



601 - Doing Business Overseas: Advanced Legal Issues with Managing International Subsidiaries

Monday, October 01, 2012

11:00 AM - 12:30 PM



Overview

1. Introduction/Present the Problem
2. Legal Structure and Tax issues
3. Intersection of Sarbanes-Oxley, FCPA, Dodd-Frank and the UK Bribery Act
4. Managing human resource issues both at home and abroad
5. Effectively managing legal issues, local employees and negotiation through cultural lenses



The problem...

The General Counsel of XYZ Corp., your boss, has come to you with a new assignment. XYZ Corp. is a major US-based technology company, producing manufactured hardware, commercially available software, and recently has begun offering apps.



The problem...

While XYZ products can be found around the globe, in the past it has relied on a network of distributorships to market and sell its products in foreign jurisdictions. But the recent headlines regarding bribery scandals has made some in the executive suite nervous, and they believe this may be the time to look into starting its own overseas operations.



The problem...

The General Counsel has asked you to look into the legal issues involved in setting up a network of overseas subsidiaries. While he realizes that the company will face a number of issues based on each specific jurisdiction where you set up operations, he is looking for a high-level, but in-depth, understanding of what issues XYZ will face in setting up one or more subsidiaries in a foreign jurisdiction, what tax law considerations might come into play, whether this will improve the company's ability to avoid bribery scandals, how hiring (and firing) is different overseas, and what cultural and how the legal operations will be different while doing work across borders.



The problem...

While you have addressed some of these issues in the past, it's been a while. But he needs a briefing in a week so he can be prepared to advise the CEO and, ultimately, the Board of Directors. So, knowing that you can learn from your colleagues, you first consult the experts at the ACC Annual Meeting...



Legal Structure and Tax issues



Major Topics

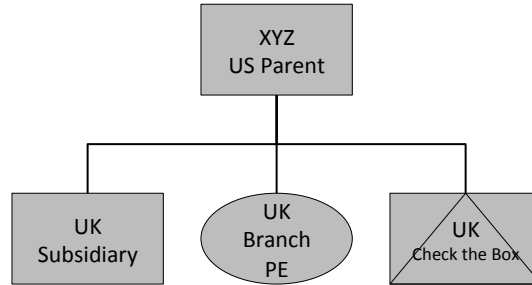
1. Tax Aspects of Alternative Legal Forms
2. Transfer Pricing
3. Tax Issues in Commercial Agreements



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Tax Aspects of Alternative Legal Forms



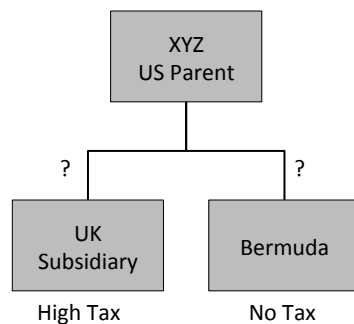
1. Deferral of US Tax (or not) – CFC Rules
2. Foreign Country Corporate Tax
3. Foreign Withholding Tax (Dividends, Interest & Royalties)
4. Indirect Taxes
5. Double Tax Relief (Foreign Tax Credit) – “Limitation”
6. Tax Treaty Relief (“Competent Authority”)



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Tax Aspects of Alternative Legal Forms



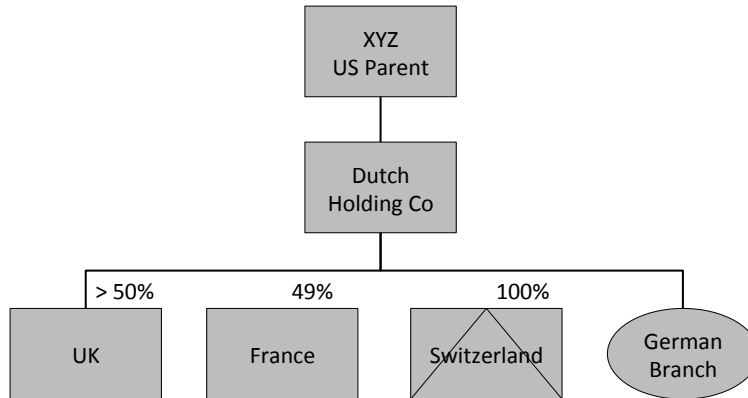
1. CFC or Not? - % of ownership
2. High, Medium & Low Tax Jurisdictions
3. Tax Treaty Jurisdictions: Why Important



