

Private Company Services

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Growing your business™

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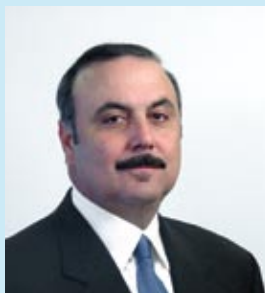
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Finding opportunities for growth on the road to recovery

Growing Your Business is published by the Private Company Services (PCS) practice of PricewaterhouseCoopers. It is focused on providing privately-owned-business owners and management with a point of view, guidance and insights on issues affecting their businesses and personal wealth.

Please visit the *Growing Your Business* Web site at www.pwc.com/gyb for archives and local contacts.

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Most economists now forecast that the recession will be over before the end of the calendar year. And while that is encouraging news, it is not cause for a return to business as usual. The recovery, while imminent, is predicted to be long and slow, and the economy that will emerge is expected to be different than any that businesses have ever encountered.

No one knows what the new normal will look like. But we do know that amid continued change, private companies in particular will need a renewed focus on fundamental business disciplines. Forecasting, scenario planning, and risk management will prove increasingly critical in navigating an uncharted business landscape. At the same time, successful private companies will continually seek out opportunities for new markets and increased efficiencies. And many of these may be outside our borders.

The global scope of the financial crisis revealed that the economies of the world are, for better or for worse, inextricably linked. And operating in a truly global economy presents both challenges and opportunities. Private companies will need to dedicate the time and resources to understanding local regulatory and reporting requirements as well as the expectations of local workforces. But experience suggests that these efforts will pay off; even in times of crisis, we've seen that those companies operating internationally consistently report much stronger projected revenue growth rates than do their domestic-only counterparts.

In this issue of *Growing Your Business*, we offer insights into four key areas we view as critical for those private companies currently, or considering, operating internationally. These companies will want to carefully consider their approaches to accounting and reporting, especially in light of the recent release of IFRS for Small and Medium-sized Entities (SMEs); managing benefits on a global scale; navigating local tax laws; and, for those executives actually living abroad, understanding the impact of foreign residency on wealth management and transfer planning.

As we continue to manage the short-term demands of our businesses in a challenging economy, all private companies—both yours and ours—must continue to look ahead for new opportunities to position ourselves for success through the recovery, and beyond.

Sincerely,

A handwritten signature in blue ink that reads "Richard Calzaretta". The signature is fluid and cursive, with a long horizontal stroke at the end.

Richard Calzaretta / US Leader, Private Company Services

Growing your business in the global economy



04 / IFRS: What private companies should know

With the release of IFRS for Small and Medium-sized Entities (SMEs) in July, the topic of IFRS is back in the news, and private companies should take note.



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A large white cable-stayed bridge spans across a body of water. The bridge features a prominent white pylon with multiple stay cables. In the foreground, a red barge is visible, supporting the bridge's structure. The sky is a clear, light blue.

IFRS: What private companies should know

With the release of IFRS for Small and Medium-sized Entities (SMEs) in July, the topic of IFRS is back in the news, and private companies should take note.

IFRS first piqued the interest of most private US companies and other stakeholders in 2007, when the US Securities and Exchange Commission (SEC) took its first tentative step toward moving US public companies to IFRS by issuing a Concept Release asking for feedback on the idea. The SEC maintained that momentum in 2008 by issuing a proposed road map that discussed the benefits, challenges, and a proposed timeline for a path forward that would require IFRS adoption by all public companies. But then, as a new administration took office, the credit crisis intensified, and the ailing economy redirected the focus from bringing IFRS to the US and created uncertainty around the timing of adoption. Now, however, the release of IFRS for SMEs, a somewhat simplified version of the standards, has reinvigorated the discussion, and it presents private companies with a new opportunity to carefully consider whether adopting one of these standards makes sense for them.

The ongoing impact of IFRS

Over the past several years, IFRS has quickly become the most widely used financial reporting language globally; more than 100 countries allow IFRS for certain types of reporting. Nevertheless, many private companies have little knowledge of the standards or of what the standards may mean for their businesses: 63% of respondents to PricewaterhouseCoopers' Private Company Trendsetter Barometer said they are not very knowledgeable about IFRS; nearly half were uncertain about what kinds of changes IFRS might mean for their businesses.

Nevertheless, US companies, whether public or private, are already—or will soon be—affected by IFRS. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have been working diligently to improve both sets of standards while reducing the differences between US generally accepted accounting standards (GAAP) and IFRS. The boards have an aggressive project agenda that includes rewrites of major accounting standards, such as revenue recognition, leasing, and financial instruments. These joint standard-setting efforts will have widespread and immediate impacts on US companies. In many instances, the new standards will look more like IFRS than like US GAAP. In fact, they may impact almost every significant line item on the balance sheet, as well as both the top and bottom lines of the income statement.

Ongoing global adoption of IFRS for statutory reporting impacts private companies that have non-US subsidiaries. In addition, IFRS may already impact private companies through interactions with vendors, customers, and other parties that already

have adopted IFRS. Finally, private companies considering an acquisition of or by a company already reporting under IFRS would benefit from a clearer understanding of IFRS.

In other words, change is coming—whether through modifications to US GAAP driven by convergence with IFRS, the impact of the global adoption of IFRS, a voluntary decision to convert to IFRS, or a mandate to convert to IFRS from company stakeholders or potential stakeholders. Leadership will want to understand the potential impact of these possible changes on their financial statements as well as on their broader business strategy. “Management must be informed about this new accounting framework so that they can make educated decisions about whether they should adopt IFRS or continue to report under US GAAP,” said Timothy O’Hara, partner with PricewaterhouseCoopers' Private Company Services practice in Philadelphia.

IFRS for SMEs

To ease the burden of IFRS reporting on smaller, nonpublic companies, the IASB released IFRS for SMEs in July 2009. Though IFRS for SMEs has its roots in many of the same principles as IFRS, it was specifically designed to address the needs of companies that do not have public accountability.

IFRS for SMEs offers private companies the opportunity to simplify their accounting and disclosures as compared with both IFRS and US GAAP. For example, it allows for broader use of the cost method (for instruments that may require fair value accounting under IFRS or US GAAP), and it allows goodwill amortization rather than requiring an annual impairment test (although an impairment test would still be required at times).

