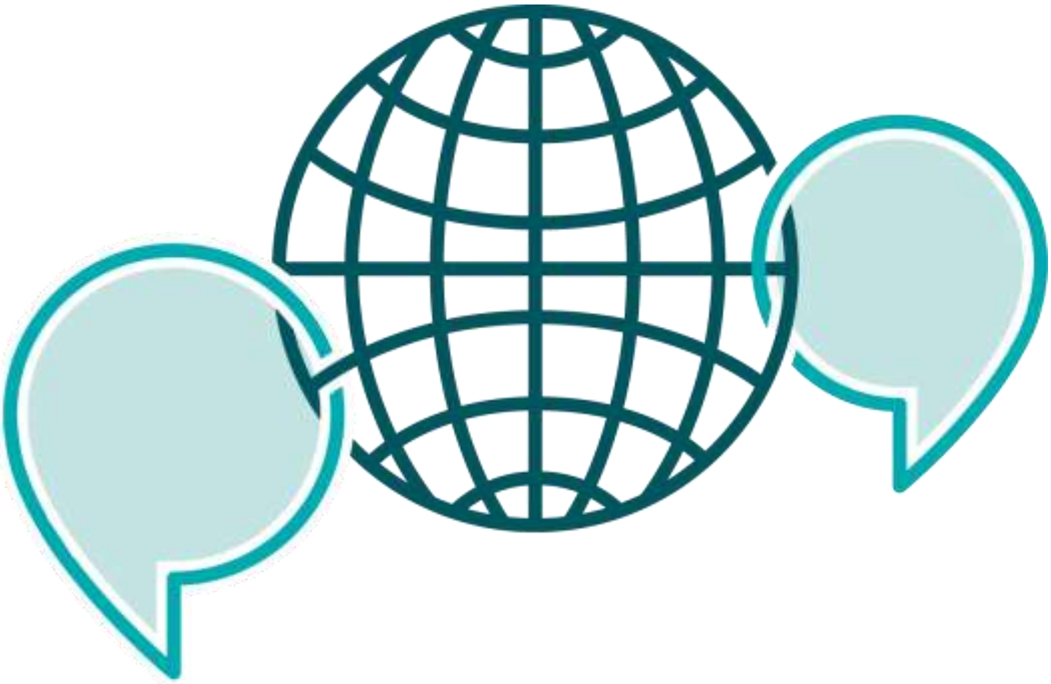
Global Insight – October 2018



The growing importance of corporate social responsibility in business

In recent years corporate social responsibility (CSR) has become a higher priority for companies as they recognise the numerous benefits to their businesses, employees, communities and the environment. Being a good corporate citizen is an increasingly important objective for many successful organisations.

CSR is about much more than philanthropy. As largely voluntary actions taken by businesses to help them become more accountable to stakeholders by providing economic, social and environmental benefits, it can take many forms.

CSR involves going beyond minimum legal requirements on a business to manage the economic, environmental and societal impact of its operations. India was the first country to legally oblige large corporations to allocate spending on CSR. This is discussed in this article later in this issue of *Nexia Global Insight*.

Businesses increasingly set their own standards and choose activities based on their values. Many have developed their own codes of conduct and best practice guidelines to inform programmes aimed at being more socially responsible.

Changes in consumer attitudes have become a key driver for increasing CSR activities as well as increasing pressure from employees who want to work for reputable, ethical and charitable businesses.

Many businesses are choosing to help their local community, support their staff and improve their environmental footprint in order to become a more responsible employer. This can include promoting car-sharing and cycle-to-work initiatives or engaging with local tree-planting schemes. Others encourage employees to make donations to the company's chosen charities through payroll giving, or provide pro bono services to local charities and not-for profit organisations, and some businesses promote employer-supported volunteering schemes where employees can volunteer in the local community for a specified number of hours during working hours

Delivering the benefits

Being a socially responsible employer can offer numerous benefits for the businesses involved as well as to employees, the local community and the environment, including:

- Boosting employee engagement.
- Creating a positive workplace environment.
- Increasing innovation and creativity.
- Encouraging professional and personal growth.
- Promoting individual philanthropy.
- Attracting and retaining talent.
- Improving public image and brand reputation.

As a result, more and more businesses are realising the importance of CSR and incorporating it into their overall business plan.

