UHY

International Business

Issue 13

Smaller companies take AIM for growth

AIM gives smaller, growing companies from all countries and sectors access to the UK's London Stock Exchange at an early stage of their development, allowing them to experience life as a public company.

In the 10 years since its launch, AIM has grown into the world's most successful market for smaller, growing companies - a total of 54.5 billion USD has been raised to date by companies on the market.

Latest statistics show that AIM has 1,501 quoted companies, of which 252 are based outside the UK, drawn from countries as diverse as Australia, China, India, Israel and the US.

In 2005, the market attracted a record 19 companies from the US alone, raising a combined total of 2,126 million USD. Currently there are 41 US companies admitted on AIM.

US companies have flocked to float on AIM attracted by its regulatory regime (which although quite tough, is less complex to comply with than the regime introduced in the US following scandals such as Enron); simpler rules on acquisitions; and tax breaks.

Steve Samek, CEO of UHY Advisors in the US, says the second half of 2006 will see even more US companies moving to AIM. 'The fact that almost 16.5 billion USD was raised for AIM companies in 2005 has not gone unnoticed in the States.'

Meanwhile, AIM itself has been promoting its services in selected global regions – and not least sought the support of investment communities in other major European financial centres by developing a network of links with investors, advisors, intermediaries and issuers in markets across Europe.

No wonder - independent research, by the UK's Oxford Analytica firm, estimates that the economic benefit of a truly pan-European market for SMEs would be in the range of a 0.3% to 0.6% uplift in EU GDP.

Benefits of AIM

AIM offers smaller to medium-sized companies greater flexibility and lower costs to register than on the main London Stock Market. Companies can raise as little as 3 million USD on the AIM (although it is within the rules to list on the AIM without raising any funds) and there are fewer regulatory requirements.

AIM is open to companies from all sectors and from all over the world. There are no specific suitability criteria for companies to qualify for AIM, however under AIM Rules all companies must produce an admission document that includes information about the company's directors, their promoters, business activities and financial position.

UHY reporting accountant teams provide services for each stage of the AIM admission process including:

- Reviewing appropriateness of the flotation and choice of stock market.
- Time-scheduling, planning and budgeting of the transaction.
- Preparing and reviewing the business plan and financial model.
- Preparing a business valuation.
- Introducing and approaching pre-Initial Public Offering investors.
- Introducing 'nomads' (nominated advisors) and stock brokers.
- Liaising with the stock market authorities.
- Assisting with prospectus preparation.

In addition, UHY provides due diligence on financial information in the admission document; a report on the issuer or the acquisition target as appropriate; a report on the adequacy of working capital and financial reporting procedures; and tax structuring advice.

Successful placements

One Australian company advised by UHY in its admission to AIM is newly formed Pantheon Resources plc which was looking to raise finance for its 25% stake in the exploration and development of six natural gas wells in the Gulf of Mexico. Prior to the floatation the management company was based in Perth, Western Australia. Market capitalisation of the company following placement was 28.5m USD.

Another UHY client, an international internet advertising services company, had a market capitalisation of 125m USD following its placing on AIM in April.

Chief Executive Officer Jarvis Coffin says the listing provides the company with an acquisition currency for the future; helps position it for European expansion; and raises the company's profile and status..

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Who to back in a two-horse race

The Indian economic momentum, spurred on by the visit of US political heavyweights earlier this year, has rekindled the debate about what kind of economy will emerge over the coming decades – and whether India is a better prospect for investment than China.

India's boom, founded largely on exporting services and soft technologies Westwards, has resulted in GDP growth averaging 8% over the past three years and established it as the world's second fastest-growing economy behind China.

Investors are capitalising on its large numbers of well-educated urban dwellers fluent in English, and the government has stimulated growth by opening up markets through economic reform and reducing controls on foreign trade and investment.

With the Government targeting 10% annual growth, economic observers are confidently predicting that India could well expand at the top end of this rate for the next decade.

They point to its workforce which is younger than in most economies. Macro trends indicate a surge in the number of people entering the productive work phase of their life (half the population is under 25; 70% is under 35) which is expected to have a positive impact on productivity. Contrast this with the ageing population in the West and China.

