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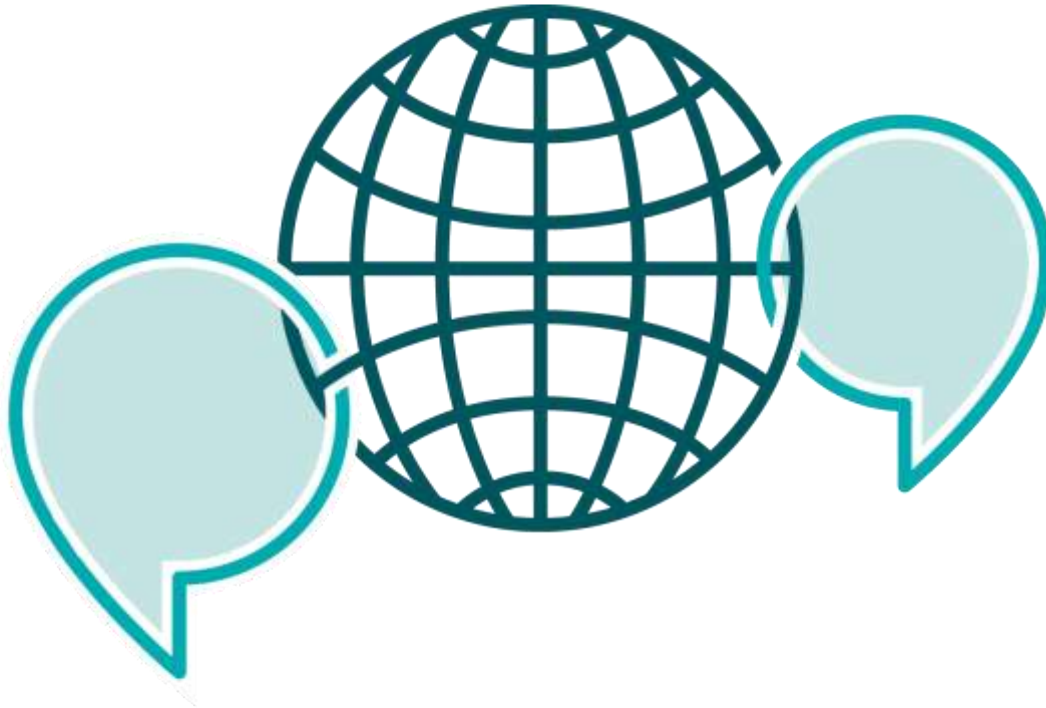
Global Insight – April 2018



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GDPR: why businesses need to act now

The 25 May 2018 deadline for the new European data protection regulation is fast approaching and will affect almost every company in the EU, as well as any business outside the EU that holds data on EU citizens.

For any business that processes personal data, the General Data Protection Regulation (GDPR) should be of real concern, as failure to comply could result in fines of up to the higher of €20m or 4% of aggregate global group sales.

GDPR imposes increased obligations on the handling of personal data compared to previous legislation. As such, its application from 25 May 2018 will affect most businesses within the EU economy but also businesses outside the EU that keep any data on EU citizens. Businesses need to act quickly if they have not started making preparations.

What is GDPR?

In today's data-rich environment, personal (and private) data is of increasing value. Similar to stock-in-trade, information is easily bought and sold, across many sources and platforms around the world.

GDPR is the EU's attempt to enhance the data security protection of EU individuals, set in the context of ultimately giving individuals the trust and the power to exploit their own data currency.

The need for the stringent requirements stipulated in the GDPR framework arises from the increasing volume and value of personal data, as well as the increasing number of data breaches. The regulation aims to bring together all applicable laws on the use and processing of personal data. The goal is to increase corporate accountability on data processing and provide more robust data protection compliance. All companies providing services to EU citizens are subject to GDPR.

The GDPR is set to affect three key data areas:

- Breaches

From 25 May 2018, any company that identifies data misuse or loss must notify all relevant breaches to the competent data protection authority (DPA) within a maximum 72 hours. Each EU country has a separate DPA.