Having a dedicated CSR team and structured programme can enable people from all levels of the organisation to get involved. A CSR plan detailing key CSR objectives and various actions to meet these is a useful way to organise activities and help maintain a successful CSR programme. Nevertheless, the key to an effective programme to help you become a more responsible employer is to be authentic and align CSR activities with your company values.

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India's innovative approach to corporate social responsibility

In India, corporations have a duty to protect the rights of deprived and underprivileged people and larger businesses are increasingly expected to take responsibility.

India was the first country in the world to legally oblige corporations to allocate spending to corporate social responsibility (CSR) activities. Under Section 135 of the Indian Companies Act 2013, 2% of a company's profits must be allocated to CSR. This applies to companies meeting any of these thresholds: net worth of INR5bn, turnover of INR10bn or net profit of INR0.05bn. INR1bn is equivalent to approximately USD13.8m.

Advantages of the approach

Many companies have scaled up their CSR capabilities and are looking for opportunities to help build a more viable society. They have set aside budgets to fund specialist teams to deliver CSR policies, strategies and goals. Where CSR programmes are aligned with the company's business goals, they can be very attractive and fruitful for the organisation.

For example, e-Choupal is an initiative of the Indian Tobacco Company Ltd (ITC) which makes the power of the internet available to rural farmers to help in the procurement of produce such as soybeans, coffee and prawns. By removing middlemen, this helps to unshackle the potential of farmers who have traditionally been trapped in a cycle of little risk-taking, low investment, poor productivity, weak market orientation and low added value.

The Coca Cola India Foundation, has undertaken various initiatives including water sustainability and solar energy projects. It has also launched its VEER campaign, which reaches out to disabled people across India to give them a voice and an opportunity to fulfil their ambitions and enhance their livelihoods.

Under the banner of CSR, many Indian corporations became involved with the relief programme following the recent floods in Kerala. And an increasing number of corporations are using renewable resources for production to help improve environmental sustainability.

While many of these philanthropic activities help the needy to increase their standard of living, businesses also get to reap the benefits by aligning CSR programmes with their own values and strategies.

Limitations of the approach

Although CSR is mandatory, the Government restricts the deductions towards CSR expenses. Under income tax law some organisations are eligible for a 50% deduction of their CSR expenses, subject to various limitations.

According to an official Government website, approximately 40% of relevant companies in the 2016/17 financial year recorded CSR expenditure of less than 2% of profits. However, this is an improvement on the previous year, in which 81% of relevant companies recorded expenditure of less than 2%.

To further improve compliance, accountability and transparency, the Ministry of Corporate Affairs (MCA) has introduced data portals which will capture information on CSR activities that eligible companies file in their financial statements. The MCA has also started issuing so-called show cause notices to initiate prosecution for non-compliance with provisions under the Companies Act.

CSR is not a panacea for all the world's problems. But it certainly starts to move the needle towards economies that are healthier environments in which to conduct business.

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The impact of U.S. tax reform on renewable energy investments

Base Erosion and Anti-Abuse Tax creates new complexities for wind and solar energy investors

Although the U.S. Congress did not change the federal production tax credit (PTC) and federal investment tax credit (ITC) legislation for renewable energy projects in the Tax Cuts & Jobs Act, investors and project sponsors must now assess the impact of the new Base Erosion Anti-Abuse Tax (BEAT).

The stated purpose of the BEAT was to “pay for” part of the “cost” of lowering overall U.S. corporate income tax rates to 21%, and create a disincentive to move U.S. earnings offshore. In practice, BEAT has indirectly struck at both the PTC and the ITC by affecting tax equity investors – those who are incentivized to invest through tax benefits.

Impact on wind sector

Current federal income tax rules allow PTC-eligible wind projects to elect the ITC in lieu of the PTC. This technical legal limitation (which results from the ITC being based on project cost alone) explains why the wind sector in today's market still prefers the PTC to the ITC in a wind deal, given a choice.

This is also affected by the trend towards falling costs coupled with increased wind production. The prolific output and increasing efficiency of modern wind turbine technology means that wind farm tax equity transactions that elect to claim the PTC commonly generate substantial amounts of the credit.

The new unknown created by the BEAT may increase the attractiveness of the ITC for some investors, but only if the ITC is not limited by the BEAT in the year it becomes available to the investor.