The growth of higher-income, white-collar jobs in India, inspired by its entrepreneurial culture, has created a vibrant middle-class destined to provide strong demand for services such as banking, telecoms and cars. Contrast this with China's export-driven manufacturing boom that is largely driven by foreign direct investment, less so by individual innovation or enterprise.

High-tech impact

India's other major competitive advantage lies in its vast talent pool in sciences, information technology and other knowledge-based sectors that it continues to generate - manifesting itself through cutting edge technology in mainstream business at significantly lower costs than in the West. In the pharmaceutical sector, for example, new drug development costs can be one-fifth to one-seventh of the cost in developed countries.

India's manufacturing industry is fast supporting its burgeoning IT market with the injection of high-tech into production processes. The Tata group, the country's largest business house – a conglomerate that makes a huge range of products from cars and steel to software and consulting systems - is a window to India's industrial economy. Its revenues grew last year from 17 billion USD to 24 billion USD and it is heading for extremely strong growth this year. The automobile-parts industry - made up of hundreds of small companies - had revenues totalling 4 billion USD five years ago. This year they will exceed 10 billion USD.

In addition, stocks are being supported by cash from investors worldwide, especially from Japan. Of the 150 billion USD that has flowed into the stock markets of developing nations since 2002, nearly one-fifth has gone to India. Foreigners have invested in more than 1,000 Indian companies - a record for any country outside the US.

A strong judicial system and a world class banking system is in place which gives tremendous confidence to an overseas investor looking to do business in India.

Pitfalls for the unwary

Yet, as with most developing markets, there are pitfalls for the less wary investor. Some arise from inequality in a society still dominated by the Hindu caste system and a population of which 40 million are unemployed and 300 million live on less than a dollar a day.

So, challenged by new-found American interest, political influencers have been questioning whether India wants to ape things American, or whether it should stem the tide and seek more restrained capitalism. The upshot can frustrate investors who accuse the government of 'holding modern India back' and being a retarding force with protectionist policies.

Other less obvious pitfalls arising from social imbalance have been catching investors off guard. For example, car fuel chains opening Western-style forecourt shops selling drinks and snacks lack trade - because most Indians rich enough to own cars do not buy fuel themselves. They have drivers to do that, and the drivers are too price-conscious to buy from a forecourt.

Lack of investment in infrastructure - symbolised by potholes in roads – can also take investors by surprise. The rapidly-growing high-tech metropolis of Bangalore -

trumpeted as India's equivalent of California's Silicon Valley – has attracted global brands such as Fidelity, Hewlett Packard, Microsoft, Sun, Oracle and Reuters. But from a town of two million people 20 years ago, it has now exploded into eight million - and public systems creak under the weight of people, pollution and traffic.

Some investors go to India expecting it to be another Shanghai, where growth has been the product of efficient government. The

People's Republic of China decides it needs new airports, eight-lane highways, gleaming industrial parks - and they are built seemingly within months. It courts multinationals and provides them with permits and facilities.

India is different; growth is largely unplanned. It is not top-down but bottom-up. It stems from its vast and growing number of entrepreneurs - the second highest number of entrepreneurs per capita after Thailand. Hundreds of millions of self-employed people craft a living. Chaotic growth is happening, some critics say, not because of the government, but despite it.

Key factors

Yet analysts who argue that India makes for a better investment than China cite more key factors:

India's vibrant capital market drives allocation of capital to economic activities. With the largest democracy in the world, celebrating 60 years of independence next year, the government has virtually no power in directing capital allocation or economic activity. China, on the other hand, remains a totalitarian state with very active central and local control directing economic activity – thereby, it seems, increasing the potential for malpractice and misallocation of capital.

The Chinese government has managed to keep a lid on demands for deep-rooted freedoms from among its 1.3 billion people – and has proactively taken measures in an attempt to stem the growing gap between rich and poor – but can it last? Investors need political stability to ensure returns. India enjoys the rule of law, an independent judiciary and a framework of property rights – bedrocks for a successful capitalist society. In China permanent private ownership of assets is still a murky area.

The Chinese, argue analysts, have not as yet fully grasped how the knowledge industry and intellectual capital works. India is way ahead. Indians understand branding and consumer choice. Fifty per cent of India's GDP comprises services, whereas China commoditises output and tends not to nurture innovation.