As with a move to IFRS, companies considering a move to IFRS for SMEs will need to consider the local statutory regulations in the countries in which they operate and will need to remember that regulations do not apply equally to IFRS and IFRS for SMEs. Because IFRS for SMEs was just recently issued, the rules around its acceptance for statutory purposes are still evolving.

Who might adopt

“IFRS offers one more option for private companies to consider when evaluating the best accounting framework to most accurately reflect their operations,” said O’Hara. And while all private companies would benefit from understanding the implications of IFRS, two groups in particular may want to consider transitioning sooner rather than later:

US-based multinationals with significant foreign operations. These companies tend to have higher compliance costs because their international subsidiaries maintain two sets of accounting records: one on US GAAP for consolidation purposes and one on local GAAP for statutory reporting purposes. The trend is clear: As IFRS or IFRS for SMEs becomes more widely accepted for statutory reporting purposes, companies with many foreign businesses could realize significant cost savings by converting the entire company to IFRS or IFRS for SMEs and accomplish additional cost savings by establishing shared service centers to do the bookkeeping. “Just the time to complete closings, not to mention the internal resources and external costs involved in managing and reporting, will be improved when the entire organization is reporting uniformly rather than under multiple standards,” said O’Hara. Getting all locations onto the same accounting platform also offers opportunities for enhanced consistency of accounting and financial reporting across all subsidiaries and the parent company. “When the same standards are consistently applied globally, information will be more transparent and management may achieve improved decision making,” he said. Private companies that decide against converting the entire company to IFRS or IFRS for SMEs should still retain corporate oversight of their subsidiaries’ adoption to ensure the standards are being applied uniformly.

Companies that have relatively straightforward accounting transactions. Companies whose operations necessitate fairly complex accounting—such as multielement revenue arrangements, complex special-purpose-entity structuring and heavy use of derivatives—may find IFRS or IFRS for SMEs just as challenging to apply as US GAAP.

However, companies where such accounting is unnecessary, as well as companies whose users would be comfortable with (or perhaps even welcome) a more streamlined accounting and disclosure framework than US GAAP currently requires, could be good candidates for considering whether IFRS is a better option for them.

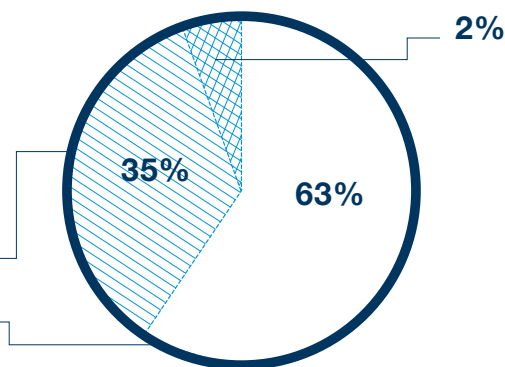
Additional considerations for private companies: For all companies, converting to IFRS or IFRS for SMEs is a commitment—of management focus, of resources, and of funding. The transition may have considerable implications to processes, systems, and people and may be costly, complex, and time-consuming. Management teams will want to conduct a well-constructed cost-benefit analysis when deciding whether a conversion is the best strategic decision overall for the company. Private companies in particular will want to evaluate certain key concerns in addition to the time and cost considerations:

- / Private companies considering exit strategies involving the US capital markets (for example, initial public offerings [IPOs] or strategic sales to public companies) will want to ensure that any IFRS conversion decisions are aligned with the SEC’s proposed timeline for moving public companies to IFRS. While we believe that IFRS will ultimately be adopted in the US for public companies, there is uncertainty around the timing.
- / The SEC will not accept IFRS for SMEs for financial reporting purposes. Companies adopting IFRS for SMEs now should consider that moving to IFRS for SMEs increases the differences with US GAAP, and those differences will need to be resolved should they consider an IPO before IFRS is adopted for public companies. In addition, after IFRS is adopted

6%

How knowledgeable are you about IFRS? In our survey, only 6% were extremely knowledgeable.*

Extremely knowledgeable	6%	} 35%
Somewhat knowledgeable	29%	
Not particularly knowledgeable	27%	
Not at all knowledgeable	36%	
Don’t know/Not reported	2%	



*Source: PricewaterhouseCoopers, 2009. Private Company Trendsetter Barometer, May 2009

Opportunities and challenges of converting to IFRS and IFRS for SMEs

Opportunities

- / Simpler accounting standards; IFRS has fewer details and exceptions than US GAAP
- / Broader reliance on professional judgment allows better reflection of the economics of transactions
- / Increased global comparability of a company's results
- / Eased access to non-US capital markets and potential to make cross-border acquisition activity more efficient
- / Streamlined reporting processes; reduced costs for companies operating multinationally
- / Eased international expansion for domestic companies

Challenges

- / IFRS does not currently allow access to the US capital market
- / IFRS for SMEs will not provide access to any global capital market
- / Cost and complexity of conversion process; time and availability of dedicated resources to manage and execute the conversion
- / Application of judgment required by principles-based standards may result in fewer black-and-white answers when setting accounting policies in certain areas
- / Modification of contracts, partnerships, and other arrangements to incorporate IFRS considerations
- / Conversion of reporting systems capability and data requirements
- / Impact on budgets, plans, forecasts, and other indicators, as well as on overall control environment and risk management strategies
- / Potential tax implications

“Management must be informed about this new accounting framework so that they can make educated decisions about whether they should adopt IFRS or continue to report under US GAAP.”

— Timothy O'Hara, partner, PricewaterhouseCoopers' Private Company Services

The background of the slide is a photograph of a large, modern concrete bridge structure extending over a body of water. The bridge has a massive, textured concrete pillar on the left side, and several tall, slender concrete piers supporting the bridge deck in the distance. The sky is a pale, overcast blue, and the water is a dark, choppy blue. The text is overlaid on a semi-transparent white rectangular area in the upper half of the image.

Although IFRS is widely accepted globally for public companies, a number of countries have restrictions on using IFRS for statutory reporting purposes by private companies (or private subsidiaries of public companies).

for public companies, private companies contemplating a public exit strategy would still need to convert from IFRS for SMEs to full IFRS.