Impact on solar sector

Although the ITC for solar was also not directly altered by the new tax law, the primary impact on the solar sector also arises from the new tax accounting rules that independently affect the wind sector, namely the BEAT, overall corporate rate reduction, interest deduction limits and elimination of Alternative Minimum Tax.

To the extent that the BEAT renders an investment in a ten-year PTC tax credit stream less attractive, some renewable energy investors may judge that a solar ITC project could be a sufficiently more attractive investment than a wind PTC or a wind ITC project. This is because the tax equity investment cost of a solar ITC investment differs from the cost of a PTC investment whose credits are claimed annually over ten years.

Each investor will assess these investments differently, depending on how they estimate their BEAT liability, their time value of money calculation, total investment, holding period criteria, and other factors compared to a ten-year PTC investment.

The greater relative near-term certainty of the one-time, up-front solar ITC could make these investments attractive compared to the value of a PTC wind project or even a wind ITC investment.

Outlook

Preliminary assessments of the impact of BEAT on tax equity were dire. However, apprehension appears to be waning as corporate treasurers and tax professionals become more familiar with the new BEAT rules, despite minimal guidance so far from the U.S. tax authorities.

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Turbulent times for the Polish wind farm sector

Lack of clarification around the real estate taxation rules for wind power plants in Poland means continued uncertainty for investors.

Real Estate Tax (RET) is payable on construction structures (or their parts) and is a significant cost factor that affects the profitability of wind farm investments in Poland. As a rule, the tax rate is 2%. However, complexities arise in the case of a wind farm as to whether RET applies to the whole wind farm or just part of it.

In the past, taxpayers and the tax authorities applied RET solely to the building parts of a wind farm, i.e. the foundation and tower. It did not apply to the wind turbine generator (WTG), which constituted around 60-70% of a wind farm's investment value.

In 2017, on the basis of an unclear amendment to the Building Law Act, the tax authorities started to demand RET on the whole investment value (including WTG, which was agreed by Poland's Voivodship Administrative Courts. It was planned that in September 2018 the Supreme Administrative Court would decide on the matter, but due to procedural issues it did not make a decision and said that no general resolution would be made for similar cases. Instead, only judgments in individual court cases would be made.

Moreover, unexpected further changes have been adopted over the course of 2018. As of January 2018, on the basis of a recent retrospective amendment of RET regulations, the 'old', more favourable rules became binding (taxation without consideration of WTG). Investors have already initiated refund proceedings aimed at the collection of unduly paid RET for the year 2018. Some tax authorities do not agree with the reduced tax burden as it favours investors. A challenge to these amendments in the Constitutional Tribunal may happen on the basis that they are potentially non-constitutional.

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A brief guide to U.S. bank financing for acquisitions

The U.S bank lending environment is currently robust but navigating the loan application process is not straightforward. Here is an outline of the lending landscape, some key elements of the process and possible post-closing requirements.

The U.S. banking world has highly sophisticated lending operations that are governed by the Federal Reserve Bank and the Federal Deposit Insurance Corporation (FDIC). In acquisition transactions the lender will usually perform a thorough and detailed underwriting of both the business to be acquired and the acquirer. U.S. banks tend to want a relationship that will continue after the loan is made, and are likely to require the acquirer to sign on for further banking services.

If the acquirer targets a lender with an existing relationship with the acquiree it can help speed up the due diligence process.

The process

When approaching financing, the acquirer needs to think like the lender and put themselves in the bank's shoes. The acquirer must be prepared with a detailed business plan that explains the reasoning behind the acquisition. The acquirer must incorporate a three-to-five-year forecast including sources and uses of the financing. The bank will also want to see a due diligence report obtained by the acquirer, ideally prepared by a firm of certified public accountants (CPA).

Further issues to consider pre-acquisition

- The acquirer will need legal representation to negotiate the loan documents.
- The acquirer should also engage a CPA to assist in the negotiation process, particularly for negotiating financial covenants.
- Workforce management is crucial due to litigation risks and retention matters. An HR expert on the due diligence team will strengthen the acquirer's loan application.
- An IT consultant should look at the acquiree's existing IT structure to help the acquirer understand what further IT investment could be necessary after the deal is closed. The consultant should also review IT security for any vulnerabilities as any liability from a data security breach post-acquisition will be the responsibility of the buyer.