Moreover, analysts argue, whereas India has its superior banking and monetary system, one out of two loans in China is said to 'go bad'. China's problem is a legacy of its state-directed lending practices. Interest rates are controlled by the Republic, and banks controlling more than 95% of banking assets have no credit scoring or risk-based pricing mechanisms in place. India by comparison has a strong domestic credit market. Indian interest rates are market determined, and the banking system knows how to price credit.

Chinese stock markets are a recent development. They have yet to develop an investor base, argue analysts, and there are numerous structural problems. By comparison, the Bombay Stock Exchange, founded in the 1870s, is the oldest stock exchange in Asia. With 6,000 companies listed from most industries, it is easier for investors to participate in India's growth. China does not have nearly as many stocks listed and representation is narrow. A disproportionate share of its market cap is taken up by state-owned enterprises. India by comparison has numerous listed companies participating in domestic growth providing numerous opportunities in small and mid-cap stocks.

Moreover, it is claimed, if there is a problem in the Western consumption economies, China will be impacted severely. India would be impacted in the immediate aftermath, but its domestic growth opportunities are more insulated from international events.

If it's a choice between India and China, the safer bet for now looks like India. But safer bets aren't always the most profitable. And with China signaling its intent to control economic growth through interest rates, who knows how quickly China will put its house in order to compete more effectively for the world's economic centrestage compared with its more established, yet less regimented, rival from the developing world.

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China's taste for tax

Buffered by an annual economic growth rate approaching 10% and a surge in tax revenue – which jumped 20.3% last year alone – the Chinese Government is implementing further staged tax reforms to underpin its prospective status as a world economic superpower.

China generally overhauls its tax system every decade – past reforms took place in 1983 and 1994. But this time reform is more extensive. It includes plans to align corporate income tax for both domestic and overseas firms.

Currently, foreign companies pay, on average, half of the 33% levied on domestic Chinese companies. But the gap will erode as plans to reform the rate to about 25% for all companies are introduced – tempered to a degree by provisions that enable companies to keep to lower rates for a two- or three-year transition period.

With foreign investment presently running at 600 billion USD, the Chinese Government is anxious to minimise the corporate tax impact on foreign investors and intends to introduce its reforms in stages. However, the plan has met with strong opposition from those who say a unified rate will dampen foreign investment growth. They worry that China will become less competitive at a time when Asian neighbours are trying harder to attract overseas investors.

David Dollar, director of the World Bank's China Programme, believes the opponents' argument is not valid. He says the preferential rate for foreign companies has increasingly become inappropriate as China's investment climate has substantially improved. Tax is not that important, he argues, when attracting investors - who pay more attention to the overall investment environment including infrastructure and government efficiency.

But the Chinese Government is mindful of the possible downside – and so its corporate tax policy will run concurrently with phased-in incentives to certain industries arising from China's entry into the World Trade Organisation. Investors who plan in line with the phase-ins can adjust product timings to maximise benefits.

In addition, agreements between China, Hong Kong and Macau, called CEPAs (closer economic partnership arrangements), will potentially create more efficient points of entry for investors. To realise these benefits, foreign companies can structure supply chains to export into China duty-free.

Other tax reforms

China's Director of the State Administration of Taxation, Xie Xuren, has also said that China will reform existing tax on the use of farmland for non-agricultural purposes; re-adjust the administrative mechanism of contract tax; and formulate programmes to introduce pro-business transformation of value-added tax (VAT) nationwide.
The Republic's experiment with VAT reform in north-east China's Heilongjiang, Jilin and Liaoning provinces has achieved positive results since it was launched in July 2004.

It has allowed companies in eight major industries, including equipment and automobile manufacturing, to take tax rebates when buying new machinery. The trial - which moved the tax from production to tax on consumer spending - resulted in significant new machinery and the phasing-out of outdated equipment.

Since April, consumption-type VAT has been introduced fully - at varying rates on various items (disposable wooden chopsticks 5%; cars 3% to 20% depending on engine size). Analysts say it will result in tax cuts for manufacturing companies as they take entitlement to rebates on the tax levied on expenditures of raw materials and fixed assets.

