

Global Insight

April 2016



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Understanding UK-US regulatory terminology can help build stronger business relationships

Familiarity with the differences between regulatory climates can help strengthen relations and increase the ability to navigate global challenges with greater success.



"Each time I must choose between you and Roosevelt, I shall choose Roosevelt." These were Winston Churchill's words to France's Charles de Gaulle shortly before D-Day, signifying the strength of the British-American alliance. Even now, as Britain considers its future relationship with the European Union, many of its citizens agree there is still one country they will never walk away from.

The UK is the single biggest contributor of foreign direct investment in the US (approximately US\$42bn), and the US gladly returns the compliment (approximately US\$16bn). However, despite the mutual respect and trust, shared trade opportunities and common language, a few regulatory matters still

manage to get lost in translation. Here's a brief list of the concepts that can stymie people on either side of the pond as they conduct business between the two countries.

- **Public records** – in the UK, Companies House requires incorporated entities to publish business financial data and personal details of the ultimate beneficial owner(s) on public record. But in the US, all financial and ownership data are retained by the IRS and kept out of the public domain.
- **Statutory audits** – the UK requires an audit under statute should the subsidiary and/or its parent fall foul of the rules by virtue of its size.
- **State taxation** – as if it wasn't bad enough tackling US federal laws and regulations, there are a further 50 states' individual taxation policies to contend with.
- **Sales tax is not VAT** – VAT in the main is a recoverable tax for businesses in the UK. Sales and use tax is not its equivalent in the US and is a direct cost for a business.
- **LLC = LLP = LTD = INC** – don't assume that a US limited liability company (LLC) or incorporated business (INC) is the equivalent of a UK limited company (LTD), or that a limited liability partnership (LLP) is the same in each country.
- **Employment rights** – the UK has protective rights for employees, while the US employs 'at will'. Neither is simple.

When engaging in US-UK trade, it's wise to acknowledge and understand the differences in the two countries' laws and customs, and the terms above are a good place to start.

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Cyprus energy developments and investment opportunities



Cyprus is becoming a key energy player in the eastern Mediterranean sea region following the recent offshore discovery of natural gas resources. As a member of the EU, with an open market economy and established international shipping and tourism industries, investment opportunities in the country are worth considering.

In recent years, substantial natural gas resources have been discovered offshore in the Levant Basin, along with possible recoverable oil reserves, offering Cyprus significant opportunities to develop its energy sector.

Since the discovery of the Aphrodite field by a US oil company in 2011, the country has gone through two bidding rounds for 'blocks,' giving companies exclusive exploration rights in Cyprus' Exclusive Economic Zone (EEZ). Energy companies from the US, UK, Israel, France, Italy and South Korea now hold a large percentage of these blocks and the Government has now announced the launch of a third bidding round.

Infrastructure improvements

A key focus for exploiting Cyprus' natural gas reserves is the construction of a Liquefied Natural Gas (LNG) storage facility. A storage facility is planned at the site of the LNG terminal in Vasilikos in Cyprus for the storage of gas from the Levant Basin of Israel in liquefied form. This location could make it a potential source of gas to Egypt.

The country is also considering its options for constructing a pipeline to transport natural gas to either Egypt or Europe. One proposal is for the transportation of natural gas between Egypt and Cyprus through a direct pipeline, while another is an East Med pipeline that would transport gas from offshore Cyprus to mainland Greece and the rest of the EU.

Construction of the VTTV oil storage terminal was completed in November 2014 costing approximately EUR300m and with a storage capacity of 28 tanks of gasoline, diesel, jet fuel and gasoil. A second phase is now under development to increase the storage capacity by a further 13 tanks with an additional investment of EUR105m. Cyprus has the potential to become a regional fuel hub thanks to its strategic location, connecting Europe and the Black Sea with markets in the Middle East and Asia. The widening and deepening of the Suez Canal could also significantly increase traffic in the region and bring more opportunities to Cyprus, which is likely to entice more oil product transshipment opportunities to its shores.

