UHY

International Business

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Business in the eye of the storm

Business leaders are increasingly finding new opportunities as a result of two evolutionary paradigms – the transformation between the Technology Age and what futurists are calling the Knowledge Age.

The concept stemmed from a study that tracked human knowledge for the past 2,000 years. It showed that, currently, mankind is doubling its cumulative knowledge every 18 months.

"This obviously puts extreme pressure on any company to stay ahead of the curve," says UHY Advisors Inc. CEO Steve Samek. In the 40,000 years of mankind there have been six ages, he argues - stone, iron, agricultural, industrial, technology and, now, knowledge. "The change from each age creates seismic shifts," he says.

Today's Knowledge Age was ushered in when Microsoft's market cap exceeded IBM's in October 1998. Yet, Microsoft had only 1/40th of the tangible assets of IBM at the time.

"In other words, it's not what you own that creates value, but what you know," says Steve. "This is the first time in the professional careers of most people that we're living through such change."

In former times, says Steve, assets meant more wealth. But today assets can rapidly turn into liabilities. Woolworths discovered this about a decade ago. Today eBay is the world's largest retailer given global transaction volume, but without the physical outlets or ownership of inventory.

As an example of how value creation is changing, among UHY's clients in the US is a company providing customised software applications for industry-focused compliance tasks – such as documenting potentially hazardous chemicals for manufacturers, hauliers and retailers to self-comply with government regulations.

"The company has reinvented itself so well that it partners with Wal-Mart to provide a common standard for documenting all of the retailer's products – from shampoo to lawn pesticide," says Steve. "They have created a portal that Wal-Mart requires every company with monitored chemicals to update before products reach their shelves. This creates value because it is easier for suppliers to comply and provides Wal-Mart with a self-compliance policy."

In the Knowledge Age you can't just count inventory, value plant and

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Key characteristics that typify how business is being transformed:

Technology Age	Knowledge Age
Speed to market (and the market forgives for working out kinks in software releases)	Speed to market and the right product. Customers expect it right first time.
Better or faster companies win	Only better and faster companies win
Your technology is a competitive advantage	Your technology is a commodity; your people's knowledge drives competitive advantage
Being paid for what you do	Being paid for what you know
Doing things quickly and efficiently	Doing the right things quickly, effectively and efficiently
Quality is a differentiator	Quality is a given
Adding value will propel you to the top	Adding value will allow you to survive

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UHY is a worldwide network of independent accounting firms

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equipment, or appraise real estate holdings to judge value. "We're more focused on business risks throughout the company in the form of intellectual property, business model, competitive advantage and other intangibles," says Steve.

So what advice can UHY give its clients?

"You can't be a 'fast follower' any more," says Steve. "You can't wait for someone else to invent and take the risk. The profitability window of any innovation closes a lot faster. When you're in the middle of an age, you simply need to keep up with the age to remain competitive. But when you move to a new age, you have to keep your eyes on maximising the productivity of the age you're still living in whilst inventing ways to win in the new age."

Life-cycle curves are compressing dramatically. A product can come and go in months. While in the past you could be a productivity-driven company or an innovator, now you have to be both. You're creating value in both ages amid a hurricane of change."

International business becomes more important in this transformation – "If you're not thinking about China or India, for example, as either a labour source or a market, you'd better take a crash course". If you decide not to engage these countries you will need to compete with those who do.

But because competitive advantage is fleeting, mid-size companies can use their speed to anticipate change. "Your ability to move quickly will be your competitive advantage." Also, because of connectivity and knowledge, a smaller company can look and feel a lot bigger than it is. "There has never been a better time to be a mid-sized company," says Steve.

Excitement about what this transformation can offer is being triggered in the US by UHY Advisors' launch of a TV show called 'Business in the Eye of the Storm' featuring companies taking advantage of this opportunity.

A pilot filmed in India featured a small Californian accounting firm who bought an operation in Pune, India, and is using lower-cost labour to complete individual and some corporate tax forms.

For 2007, UHY Advisors Inc is producing 13 episodes, each lasting 30 minutes, for a national cable TV network. "The show is the centrepiece of our thought leadership programme for 2007 and beyond," says chief marketing officer Bill Penczak.

The first programme will delve into how family-owned businesses weather what some have described as the ultimate storm - working with family members and transitioning generational ownership.