Minister of Finance Jin Renqing says VAT reform will be extended during the next five years and China will also implement tax policy to increase energy and resources efficiency. It will reduce tax rebates on some energy-intensive and polluting products, and will promote technological upgrading. The Government is also working to improve tax policies to encourage the restructuring of China's cultural sector, including preferential tax policies designed to 'build morals' among younger people - for products such as approved, selected computer games.

Tax collection

China is also stepping up the management of international tax and collection of tax involving overseas-funded firms, and making tax regulations for multinationals more robust to prevent tax evasion. New-found tax collection regimes netted China a record high of 3.0866 trillion Yuan (about 386 billion USD) in tax revenues, excluding tariffs and agricultural tax, in 2005 - up 20% year on year.

Personal tax

Meanwhile, the focus of public debate is on the doubling of the personal income tax threshold to 1,600 Yuan (192 USD). The former level was set in 1980 when the Personal Income Tax Law was promulgated; the economic situation is enormously different today compared with two decades ago; and all expected the threshold to be raised. In 1993, only 1% of citizens earned more than the 800 Yuan (96 USD) threshold per month, but by 2002 the ratio had leapt to 52%.

But doubling the tax threshold, backed by more stringent anti-evasion measures, has raised grievances among the newer generation of earners who left the countryside for city jobs but are not yet wealthy. They do not like seeing their self-made wealth disappear in tax.

The Chinese Government, it seems, has acquired a taste for tax.

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Forensic search to avoid scandal

Strategies to guard against fraud and resultant damage to reputation are increasingly a fundamental corporate essential.

In an increasingly complex regulatory and legal environment – where failure to adhere to corporate governance standards can mean winning or losing contracts, and where financial scandal can undermine an established brand overnight – is it any wonder companies are increasingly looking to their lawyers and accounting specialists to proactively scrutinise for wrongdoing, irregularities, waste and misdemeanours?

Scandals involving Parmalat, Enron, Tyco and Anderson, among others, have put the onus on all entities - corporations (public and private), not-for-profits and service providers – to design and implement company codes of ethics and compliance programmes.

Not only that – they need to plan in advance to deal with the foreseeable and the unforeseen, assure system integrity and continuously test their plans to be assured that they are in compliance.

This type of planning is part of the crisis management and risk management strategy necessary in today's post-Enron, Sarbanes-Oxley, Corporate Sentencing Guidelines, Bank Secrecy Act, USA Patriot Act and Foreign Corrupt Practices Act environment in the US – and increasingly elsewhere – to help prevent risks and exposure, and provide for remediation and recovery.

However, issues will always arise and companies must quickly ascertain what is going on, what went wrong, who is responsible, and how to deal with the regulators, prosecutors, class action counsel, stockholders and the press. Advance planning and responsive action will minimise the unforeseen and limit exposure once it occurs.

Support services

Determining how to deal with situations of wrongdoing, fraud, dishonesty, waste and corruption, whether the entity is the victim or the bad actor, frequently necessitates that consultants, accountants and lawyers render services to provide the answers.

Such is the growth in demand that a relatively new unit in the UHY global network, the Fraud & Forensic Team, based primarily in New York and Houston, has more than 50 professionals specialising in forensic accounting.

It is part of the 110-strong, US-based UHY Advisors' Forensic, Litigation & Valuation Services Group, headed up nationally by Houston-based Saul Solomon and located in Boston, Dallas, Detroit, Houston, New York, St Louis and Washington, DC. Working with law firms, corporate counsel, insurance companies, financial institutions, venture capitalists, private practitioners, arbitrators and judges for more than 25 years, this team of experts represents the ultimate forensic accounting and investigative arsenal in the world of corporate risk management.

The team deals with:

- Corporate and business fraud investigations.
- Special investigations related to securities litigation.
- Fraudulent financial reporting.
- Review and development of fraud policies and procedures.
- Misappropriation and diversion of assets.
- Recovery of electronic data files and digital forensics.
- Asset searches and recoupment.
- Design and implementation of internal and operational controls and ethics and compliance programmes.
- Anti money-laundering programmes.
- Design and review of prevention and detection controls.
- Federal sentencing guidelines.
- Financial institution fraud, including money-laundering.
- Analytical and forensic analyses.
- Industrial and economic espionage investigations.
- Intellectual property theft.
- Information leaks.
- Antitrust.
- Environmental investigations.

