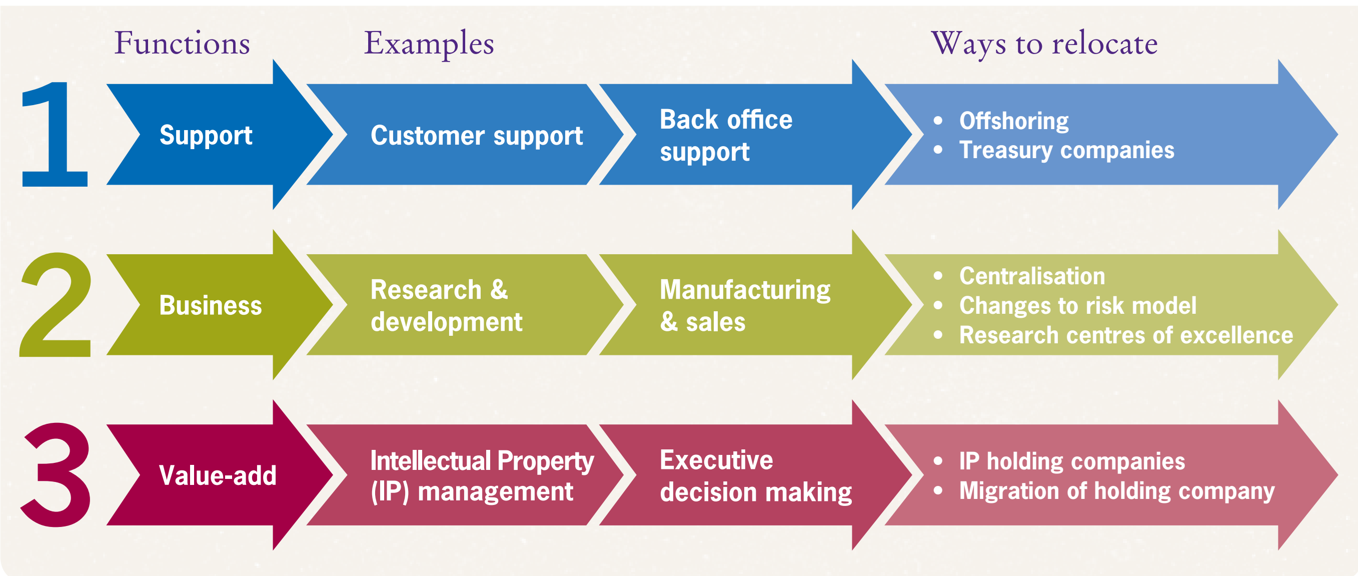
Smart move:
Making relocation work for your business

Business relocation and associated restructuring can deliver significant commercial, operational and tax management benefits. And it isn't just large multinationals who are on the move, many smaller and privately-owned companies are now realising the potential gains.



The possibilities range from moving your head office and holding company into a new jurisdiction through to less all-encompassing alternatives such as streamlining support services. The simplest options can often be the most effective.

Figure 1 above outlines the functions that can be relocated and how. In many cases, there may be a limited amount of relocation needed to deliver the benefits.

Many countries offer simpler tax arrangements, more straightforward regulatory regimes and other incentives to attract successful companies. Developed markets are now vying with offshore locations to offer the most favourable business environment, which is making the direction of travel more varied.

Yet relocation can also throw up difficult tax, operational and HR issues. The tax considerations are likely to be complicated by the Organisation for Economic Co-operation and Development's (OECD) planned changes to the international tax system (Base Erosion and Profit Shifting (BEPS) Action Plan). Grant Thornton is playing an active role in the discussions and consultations on the Action Plan, making us well placed to help you navigate the issues that emerge.

The key to successful business relocation is therefore clear evaluation, which takes full account of the complexities and potential trade-offs, as well as the likely benefits. The resulting assessment can form the basis for early and realistic planning and then careful execution.

Drawing on Grant Thornton's experience of advising a wide range of clients worldwide, this article looks at how to navigate through the complexities and different choices to make relocation work for your particular business.

If you would like a more detailed country-by-country overview, please see our **'A global guide to business relocation'**.