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Tax Aspects of Alternative Legal Forms



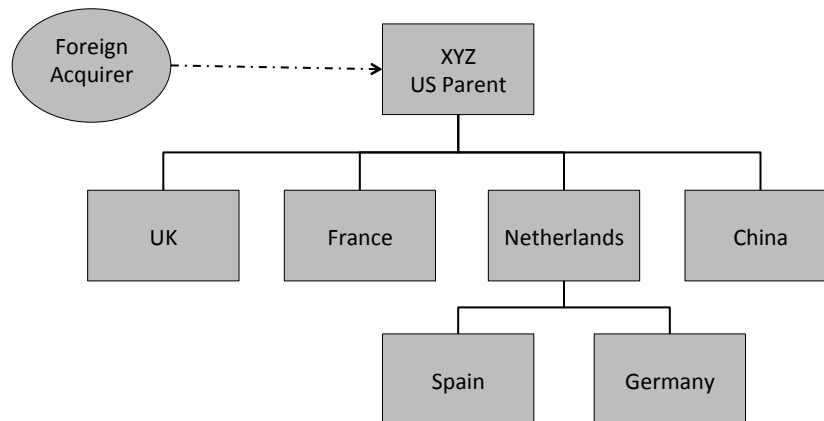
1. Holding Company Regimes – Advantages & Disadvantages
2. Various US Tax Consequences
3. Foreign Tax Consequences



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Tax Aspects of Alternative Legal Forms



Foreign Acquirer – XYZ becomes the “Target” of an Acquisition
“Sandwich Structure”



Transfer Pricing

- #1 Global Tax Issue for Multinationals – very high degree of enforcement
- Arm's Length Standard
- US Methods, OECD Methods, Non-OECD Countries
- Corporate Policy – “Tolerance for Risk”
- US Documentation + Foreign Documentation (Most Countries) – “How much is enough?”
- Treaty Relief
- Advanced Pricing Agreements
- Transfer Pricing in the Context of an Acquisition



Transfer Pricing

Main Categories

- Sale/Purchase of Goods
- Intangibles
- Goods with Imbedded Intangibles
- Intercompany Services
- Financing
- Cost Sharing (IP) and Contract Services



Tax Issues in Commercial Agreements

Type of Agreements

- Licenses
- Franchises
- Distribution
- Joint Ventures
- Acquisitions & Reorganizations
- Employment Contracts



Tax Issues in Commercial Agreements

Licenses (Unrelated)

- Withholding Tax issue on Royalties for IP – whose liability?
- Tax Treaties – possible reduction in rate
- Limitation on Benefits (Treaty Entitlement)
- Certification of Residency
- Royalty rate may be relevant for related party licenses - comparability



Tax Issues in Commercial Agreements

Franchises (Unrelated)

- Withholding Tax
- Merchandise supply agreement plus royalties
- Pricing of Merchandise Versus Related Party Pricing
- Transfer Pricing (Potential “CUP”)
- Custom or Import Duties – is the royalty dutiable?
- Buy-back of Franchise



Tax Issues in Commercial Agreements

Distribution Agreements (Unrelated)

- Normally, not a tax problem ...
- If XYZ has a substantial business presence in the customer’s country, there is a possible “doing business” or Permanent Establishment (PE) Issue.
- If XYZ has a local foreign affiliate, consider whether the local company should enter into the third party transaction agreement
- Some countries might attribute the sale to the affiliate
- Comparing pricing of product / technology to unrelated and related needs to be considered.
- Who is the importer of record?
- What about internet sales?
- Does a website create a PE?