It will feature interviews with two client family-owned manufacturing companies - Hannay Reels, one of the world's leading manufacturers of industrial hose reels, located near Albany, New York; and Hamilton Shirts, a Texan manufacturer of custom shirts which is Houston's longest continually-operating family-owned business.

Another episode, currently in production, features another New York client, The Werks, which has created an online service for major US retailers and their vendors to categorise and monitor potentially hazardous products like cleaning fluids or fertiliser. The Werks has taken its unique knowledge of the retail and transportation industries and leveraged it to create a service for some of the country's largest retailers.

To accompany the interviews, 'Business in the Eye of the Storm' will feature discussions with UHY subject matter experts and university professors from across the country.

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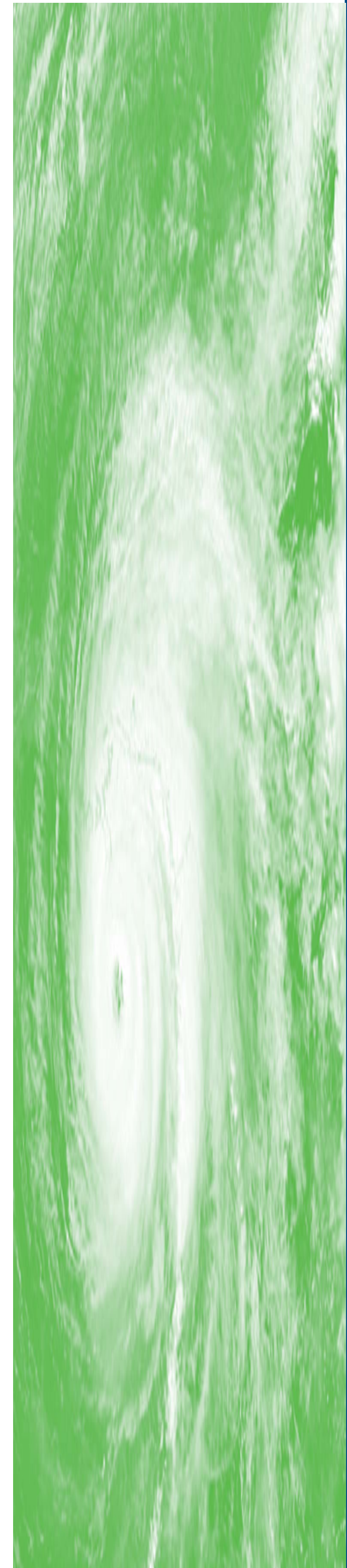

UK court case paves way for EU tax benefit

The result of a court case in the UK looks like good news for businesses that invest in the European Union (EU). The ruling appears to enable companies to gain a tax benefit.

Last summer the European Court of Justice (ECJ) ruled on a case between Cadbury Schweppes and the UK tax authorities. Its ruling legitimises businesses locating part of their business in a particular country to gain a tax benefit within the EU.

Cadbury Schweppes had set up a finance business in Ireland, which charged interest to the various subsidiaries of Cadbury Schweppes around the world. Ireland was chosen for the special tax regime for companies at the time - 10% corporation tax.

Cadbury Schweppes admitted the low tax rate was the reason for choosing Ireland as a location for the financing business. The Irish company had only one employee who ran the company from Ireland.

In UK tax law, there is a concept called 'controlled foreign companies' (CFC) that allocates the profits of subsidiaries to the UK owner if the tax suffered in the foreign company is less than 75% of the equivalent UK tax.

There are various exemptions to try to protect genuine establishments from attracting the tax charge, but this usually involves subsidiaries distributing most of its profits back to the UK and the end result is that the profits of the foreign company are taxed under UK corporation tax; plus to qualify for this treatment the subsidiary had to undertake certain activities, for example, manufacturing with a permanent presence in the foreign country.

The UK tax authorities sought to tax Cadbury Schweppes on the profit made in Ireland under the CFC legislation. Cadbury Schweppes appealed and court proceedings started with the case being referred to the UK Special Commissioners.

Cadbury Schweppes' appeal was based on the fact that the UK legislation was a breach of Articles 43EC, 49EC and 56EC of the EC Treaty (Freedom of Establishment). The Special Commissioners referred the case to the ECJ for review.

The ECJ concluded:

- The fact that the company is established in a member state solely for the purpose of benefiting from favourable tax arrangements does not in itself suffice to constitute an abuse of community rights.
- The CFC legislation constitutes a restriction on the freedom of establishment by imposing an additional level of taxation on a resident company on the basis of the level of tax upon its controlled companies.