If these breaches have no impact or present no risk to the rights and freedoms to the data subjects concerned, then no report is required to the DPA. If the misuse of data puts individuals at high risk of adverse impact, then the individuals must also be notified immediately.

The potential adverse publicity from such data breaches means many businesses will need to focus on enhancing their cyber security.

- Management

Anyone controlling and processing data, along with any service providers, must maintain records about their processing activities. For many businesses, identifying the source and location of personal data will be one of the biggest and most time-consuming GDPR challenges. These records should contain information such as:

- data content
- purposes of data application
- data categories processed
- categories of data recipients
- data security measures adopted
- length of planned storage period.

Many companies engaged in processing personal data will be required to appoint a data protection officer, for instance if they process certain specified categories of data or perform online behaviour tracking of individuals, such as consumer preferences.

• Rights of individuals

Many of the rights of individuals are enshrined in existing EU directives. However, GDPR also introduces new rights for individuals, including the right to permanently delete all information held about them. Companies will have to obtain specific consent from individuals on an opt-in basis regarding the collection and processing of their data, and with clear privacy notices, which can no longer be buried in terms and conditions.

Penalties for non-compliance

The potential penalties for non-compliance with GDPR may be draconian, although in reality it is likely that the more severe penalties will only be applied to businesses who choose to ignore GDPR. Either way, it should be recognised that GDPR affects just about any economic entity holding data about EU subjects, regardless of scale and location. This includes, for example, any company that has its own payroll accounting department or a comprehensive customer administration system, or any company that requests personal data from customers.

Get started

These changes are far-reaching, since very few companies can exist without the personal data of customers, suppliers or employees.

It will be a major challenge for many organisations to be fully compliant with GDPR by 25 May 2018. Although the legal framework continues to be developed and interpretations are still being refined, organisations should plan their journey towards GDPR compliance as soon as possible. It is particularly important for businesses that hold sensitive data.

At the very least, all businesses must be able to recognise notifiable data breaches if they occur from 25 May 2018, and know how to make an appropriate report within 72 hours.

Here are some high level suggestions on what organisations can and should immediately undertake to help ensure their compliance with GDPR:

- Appoint a senior manager to oversee the project.
- Prepare a data inventory and data flow map.
- Prepare a gap analysis.
- Update data protection policies.
- Review and update cybersecurity measures.
- Review existing contracts with clients, suppliers and employees.

- Review adequacy of consents previously provided.
- Implement breach management processes.
- Provide staff training.

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Gulf states introduce VAT

The UAE and Saudi Arabia are the first two Gulf Cooperation Council countries to introduce VAT to help boost government revenue.

The six Member States of the Gulf Cooperation Council (GCC) – Saudi Arabia, the United Arab Emirates (UAE), Kuwait, Bahrain, Oman and Qatar – ended their decades-old reputation as being tax-free in 2016 by announcing their intension to implement a unified value added tax (VAT) system, in an attempt to revitalise their economies.

The decision to implement VAT across the region suits the GCC's long-term strategy to enhance economic stability and diversify revenue streams away from their past dependency on oil profits. VAT is touted as being an ideal revenue instrument for the GCC – a modern consumption tax that effectively mobilises tax revenue while avoiding economic distortions. It is estimated that VAT revenues will generate 1.5% to 3% of non-oil GDP, and Saudi Arabia and the UAE alone could raise as much as US$21bn in the first year.

The UAE and Saudi Arabia led regional fiscal reforms by introducing VAT on 1 January 2018, while Bahrain intends to follow suit later this year and Oman from 1 January 2019. Political resistance has delayed VAT in Kuwait, while Qatar is not expected to introduce VAT due to the closing of diplomatic ties with other GCC countries.

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Despite the scepticism surrounding the implementation of VAT being achieved by Q1 of 2018, both the UAE and Saudi Arabia rolled out VAT six months after the legislation was finalised. Most comparable VAT-enforcing jurisdictions take 18 months to achieve the same aim. While this has given businesses little time to prepare, the authorities are offering amnesty in the form of extensions to deadlines for registration and filing returns to relieve pressure on firms struggling to comply.