Why invest in Cyprus?

These developments present a number of potential opportunities to invest in Cyprus, including taking advantage of the unallocated exploration blocks. There may also be opportunities resulting from the storage terminals, and the fact that Cyprus is at the crossroads of major international energy routes. Additionally, the country's status as a shipping maritime centre as well as its attractive tax system and strategic location, make it a worthwhile consideration.

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Make in India campaign boosts FDI inflows

Foreign direct investment in India is on the up thanks to incentives aimed at foreign companies.

The Indian Government's 'Make in India' campaign has received significant attention from countries across the globe. With the core objective of making India a global manufacturing hub by building the country's capabilities and incentivising foreign companies to set up their facilities in India, the initiative has led to some important policy reforms and process improvements.

Focusing on 25 key sectors, the campaign has brought in significant reforms such as higher limits for foreign direct investment (FDI) and simplified investment norms for several sectors, including railways, defence, insurance and medical devices. The campaign has been supplemented by initiatives to make it easier to do business in India – simplifying processes of incorporation and obtaining clearances, easing regulatory requirements, digitising regulatory processes, along with various other state-specific initiatives. With the help of these campaigns, India has become one of the most favourable investment destinations in the world.



Since the launch of the Make in India campaign in September 2014, gross FDI inflows have increased substantially, by 32% to US\$64.8bn, compared with a 16% increase in the 15 months before the campaign. The main sectors attracting investment include services, construction development, computer hardware and software, telecommunications and automotive.

What's next?

In order to showcase the impact of the campaign and its achievements, and the potential of design and innovation across India's manufacturing sectors, the Government held a 'Make in India Week' in February 2016 in Mumbai. The event saw an investment commitment of over US\$221bn, along with the announcement of several new policy reforms and investment plans. The Government has stated that in the coming year, it aims to further improve the environment for investors, help start-ups and small and medium enterprises to scale up operations, and promote quality jobs through innovation and by developing a design ecosystem.

The campaign's immense success, despite sluggish global growth, is a positive sign for India's future. While the world economy expanded by 3.1%, India witnessed robust growth of 7.6% in 2015-2016, becoming the fastest-growing major economy in the world, with further acceleration expected over the next two years. Manufacturing activity contributed 17.4% to the total value added to the economy in 2015-2016, and manufacturing growth, as measured by the Index of Industrial Production, accelerated to 3.1% during April–December 2015, from 1.8% in the same period of 2014.

While expectations of a global revival may be weak, it's evident that prospects for India remain bright.

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Assessing your business strategy in a changing world

Finding the right advisers is a key part of keeping a business strong, despite a changing marketplace.



“It is not the strongest of the species that survives, nor the most intelligent. It is the one that is most adaptable to change,” according to Charles Darwin. Although Darwin was referring to the evolution of mankind, this principle applies equally to many businesses that have managed to stay afloat through the financial difficulties of the last decade.

Managing change is vital to the success of a business at every stage of its lifecycle – from incorporation, to operations restructuring or transformation, to succession or exit. Finding adaptable business solutions and the right professional support are just as critical.

Shareholders and management teams around the world need to ask the same post-financial crisis questions: What’s the best direction for my company to take? How can we better adapt to a changing market? How can we improve operational efficiency? In order to improve a company’s competitive edge, the answers to these questions may lie in, for example, restructuring, business remodelling or acquisitions.

Assessing the status quo

Even if major change isn’t necessary or desired immediately, it’s critical to have an accurate assessment of the current situation, along with potential scenarios and prospects for the future.

The first step is to analyse the position of the business – and not just in terms of operations, finances, legal matters, HR or marketing. Business leaders should also be aware of the regulatory environment that may impact their operations and structure as part of their strategic planning, from both a local and international point of view. Business leaders need to have a complete, holistic view of their business if they are to successfully devise a strategic plan that will serve their specific interests over the long term.