The team's cases have included:
Analysis of financial transactions and evaluation of damages arising from the alleged fraudulent transfers of assets and breaches of agreements involving a wholesale distributor of stainless steel products.

Determination of damages based on the analysis of financial statements, accounting records, bank statements, invoices, expense reports, tax returns, and capital contributions for a six-year period, arising from the alleged fraud by a property management company.

Investigation of potential fraud allegations in a matter involving an office equipment and supply company.

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Investigation of allegations of employee dishonesty resulting in criminal and civil prosecution of the wrongdoer, resulting in substantial recovery for the corporation and incarceration of the employee.

Digital imaging and digital forensic investigation to establish wholesale theft of intellectual property and confidential information by former employees from a fund owned by a large multi-national corporation.

Tyco investigation

One of the unit's most significant completed commissions to date involved one of the biggest financial analyses in US corporate history – the Tyco investigation carried out in conjunction with UHY member firms worldwide.

Another includes extensive financial investigations and document handling assignments involved in civil suits arising out of Enron (a number of which have already been settled favourably for the clients), where the team was involved in document management of massive amounts of information as well as fraud and forensic review.

The Fraud & Forensic Team's office in New York is headed by Managing Director Joseph Jaffe, a partner in a general practice law firm for 10 years. A former Federal Prosecutor in Manhattan and former elected State District Attorney, Jaffe says: 'UHY's international capabilities provide us the means to provide our clients with a one-stop shop, giving them the assurance that they are in compliance with all regulatory and statutory requirements, have created an atmosphere of ethics, compliance and honesty within their organisations, and are in a position to front run, protect against, and to detect fraud, waste, corruption and illegality, and dishonesty. We also help them establish the facts they need to go after wrongdoers and to protect themselves against false claims and unwarranted lawsuits.'

Electronic detection

But UHY's experience extends still further – because investigations, dispute resolutions and regulatory assignments increasingly revolve around information collected, stored and manipulated on computers and other digital and electronic media.

Both the US' Fraud & Forensic Team and UHY Haines Norton Forensic, Australia, have specialists collecting, analysing and interpreting data and restoring information thought to have been deleted.

'It is one thing to collect evidence, but ensuring that computer evidence is accurate and hasn't been tampered with during a collection process is significantly more important,' says UHY Haines Norton partner David MacDonald. 'We can assist clients through the analysis of information that can be provided in a format that is reviewable, understandable and presentable in a legal proceeding.' Through such services, UHY highlights where an organisation should introduce risk management processes.

'A comprehensive strategy for fraud governance is essential if an organisation is to reduce the likelihood and impact of major fraud,' says MacDonald. 'Good fraud governance requires more than just ensuring an effective system of internal controls. It also requires a clear message and oversight from senior executives and non-executives, clear policies and standards, knowledge of the key fraud risks, effective fraud reporting, awareness training, and the development of a culture of high ethics and honesty.'

Preventative measures

Jaffe says: 'There are three elements to assure crisis recovery - planning, documentation and record keeping, each done flawlessly, followed by constant testing, practice and refinement, so that when something happens there is the least downward effect on the entity and downtime from the happening, and the entity quickly is on the road to recovery.'

When even, despite the most robust strategy, fraud does occur, preventative measures can avoid dissipation of criminal proceeds, and help capture evidence to recover assets – so reducing the likelihood of loss through fraud.

Currently, says MacDonald, when a client engages a forensic accountant it generally means some form of fraud has already impacted upon their business.

Instead, clients should be proactive, he says. 'Our experience has proven on many occasions that an investment in an effective mitigation framework is far more cost effective than an investigation into losses.'

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Reaping the benefits of SOX compliance

Proactive companies are pursuing compliance with standards as an opportunity to get ahead of their competitors – and are reaping the benefits of planning for global reach.