The court went further to state that it is irrelevant that the imposition of a CFC charge has the same tax effect as if the activity was conducted in and taxed in the UK; the parent is still made subject to tax upon the profits of another company.

The court did accept that restrictions can be justified where the national legislation pursues: "The specific objective... to prevent conduct involving the creation of wholly artificial arrangements, which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory"; and also commented on the dividing line of what is wholly artificial.

It is apparent that the court is looking at cases where there is a fairly high level of abuse as set out by the court: "If checking those factors leads to the findings that the CFC is a fictitious establishment not carrying out any genuine economic activity in the territory of the host member state, the creation of that CFC must be regarded as having the characteristics of a wholly artificial arrangement. That could be so in particular in the case of a 'letter box' or 'front' subsidiary."

The court has passed the case back to the Special Commissioners in the UK, who will review the ECJ ruling and will decide the position for Cadbury Schweppes in 2007.

The case is probably good news for business as it has helped allow businesses to focus on commercially driven structures knowing that if activities are located elsewhere in the EU, the CFC rules will not apply as long as they can provide genuine substance locally. The case applies to the whole of the EU and will benefit businesses that inwardly and outwardly invest in the EU. Based on this, the Chancellor announced in December 2006 that the CFC rules would be relaxed somewhat so that profits from CFCs resident in both member states of the EU and the European Economic Area from genuine economic activities may, subject to conditions, fall outside the scope of the regime.

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Business resilient despite political conflict

Consider this paradox: over the past five years, political turmoil has swept the world. It began with the attacks of 9/11, followed by bombings in Bali, Casablanca, Istanbul, Madrid and London. There have been two major American-led wars, in Afghanistan and Iraq. Add to this the war between Israel and Hezbollah in Lebanon.

But during this same period the world economy has experienced its fastest five-year growth spurt in more than three decades. In fact, per capita GDP growth during these stormy years has been 3.2% – higher than any comparable period in recorded history.

Analysts suggest, therefore, that the current era of globalisation is more powerful, widespread and resilient than many people realise.

In this article, we consider the 'war effect' from the 45-day Israel-Lebanon conflict in July 2006 – an economic yet personal insight through UHY's member firms in both countries.

We spoke with Shmuel 'Sami' Naiberg, partner at Shiff-Hazenfratz, Tel Aviv, and Elie Abboud, managing partner of UHY Andy Bryan, Beirut. Both forecast a fast and resilient bounce-back in business conditions once political stability returns.

Israel

The most surprising result of the 2006 war was how strongly and how quickly the economy recovered, says Sami.

Previous wars had been followed by a period of recession and harder business times as war losses and expenses took their toll.

But in 2006, the war happened to take place at a time when the Israeli economy was at its strongest. In the immediate aftermath of war the Government moved swiftly to sustain confidence by providing compensation for damage to homes and businesses, as well as by covering the salaries of employees whose livelihoods had been devastated by the conflict.

Another factor was that the war zone structural damage was confined to one-third of Israel, in the north. For the rest of the country it was, by comparison, 'business as usual': in the other two-thirds people turned up for work and traded normally, especially to achieve export deadlines.

But wherever Israelis worked, there was always an undercurrent of concern for relatives called up as army reservists, and Israelis' social lives - such as holidaying away from home in the popular northern Israeli resorts - were largely wiped out. Most people went only to work and then home - nowhere else - and retail businesses suffered as people rarely went shopping, except for essentials, during the conflict.

The Israeli stock exchange lost 10 to 15% across the board (it has since recovered quickly and is stronger than it was before the war), but tourism was badly hit and has yet to recover. The year had been expected to be a bumper year for tourists from abroad and from Israelis holidaying within their own country. "We lost the summer," says Sami, and confidence that tourists will return in 2007 has yet to surface.

Tourism from abroad within Israel had long been damaged by six years of suicide bombings, but recently begun to improve after Israel evacuated Gaza and suicide bombings almost ceased. The war, however, reversed this process.

Even so, the value of the shekel has not been devalued against other currencies – it has survived resiliently. Both Israel's stock market and its currency were higher on the last day of the war than on its first day. And, although the Central Bureau of Statistics shows the economy shrank 1.4% in Q3 2006, economic growth is now stronger today than it was before the war. Talk of the need to raise corporate taxes to spend more on defence, and on social costs in support of the most needy, have largely subsided as the economy has proved itself resilient.