Finding the right strategic partner

The ideal adviser will be a specialist who can work collaboratively with management and help with decision-making. It’s important to have an unbiased picture of the company’s current position as well as an achievable vision for the future. So it’s critical to carefully consider the best person for the job of creating a future strategy. People within the business will tend to view it with ‘insider’ eyes, so they may not be in the best position to do this.

Beyond having the right skills, an adviser should be able to identify and develop the optimal solution from a range of possible scenarios, choosing the one that best suits and serves both the interests of the shareholders and the market environment.

The adviser should be adept at using diagnostic tools as the basis of a strategic assessment and at getting feedback from each of the key areas of the business. A business valuation is often helpful for business leaders to position themselves in their market and gain an objective view of their status.

Although we live in an uncertain world, proper planning and having the right team in place can make all the difference in preparing for change.

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Multinational pooling

Multinational businesses of all sizes can reap the rewards offered by pooling employee benefit plans

Multinational pooling is a mechanism that allows multinational companies to combine the insured employee benefit plans of their subsidiaries in different countries with a multinational pooling network. These insured benefits can then be 'experience rated' to take overall claims performance into account and an overall surplus or loss can then be determined.

Where a surplus arises, rather than being retained by insurers on a plan-by-plan basis, it is returned (less expenses) to the multinational as a dividend. If claims performance is such that a deficit arises, this can be carried forward or covered by stop loss insurance. Over the medium-to-long term, 8% to 15% of premiums can typically be returned as dividends. Importantly, plans remain insured in each country with local insurers benefiting from normal terms, conditions, administration and local claims settlement. Premium rates are set locally by insurers who compete on price and service quality in each country. Pooling can also offer improved visibility of local plans, and in certain circumstances can result in improved terms at a local level.



A growth sector

There are eight major pooling networks operating in various forms. They are either owned by insurers with a regional or global presence or are independent. Independent networks generally have a wider geographical coverage and have the ability to select leading insurers in each country as local members. Pooling offers firms the potential to realise economies of scale and to reduce the cost of their employee benefits provision through the payment of multinational dividends, while in each country, maintaining contracts with leading local insurers ensures that the best terms are achieved for the firm. Given the trend towards higher premium rates in some countries and the increasing globalisation of business, the use of multinational pooling can only be expected to grow.

Pooling is not only the preserve of large companies: several networks offer small groups pooling, which is designed to allow smaller multinational businesses to take advantage of pooling with other similar-sized companies while being protected from variations in their own claims performance. There are usually no minimum employee or premiums criteria to join, provided there are insured contracts in at least two countries. Any losses are generally not carried forward. One of the leading small group pools has generated a dividend of an average of 13.94% over the period from 2011 to 2015.

Although it's often overlooked, pooling has the potential to add significant value to the employee benefit programmes of multinational companies.

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UK entrepreneurs say they want to stay in the EU



The consensus among UK entrepreneurs is that the UK should remain in the EU, albeit a potentially reformed one, according to a survey by Nexia member firm Saffery Champness.

The results of the second Saffery Champness Entrepreneurs Survey provide a snapshot of UK entrepreneurs' views on a range of topics, from their plans for growth over the next 12 months to their outlook on Europe.

The survey reveals that UK entrepreneurs are reporting better results and increased growth in headcounts across their businesses. However, it also reveals increasing uncertainty about the business environment that lies ahead.

How important is Europe?

When asked how they would vote in a referendum on whether the UK should remain in the EU, 67% of entrepreneurs said they would vote to stay while 9% said they would vote to leave. This compares to 17% who had said that they would vote to leave in 2014.

This is in spite of the fact that fewer entrepreneurs thought the UK's relationship with Europe was important to their business this year: 48% of those surveyed in 2015, which represents a drop from 53% of those surveyed in 2014.

Whilst almost a quarter of respondents had not made up their mind at the time of the survey, the overall consensus from UK entrepreneurs seems to be to remain in the EU (albeit a potentially reformed one).