- / Although IFRS is widely accepted globally for public companies, a number of countries still have restrictions on the use of IFRS for statutory reporting purposes by private companies (or private subsidiaries of public companies). And since it was just recently issued, statutory acceptance of IFRS for SMEs is still evolving. Private companies contemplating a move to IFRS or IFRS for SMEs should understand the specific rules of each country where they have statutory reporting requirements to ensure that all of the benefits of moving to a single set of standards are achieved.
- / IFRS encourages, even requires, more professional judgment than US GAAP does, which could be burdensome for private companies that may not have sophisticated accounting resources on staff. To a lesser extent, this also applies to the somewhat simplified, IFRS for SMEs.
- / Companies that currently apply last in, first out (LIFO) for inventory valuation should carefully consider the tax implications of an IFRS adoption. Neither IFRS nor IFRS for SMEs allows LIFO, and as a result of book/tax conformity rules in the US, companies could face considerable cash tax liabilities when adopting either set of standards.
- / Adoption of IFRS or IFRS for SMEs may have additional tax implications, both domestically and internationally. Companies should carefully consider the tax expense and cash tax impact of IFRS or IFRS for SMEs adoption in each of their tax jurisdictions.

Accounting for change

After considering all the options and evaluating the business as a whole, some private company leadership may decide that US GAAP is still their best option. Regardless of the ultimate decision, it's important for private companies to make this assessment at some point. "While there is uncertainty around the adoption date for US public companies," said O'Hara, "those private companies that carefully consider the issues and implications of the transition now will be best able to manage costs, avoid surprises, and position themselves advantageously for the coming change."

Want to know more about how IFRS could impact your company? We will be releasing publications that examine the technical accounting differences and related business implications between IFRS and IFRS for SMEs, as well as the differences between IFRS for SMEs and US GAAP. Please contact:

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Balancing act: Providing benefits globally

Successfully addressing issues of pay and perquisites for a global workforce requires a blending of a structured overall framework with local flexibility.





Rapid turnover saps productivity and drives up training costs for a customer service center in India. While the home office in Houston holds up paperwork, an important sales position goes unfilled in Great Britain. Human resources (HR) officials set an unintended and costly precedent when they raise a handful of employees' salaries in Brazil.

These examples are hypothetical, but the challenges they represent are real.

For private US companies that employ a global workforce, poorly managed areas such as pay and perquisites create obstacles to productivity, revenue growth, cost savings, and new business opportunities. Some companies are encumbered by monolithic HR bureaucracies, overly reliant on paperwork and protocols set by the company's headquarters. Other companies may be unable to corral their international efforts because they lack centralized controls and communications; operations in each country or region run nearly autonomously.

For companies caught between the extremes of centralized and decentralized HR approaches, the solution lies in finding a blended, balanced strategy that employs a global compensation framework—a philosophy that sets parameters for their HR operations around the world yet provides flexibility so that practitioners can draw upon their talent, expertise, and knowledge of local customs.

“Companies need to find the middle of the spectrum,” said Scott Olsen, a principal at PricewaterhouseCoopers' Global Human Resources Services group. “When we talk about flexibility, we want it to be within a framework.”

This framework allows organizations to:

- / Respond strategically to internal and external challenges and opportunities
- / Improve efficiencies while employing the full potential of local resources
- / Control costs and improve savings
- / Provide responsiveness in hiring and retention

The following chart shows how the blended, framework-based global compensation strategy compares with centralized and decentralized approaches.

	Centralized	Decentralized	Blended: The framework approach
Description	Imposes the home country's systems and processes on overseas operations. Salary structure and compensation plans (e.g., incentive plans) are managed the same way across all locations and business units regardless of differences in local environments.	A true multinational approach, with separate, local managements for each country or region. Salary structure and compensation plans are managed at each local level.	A common framework, instead of a one-size-fits-all plan, which supports the organization's mission. The framework is flexible and broad enough and can be customized to respond to local needs. Guidelines for salary structure, job titles, and compensation/perquisite plans are set by headquarters and tailored for each local market.
Advantages	Provides global consistency in HR management. Centralization lessens administrative challenges.	Allows many locations to act autonomously and respond quickly to market labor conditions.	Fosters a consistent worldwide corporate culture while balancing global standards and local needs. Costs are allocated efficiently across offices.
Disadvantages	Not a true multinational strategy. May miss opportunities for cost savings, attraction, and retention at the local level.	Doesn't allow organizations to have shared global objectives or cultures. Presents reporting, compliance, and communication challenges.	Requires high levels of communication between headquarters and local and regional teams. Also requires streamlined systems and processes plus training on change policies and procedures.

The case for a framework-based global compensation strategy

A framework-based global compensation strategy does not just represent the most favorable, most effective balance between the centralized and decentralized HR approaches. It also represents a cost savings to companies, according to Olsen. The savings can come in many forms: greater revenue, enhanced performance, fewer overpaid employees, and lower training and development costs.

Olsen also explained that framework-based global compensation strategies are cost-effective because they provide a balance between global consistency and local customization. For example, without a common framework to guide their decision making, HR departments around the world could make arbitrary decisions about raises, salaries, or perquisites. These precedents may be difficult to undo.

Companies may create recruiting and retention problems by systematically underpaying workers, which increases turnover and raises training and development costs. Companies may also exacerbate budgeting and inequity problems by overpaying workers. Both issues highlight a lack of understanding of local labor markets.

For employees, frameworks mean fairness and transparency. They can also lead to a more flexible and mobile workforce, as workers may be more amenable to moving to a different country if they know they will be compensated appropriately. A framework also “avoids situations where two people who work next to each other are treated differently,” Olsen said. Improved transparency and workforce mobility “are two tangible benefits” for companies and are easily communicated to employees.

Olsen described a US-based software company that recently developed a framework-based global compensation strategy. The company had grown aggressively through acquisitions and as a result, had a lot of HR departments in different countries that functioned somewhat independently from headquarters. Because of this, the global workforce was not integrated, and the company was not able to move workers around the world as much as it had hoped. Titles, job descriptions, and skill ratings did not correlate across borders.

Olsen said that after implementation of a framework-based global compensation strategy, “what they came out with was a much more equitable way to review their workforce—a much more objective way to make sure they were promoting the right

people. It made their business work better and also helped their recruiting.”