Implementation challenges

As VAT is being adopted, friction between VAT legislation and commercial practices are emerging. In particular, family-owned businesses, characteristic of the region, face many challenges. A lack of segregation between private and business wealth is complicating the implementation of VAT beyond the conventional dilemma of simply offsetting input and output tax. Teething problems are common when tax systems are first launched, but the introduction has been more challenging in the GCC, where many businesses have been less than proactive in understanding the significance of VAT.

However, the cultural shift that this recent tax procedural legislation has instigated should promote improved recordkeeping across the value chain and encourage businesses to take advantage of technological innovations to fuel business growth.

A developing system

As VAT systems in mature jurisdictions continue to evolve, so will VAT in the GCC, as both regulators and businesses negotiate the unforeseen complexities of the new rules. Despite the abundance of guidance, changes to the legislation are likely as the system continues to be tried and tested.

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What does US tax reform mean for foreign-owned companies?

The US Tax Cuts and Jobs Act, which was passed at the end of 2017, offers several rate cuts and improved expensing treatment for pass-through and corporate inbound businesses.

Most provisions under the new US Tax Cuts and Jobs Act generally applicable from 1 January 2018, and many will only be effective for seven to ten years before reverting to the previous rules – unless there is further legislation. Foreign-owned companies should be aware of the following changes.

Corporate tax rate reduction

The corporate rate has been reduced from 35% to 21%. Companies structured as C Corporations stand to save a considerable sum. But it's important to bear in mind that net deferred tax assets and liabilities will need to be revalued under the new enacted rate for financial statement purposes.

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Corporate net operating loss limitations

Beginning with losses generated during the 2018 tax year, net operating losses (NOLs) for C Corporations will be limited to 80% of (pre-NOL) taxable income. While NOLs will be eligible for unlimited carry-forward, most carry-backs will no longer be permitted.

Increased Section 179 expensing

Section 179 of the Act provides one of the elective provisions allowing the deduction of capital asset costs. In 2017, up to US$510,000 of property additions can qualify for deduction under Section 179. For tax years beginning in 2018, the new law raises the maximum amount deductible to US$1m for taxpayers with total qualifying additions below US$2.5m, after which qualification phases out.

Hybrid transactions

A US C Corporation making interest or royalty payments to a foreign related party is denied a deduction if there is not a local country income inclusion or if there is a deduction against this type of income in the local country. This provision also denies a deduction if the interest or royalty payments are made to a hybrid entity, i.e., an entity treated as fiscally transparent for US tax purposes and a regarded entity for local country purposes, or vice versa.

Interest expense limits

Interest expenses continues to be fully deductible for taxpayers with three-year trailing average annual gross receipts of less than US$25m. Above the US$25m threshold, the disallowance is for net interest expense (interest expense less interest income) in excess of 30% of the business's adjusted taxable income. Excess interest will carry forward indefinitely.

Sale of US partnership interest by a non-resident person

Historically, the IRS has taken the position that the sale of a US partnership interest by a non-resident person was subject to US taxation, to the extent the sale of the underlying assets constituted US effectively connected income. This position has now been codified in the new law. In addition, the purchaser of the partnership interest is required to withhold 10% on the gross sales price.

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Representative Office vs Wholly Foreign-Owned Enterprise in China

China offers foreign companies a huge market for goods and services, but it's important to choose the right entity to fit their activities.

During the double-digit GDP growth years leading up to China's modernised Enterprise Income Tax (EIT) law in 2008, most foreign companies conducted business in China in one of two ways. Many took advantage of tax breaks and inexpensive operating costs by establishing joint venture or Wholly Foreign-Owned Enterprise (WFOE) manufacturing companies, which produced goods for export and consumption outside China. Others chose to source goods in the country and establish Representative Offices (ROs) to assist with the process.

Changing times

Considerable change has taken place since 2008, not only because of more moderate GDP growth and the evolving taxation system, but also as a result of the increasing number of foreign-invested entities directly selling goods and services into an expanding Chinese market.

An RO is established without any capital investment, and allows the foreign parent company to conduct necessary business dealings in China without the RO performing any of the direct profit-

making activities. The structure is ideal for those that source goods in China and simply want local personnel in place to assist with purchasing negotiations and quality monitoring.