The business environment

Respondents also identified the three most important current challenges to business success. These remain unchanged for the second consecutive year: availability of skilled labour was seen as the most important challenge (61%); quality of the management team was the second most important challenge (57%); and economic conditions/uncertainty was also a key concern (52%).

Only 25% of respondents cited the availability of external finance as one of their top three challenges in 2015, down from 40% last year – an indicator that access to finance may be steadily improving.

Turnover

More than three-quarters reported a growth in their turnover in 2015, with 61% seeing growth in excess of 5%. This compares to 67% of entrepreneurs who reported growth in turnover in 2014.

Levels of confidence

The survey reveals a slight decline in the levels of confidence among the entrepreneurs surveyed. In 2015, 78% were either very or quite confident they would achieve their business objectives over the next 12 months. This compares to 84% in 2014. While still a relatively high percentage, the level of confidence demonstrated by this latest survey, suggests that market conditions have perhaps somewhat cooled a little.

Plans for growth

The number of respondents who said they would be concentrating only on organic growth over the next year was virtually unchanged (68% in 2014 and 69% in 2015). Likewise, the number looking to make corporate acquisitions was very similar (25% in 2014 and 26% in 2015).

Just over a quarter of respondents (27%) had secured bank loan funding over the past year and 23% had secured asset finance. Just under half (45%) of respondents had not explored any forms of funding over the past year.

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A unified tax regime across Europe: evaluating the impact

Turbulent times in the EU have caused political leaders to consider the benefits of having a unified tax regime once again.

Politicians across the EU are under pressure to address many problems, but a particular focus for the media and many voters is the issue of tax avoidance. With EU politicians needing to show consensus on a range of issues, could the introduction of a unified tax regime, a Common Consolidated Corporate Tax Base (CCCTB), across the EU provide an opportunity for a relatively 'easy' win?

Two previous attempts at a unified tax regime have failed. What are the likely consequences and will it be any more successful this time?

Proposed benefits

According to the European Commission, a CCCTB would:

- be a solution to profit shifting and corporate tax abuse within the EU by eliminating the mismatches between national tax systems
- enable a common approach to non-EU countries
- provide a unified approach in countering aggressive tax planning.

Both the European Parliament and the President of the European Commission are in favour. Corporate tax as a source of tax revenue is diminishing and changes here will have less of an impact. And, of course, the EU is supposed to be a single market.

The drawbacks

After the reduction and elimination of preferential regimes, there will be winners and losers among member states. The losers will need to raise taxes in other areas, reduce public expenditure or a mixture of both. Higher tax expenses will reduce companies' profit margins. This could mean raising prices for customers or cutting back on operations and employing fewer people. Those investing in the corporate sector could receive a lower return on their investment. Finally, if the CCCTB is introduced successfully, attention will then turn to other taxes.

But will it succeed this time?

The answer is 'probably not'. Regardless of whatever else is happening, sovereignty over fiscal policy is probably a 'red line' over which member states will not cross, particularly for those outside the eurozone. 'Austerity' is still a difficult issue in most parts of the EU, and competition between member states for tax revenues is likely to remain for some time yet.

Dividing EU consolidated taxable profit between member states is probably too difficult to resolve for the time being. Any benefit derived from the momentum generated by the OECD BEPS project will be put to the test as all countries involved with BEPS are requested to introduce changes into their domestic legislation.

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The base erosion and profit shifting project – a watershed moment in the making



The shake up of the global tax system is being closely monitored by low-tax countries in particular.

The OECD has announced an important series of developments regarding the base erosion and profit shifting initiative, which are of special interest to countries such as Singapore, whose business friendly environment is due in part to its competitive tax regime.

BEPS comes to fruition

On 5 October 2015, the OECD released its long-awaited final reports on all 15 focus areas under the BEPS initiative. BEPS is widely regarded as the most significant global tax overhaul in recent times, forcing multinational enterprises to rethink the way they invest and structure their operations globally. The 15 focus areas address the coherence of tax rules in order to remove loopholes at the same time as emphasising substance over form so that taxing rights are aligned with value-adding activities. BEPS also aims to address issues of transparency around tax reporting and disclosure requirements and shed light on sectors such as the digital economy which continue to challenge tax authorities around the world.