In the post-Sarbanes-Oxley era, US companies are compelled to comply with SOX standards. Subsidiaries abroad are required to conform. Then, increasingly, global suppliers looking to provide services into the US have needed to prove their SOX-type credentials.

But what was often seen as a 'necessary evil' has, for some, grown into a marketing opportunity - as companies seek competitive advantage from compliance, especially when it benefits them transnationally.

One such pacesetter, with a two-year lead over some competitors, is transnational electronics manufacturer Photronics Inc, a world-leading manufacturer of high-precision photographic quartz plates.

The company operates principally from nine facilities, three of which are in the US, three in Europe and one each in Korea, Singapore and Taiwan.

UHY firms in the US, the UK and Taiwan worked together to formulate Photronics' SOX masterplan with reach into foreign subsidiaries and service providers.

Like Photronics, companies embedded into SOX principles are increasingly looking to extend their standards to service providers – realising they are vulnerable if suppliers' standards are not as robust as their own.

Says Jacqueline Jordan, principal at UHY Advisors in the US: 'Think about the huge transactions a credit card processing agency, health care records company or an IT services vendor performs for its clients. How would the clients – banks, hospitals and just about any other kind of business – react if controls lapsed when their customer information passed through such third-party systems?'

In the US, an SAS 70 audit (Statement on Auditing Standards No 70, Service Organisations) is the recognised standard aimed at ensuring service providers meet audit requirements. It is fulfilled through in-depth analysis and testing of internal controls, involving IT and related processes. It gives companies 'peace of mind', says Jordan.

An SAS 70 audit enables service providers to disclose their financial controls and processes to their customers in a uniform reporting format. The audit signifies that the service provider has had its controls examined by an independent auditing firm. A formal report, including the auditor's opinion ('Service Auditor's Report'), is issued to the service provider at the end of the audit.

A Type I report describes the service providers' description of controls at a specific point in time. A Type II report also includes detailed testing of controls over at least a six-month period.

Service providers receive significant value. The Service Auditor's Report giving an unqualified opinion issued by an Independent Auditing Firm, differentiates the service provider from its peers by demonstrating the effectiveness of its controls. A Service Auditor's Report also helps a service provider build trust with its customers.

Without a current Service Auditor's Report, a service provider may have to entertain multiple audit requests from its customers and their auditors. A Service Auditor's Report ensures that all user organisations and their auditors have access to the same information, and in many cases this will satisfy the user auditor's requirements.

Very often, in addition, a SAS 70 audit identifies opportunities for improvements in operational areas. But SAS 70 isn't just an optional marketing and self-improvement device. The US current regulatory environment demands that if third-party services directly impact financial reporting or internal control activities, a company's management is responsible for evaluating the design and effectiveness of the control structure in place, both within the third-party provider and between the two organisations.

Section 404 of the Sarbanes-Oxley Act 2002, as currently interpreted, compels publicly traded companies and service providers to expand the use of SAS 70 reports when assessing the effectiveness of internal control over financial reporting.

So might SAS 70 become a global standard? An SAS 70 audit can already be performed outside of the US so long as the engagement is with a US-based auditor who subscribes to professional standards of the American Institute of Certified Public Accountants. UHY's global network of auditors therefore enables it to provide SAS 70 audits for US subsidiaries and US company service providers throughout the world's major financial centres.

The will for transparency versus cost is a key factor in the global pace of change. US-based Finance Executives International surveyed companies and found that the average cost of SOX compliance is 4.4m USD per company. Yet a report by CRA International, a Boston-based economic consulting firm, suggests SOX is a price worth paying.

Post-SOX conformance, companies surveyed reported a significant decline in weaknesses and deficiencies discovered in controls. Larger companies said deficiencies had been cut by half, while smaller companies reported a two-thirds reduction.

Dawn Cresswell, of SOX Advisory at UHY Hacker Young in the UK, says companies that approached SOX in the right way have seen it bring benefits for their business.

'For many businesses, a SOX compliance project will be the first time they have gone through such an in-depth analysis of internal financial processes,' she says.

'In our experience, companies which have tackled this well have picked up poor processes that are operational as well as those that are SOX-related.

'Often it will be the first time companies have assigned responsibility for internal controls to one person and made them accountable. This can only help improve a company's performance as it puts operational efficiency at the heart of its strategy and focuses managers' minds on achieving it.'