Foreign investment has also been sustained. It slowed briefly, but, for example, a recent report on the real estate market showed that foreign investment had continued on its upward growth and had been worth USD 2.5 billion over the previous two years. Also, Israel's interest rate in the aftermath of war was lower than in the US.

The offices of UHY member firm Shiff-Hazenfratz, were thankfully beyond the war zone, but 'the mood

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was not at its best', says Sami. Employees were affected by what was happening to their family members, by having friends and colleagues called up into the reserve army, and by taking in displaced citizens from the north who arrived in great numbers seeking shelter in the southern areas. Estimates show 20% of Israelis were displaced during the war.

The firm also had clients in the war zone. Fortunately, none of Shiff-Hazenfratz's clients lost their businesses or suffered employee deaths during the war – but several companies in the north did: bombs destroyed factories and agricultural land was set ablaze. No audit work was carried out on site at northern client businesses during the conflict.

Lebanon

"I believe it's time for all the people to live in peace in this region," says Elie. "Nations have suffered enough. Enough is enough."

Before the conflict, the Lebanese economy was on track to grow by 5% at the end of the first half-year in 2006, reported the International Monetary Fund (IMF). Now, for 2007, the IMF projects a deficit of more than 15% of GDP and Lebanon's economy is expected to shrink by 5%. Forecasts from the London-based Economist Intelligence Unit are even more bleak.

One example of the war effect is demonstrated by the results of Lebanese real estate developer Solidere, which reported a 2006 Q3 net profit of under USD 4.3 million, a decline of 81.5% compared with the previous year. The main area of its development, central Beirut, was mostly untouched by the fighting, but real estate transactions ground to a halt during the conflict.

As in Israel, tourism has inevitably been hit hardest. In early 2006, stability had been achieved throughout much of Lebanon. Beirut's reconstruction from the civil war was almost complete, and an increasing number of foreign tourists were visiting Lebanon's resorts. Tourism then accounted for 15% of the economy and had been expected to rise by USD 2.5 billion during 2006. The conflict put an end to that.

Before violence broke out many Lebanese living abroad had begun to return home and invest in their country. Many Arabs were investing in Lebanon. But investment has largely ground to a halt because of the political instability. "We are facing a bad time here in Lebanon," said Elie. "There are a lot of political problems effecting the economy and instability is detracting new investors for the time being. The next two or three months [from December] will be crucial, but I believe there will be compromise and political resolution, and from there we will have a quick recovery and attract new capital."

UHY Andy Bryan and its team did not suffer directly during the conflict, although the firm lost one client who abandoned outsourcing of its internal audit because of travelling and accessibility problems.

UHY Andy Bryan had to stop most work for a month and a half – "people were sitting at home", says Elie. "The psychological effect was horrible. It was horrible for everybody." But by September "we started to move again" and business was showing signs of recovery in October and November. "We can see again the potential for acquiring new business. It has been manageable," says Elie.

Reconstruction - estimated by the Lebanese government to cost USD 10 billion - will take many years compared with the relatively short conflict. Nine hundred factories, farms and small businesses are reported to have been damaged or destroyed. Power stations, water treatment plants and hundreds of roads and bridges will need reconstruction.

President of the Lebanese International Chamber of Commerce, Wajih Bizri, estimates that more than USD 200 million in direct damage was inflicted on the industrial sector – with dairy, cement, glass and prefab housing factories hit hardest. Factories asking the Lebanese government for reconstruction funds are having to wait their turn behind the rebuilding of essential services.

The global economy's resilience to bounce back when political stability returns is a phenomenon of hope.

Low tax and double tax treaties create investor opportunities

Offshore tax regimes and tax treaties provide investors with opportunities. We provide examples of the benefits that can be secured through two of UHY's member firms specialising in offshore arrangements.

Channel Islands

As a finance centre, Guernsey never stands still. It is constantly evolving through the development and introduction of new structures specifically aimed at the corporate and private client financial planner.

The Guernsey trust, together with the Guernsey company, are the traditional cornerstones of these opportunities. However, over the years, new concepts have been introduced such as the Protected Cell Company, the Incorporated Cell Company, Limited Partnerships, even a Channel Islands Stock Exchange. Also, 2007 expects to see the introduction of Purpose Trusts.