Post-acquisition

The lender will likely require monthly or quarterly financial statements, in addition to an annual financial statement which should be reviewed by a CPA firm.

Getting the right team together

It takes good planning and a team of experts to put together a strong presentation for a U.S. bank lender. CPAs can help guide the process as they will have established connections with bankers, lawyers, HR and IT experts.

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International consequences of the U.S. Wayfair decision

Following a recent U.S. Supreme Court decision, non-U.S. companies and their subsidiaries selling goods or services in the U.S. need to evaluate whether their state sales tax responsibilities have changed.

In a recent high-profile case, *South Dakota v. Wayfair*[1], the U.S. Supreme court overturned the requirement, from its 1992 ruling in another case, *Quill Corp. v. North Dakota.* This had stated that companies selling in the U.S. must have a physical presence in a state before they can be required to collect sales tax there.

Because of *Quill,* many non-U.S. companies selling into the U.S. had not been subject to a U.S. state sales tax collection obligation. Now, due to *Wayfair* and the sales tax economic nexus requirements that many U.S. states have implemented in response, many non-U.S. remote sellers may now be required to collect and remit sales tax in U.S. states even if they have no physical presence.

[1] https://www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf

The impetus for the *Wayfair* decision was a South Dakota law that asserted sales tax nexus over any seller with either more than USD100,000 of in-state sales annually, or at least 200 transactions to in-state purchasers annually – even if the seller had no physical presence there (a so-called "remote seller").

As of 1 September 2018, about half of the U.S. states have a similar nexus law in place. These laws have varying enforcement dates, but many began on 1 October 2018.

What should non-U.S. businesses do now?

In the past, foreign companies selling into the U.S. without any physical presence in the U.S. did not have a reason to understand or implement sales tax collection regimes. But in light of this change it is now important to evaluate their U.S. business.

There are many factors to consider, such as whether the business exceeds a particular state's sales tax economic nexus threshold, whether the product or service being sold is taxable in the given state, and whether an exemption applies.

It may also be questionable as to whether a U.S. state would have the ability to legally enforce a sales tax assessment against a business with no assets physically located in the U.S. But this issue has not been tested by the courts yet as these requirements are new.

All remote sellers with significant sales to U.S. purchasers should consider a '*Wayfair* check-up' by a CPA firm. This would include a comprehensive analysis of the issues noted above, as well as the company's overall nexus profile and the practical aspects of collecting and remitting sales tax, such as collecting exemption documents, systems considerations and overall process review.

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Using the Netherlands as a business gateway to Europe

The Netherlands can be an attractive country of establishment or transit to companies outside Europe due to its location and infrastructure, but financial and tax arrangements often prove decisive.

To illustrate some of the issues involved in using the Netherlands as a gateway to Europe, take the example of a large chemical group based in south-east Asia that already has a production facility in Germany and is looking to expand further into Europe.

The group is initially looking to import and resell semi-finished products from Asia on a large scale and picks the Netherlands as its operating base. The country is an attractive place to do businesses thanks to the Port of Rotterdam and good infrastructure connecting it to mainland Europe. In addition, beneficial agreements can be made with the tax authorities in the Netherlands.

To deal with its VAT levy and import duty obligations, one option is for the company to engage a general tax representative to handle its tax liabilities in the Netherlands.

An upside of this approach is that VAT registration in the Netherlands would be unnecessary. A VAT reverse charge mechanism could also be used for the imports to prevent any financing losses.

However, using a general tax representative and the required surety bond to submit VAT returns would involve considerable costs. Moreover, this is not a viable long-term solution as the company also plans to start production and set up a sales office in the Netherlands.

On the other hand, VAT registration would mean that the VAT reverse charge mechanism for imports could no longer be applied. The reverse charge mechanism can only be applied when a tax representative is used, or when the importing party is established in the Netherlands. The non-applicability of the VAT reverse charge mechanism would mean that VAT would be due immediately on any imports instead of through the regular VAT return. This would result in a considerable financing disadvantage.

An alternative option is incorporating a private limited company in the Netherlands. This is a future-proof solution that avoids the considerable costs and surety bond of tax representation, while keeping a VAT reverse charge mechanism with imports in place.