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UHY has 5,000 professionals to choose from – trusted advisors and consultants operating in more than 160 offices, based in over 50 countries around the world:

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Australia
China
India
Indonesia
Korea (Republic of)
Malaysia
Mauritius
New Zealand
Philippines
Singapore
Taiwan

Europe
Austria
Channel Islands
Cyprus
Czech Republic
Denmark
France
Germany
Greece
Hungary
Ireland
Isle of Man
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Sweden
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United Kingdom

Tax efficient investment in international property

The island of Guernsey, offshore from the UK, offers the international property investor and developer excellent tax planning and risk management opportunities. Both institutional and private clients can benefit from innovative structures such as the Guernsey Protected Cell Company.

A problem frequently faced by many corporations, institutional fund managers and wealthy individuals alike is not only how to structure their property portfolios in the most tax efficient manner, but equally importantly, how to segregate and safeguard valuable assets from those that may attract serious liability.

This is never truer than with property where the ideal is to be able to isolate the risks associated with each investment. These may be environmental, from the previous or new land usage (thereby ring-fencing other valuable property in the portfolio from litigation claims), or as a result of a collapse in demand for a certain type of property which can, for example, undermine income and lead to the insolvency of one part of a property fund.

PCC structure

One excellent solution is the Guernsey Protected Cell Company ('PCC'), a cellular corporate structure that allows assets to be held within individual cells. The assets of any one particular cell are only available to the shareholders and creditors of that cell – creditors of another cell have no recourse against them.

The PCC was introduced in 1997 and was initially the sole domain of vehicles carrying out financial services activities, such as collective investment funds, captive insurance and securitisation. However, Guernsey's authorities have now relaxed the regulations to allow the PCC to be used for a range of commercial non-financial activities.

The basic structure of the PCC is straightforward. A 'core' company is established and managed by a Guernsey financial services provider. The 'core' company is able to create cells. These cells are then made available to clients, thereby saving them the expense of establishing the PCC themselves. Individual assets and liabilities (or assets with the potential to attract a liability on the happening of some future event) can be placed into the cells.

The key principal is that the PCC legislation expressly provides that the assets of one cell are only available to the shareholders and creditors of that cell. The assets of one cell cannot be attacked by the creditors of another cell.

It is clear how this can be applied to a property portfolio by the institutional manager or the private client and it is worth noting that, with the relaxation of regulations surrounding PCCs, they may now be used by the private client for, perhaps, segregating personal assets other than property – such as yachts, jets and portfolios.

Taxation of the PCC will depend on the purpose for which it is being used. Suffice to say that, being based in a low or zero tax environment like Guernsey, these factors will play an important part in mitigating any overall tax liability.

Guernsey has also extended the PCC concept still further with the introduction in April of the Incorporated Cell Company ('ICC'). In this structure each cell can be set up as a separate company with full incorporated status and with different directors and shareholdings to further emphasise the independence of one cell from another.

Maximising profits

Many non-UK clients and property investors have taken advantage of the booming property market in the UK and used the Guernsey International Business Company ('IBC') as the mechanism to extract maximum profits.

A typical case study will involve a client establishing two Guernsey companies; the first will take ownership of the UK land or property and will be resident in Guernsey for tax purposes, while the second will be an IBC and its 100 per cent shareholder. It is important that all management of the UK land and property takes place from outside of the UK – for example, all planning and development decisions. Using this structure may allow the extraction of all profits almost free of UK tax.

For the individual wishing to move to the UK, thereby establishing a UK resident but non-UK domicile tax status, the usual route of property ownership has been through a Guernsey discretionary trust and a Guernsey company. This effectively takes the situs of the asset (being the shares in the company) outside of the UK and thereby outside the UK capital gains tax net. It also assists with inheritance tax planning in the event of the untimely death of the client, again, by removing the asset from the UK inheritance tax net.

Using Guernsey PCCs, the new ICCs, the offshore trust and Guernsey companies in client and institutional tax planning, much can be done to segregate assets and limit risks, whilst at the same time enjoying the tax advantages afforded by planning through a well-regulated low tax jurisdiction.

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