How to develop a framework

A properly developed framework provides a set of consistent values, strategic goals, and operating practices for HR operations to use around the globe. Anne Goodyear, director of PricewaterhouseCoopers’ Human Resources Services, said a company should start developing its frameworks by studying its existing HR approaches and researching how compensation and perquisites are handled in each operating country and region. It is critical to look at the HR challenges that the company currently faces, such as retention or recruiting problems.

Goodyear said stakeholders from operations and finance departments need to be involved in these discussions, because they play roles in crafting and implementing compensation strategy. Only after the company completes its due diligence can it understand the breadth and depth of the challenges at hand and the issues that need to be addressed in each region. At that point, leaders must begin to consider a broad compensation strategy—the framework—that will set the philosophical direction for the company and set HR parameters.

Sometimes, Goodyear said, companies are tempted to apply local fixes to what are often symptoms of global compensation problems. She advised against these kinds of temporary solutions. “You’re pushing off issues that will simply resurface,” she said. Also, handling these challenges on a one-by-one basis could create inequity issues for employees.

The strategy framework should always be seen as a set of guidelines. Olsen called it the “common lens” for a company.

On the whole, it is important that companies not correct an overly centralized approach to HR by adopting an overly decentralized strategy or vice versa. “Stay focused on the issue that you’re trying to solve, and make sure your solution doesn’t create a bigger problem,” he said. “You really must understand where you want to land on this continuum between consistency and flexibility. Companies often go too far in the other direction in terms of applying a fix, and they end up on a seesaw.”

The flexibility to tackle new challenges

A framework-based global compensation strategy allows a company the flexibility, guidance, and local expertise it needs to handle some of today’s biggest global HR challenges:

National economies grow at different rates, making it difficult for companies to account for, forecast, and budget compensation. While a company's financial results may be down in many markets, employees in emerging markets might be eligible for merit increases.



Obtaining adequate data in developing markets

When expanding outside North America and Western Europe, companies discover that labor market information used to set salaries is difficult to access and often unreliable. In some markets, there may be gaps in geographic and historical data. In addition, some countries have experienced recent volatile activity in their labor markets, which makes it even harder to calculate compensation figures. Companies should rely on multiple data sources and triangulate to find salary, compensation, and requisite information, Olsen said. “This can be difficult. We can’t rely on the same data sources and testing that we rely on in our home market.”

Some countries and regions may have an additional consideration. There could be two distinct workforces: a native population and a separate, expatriate labor force that receives an entirely different level of compensation.

Private companies may face another level of difficulty in obtaining certain salary and compensation information, especially if competitors are also private companies and do not report information to shareholders and regulatory agencies.

“These are some of greatest challenges that a US-based company that’s becoming more global must face,” Olsen said. “It’s more difficult, and you must be more creative to identify solutions.”

Competing for labor overseas

Goodyear says the talent pool in many foreign markets is “much more blended” than it is in the United States, and private companies must compete more aggressively abroad against larger publicly traded companies and the public sector for skilled workers.

In these circumstances, a private company that has a framework-based global compensation strategy may have an easier time showing prospective candidates that issues of compensation and perquisites are handled fairly and transparently. Private companies usually cannot offer the same kind of equity deals to new employees as can public companies but may be able to structure other compensation and perquisite programs to offset this issue.

Cutting costs in the long run

Embracing a framework-based global compensation strategy takes time, effort, and energy—not an easy sell in a challenging economic climate.

“This is not exactly what you’d call a low-hanging fruit,” Olsen said. Companies may want to make an immediate impact on the budget by freezing salaries and cutting travel expenses. However, “eventually you run out of those things.”

Face today’s challenges

National economies grow at different rates, making it difficult for companies to account for, forecast, and budget compensation. While a company’s financial results may be down in many markets, employees in emerging markets might be eligible for merit increases.

“If you forecast all your merit increases around the globe based on what’s happening in the US, you might not be compensating everyone appropriately,” Goodyear said. “There is no one-size-fits-all answer.”

A framework-based global compensation strategy creates a structure for addressing problems while providing flexibility for markets experiencing greater-than-average growth.

[Want to know more about global benefits?](#)

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Foreign filings: Navigating international tax

Efficient global operations require an understanding of international taxes as well as an awareness of legislative changes proposed by the Obama Administration.

When US private companies start operating offshore, they're often not aware of international tax provisions. "They're used to dealing with US tax structures, so they think the world operates like the United States," said Thomas Guaraldo, a partner with PricewaterhouseCoopers' International Tax Services group.

But there is an important difference. Whereas most foreign countries collect taxes only on income earned within their borders, the United States taxes its citizens' income worldwide. "If you're a US individual or corporation, you pay US income taxes on your income no matter where you're located or where the income was earned," said David Gilbertson, international tax director with PwC. "The only question is when you pay: in the year it was earned or when it's repatriated to the United States."

An international tax strategy begins with choosing what type of business entity to use. If a US company operates as a pass-through entity (meaning a partnership, LLC, or S corporation), US income taxes on its earnings are "passed through" to its owners, who pay them on their annual tax returns. If the business operates as a corporation, the corporation pays income taxes initially on earnings, while its shareholders pay a separate tax on those earnings when they are redistributed as dividends—in effect, a form of double taxation.

Depending on their earnings and transactions, it may be advantageous for US corporations operating offshore to set up a separate foreign entity to conduct business overseas. If a US corporation operates offshore as a foreign corporation and reinvests its foreign earnings offshore, then the US income tax is deferred until the income is repatriated in the form of a dividend or is deemed repatriated under antideferral regimes (explained later). Also, a US corporation (with the exception of a Subchapter S corporation) can claim a credit for foreign income taxes paid, which can mitigate the fact that that income gets taxed twice: by the United States and by the foreign jurisdiction where it is earned.

Another way companies can alleviate their tax burden is to look for ways to create wealth in countries with lower tax rates. "If your company is earning income outside the United States, you can arbitrage the differences in tax rates by structuring the company so that income is earned in a low-tax jurisdiction," Guaraldo said.

Six key areas of focus

Because of the complexity of rules governing certain types of transactions and earnings, there are many hazards to international tax planning. Here are six key areas to bear in mind.

Transfer pricing. This concept refers to the pricing for transactions between related parties in different jurisdictions, such as those between a parent company and its subsidiaries or between brother-sister corporations. Under US tax law, related parties cannot enter into such transactions on terms that would not occur if they were conducting business with a third party. For example, the production division can't sell its products to the marketing division at artificially low prices in order to inappropriately reduce its taxable income.