Meanwhile, a capital-invested WFOE is a fully operational business entity, legally separate from its parent company, and capable of conducting all manner of business, just as domestic Chinese companies do. Before 2008, ROs were commonly exempted from EIT. This is no longer the case, and since RO taxation can now exceed that for WFOEs, many foreign companies are re-evaluating their RO business structures.

Weighing up the options

Where a foreign company requires a presence in China and is deciding between a RO and a WFOE, it must evaluate its long-term goals. If it is only sourcing goods with no intention to ever sell goods or services in China, an RO is likely to be the best option. They are easier to set up and to exit, and if planned appropriately, taxation can be on a par with a WFOE.

However, if the ongoing sale of services in China is expected, a properly planned WFOE is usually preferable. For the sale of goods, a WFOE is usually only necessary where both sourcing and sales occur within China.

As China's economy continues to mature, the country offers a vast market for both goods and services supplied by foreign entities. This trend has inspired the conversion of many ROs into WFOEs. At the same time, the elimination of tax exemptions for ROs has led to an increase in RO closures and a decrease in new RO registrations.

Many companies now prefer to conduct business in China entirely cross-border. The choice of most suitable method is subject to numerous considerations. It is therefore essential that businesses engage a knowledgeable adviser to help make the right decision.

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New incentives give AIM Italia a boost

The Italian Government has adopted a number of measures aimed at doubling the size of AIM Italia over the next five years.

AIM Italia is the Borsa Italia's market dedicated to small and medium enterprises (SMEs) with high growth potential. The market offers high visibility at an international level and a flexible admission process. In terms of market capitalisation, the key industries represented on AIM Italia are energy and cleantech, manufacturing, financial services and investment companies, IT, digital and media. Agri-food, IT, digital & media companies have attracted the most investment.

Individual Savings Plans

Italy's 2017 Budget introduced long-term Individual Savings Plans (Piani Individuali di Risparmio (PIR)), which benefit from tax incentives, encouraging savers to invest in Italian SMEs. The aim is to channel household savings towards productive investments to help grow the Italian entrepreneurial market.

PIRs can be sold as mutual funds, discretionary accounts, life policies or security deposit accounts carrying full exemption from 26% income tax if investors hold the investment for at least five years.

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Retail investors resident in Italy can invest a maximum of €30,000 per year and up to €150,000 over five years in PIRs. As a result of PIRs, almost €2bn of new investment is expected in SMEs listed on AIM Italia over the next three years.

New tax credit incentive

On 1 January 2018, the Government introduced an additional tax incentive for SMEs planning to list on AIM Italia. SMEs with turnover of between €2m and €50m will be granted €500,000 in the form of tax credits. This is expected to reduce the cost of listing on AIM Italia by 5% to 6%. Savings can be used by SMEs to support their growth and improve governance and transparency.

These incentives may enable well-performing SMEs to obtain a competitive advantage on an international level and help them to attract local and international institutional investors.

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The rewards and challenges of a booming economy

While the cost of debt is at a historic low and investment opportunities abound, businesses must be sure to manage the risks of rapid growth.

A booming economy can reward the bold, but opportunities often exceed capacity. With low-cost credit easily available and economic conditions in many parts of the world conducive to new investment opportunities, many companies will be contemplating their growth plans.

Yet competition is also likely to intensify during a boom period so it is important to be aware of the inherent risks when managing growth.

With some economies at or near full employment, the acquisition of talent is generally more challenging, costlier and more complex. Companies need to work much harder on their talent retention strategies. Higher recruitment and labour costs can start to have a negative impact on competitiveness.

In a small market, the combination of a readily available supply of finance and a wide range of potential investors easily brings about an inflationary spiral, which sows the seeds for an eventual tapering off of the economic cycle. In a larger market, easy availability of finance and a pool of enthusiastic investors

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converts a recovery into a boom, until the monetary system starts to raise the cost of credit to prevent overheating.