Before the final reports were released, another major milestone was reached with the signing of the Multilateral Competent Authority Agreement (MCAA) by 31 countries for the automatic exchange of Country-by-Country (CbC) reports, which is a significant component of the BEPS measures around transfer pricing. It will help tax authorities compare profits that are earned by multinational enterprises in the various countries where they operate against measures of real economic activity such as employment and sales. This could, possibly for the first time, start revealing to tax authorities the extent to which profits of multinationals are being booked in tax havens or low tax jurisdictions.

The impact on individual countries: Singapore

National tax authorities, local businesses and inward investors will be weighing up the potential impact of BEPS. Each country still has the sovereign right to set its own tax policies in response to its own domestic priorities. Singapore, for example, has been supportive of the BEPS initiative from the start. There is no doubt that

Singapore's role as one of the key locations in the Asia-Pacific region for the establishment of headquarter operations makes it acutely sensitive to developments on the BEPS front. While Singapore's role in the BEPS initiative has thus far largely been that of a passive observer, it has already been taking some cautious steps in responding to these new rules. The assessment criteria for tax incentives, for instance, is being enhanced to provide the added assurance that profit levels are commensurate with the level of activities and functions being performed in Singapore from a transfer pricing standpoint.

What's next?

The issue is not so much what reforms countries like Singapore will need to put forward but more so what measures they may need to consider in response to the reforms that other jurisdictions choose to implement in response to the final BEPS reports. While it's questionable as to whether Singapore and others will continue adopting a 'passive observer' approach to the many unfolding developments on the BEPS front, the more pertinent test would be whether they can stay nimble enough to calibrate their responses such that they maintain their tax competitiveness while ensuring that they play their part in upholding a robust and fair international tax framework.

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Global Insight

April 2016

To fight a big data security problem, think 'small'

For spammers, small is the new big, as they try to avoid detection by sending fewer messages than ever before.

Following a report from Bloomberg, more light has been cast on what is called 'artisanal spam,' or 'snowshoe' spam. Rather like how an actual snowshoe redistributes the weight of the person wearing it, snowshoe spam involves redistributing the load of a spam message across multiple IP addresses. This is done to help avoid detection by filters designed to combat spam messages sent from one IP address to many thousands of email addresses.

Spamming is about more than trying to entice recipients to buy into various stock schemes or pharmaceutical enhancers. It's also a petri dish spawning malware of all sorts. That's why it's a good idea to fight back at a similarly micro level. Here are three tips you can employ right now to help combat spam attacks.



Give employees guidelines

If you haven't already, develop clear employee guidelines for everything from clicking on links to using personal email accounts and more. Remember that employee guidelines that are not promoted internally and discussed at least annually will be as effective as a billboard in the middle of a desert.

Watch out for red flags

Whether or not it's covered in the employee guidelines document, encourage each associate to simply read the message carefully to spot any tell-tale red flags:

- A long, nearly unintelligible 'From' address. An official message from your bank probably isn't coming from an email address like bank_name@omega.19991.ca. You might have to click 'Show details' or a similar button/command to see this information.
- Urgency that isn't being conveyed through any other communication method. If your CEO really needed US\$10m wired to an account in another country, she or he would probably do more than send an email. Be skeptical of any message touting urgency and seek colleagues' input before taking any action whatsoever.
- Generic salutations, such as 'Dear Friend,' or one you don't commonly receive. If you're commonly called Bob but you receive a message addressed to 'Robert', because it's in your email address, you'll know the sender isn't a close friend, colleague or business associate – even if the email address (which can be faked easily) suggests otherwise.

Think before you hit 'send'

If a reply absolutely MUST be sent, do so carefully. The reason there's so much spam out there (estimates are as high as 400 billion messages per day) is that it works. If a message comes across your desk that is so enticing as to require a response, consider doing the following:

- NEVER click on a link within the message itself. Conduct a search online to seek out whatever offer or information is presented.