Tax Issues in Commercial Agreements

Joint Ventures

- Percentage of our ownership interest will influence XYZ's legal structure, i.e., whether we form a local company to own joint venture interest or own our interest directly from the US
- Choice of legal entity- taxable entity versus flow-thru
- Dividend Distributions-timing of payment of dividends will impact withholding, cash flow, etc. Need to agree upfront on the parameters for declaring and distributing dividends.
- Buy-back of joint venture



Tax Issues in Commercial Agreements

Acquisitions & Reorganizations

- In general: stock versus assets
- Who should acquire?
- Tax basis of assets versus share purchase price
- How will it be financed?
- Local debt versus related party borrowings?
- Tax considerations of the seller? Capital gains?
- Purchase price allocation
- How and when to move the legal ownership of entities post-acquisition in a tax efficient way, country-by-country analysis
- Transitional Service Agreements



Tax Issues in Commercial Agreements

Employment Contracts

- Who is the employing entity?
- Will the individuals be seconded?
- Re-charges of costs between related entities
- Employee versus Independent Contractor Issues
- Tax Equalization for Expats / Inpats
- Contracts with non-resident third parties



Intersection of Sarbanes-Oxley, FCPA, Dodd-Frank and the UK Bribery Act



Intersection of FCPA, UK Bribery Act, SOX & Other Key Laws on XYZ Plans

Ross Booher

Member, Bass, Berry & Sims PLC

1. The Challenge: Multiple Applicable Standards
2. Survey of Key Standards
 - FCPA
 - UK Bribery Act
 - SOX
 - Dodd-Frank
 - Others
3. Common Problems
4. Practical Solutions
5. Roundtable of Examples & Suggestions



Overview of the Foreign Corrupt Practices Act (“FCPA”)

- Creates both civil and criminal liability for individuals and companies and is enforced by the U.S. Department of Justice and the Securities and Exchange Commission
- Two components:
 - **Anti-bribery Provisions:** prohibit offering or providing anything of value to a foreign official to obtain or retain business, direct business to any person, or obtain a business advantage
 - **Accounting Provisions:** require U.S. public companies to maintain accurate books and records and internal controls sufficient to detect and prevent violations



FCPA Accounting Provisions

- Books and Records Provision
 - Maintain books, records, and accounts that in reasonable detail accurately reflect the transactions and dispositions of assets – ***no materiality requirement***
- Internal Controls Provision
 - Devise and maintain a system of internal accounting controls to provide reasonable assurance that transactions are authorized by management and financial statements are in conformity with GAAP
 - Designed to detect and prevent violations



Elements of FCPA Anti-Bribery Violation

- Offer, Promise, or Payment
- Of Anything of Value
- To a Foreign Official
- Made with Corrupt Intent
- To Assist in Obtaining or Retaining Business or Directing Business to any Person or Obtain a Business Advantage



Anti-Bribery Elements (cont.)

- **Element 1: Offer, promise, or payment**
- **Element 2: Anything of value**
 - Money or equivalent (e.g., gift card)
 - Anything else of value (e.g., tuition, loan, travel upgrades, dinner, entertainment, in-kind services)
 - Gift (e.g., champagne, moon cakes, a car)
 - Charitable contribution or donation (e.g., donation to foreign official's wife's charity)
 - Employment for relatives
- **Key Points**
 - Very broadly defined
 - Payment need not actually be made: offers and/or promises count
 - The official's ability to fulfill the promise is not required
 - *No minimum value threshold*



Anti-Bribery Elements (cont.)