The current reality in most of the world markets is that liquidity is improving, many multinationals are cash-rich, yet investment opportunities do not appear to be a limiting factor. Is increasing regulation mitigating entrepreneurial spirit, or is liquidity being accumulated rather than invested? If so, will share buybacks become more of a norm in the coming years?

Be ready for change

It is important for business leaders to remember that economic conditions move in cycles. No boom lasts forever, so organisations should constantly be prepared for more challenging conditions in the future. In particular, they should take stock during the boom times, focus on their strategies for both the short and for the long-term, and recognise the need to take possibly more adverse future conditions into account in their planning scenarios.

From an advisory perspective, the onset of stronger economic conditions invites the need for more focus on strategic consulting, change and innovation management, and stronger treasury support.

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Financial modelling for business growth

Businesses of all sizes can benefit from financial modelling to help reduce uncertainty and plan for growth with greater confidence.

Uncertainty is a given for many businesses, whether it's around where the next customer is coming from or the size of the next electricity bill. However, these uncertainties can multiply for businesses looking to scale-up. Growing too fast can be just as disastrous as not growing at all.

Avoiding business failure

SMEs can easily overextend themselves as they expand. Incurring large liabilities that can no longer be serviced can lead to complete closedown. In many cases the lure of an improving economy or expansion into an untested market can lead to failure. Using a well-designed financial forecast model to underpin a business plan can help to avoid these problems.

Financial forecast solution

A financial forecast model shows a business how it is likely to perform based on a series of assumptions. It can help determine the validity of a business' expansion plans by forecasting expected revenues and costs. Critically, a good financial model will highlight fixed costs to determine the

required breakeven level of revenue. In many cases, costs such as leases and wages become unsustainable if demand for products or services falls away.

Scenario testing

Proper business modelling includes forecasting what's expected to happen, as well as alternative scenarios of what could happen. Scenarios will be built around a number of alternative assumptions to determine their impact on the business. These might include new projects, rent increases and factors affecting the underlying drivers of demand.

Scenarios help businesses to reduce the uncertainty of a course of action by determining the upper and lower limits of the impact of both positive and negative factors. Armed with this knowledge, a company can act with greater confidence based on an understanding of whether actual results are within acceptable benchmarks.

For example, effective financial modelling could have prevented a number of recent business failures in Australia by putting the companies involved in a stronger position to consider the impact of large increases in leasing costs when opening new stores and their ability to secure the revenue required to meet these costs. They might have asked themselves whether demand would still be sufficient in, say, 6 or 12 months, and perhaps considered delaying opening a new store by a few months.

Financial modelling for all

Financial modelling has traditionally only been available to large corporations or government-owned utilities, but recent business failures show that it is a fundamental discipline that every business should use. Without a full picture of the possible consequences, the potential risks of aggressive growth plans are too significant to ignore.

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Insight into Canada's booming cannabis market

The upcoming legalisation of cannabis for recreational use in Canada has created global interest in the market, as well as raising some accounting challenges.

The use of cannabis for medical purposes has been legal in Canada since 2001. In July 2018, the Canadian Government is expected to also legalise recreational use. There is currently a great deal of discussion around how each province and territory will approach distribution and regulation.

While the majority of licensed Canadian cannabis producers grow their crops domestically, some have begun to look abroad for foreign production opportunities in an effort to reduce electricity, heat and labour costs.

Listed company boom

There are currently 84 cannabis stocks listed on the Canadian market. Although they have experienced some price volatility, overall performance post-IPO has been impressive to date. The total value of cannabis stocks has surged to more than CAD$35bn[1]. Trading in cannabis-based

[1] Financial Post, "Marijuana sector's books more like 'audited hallucinations' than financial statements, accountants say," http://business.financialpost.com/investing/pot-sector-gets-audited-hallucinations-amid-accounting-quirks

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businesses has skyrocketed, amounting to about half of all trading on the Canadian Securities Exchange[2].

South of the border, many American states have legalised recreational cannabis use, though it remains a Schedule I narcotic at the federal level. As a result, American cannabis companies cannot file a listing prospectus within their own country. The Canadian markets therefore represent a significant opportunity for American cannabis companies.