A transfer-pricing study allows a company to determine the third-party comparable price on a product or service and use that as the intercompany price. "When times are tough, companies often try to avoid spending resources by not doing a study and instead playing the 'audit lottery,'" Guaraldo said. "But the prudent thing to do is to get a transfer-pricing study so that you have contemporaneous documentation supporting the price you set."

Withholding taxes. Certain business charges—interest, royalties, dividends, and some services—are subject to withholding taxes in foreign jurisdictions. For example, if a Brazilian subsidiary of a US company pays a royalty to its parent for the use of intellectual property, the Brazilian government imposes a 25% withholding tax on that royalty payment. Since the parent company also pays US income tax on the royalty, this scenario creates a double tax. Many countries have double-tax treaties with the United States, which lower the withholding rate to 0% to 15%.

US companies that receive payments from foreign jurisdictions should consider whether there will be withholding taxes on those payments and if so, investigate whether there is a double-tax treaty dictating how that source of income would be taxed. In the example given, if the US company can't avoid doing business with Brazil (which does not have a double-tax treaty with the United States), another option may be for it to establish a holding company from the Netherlands or another jurisdiction that does have a double-tax treaty with Brazil.

Inefficient capital structure or intercompany debt.

US companies setting up businesses offshore can finance them with either debt or equity. Using debt—that is, loaning cash to the foreign subsidiary—allows the subsidiary to take a deduction on interest expense, which will reduce the amount of taxable income in that foreign jurisdiction. Companies may want to create a tax-efficient debt structure, in which the lender is in a low-tax jurisdiction and the borrower is in a high-tax jurisdiction. This enables them the company to increase the difference between the tax paid on interest income and the taxable-income deduction.

US antideferral rules. One of the main advantages of setting up a foreign subsidiary is that it allows US companies to defer US income tax payments on the subsidiary's earnings until the earnings are repatriated in the form of a dividend. But there are several key exceptions: foreign passive income such as interest, rents, royalties, and dividends, as well as certain types of intercompany transactions. Under Subpart F of the Internal Revenue Code, these earnings must be immediately included in US taxable income.

"The difficulty with Subpart F income is that you pay US taxes on those earnings currently, but unless you pay a dividend, those earnings are still offshore," said Gilbertson. "So you have taxable income, but you don't have cash from that same source to pay the tax bill." He advises clients either to repatriate the income as a dividend or to structure the transaction in question so that it doesn't involve buying from or selling to a related party.

Outbound transfer of intangible assets. The United States and many other countries have prohibitions against moving intangible assets such as intellectual property overseas. If a US pharmaceutical firm, for example, develops a new drug and uses a foreign subsidiary to manufacture and sell that drug, that subsidiary has to pay royalties to the US parent.

"Companies have to be careful of this," said Guaraldo. "They can't set up an operation offshore and assume that entity has the right to use the parent company's intellectual property without paying royalties. If you do that, the US may decide you've effectively moved that intangible asset offshore and charge you income tax based on the value of the property moved." Often, these exit charges mitigate—if not cancel out entirely—any benefit the company could gain from offshoring the intangible asset.

Indirect taxes, including value-added tax (VAT) and custom duties. US companies are often unaware of the VAT system used in most other countries (see chart). With VAT, a sales tax is imposed at each stage that value is added to a given product or service (in an oft-quoted example, when the farmer sells wheat to the miller, when the miller sells flour to the baker, and when the baker sells bread to the consumer). Although ultimately, the cost of VAT is paid by the end user, if a US company is the importer of record in a foreign jurisdiction with VAT, it is responsible for collecting and administering VAT and must therefore be knowledgeable in order to comply with local laws.

Depending on the jurisdiction, custom duties can also be significant. If a US company is exporting its goods to a country that charges high import duties,

those added costs have the potential of making its products less competitive than domestically produced ones.

Changes on the horizon

The Obama Administration has proposed several reforms to the international tax system that have the potential to seriously impact US multinationals. If enacted, these new rules would take effect in 2011.

One proposed change would place restrictions on what are known as the "check-the-box" rules, which currently allow US companies to treat foreign subsidiaries of foreign holding companies as disregarded entities for tax purposes. (This is frequently done to plan around the Subpart F antideferral rules discussed earlier.)

"If US companies have a second-tier foreign entity that's currently disregarded, they'll need to reexamine that structure and see if it would generate significant Subpart F income under the new rules," Gilbertson said. "If so, they may want to consider restructuring their foreign operations."

Another proposal would no longer allow US corporations to take US tax deductions on expenses related to deferred foreign income until that income is repatriated (in particular, this would mean higher expenses for bank interest). Still another would create a single foreign tax credit pool based on all foreign earnings, which would restrict US corporations' ability to maximize US foreign tax credits.

Conclusion

With effective tax planning, US multinationals can take advantage of different tax rates in different jurisdictions without making themselves subject to the US antideferral provisions that would make some of that income taxable in the United States. Ignorance of the tax system can affect a corporation's cash flow and its international competitiveness—especially with credit markets tight and many governments looking to balance their budgets through tax revenues.

[Want to know more about international tax planning?](#)

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How should US companies operating internationally plan for the Obama Administration's proposed regulatory changes?

1. Educate themselves and senior management on the proposals.
2. Quantify the potential impact of the proposals to their financial income and cash tax.
3. Lobby through industry groups or hold discussions with legislators in order to seek favorable revisions.
4. Plan alternatives. Planning should take two forms:
 - / Prior to enactment (by 2011)
 - / Postenactment