- **Element 3: "Foreign Official"**
 - Any officer or employee of
 - Any foreign government (i.e., national, state, provincial or local)
 - Any department, instrumentality, or agency of a foreign government
 - Any state-owned or controlled entity (e.g., a state oil company or state-controlled utility)*
 - Any non-U.S. political party
 - Any public international organization (e.g., United Nations)
 - Any candidate for non-U.S. political office
 - Any non-U.S. political party
- **Key Points**
 - DOJ broadly construes* the FCPA to apply to any official or employee regardless of rank or title
 - *Not always obvious; sometimes investigation is required*





Anti-Bribery Elements (cont.)

- **Element 4: Corrupt Intent**

- Intent to induce the foreign official to misuse his/her official position
- The intent to make the payment is relevant; not the intent to violate the FCPA



- **Key Points**

- Ignorance of the FCPA is no defense
- Local custom is no defense



Anti-Bribery Elements (cont.)

- **Element 5: Business Purpose**

- Payment, promise, or offer of thing of value must be made to assist in:
 - Obtaining business
 - Retaining business (loosely defined)
 - Directing business to any person or entity



- **Key Points**

- This, too, is very broadly construed
 - Covers payments to assist in obtaining or retaining business indirectly, such as reducing taxes or customs duties, thereby lowering a company's overall expenses in a particular market



Potential Liability for Third Parties

- Two situations where the U.S. government holds companies liable for conduct of third parties:
 - Agents: If a third-party is legally considered an “agent” of a U.S. company, the government may hold the company liable for the actions of its agent.
 - “Knowing”: Even if the third party is not legally considered an “agent,” it is unlawful to make a payment to the third party while knowing that all or a portion of the payment will go to a foreign official.
 - In the U.S. government’s view, “knowing” includes “conscious disregard” and “deliberate ignorance” – not just actual knowledge. The U.S. government *strongly* encourages U.S. companies to conduct due diligence on all business partners.



Recent U.S. Enforcement Trends

- Emphasis on prosecuting individuals and industry-wide investigations
- 2010-2011: 72 enforcement actions against 53 companies & 16 individuals; over \$2.2 billion in fines & penalties

“We are unequivocally opposed to weakening the Foreign Corrupt Practices Act. We don’t need to lower our standards. We need to work with other countries to raise theirs.”

—Hillary Clinton, Secretary of State (March 22, 2012)

“Fighting corruption is the Department’s top priority.”

—Nathaniel Edmonds,
Assistant Chief,
DOJ Fraud Section
(April 12, 2011)

“If you look at who we’re prosecuting, we’re prosecuting mid-level to senior-level corporate officers and employees, CEOs, CFOs, heads of international sales.”

—Mark Mendelsohn,
Then-Deputy Chief,
DOJ Fraud Section
(April 12, 2011)



FCPA in the News



FCPA in the News – Walmart

Save money. Live better.

The New York Times

“Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle”

April 21, 2012

“In an interview with The Times, Mr. Cicero said Mr. Castro-Wright had encouraged the payments for a specific strategic purpose. The idea, he said, was to build hundreds of new stores so fast that competitors would not have time to react. Bribes, he explained, accelerated growth. They got zoning maps changed. They made environmental objections vanish. Permits that typically took months to process magically materialized in days.”



U.K. Bribery Act

Generally

- Jurisdictional reach based on “carrying on business”
- Prohibits public and private sector bribery
- Strict corporate criminal liability for “failure to prevent” bribery committed by “associated persons” but “adequate procedures” defence available

Penalties

- Individuals - 10 years’ imprisonment and significant fines
- Companies – unlimited fines
- Potential debarment from EU contracts
- Civil recovery under Proceeds of Crime Act



The U.K. Bribery Act & the FCPA: Key Differences

- U.K. Bribery Act applies to private sector bribery
- U.K. Bribery Act contains no exception for facilitation payments
- U.K. Bribery Act provides for strict corporate criminal liability for failure to prevent bribery but “adequate procedures” affirmative defense:
 1. proportionate procedures
 2. top-level commitment
 3. risk assessment
 4. due diligence
 5. communication (including training)
 6. monitoring and review



Sarbanes-Oxley Act

- Requires control persons to certify
- Dodd-Frank Act: SOX whistleblower protections cover subsidiary/affiliate employees where financial statements consolidated



Dodd-Frank Act Whistleblower Awards (§ 922)

SEC rules effective August 12, 2011

- 10% - 30% awards
- May report anonymously through counsel
- 120 day window
- After 120 days, even compliance officers, directors, officers & auditors (if not bound by attorney-client privilege) can become an anonymous whistleblower . . .