Underlying all of this is a beneficial tax regime - a corporate income tax rate fixed at 20% for a resident company, but 0% for a company that is not trading in Guernsey and has no beneficial owner in Guernsey. Similarly, a trust will not suffer income tax or capital gains tax on its assets and, when distributions are made, there is no withholding tax or liability to inheritance tax.

Case study 1

UK resident, non-UK domiciled individual buying property in the UK

Wealthy foreign nationals moving to the UK to take up residence are able to use a Guernsey company to purchase residential property in the UK.

By doing this, they effectively convert the asset into a non-UK situs asset (being the shares in the Guernsey company). This is important in the event of their untimely death, because it takes the asset out of their UK estate for UK inheritance tax purposes. In addition, on the future sale of the property, if the shares in the company are sold, then no capital gains tax arises.

Case study 2

The Family Trust Company

Wealthy multi-generational families are increasingly turning to the establishment of their own trust company as the solution for not only segregating the family wealth between individuals and generations, but also, segregating assets with potential liabilities from those that represent the core wealth.

The trust company acts as trustee to the family trusts, of which there can be as many as required. Simple examples are those for the education of children and providing for grandparents, whilst underlying Guernsey companies can be used to hold investment portfolios, real estate and luxury items such as yachts and jets.

The additional attractive benefit that accrues is that, because family members are on the board of trustees, they can maintain a role in overseeing and controlling the assets.

UHY Louvre in Guernsey will be pleased to assist and advise worldwide. Please contact Lynn Giovinazzi by telephone (+44 (0) 1481 727249) or email lynn.giovinazzi@louvregroup.com

Mauritius

Structuring investments in other countries, through the Mauritius Global Business Sector (better known as the offshore sector), presents foreign investors and investment funds with significant fiscal planning opportunities. This is mainly because Mauritius is a low-tax jurisdiction and has double tax treaties with more than 30 countries.

Vehicles commonly used by investors are Category 1 global business licence companies (GBL1s) and Category 2 global business licence companies (GBL2s).

Provided they demonstrate that management and control is in Mauritius, GBL1s are regarded as tax-resident in Mauritius and can take advantage of double tax treaties. They are taxed at 15% less tax credits such that the effective tax rate is a maximum of 3%.

GBL2s are not tax resident and, therefore, not liable to tax in Mauritius, but cannot take advantage of double tax treaties.

The absence of exchange controls, capital gains tax (CGT) or withholding tax (WHT) in Mauritius further enhances the attractiveness of the Mauritius Global Business Sector to investors.

Case study 1

Investment in real estate, private and listed equity and capital ventures in India

A US company creates a special purpose vehicle (SPV) to construct and develop a hotel in India, which is then sold. SPV in India is liable to Capital Gains Tax (CGT) on the sale.

The same US company creates a GBL1 company in Mauritius, which owns the SPV in India. To complete the sale, the GBL1 company is sold instead of SPV. The capital gain arises in Mauritius and is not taxed, as there is no CGT in Mauritius.

Similarly, the US company will not be liable to CGT on gains on the sale of investments in private and listed equity and capital ventures in India, if the above structure is adopted.

Case study 2

Investment Funds investing in the Indian financial market

A US Fund is liable to CGT in India on gains on the sale of its investments. If the US Fund sets up a subsidiary Fund in Mauritius, which is used as the investment vehicle into India, gains will not be subject to CGT in India, by virtue of the double tax treaty between India and Mauritius.

UHY Heeralall in Mauritius does not provide offshore management services, but can advise investors on fiscal planning issues involving the Global Business Sector in Mauritius and refer them to reputable offshore service providers. To find out more, contact Nirmal Heeralall of UHY Heeralall, email nirmal.heeralall@uhyheeralall.com

Footnote

Considerable care would need to be taken to ensure that the provision of a UK home to the foreign national does not constitute a benefit for employment tax purposes

Latin America prospers from US trade flow

The US has realised that the best way for countries to achieve political stability and economic development is through free trade agreements, offering more freedom internally to companies and promoting employment. This, in turn, explains why the US has been supporting trade deals across Latin America and it has already signed accords with most of the countries of the region, with only a few now opposing them.

From the US-Mexican border to the southernmost tip of Chile and Argentina, the Latin American countries enjoy a prosperous trading relationship with the US.