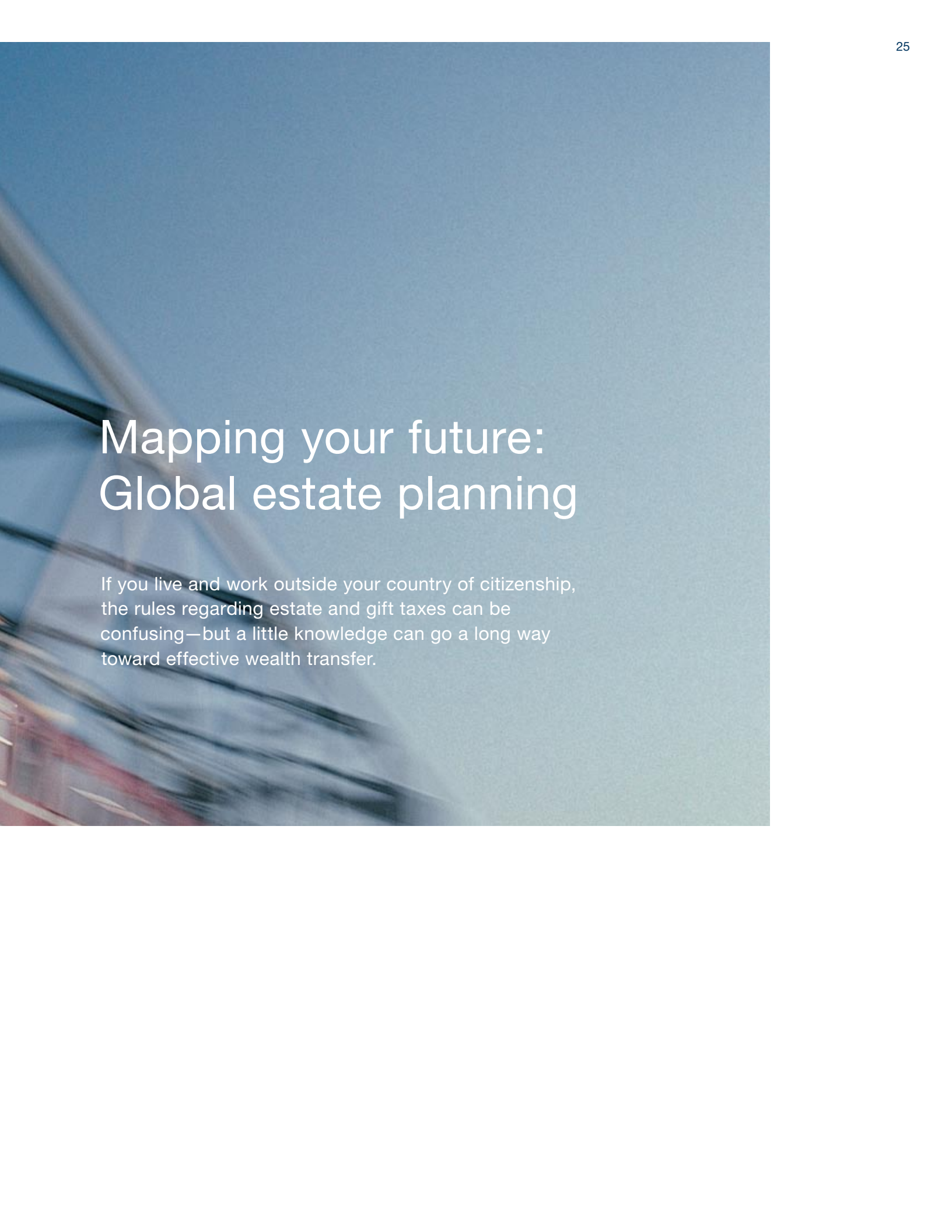
Comparison of tax rates worldwide

Country	Income tax corporate	Income tax individual	VAT
Austria	25%	21-50%	20%
Brazil	34%	7.5-27.5%	17-25%
Canada	19.5%	15-29%	5%
China	25%	5-45%	17%
Czech Republic	20%	15%	19%
Finland	26%	7-30.5%	22%
France	33.33%	5.5-40%	19.6%
Germany	30-33%	14-45%	19%
Greece	25%	0-40%	19%
Hong Kong	16.5%	2-17%	—
Hungary	16%	18% and 36%	20%
India	30-40%	10-30%	12.5%
Indonesia	28%	5-30%	10%
Ireland	12.5%	20-41%	21.5%
Israel	26%	10-46%	15.5%
Italy	31.4%	23-43%	20%
Japan	30%	5-50%	5% (consumption)
Luxembourg	21%	0-38%	15%

Comparison of tax rates worldwide (continued)

Country	Income tax corporate	Income tax individual	VAT
Mexico	28%	0-28%	15%
Netherlands	20-25.5%	0-52%	19%
Norway	28%	28-49%	25%
Philippines	30%	5-32%	12%
Poland	19%	18%/32%	22%
Portugal	25%	0-42%	20%
Romania	16%	16%	19%
Russia	20%	13%	18%
Saudi Arabia	20%	20%	—
Serbia	10%	10-20%	18%
Singapore	18%	3.5-20%	7%
South Africa	28%	0-40%	14%
Spain	30%	24-43%	16%
Sweden	26.3%	0-57%	25%
Switzerland	13-25%	0-13.2%	2.4-7.6%
Taiwan	25%	6-40%	5%
Thailand	30%	5-37%	7%
Turkey	20%	15-35%	18%
United Kingdom	28%	0-40%	15%
United States	15-35%	15-35%	—





Mapping your future: Global estate planning

If you live and work outside your country of citizenship, the rules regarding estate and gift taxes can be confusing—but a little knowledge can go a long way toward effective wealth transfer.

In today's mobile and global economy, as people and assets rapidly circle the world, issues like estate and gift tax planning may not always be a high priority. But for those US citizens living and/or working abroad and for foreign citizens living and/or working in the US, understanding the laws and regulations that govern this area is instrumental to sound financial planning.

Several elements—including gifting policies, the amount of property involved, resident or domicile status, the availability of deductions, and exclusions and credits—play important roles in estate and gift tax planning. And while each individual's strategy depends on a number of personal circumstances and objectives, keeping a few guidelines in mind can make a big impact in the efficacy of your wealth transfer plan. It's important to understand US federal rules in this area; proper planning should also include a review of the rules in the state of residence, as those rules may also influence planning.

Citizen, domicile or resident?

“At the heart of international estate and gift tax planning is the distinction between people who are either US citizens or domiciliaries and people who are either resident or nonresident aliens of the US,” according to Andrew Martone, a director in PricewaterhouseCoopers' Personal Financial Services practice. While this distinction is relatively straightforward for determining income tax liability, “it's a much more subjective process when it comes to estate and gift taxes,” said Martone.