Dodd-Frank Act Whistleblower Awards (§ 922)

“[A]n officer, director, auditor or one of the other designated persons can become a whistleblower after at least 120 days have elapsed since the whistleblower provided the information to the entity’s audit committee, chief legal officer, chief compliance officer (or their equivalents) . . . or to his or her supervisor, or since the whistleblower received the information, if he or she received it under circumstances indicating that the entity’s audit committee, chief legal officer, chief compliance officer (or their equivalents), or his or her supervisor was already aware of the information.”

-- SEC Release No. 34-64545, p.75



Other Frequently Intersecting Issues/Laws

- Do Legal Privileges Exist/Apply to In-house?
- Data privacy
- Labor
- State secrets
- Export controls
- Financial
- Conflicts of interest



Common Problems

- **Lack of awareness of multiple applicable laws by parent employees**
- **Lack of appreciation of resulting risks & potential costs/effects on business**
- **Balancing risk reduction measures with business considerations**
 - Corporate structure
 - Market
 - Methods
 - Staffing
- **Desire to proceed swiftly without proper compliance foundation/prep**
- **Local or expat staff who do not comply with standards**
 - Unintentional or Willful
 - Conflicts/Loyalty
- **Failure to integrate and exercise sufficient compliance oversight**



Examples of Solutions to Common Problems

- **Lack of awareness of multiple applicable laws**
 - **Brief execs & planning team early on issues**
 - **Policy that triggers legal involvement at outset of expansion planning**
 - **Local counsel early**
 - **Training**
 - **Direct legal involvement throughout process from outset**
- **Lack of appreciation of resulting risks & potential costs/effects on business**
 - **Consider and advise on effect of local risks on contemplated business methods/structure**
 - **Raise issue of effect of staffing approach to risk**
 - **If changes needed, re-analyze effects and expected cost/benefit**
- **Balancing risk reduction measures with business considerations**
 - **Risk-based compliance**
 - **Eyes wide open**



Examples of Solutions to Common Problems

- Desire to proceed swiftly without proper compliance foundation/prep
 - Periodic training to highlight corporate & individual risks
 - Policies that trigger involvement of legal
 - Legal directly involved at all stages of planning from outset
- Local or expat staff who do not comply with standards
 - Due diligence & screening
 - Policies/procedures that can be used/enforced under local law
 - Swift integration & oversight
 - Effective disciplinary procedures that are consistently applied
- Failure to integrate and exercise sufficient compliance oversight
 - Plan in advance so built into cost/staffing model
 - Swift on-the-ground integration (e.g., training, mentoring)
 - Risk-based routine oversight – on the ground, periodic
 - **SWIFT** response to red flags, reports and enforcement activity
 - Prepare incident response plan in advance



• Roundtable Discussion

• Other Resources

- Local counsel: LexMundi.com
- Risk assessment: Transparency.org
- ACC InfoPAK: “Managing Foreign Subsidiaries”

• Questions?