Accounting concerns

As activity in this market continues to grow, a number of accounting issues have been identified. In Canada, public companies must abide by International Financial Reporting Standards (IFRS), which mandate a fair value model for the agricultural industry. IFRS 41 requires companies to place a fair value on plants while still in the ground. While this is fine for a crop of carrots, it poses problems for the cannabis production industry, where standardised approaches to measuring the fair value of biological assets have not yet been established.

Canada's provincial securities commissions advise that companies must:

- have a model in place for their valuation approach
- disclose the underlying assumptions used to value biological assets.

Many companies are struggling to produce meaningful valuations. Even Canopy Growth Corporation – a Canadian producer and the world's largest cannabis company – had to file amended financial statements in late 2017[3] to address an immaterial non-cash error in the valuation of its biological assets.

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[3] Stockwatch, "Canopy Growth refiles fiscal 2017 results," https://www.stockwatch.com/News/Item.aspx?bid=Z-C:WEED-2530334&symbol=WEED®ion=C

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News round-up

Making Tax Digital in the UK

The UK Government is pressing ahead with plans to introduce digital recordkeeping and reporting for tax.

A trial of digital VAT reporting in the UK is due to start in 2018, with digital recordkeeping and reporting for VAT to become compulsory for all businesses with turnover over the VAT threshold (£85,000) from April 2019. This will include non-UK businesses whose UK turnover subject to VAT is over the threshold. Digital reporting for other taxes is expected to follow, possibly from as early as 2020.

Businesses likely to be affected by the VAT changes should start preparing now. Although information on software options is still limited, businesses should evaluate their current recordkeeping and VAT return processes and identify where change will be needed. There is no one-size-fits-all solution to digital reporting. Much will depend on the complexity of current recordkeeping systems and processes, and on how digital the business already is.

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Transfer pricing and salary splits in the Netherlands

German entrepreneurs, engaged in cross-border activities with the Netherlands, face a number of challenges in relation to salary splits and transfer pricing.

These challenges are coupled with the pressure of the 1 May 2018 mandatory deadline requiring Dutch companies, who are part of a multinational group with a consolidated turnover of more than €50m, to prepare and file master and local files in the Netherlands. In case global turnover exceeds €750m, preparing country-by-country reports is also required as well as notifying the tax authority in respect of the transfer pricing. The obligations to prepare a local and a master file are also applicable when it concerns a small-sized subsidiary entity.

An international salary split applies when the salary of an employee is assigned to two or more countries. In this situation it will have to be assessed which country is entitled to levy taxes on earned income. With respect to directors' remunerations, the tax treaty between the Netherlands and Germany is in accordance with the OECD model treaty. Germany applies the same credit method to prevent double taxation. On the grounds of the tax treaty, the Netherlands also applies the credit method. However, the exemption method may also be applied if based on a tax authority's decision. Directors will always have to file an official request thereto.

Businesses should consult and engage an expert to ensure salary splits and transfer pricing are performed correctly.

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Argentina passes new anti-corruption law

Argentina's new anti-corruption regime aligns with international standards.

Argentina's new anti-corruption law came into force on 1 March 2018 creating a criminal liability regime for legal entities. This is the first time that companies doing business in Argentina can be held liable for corrupt or criminal activities. The law aligns with the legislation in many other nations aimed at combating corporate corruption.

Key features of Argentina's new legislation include the following.

- Companies are criminally liable for corrupt acts committed by their owners, directors, executives, employees and third parties acting on their behalf, if the crime benefits the company.
- A company's criminal liability is treated separately from the liability of the individual who committed the corrupt act. A company can be convicted whether or not the individual responsible for the action is also convicted.
- Penalties are potentially severe and can include fines of between two and five times the benefits gained, total or partial suspension of the company's activities or even compulsory dissolution.
- Companies can avoid prosecution if they voluntarily disclose any corrupt activity, and have implemented a compliance programme, which as a minimum includes: a code of conduct, including policies and procedures for public procurement for all staff; specific rules to prevent unlawful acts in tenders, bidding processes or administrative contracts; and periodic training on the compliance programme.

Companies doing business in Argentina will need to make sure their compliance efforts are aligned with the new regime.

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