“Resident and nonresident aliens fall under substantially different US estate and gift tax rules than do US citizens and domiciliaries. The key differences lie in the amount of property that is subject to tax and in the allowable deductions, exclusions and credits,” said Martone.

While US citizens and domiciliaries are subject to US estate and gift taxes regardless of where in the world they or their property is located, non-US citizens living in the US (on long-term work assignments, for example) should be aware of the factors that determine how the US views their domicile status. The first step is to understand how the definitions are applied: Individuals are generally considered US “domiciles” if they live in the US and have no definite intention of leaving. Individuals are considered “residents” for this purpose if they live in the US but are not considered US domiciliaries.

The resident or domicile distinction is a frequent point of confusion for non-US citizens living in the US. Determining domicile is a subjective process that considers several factors seen as demonstrating intent, such as the country in which the person's family resides; if on work assignment, the length of the assignment and whether a definitive end date has been set; green card status; the country in which the person owns substantial property; and the country where the individual maintains social, business, and professional contacts.

What is subject to US estate tax

US citizens and US domiciliaries are subject to US estate tax on their worldwide assets regardless of where they reside at the time of death. (While the exemption amount varies slightly from year to year, US citizens and domiciliaries who die in 2009 are entitled to an estate tax exemption that shields the first \$3.5 million of property from estate tax.)

Individuals who are resident aliens (neither US citizens nor US domiciliaries) are typically subject to US estate tax only on property located in the US. The common types of property deemed to be located in the US include real estate, shares of stock in US corporations, bonds and notes issued by US people or US entities, pension amounts under a US employer, and tangible personal property. The exemption amount varies slightly from year to year in this instance as well; non-US citizens and domiciliaries who die in 2009 are entitled to an estate tax exemption that shields the first \$60,000 of property from estate tax.

What is subject to US gift tax

The same general rule applies for US gift tax purposes: US citizens and domiciliaries are subject to US gift tax on their worldwide assets, and non-US citizens and nondomiciliaries are subject to US gift tax only on their US property. There is, however, an important exception that applies to intangible property (such as stocks and bonds) owned by non-US citizens and domiciliaries. Under this exception, non-US citizens and domiciliaries are not subject to US gift tax on gifts of intangible property. In other words, non-US citizens and domiciliaries can give away shares of US stock without being subject to US gift tax, even though they would be subject to US estate tax on such shares if they held them until they died.

All individuals are generally entitled to give \$13,000 (as of 2009) per year to as many different people as they want without incurring a US gift tax. For gifts in excess of this amount, US citizens and domiciles are exempt from US gift tax on cumulative lifetime gifts of \$1 million. No such exemption is available to non-US citizens and domiciles.

Marital deductions and joint property

A spouse's citizenship can drastically impact US estate and gift tax planning. For example, if a US citizen's spouse is not a US citizen, the citizen may be limited in the amount of property he or she can transfer to the spouse without an estate or gift tax liability, unless the citizen leaves that property in a special type of trust.

There is a US estate tax marital deduction that allows all individuals to leave unlimited amounts of property—estate tax free—to a surviving spouse. However, this estate tax marital deduction is available only if the surviving spouse is a US citizen. “What this means for estate and gift tax marital transfer planning,” says Martone, “is that the citizenship of the surviving spouse is more of a factor than is the citizenship of the deceased spouse.” If the surviving spouse is not a US citizen, the estate tax marital deduction is not available unless the property is left to the surviving spouse in a special type of trust known as a qualified domestic trust (QDOT).

The rule is generally the same for US gift tax purposes: one can give unlimited amounts to one's spouse as long as the spouse receiving the gift is a US citizen. Gifts to a non-US citizen spouse do not qualify for the unlimited US gift tax marital deduction. The QDOT, which allows transfers made at death to a non-US citizen spouse to qualify for the US estate tax marital deduction, is not available for gifts made to a non-US citizen spouse. However, in order to partially compensate for this denial of the gift tax marital deduction, gifts of \$133,000 (as of 2009) per year may be made to a non-US citizen spouse without incurring US gift tax.

Recent changes to US expatriation rules

New rules have recently been enacted that can affect the US estate and gift tax treatment of certain individuals who give up their US citizen or long-term US residency status (covered expatriates). Under the new rules, a US inheritance tax

is imposed on gifts or bequests received by a US citizen. This inheritance tax generally applies to any property acquired (directly or indirectly) by a US citizen from an individual who was a covered expatriate on either the date of the gift or the date of death. The gift or bequest is subject to US inheritance tax at the highest US gift or estate tax rate.

This is an important consideration for former US citizens and long-term US residents. Under the rules discussed earlier, such individuals could transfer non-US property without being subject to US gift or estate tax. Under the new rules, transfers from covered expatriates to US people may be subject to US inheritance tax.

Considerations under the Obama Administration

Due to rules enacted several years ago, the US estate and gift tax system is currently in a state of flux. As mentioned previously, US citizens and domiciles dying in 2009 are currently entitled to an estate tax exemption of \$3.5 million. The highest estate tax rate applicable to individuals dying in 2009 is 45%. US citizens and domiciles are also currently entitled to a gift tax exemption of \$1 million, and the highest gift tax rate is also 45%.

Under current US law, the US estate tax is scheduled to be repealed for one year for persons dying in 2010, and scheduled to be reinstated in 2011. The US gift tax is not scheduled to be repealed, and the highest gift tax rate is scheduled to be 35% in 2010. For 2011 and thereafter, the estate tax exemption is scheduled to be \$1 million; the gift tax exemption is scheduled to remain at \$1 million; and the highest tax rate for both estate and gift tax purposes is scheduled to be 55%.

Although it is not currently possible to know how the uncertainty caused by this scheduled one-year repeal of the estate tax will be resolved, the general consensus is that some action will be taken before the temporary estate tax repeal takes effect.