Ross Booher

Member, Bass, Berry & Sims PLC



Managing Human Resource Issues Both at Home and Abroad



Nature of Foreign Worker Relationships

- Various Structures for HR Resources (e.g., JV, wholly owned entity, distributor)
- Special Issues Associated with JVs
- Special Issues Associated with Subsidiaries/
Employees Acquired through M&A
transactions
- Use of Independent Contractors v. Employees
(registration requirements for sole
proprietors)



Staffing with Local Employees v. Expatriates

- Requirements to Use Local Employees (e.g., governmental or large customer driven)
- Advantages of Disadvantages to Using Local Employees (e.g., legal considerations, local knowledge)
- Advantages and Disadvantages to using Expatriates (e.g., financial considerations, knowledge of company and global issues)
- Application of US Law Abroad and Treatment of Expatriates (e.g., intra-company transfers, termination issues for relocated employees)



Managing Foreign Employment and Labor Law Issues

- Due Diligence in Hiring (e.g., background checks and screenings)
- Use of Employment Agreements and Offer Letters
- Privacy Considerations
- Whistleblower Policies
- Restrictive Covenants
- Harassment & Discrimination Issues
- Training Challenges (anti-corruption, harassment policies)



Immigration, Compensation & Benefits Pitfalls

- Payment Issues (local currency restrictions)
- Global Stock Option Issues
- Independent Contractor Considerations
- Effects of Restructuring on Foreign Employees



Practical Suggestions for Dealing with Foreign Employees

- Integration and Interaction between Legal and HR Departments
- Employment of Strong Local Advisors (local counsel, accounting firms, ACC resources)
- Personal Oversight and Relationships
- Advance Planning



Effectively managing legal issues, local employees and negotiation through cultural lenses



Managing legal issues

- Country Legal and Business Guides
- Picking the Right Lawyer
 - Importance of the relationship
 - Single Firm or Firm Network?
 - Generalists or Specialists?
 - Network your way to finding local counsel
- ACC Value Index and Member-to-Member
- Financial and Accounting Professionals



Attorney-Client Privilege

- Akzo Nobel v. Commission (Case C-550/07P, *Akzo Nobel Chemicals Ltd. and Akcros Chemicals Ltd. v. Commission*, September 14, 2010)
- European Court of Justice holds that attorney-client privilege will be respected where 1) documents are connected with client's 'right of defence' and 2) the exchange must be with 'independent lawyers'
- Independence in this context means 'lawyers who are not bound to the client by a relationship of employment'---NOT IN-HOUSE COUNSEL



Attorney-Client Privilege Practical Considerations

- Remember that outside the U.S. the privilege may not attach—check with local counsel!
- Think about international issues when designing your document retention and legal department policies.
- Utilize your international outside counsel to secure the privilege.



Managing local employees

- While managing employees is often HR, they can be terribly helpful in supporting the legal role at the company:
 - Front line information for investigations, conflicts, violations of law, compliance matters
 - Implementing and understanding the necessity for U.S. (or other country) legal policies/procedures
 - Can often find out about legal problems before they mushroom into something larger



Negotiation through cultural lenses

- ‘How to do Business In’ guides
- Business customs, manners, protocol guides
 - Make a good impression
 - Also, seek to uncover potential cultural sticking points
- Obtain local counsel, build strong relationship
 - Even if just for reference on the trickier parts
 - May also want an accounting or tax specialist
- Understanding business objectives thoroughly
 - Then, understand other side’s motivations, assumptions and potential deal killers



Negotiation through cultural lenses

- Your role as business lawyer is often more like a mediator, trying to make sure everyone is on the same page
 - Understand the foreign law concepts thoroughly so your business teams understands
 - Explaining your company's position as well
- If you can balance all of these needs, and foresee potential pitfalls in business, law and culture, hopefully you will have a successful negotiation



Practical Tips

- Network, network, network to support your legal function
 - Plus, your domestic work can benefit from exposure to new legal concepts
- Assume you won't be able to rely on A-C Privilege except with outside litigators
 - Many companies already assume this domestically
- Invest the time and money to visit your foreign locations periodically
 - This will pay huge dividends in managing your legal process and workload across borders
- Reap the negotiation benefits of being seen as a considerate, thoughtful, articulate advocate for your client
 - You will be surprised at how others want to meet you halfway when you are showing them respect and consideration
- Have fun!