

Ten top tips for SMEs to expand internationally

More SMEs than ever before are trading internationally, and many more have stated their intentions to expand into new overseas markets in the next few years. But what do these businesses need to think about to ensure that this is a positive and rewarding experience? Nick Farmer, International Tax partner at Menzies LLP, provides his top 10 thoughts.

1. Look before you leap

Research the overseas market for your products or services and be clear on your reasons for seeking to expand internationally. Be prepared to spend time in-territory gaining detailed local market knowledge to develop an international strategy and assess how to get a good return on your investment. By analysing the local market and competitive environment you should build up answers to questions such as:

- i) Does the market want your product or services and who are the customers?
- ii) How will your commercial activities need to be carried on and what level of capital investment will be required?
- iii) What strategy should be adopted for penetrating the market - acquisition, natural growth, joint venture arrangement, franchising?
- iv) What are the risks and how can these be managed?

2. Country specific expertise

There is no substitute for taking local professional advice and building international connections to support your expansion. Don't expect the foreign country to have similar systems to the UK. In-country advice should be taken early on in your planning. This will enable you to build an upfront understanding of the local issues. Getting the framework and paperwork in place to trade overseas takes time, and reaching out early for local accounting, tax, legal and banking support will provide you with the foundations necessary to successfully expand into a new territory.

3. Determine the structure

One of the early decisions to make will be to determine the nature and ownership structure of the local trading entity. Countries are likely to have a variety of business vehicles available and different tax, legal and commercial issues will arise from this decision. Relevant factors to consider in making your decision would include:

“At the end of the day, cash is king...”



- i) The risk profile of the business;
- ii) The level of commercial presence needed;
- iii) The set-up and running costs involved;
- iv) Comparative tax treatment of each entity;
- v) Obtaining tax relief for any start up losses.

4. Measuring performance

Systems need to be in place to accurately determine the business performance in each territory. Decisions need to be made as to how the business

will be managed and controlled, and reporting lines need to be established. From a tax perspective, tax authorities will generally expect the profits of the business to be assessed on an arm's length basis. This means the transfer prices between related parties must be comparable to those that would be charged between two independent parties and unless this can be demonstrated there is a risk that profits may be adjusted and double taxation could arise.

5. Managing the foreign exchange

In a recent study by HSBC, 33% of international UK businesses cited dealing with foreign exchange as their biggest challenge. This highlights the importance of having a corporate strategy for managing foreign exchange volatility and the risks and exposures that may arise. It is also important to understand the accounting and tax treatment of foreign exchange gains and losses in each territory and whether or not tax is on a realised or unrealised basis.

6. Carefully analyse legal agreements

Take care to establish and analyse legal agreements that are entered into by the business with overseas parties. Different issues can arise compared to purely UK based transactions. For instance, many SMEs can be unaware of overseas withholding tax issues until they do not receive full payment for the work they have undertaken. This can have serious cash flow and tax implications. Where any contractual arrangements are being put in place with overseas

companies it is always necessary to ensure the legal and tax position has been fully clarified and agreed.

7. Know your rights

With pressure being exerted on tax authorities globally to raise more revenue, it is crucial that businesses trading internationally understand the taxing rights of each country. Reviewing any tax treaty between the respective countries will help clarify the taxing rights of each territory and should (in most circumstances) also prevent double taxation from arising. Being aware of whether or not there is a suitable tax treaty between the territories can also clarify the availability of a number of other important benefits, such as the exemption for SMEs from transfer pricing and also the exemption for small companies on inbound dividends.

8. VAT and Custom Duty

There are important VAT and Custom Duty rules to consider when businesses conduct international trade. The rules are complex and will differ depending on factors such as whether the business is trading in or outside the EU and whether the supplies are to business or non-business customers. Tax authorities are also applying increased scrutiny to VAT compliance obligations. Therefore, before conducting international trade, businesses need to ensure that they think through the VAT and Duty issues that will apply to them. Appropriate procedures also need to be put in place to take due care of the paperwork that will undoubtedly arise.

9. Anti-avoidance issues

The UK anti-avoidance tax legislation can cause difficulties for companies both large and small. This includes legislation

dealing with issues such as corporate tax residency, controlled foreign companies and transfer pricing. Indeed, the Controlled Foreign Company legislation has often been cited as one of the main reasons for the number of high profile corporate migrations from the UK. These anti-avoidance rules are intended to prevent companies from avoiding UK taxation by diverting profits to foreign incorporated companies. This legislation therefore needs to be observed to ensure that profits that are made overseas are only taxed overseas. This remains an important challenge for all SMEs operating on an international basis.

10. It's all about the cash

At the end of the day cash is king, and businesses need a robust global cash management system in place. Know where the cash is and how it can be repatriated back to the UK. Cross-border cash flows such as dividends, interest, royalties or service charges need to be assessed for their tax impact and the structure of the activities can make a difference to the tax cost of these cash flows. For example, with the introduction of a UK inbound dividend exemption system, it may be possible to pay up a dividend without incurring UK taxation. Getting the cash back to the UK with the minimum cost has to be part of the planning for all SMEs that expand into new international markets.

Menzies LLP acts for UK companies wishing to develop international operations through:

- Multilingual capabilities and advice on the best vehicle for overseas expansion.
- Strong relationships with reliable overseas partners and a fast response, so that we can complete transactions to tight deadlines.
- Support on VAT and customs issues, tax clearances, transfer pricing, double taxation relief, anti-avoidance legislation.
- Global audit and assurance solutions designed for single company or group accounts.
- Outsourced bookkeeping, management accounts, accounts preparation and outsourced payroll for reliable financial information.
- Additional support covering corporate residence, permanent establishments, treaty interpretation, HR and private client.

As a UK member of HLB International, a world wide network of independent accounting firms and business advisers represented in over 100 countries, our tax, advisory and audit teams attract clients that demand first-rate technical expertise delivered in a commercial, yet personal way.

If you would like further information on how to expand your business overseas, please contact your Menzies relationship partner or the author of this article who specialises in providing international advice to SMEs:

Nick Farmer, Partner
T: +44(0) 1784 497 100
E: nfarmer@menzies.co.uk