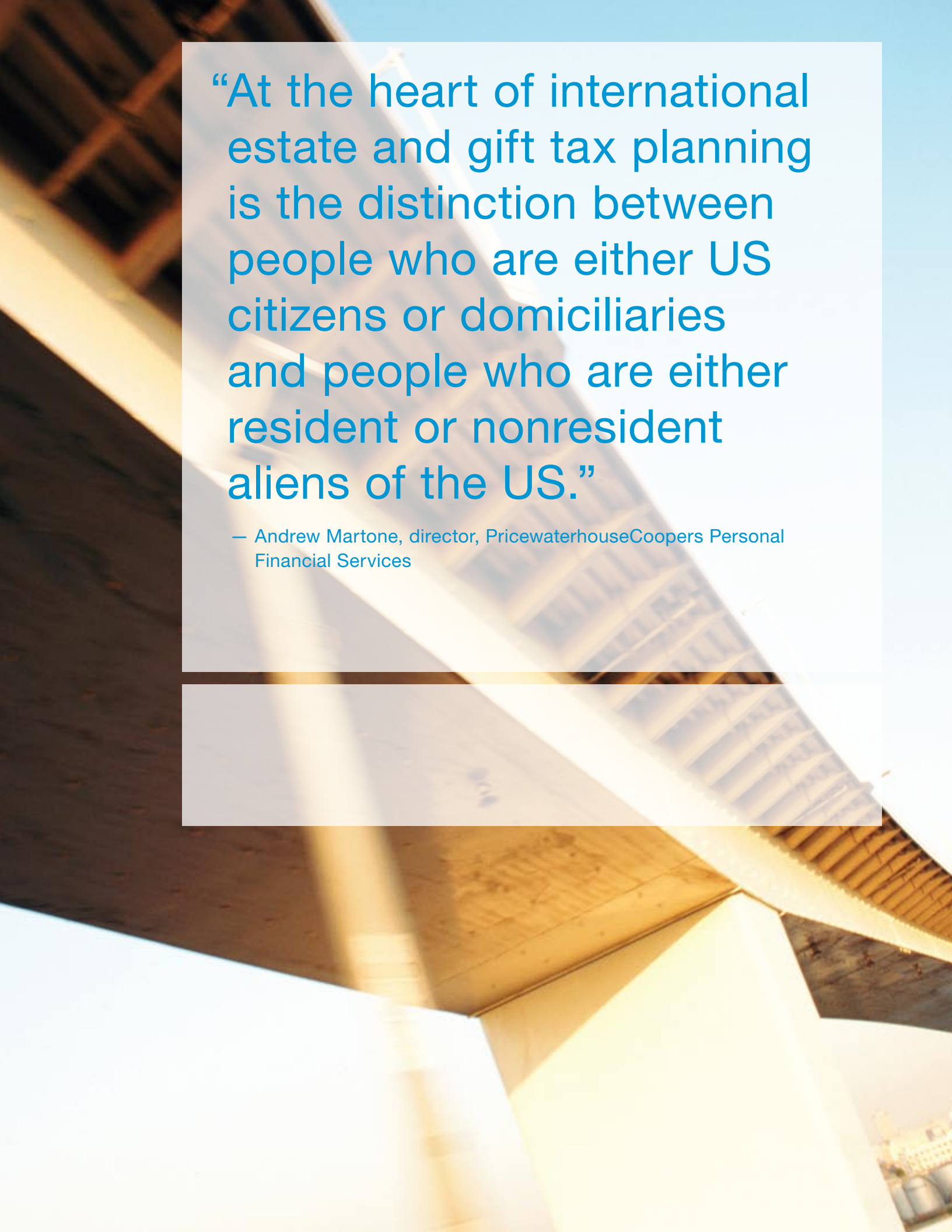
The administration and both houses of Congress currently have proposals that focus on the available exemption and the highest tax rate. The proposal that currently appears to have the most support would freeze the exemptions and tax rates at 2009 amounts. “In other words, the estate tax would not be repealed for 2010. It would still apply in 2010 and years going forward, with an estate tax exemption of \$3.5 million and a highest estate and gift tax rate of 45%,” said Martone.

Definitions for the purposes of US estate and gift tax planning

US domicile: generally, a person who lives in the US and has no current intention of leaving

US resident alien: A person who lives in the US but is not a US domicile

Nonresident alien: A person who is not a US domicile and does not live in the US



“At the heart of international estate and gift tax planning is the distinction between people who are either US citizens or domiciliaries and people who are either resident or nonresident aliens of the US.”

— Andrew Martone, director, PricewaterhouseCoopers Personal Financial Services

Other proposals being discussed are increasing the gift tax exemption to \$3.5 million (so that it would be equal to the estate tax exemption) and allowing for portability of the estate tax exemption between spouses (i.e., allowing a surviving spouse to use the unutilized estate tax exemption of the deceased spouse).

While these guidelines can direct both US citizens living abroad and non-US citizens living in the US toward estate and gift tax planning, each individual's circumstances can impact how US rules and regulations are applied. Questions or concerns about estate and gift tax planning subject to US tax law should be discussed with a professional adviser. For US citizens with property abroad, another planning step is to consult with an adviser in the country where the property is located in order to address potential issues that may arise in establishing estate and gift tax plans.

Want to know more about estate and gift tax planning for US citizens abroad and non-US citizens in the US? Please contact:

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Steps you can take in estate and gift tax planning

In addition to the larger issues outlined here, the following are key concepts you may want to consider in your estate and gift tax planning.

Treaties

- / Be aware that certain treaties with other countries affect deduction amounts and domicile rules. Research any treaty existing between the US and your home country, as each treaty has different rules (depending on your citizenship, residence location, and other factors), some of which may protect you from exposure to double estate and gift taxes.
- / In the absence of a treaty, you may also have the option of applying foreign tax credits to lessen your double taxation exposure.

Wills and asset titling

- / Having a US will helps ensure your property will be distributed according to your wishes and with minimal administrative cost and burden.
- / Have a durable power of attorney and health-care proxy, and make sure these representatives are aware of your wishes in the event of your incapacity.
- / Pay attention to how your property is titled. This can help in achieving the desired deemed asset location and enable you to fully utilize any available exemptions and deductions.

Residency status

- / Since the determination of domicile status is subjective, make sure your estate plan covers both scenarios of being a US domicile and being a non-US domicile.
- / Structure your living situation, activities, and other factors to influence your desired domicile status.
- / Leave property to your spouse in a form designed to qualify for the US estate tax marital deduction.
- / Take maximum advantage of the available US estate and gift tax exemptions and deductions as applicable to your citizenship or domicile status.
- / Make transfers prior to becoming a US domicile in order to take advantage of the exclusion of intangible property gifts from US gift tax.
- / To the extent possible, structure your activities to avoid being subject to US expatriation rules when leaving the US.

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