

- Audit
  - Many countries will require companies to be audited

- Legal compliance
  - Local lawyers should be consulted regarding local legal compliance

It sounds complex – but there is a lot of support services to help you along the way

- Route to market advice: Direct sales/ E-commerce/ agents/ distributors/ licensing/ trading companies/ subsidiaries
- Tax and export tax advice: Customs duties; Import/export paperwork & process; Incoterms/terms of trade; Indirect tax
- Logistics: Logistics / Travel services/ Shipping
- Exhibitions: Exporters visiting trade shows – exhibiting / IP / logistics
- Supply chain: Cash flow management; Customer DD ; Supplier DD; Quality control; Selection of agents / distributors etc; Tax advisory; Logistics; Supply chain integrity testing; Royalty audits (eg IP licensing, music, film exports etc)
- Intellectual property: Registration of IP; Practical protection of IP; Licencing
- Marketing and localisation: Marketing / branding / advertising / channel distribution / outsourced BD and marketing / pricing / localisation
- Getting paid: Exports – paperwork / security (LCs etc); Trapped cash; Debt recovery /Asset tracing; Foreign exchange services; Hedging; Natural hedges / overseas retained earnings etc; Forex strategy planning; Trade finance; LC / factoring / forfaiting / bonds / guarantees
- Language: Translation / interpreting / business cards
- Culture/negotiations: Culture training; Differences in negotiation strategies; Negotiation support
- Legals : Contracts; Regulations; Licences; Licensing; NDAs; Interco agreements
- IT / web design: Design services; Practical localised considerations; Regulatory understanding
- Corporate set up: Subsidiaries / joint ventures / rep offices / branches Compliance and outsourced services: Tax / audit / annual filings; Outsourced services, including book-keeping, HR/payroll, Company Secretarial.
- Structure: International structuring / tax advice/ transfer pricing
- Risk management: Internal audit - BRS – forensics – bribery & money laundering advisory
- Research services; Market selection strategy / Geography / new regional expansion / customer/ competition/ business case feasibility study / market sizing / sector/ commercial audit / pricing / customer satisfaction / trends / industry procurement / meeting packages/ distributor& partner identification
- Recruitment: Finding and keeping the best staff; Expats, visas and Global Mobility services
- Funding for expansion: Finance or financial advisory
- Product development: Consultancy, localisation, R&D
- Sourcing: Quality control / identification
- International order processes and payment procedures/ standard invoicing detail requirements / standard trade terms / notarisation / bank accounts
- Insurance: Credit Insurance / Cargo Insurance / risk management

Summary

- Understand the challenges
- Form your strategy
- Start to forecast your numbers
- Assess your routes to market
- Understand tax implications
- Implementation
- Use the help available!

Let me know if you need assistance

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