- If a reply is required once you locate relevant information, don't enter your official email address into any online forms. Use a service such as 10minutemail.com to create a temporary email address that expires in, you guessed it, ten minutes.

Outsmarting even the most dedicated spammer doesn't always require a firewall and strong email filter – although you should definitely have both. Sometimes combating cyber crooks – even the 'small' ones – just takes a little bit of effort and access to the right tools.

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April 2016

IFRS 16: what's new in accounting for leases?

In January 2016, the International Accounting Standards Board (IASB) issued a new accounting standard, IFRS 16 *Leases*. This new standard supersedes the existing IAS 17 *Leases* and related interpretations.

A company is required to apply IFRS 16 from 1 January 2019 but it can decide to apply IFRS 16 before that date as long as IFRS 15 *Revenue from Contracts with Customer* is also applied.

A need for change

Leasing is widely used by many organisations, enabling them to use property, plant and equipment without incurring large initial cash outflows.

IAS 17 classified leases as either 'finance leases' or 'operating leases'. Finance leases were reported on the balance sheet, whereas operating leases were reported off the balance sheet. This led to lack of transparency about lease obligations and a failure to meet the needs of the users of financial statements.

The way forward for lessee accounting

IFRS 16 eliminates the classification of leases as finance and operating leases. All leases are to be reported on a company's balance sheet as assets and liabilities. Some exceptions exist; IFRS 16 does not require a lessee to recognise assets and liabilities for:

1. short-term leases (i.e. leases of 12 months or less)
2. leases of low-value assets, for example, leases of assets with a capital value up to US\$5,000.

The result of applying IFRS 16 will be an increase in lease assets and financial liabilities. Hence, for companies with material off balance sheet leases, there will be a change to key financial ratios which would be derived from the company's reported assets and liabilities, for example gearing ratio, current ratio, asset turnover, etc.

Implications for lessors

There are few implications for lessors. IFRS 16 substantially carries forward lessor accounting from IAS 17.

A lessor will continue to classify leases as either finance leases or operating leases applying IFRS 16, and account for those two types of leases differently. Compared to IAS 17, the new standard requires a lessor to disclose additional information about how it manages the risks related to its residual interest in assets subject to leases.

Conclusion

The IASB concluded that the benefits of IFRS 16 will outweigh the costs. Thus, IFRS 16 will result in a more faithful representation of an organisation's assets and liabilities. As a result, it will provide greater transparency about the company's financial leverage and capital employed to all market participants. This will improve comparability between companies that lease assets and companies that borrow funds to buy assets.

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News round-up



The Indian marketing intangibles saga

How the landmark Maruti Suzuki case has affected tax legislation in India

In this era of globalisation, the momentum of growth achieved by India has attracted a multitude of multinationals (MNCs) setting up subsidiaries in the country. To safeguard diminishing tax revenues, a wide range of regulations are being introduced by the Indian Revenue Authorities (IRAs), many of which affect transfer pricing.

Over the past couple of years, MNCs across India have had to deal with a significant number of transfer pricing adjustments regarding marketing intangibles. The dispute in the Maruti Suzuki case arose because the IRAs alleged that the taxpayer had contributed to the brand (legally owned by the parent company) by incurring excessive advertisement, marketing and promotion (AMP) expenses.

The authorities used the bright line test (BLT) method to determine the excessive amount of AMP. By way of background, the BLT compares the AMP expenses incurred by the assessee with AMP expenses incurred by comparable companies. The Indian Revenue Authorities have been making transfer pricing adjustments in respect of "excessive" AMP expenditure incurred by Indian subsidiaries of foreign MNCs based on this BLT method. This approach was largely upheld by a decision in the case of LG Electronics India Pvt Ltd, and has then been applied to many other taxpayers' cases.