The region's vast natural resources – oil and gas, coal, metals, coffee, sugar and timber – are exported in huge quantities to the US.

But with the exception of Argentina, Latin American countries import more from the US (particularly agricultural products) than they export to the US. In 2003, Latin America exported USD 52 billion worth of goods to the US, but imported USD 78 billion worth of goods.

Such has been the flow of trade between Latin America and the US, that over the past ten years Latin America's economic and political climate has improved beyond recognition.

In 1990, the US lifted its five-year trade blockade on Nicaragua. To help reduce inflation from 13,500% to 9.6%, the Nicaraguan government privatised 350 of its state enterprises. In 1992, El Salvador ended its long civil war. The Argentinian economy has grown stronger since the catastrophic collapse of the peso in 2001 and has restructured its massive public debt. Currently, Cuba is the only Latin American country that does not benefit from free trade with the US.

Many Latin American countries have adopted market-based economies, which have helped to reduce public debt. Former state-owned enterprises in Brazil, Colombia and Peru were sold in a spate of privatisations during the 1990s. Import tariffs have reduced since the 1980s and many of the region's countries have opened themselves up to free trade with the US and Canada. Because of their favourable tax regimes, Central American countries such as El Salvador and Costa Rica are popular retirement destinations for American citizens

The two trade blocs operating in the Americas are Mercosur and the North American Free Trade Agreement (NAFTA). Mercosur was formed in 1991 and has been described as 'the common market of the South'. Geographically, the Mercosur region is four times the size of the EU and accounts for about three-quarters of economic activity in Latin America. Argentina, Brazil, Paraguay, Uruguay and Venezuela are all full members of the bloc. Chile, Bolivia, Peru, Colombia and Ecuador are associate members. Mexico is becoming an associate member.

Further north, NAFTA - implemented in 1993 - includes the US, Canada and Mexico.

All is not entirely well, however. A new agreement, the Free Trade Agreement of the Americas (FTAA), opening up trade between 34 countries, has been proposed by the US, but key countries such as Brazil and Venezuela are opposed to it.

Moreover, Venezuela's controversial President Hugo Chavez is overtly anti-American. He has called for developing nations to establish a world without American influence and has strengthened his ties with Iran, North Korea, Cuba and Syria.

However, despite Chavez's anti-American rhetoric, Venezuela

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continues to have close commercial ties with the US. In 2005, Venezuela exported USD 34 billion worth of goods to the US and, in the same year, Venezuela imported USD 419 million worth of agricultural products (the US supplies approximately one-quarter of Venezuela's food).

Mexico's trade with the US accounts for around one-quarter of its GDP and the country is the third largest supplier of oil and gas to the US. In 2005, 86% of Mexico's exports were bought by the US. Around half a million US citizens live in Mexico and there are one million legal border crossings daily between Mexico and the US. Around 2,600 US companies have operations in Mexico and Foreign Direct Investment (FDI) in 2005 was USD 18.8 billion (the US is the largest investor in the Mexican economy).

American companies have a presence throughout Latin America: approximately 400 US companies have operations in Peru; about 250 American companies operate in Colombia and about 25 in Nicaragua. Most of these companies are subsidiaries of large multinational corporations. In 2005, Hewlett-Packard Mexico won the US Department of State's Good Partner Award for establishing 250 community learning centres in Mexico.

Benefits for US companies establishing a subsidiary in Latin American are lower wage costs, and an increase in the opportunities available since trade barriers and tariffs are reduced. Less attractive aspects are the potential for economic and political instability, lack of infrastructure in some countries and corruption.

UHY's links across Latin America

UHY has Latin American firms in Argentina, Brazil, Peru, Mexico, and (more recently) Venezuela. The firms share information and work closely with UHY LLP and UHY Advisors Inc., the UHY member firms in the US.

For example, UHY LLP in Michigan, US, has US-based clients supplying the auto industry who have set up subsidiaries in Mexico.

Typically, Mexican operations assemble motor parts and ship them back to the States.

Clients have asked for auditors to be close to their subsidiaries as well as being based in the US – a package which UHY LLP can readily offer through the involvement of member firm UHY Glassman Esquivel, based in Mexico City.

Natural resources, the cost of labour and proximity to the US continue to be the biggest attractions for US clients setting up subsidiaries in Mexico – even though labour cost advantages may not be as compelling as they once were. Nowadays, competition is strong from China and India.