This also ties in well with the company's plans to start production and set up a sales office in the country.

To avoid the deployment and related costs of a tax representative, the group can be registered in the Netherlands as a VAT entrepreneur and submit VAT returns autonomously.

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Lack of international tax consensus on cryptocurrency

The definition of cryptocurrency and how it should be taxed varies widely among different tax authorities around the world.

With a lack of consensus on the nature of cryptocurrency, tax and revenue authorities in different countries have had to take a stand and issue guidance on their own official position on what it is and how it should be taxed.

Attitudes around the world

There have been mixed results. For example, in Canada cryptocurrency is seen as a commodity, not a currency and is taxed as property. Whereas in Germany, it qualifies as units of account and is therefore a financial instrument, taxed like any other currency. In the U.S. it is considered to be personal property and each transaction results in a capital gain or loss.

In Australia, transactions are viewed as barter arrangements and cryptocurrencies are considered assets for capital gains purposes. And in South Korea, transactions are financial transactions taxed as a capital gain or miscellaneous income.

Resolving the differences

Jurisdictions that define cryptocurrency differently will have conflicting views on the timing of taxable events, the nature of the resulting income (ordinary or capital), and the sourcing of the income (country A or B). However, international tax treaties have not yet made provisions to resolve these differences.

As a result, depending on how the jurisdiction defines and taxes cryptocurrency, individuals who are subject to taxation in multiple jurisdictions may face significant issues when claiming foreign tax credits to offset double taxation.

Tax authorities are currently focused on sorting out the tax treatment in their respective home countries, particularly as initial coin offerings, chain splits, air drops, token swaps, giveaways and other events are presenting new complexities.

It may be some time before the international tax challenges are resolved.

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Canada, Israel and cannabis finance

The combination of Canada's capital markets and Israel's clinical research expertise is leading to fruitful collaboration in the emerging cannbis sector.

As discussed in the April 2018 edition of *Nexia Global Insight*, Canada has become the global headquarters for mid-sized cannabis company corporate finance activity following the Canadian Government's implementation of the Marijuana for Medical Purposes Regulations in 2013. This created a commercially-licensed industry producing and distributing medical marijuana. Furthermore, on 17 October 2018, Canada legalized recreational cannabis.

Israel, often known as the 'start-up nation' as it has embraced innovation and an entrepreneurial spirit among its citizens and government, has also established a reputation as a global leader in the study and production of cannabis for medical purposes. The chemical structure of marijuana was discovered in 1964 by Hebrew University scientist Raphael Mechoulam[1], birthing the entire medical cannabis industry.

[1] The Jerusalem Post, "A Higher Calling: How Israeli Marijuana Research Changed the World," www.jpost.com/Opinion/A-higher-calling-How-Israeli-marijuana-research-changed-the-world-560381

Steady growth in cannabis stocks

There have been impressive gains in cannabis companies listed on Canadian exchanges. In Israel in recent months, any mention of a potential cannabis offering has felt the Midas touch.

For example, the share price for Together Pharma Ltd (Together), which is headquartered in Ashkelon, Israel, and listed on the Tel Aviv Stock Exchange increased by approximately 400% since entering the cannabis sector in January 2018. And in further evidence of cannabis collaboration between Israel and Canada, in April 2018 Together signed a binding agreement to supply dried cannabis inflorescences and cannabis oil to a Canadian company in 2019 and 2020. This agreement has a minimum estimated income of about USD300m.

However, the Israeli Government continues to debate whether it should approve the export of medical marijuana from Israel. Either way, Israeli cannabis companies or for that matter, any other international cannabis companies, are still able to list on Canadian stock exchanges.

The next step

In our previous *Nexia Global Insight* article, we outlined the opportunity for U.S. cannabis companies to launch an IPO or list on Canadian stock markets, as they cannot currently file a prospectus within their own country. Similarly, industry experts are predicting that Canada's position at the forefront of cannabis financing will result in Israeli companies approaching Canada for financing to propel them to the next level[2].

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[2] Canadian Jewish News, "For Canada's and Israel's Marijuana Industries, A Budding Partnership," www.cjnews.com/news/canada/for-canada-and-israels-marijuana-industries-a-budding-partnership

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