A number of appeals have been made to the Delhi High Court and in March 2015, a ruling in the Sony Ericsson case quashed the practice of using the BLT methodology for determining an arm's length price. It held that the AMP expenditure should be viewed as a bundled transaction as these expenses are incurred as part of distributional activities. In the Sony Ericsson case, the existence of an international transaction was not challenged. In fact, the ruling provided much needed clarification regarding the position of distributor entities.

The recent landmark ruling by the Delhi High Court in the case of automobile manufacturer Maruti Suzuki India Limited has clarified that, according to Indian transfer pricing regulations, AMP expenditure incurred by manufacturing entities cannot be treated as being incurred in respect of an international transaction and so used in a review of prices charged for cross-border transactions. The court in this case distinguished the verdict laid out in the Sony Ericsson decision and, in particular, stated that:

1. the Sony Ericsson decision cannot apply to manufacturing entities,
2. BLT was not a legitimate means for determining the pricing of an international transaction.
3. AMP expenses do not represent an international transaction merely through the application of BLT.
4. transfer pricing adjustments cannot be made merely on the basis of the amount of AMP expenditure incurred by the taxpayer.

This ruling by the Delhi High Court is a welcome one, since it has provided a road map for how to deal with such a contentious issue. Nevertheless, relations between industry and the Government in India have drastically changed over the years following the adoption of various beneficial policies by the Government. This legal clarification safeguards the interests of many multi-national corporations and should also have a positive impact on the investor-friendly environment in India.

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Ukraine pursues reform agenda

During 2015, Ukraine made significant progress in implementing reforms across key areas such as the economy, education and science, although there remains a lot more to do.

The National Reforms Council has become a platform for discussion of key issues around Ukraine's future. Leaders from across the country, including the president, prime minister as well as representatives of civil society and business associations gathered 17 times in 2015 in order to express their views on the reform process. More than 30 topics were discussed and over 200 decisions were adopted, around three-quarters of which have been implemented through draft laws, laws and other legal documents.

The Council is now monitoring the progress of priority reforms, taking public reaction into account.

To view the Report of the National Reforms Council Project Management Office, visit:

http://reforms.org.ua/sites/default/files/upload/brochura_eng.pdf

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Focus on Italian permanent establishment regulations

Italian regulations around permanent establishment (PE) have been under the spotlight since a number of changes were introduced by a decree reforming tax ruling procedures in October 2015.

"Companies carrying out multinational activities" may start a dedicated procedure aimed at reaching a five-year validity agreement with Italy's Inland Revenue, concerning:

- a) transfer prices applied in controlled transactions and determination of assets and liabilities' fiscal value whereby an Italian company becomes non-resident or a foreign company becomes Italian tax resident
- b) identification of a foreign company's PE in Italy
- c) determination of income/loss to be attributed to the foreign company's PE in Italy
- d) payment of dividends, interest and royalties to/from foreign entities.

With regards to b) and c), foreign companies which are considering operations in Italy may initiate this procedure and open early consultations with the Italian tax authorities in order to assess the potential identification of an Italian PE. However, consultations on this matter should be shared with the other state's tax authorities through a 'Mutual Agreement Procedure'.

Moreover, the decree aligned the Italian rules on profit attribution to PE with the OECD "*functionally separate entity*" approach (*Report on the attribution of profits to Permanent Establishments*", 22 July 2010). On the basis of the Italian corporate income tax code, the PE attributable income and its "free" capital shall result from an analysis of functions performed, risks assumed and assets used by the PE, and be considered as a functionally separate and independent entity. Furthermore, the prices applied to transactions between PE and its parent company must be set in compliance with the arm's length principle.

The decree also provides an optional "branch exemption" regime, an alternative to "foreign tax credit" relief, which allows Italian companies to be exempt from tax on their foreign PE income and losses from outside Italy.

The PE tax framework is rapidly evolving and companies should re-examine domestic rules in conjunction with recent OECD BEPS Action Plans to allow a revision of current flows and implementation of more effective tax value chain models.

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