We hope you will find this guide useful in assessing whether business relocation is right for your business. If you would like to discuss the next steps please contact your usual Grant Thornton adviser or one of the Grant Thornton contacts listed.

Why move – the value of relocating

As the focal points of global demand and talent shift South and East and the pressure to minimise costs and improve operational efficiency continue to mount, the rationale for relocation is becoming ever more compelling.

Even if you haven't yet considered the options, you're likely to face probing questions from analysts and investors about how the various relocation options compare to your current structures and whether you could be losing ground to competitors as a result of not making a possible move. So how can relocation add value?

1. Going where the growth is

It's important to ensure that key operations and decision making are aligned with where you see the biggest opportunities for investment and growth. Many internationally mobile employees will want to gravitate towards the main focal points of growth. Shifting demographics and changing labour costs also mean that you may need to seek out new sources of talent.

2. Sharpening cost competitiveness

Relocating to an offshore location can generate significant operational and administrative efficiencies, which could be critical as margins come under pressure in slow growth markets.

3. Easing compliance headaches

Many countries are imposing more complex compliance regimes. This is creating a huge burden for groups and is arguably accelerating the migration of businesses away from some of these markets.

4. Seeking more efficient tax arrangements

Many governments are adjusting their tax regimes to help encourage companies to relocate and create jobs within their markets. Particular areas of focus include IP management and other high-value functions.

Weighing up the options – more choice than you would think

While most people tend to associate relocation with wholesale corporate migrations, there are a number of simpler options, which can also achieve excellent efficiencies and cost savings.

Here we outline the pros and cons of the main relocation options, though the ideal structure and location will of course be specific to your business and the particular function. Determining the right choice will also require you to weigh up a number of competing factors.

1. Full migration

Full migration involves either the relocation of headquarters or holding company or both. A migration of the holding company typically involves an inversion, whereby a new holding company is set up above the existing group holding structure (see Figure 2). However, it can sometimes be achieved by moving the management and control of a holding company to a different jurisdiction. Reasons for considering full migration include:

- aligning the location of your key business functions with your target customers, suppliers and/or workforce
- replacing complex legal, tax and reporting demands with a simpler regime
- more straightforward tax structures and improved tax efficiency.

However, the costs and upheaval can be considerable. Factors to consider include:

- exit costs
- key decision makers either moving or regularly travelling to the new HQ
- impact on shareholders as some jurisdictions have high withholding tax rates (WHT) on dividends to non-resident shareholders. If treaty protection is not available, complex structures such as dividend access schemes may be required to manage WHT costs
- the potentially unfavourable reaction to relocation in existing locations.

In light of the challenges, there must, of course, be an appetite for change at board level to drive through full migration as well as recognition of the potential reputational implications.

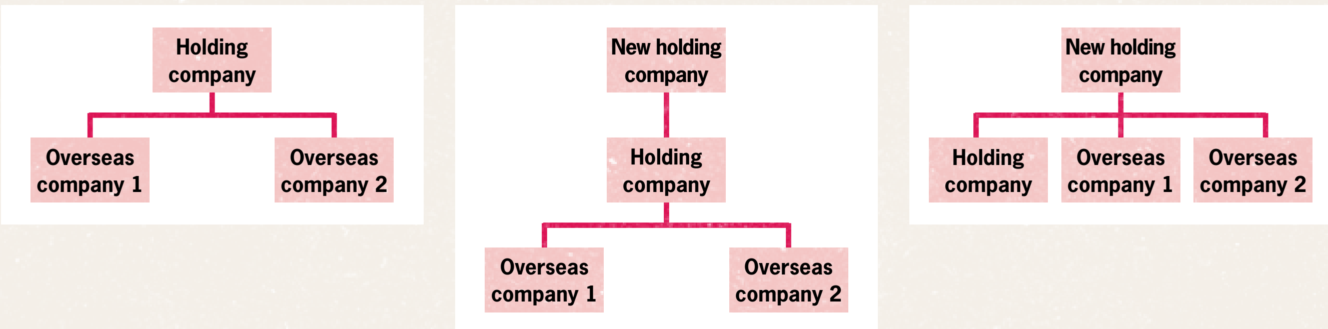
Figure 2: An inversion

The key steps to an inversion are as follows:

Existing structure

Set up a new overall holding company in a favourable jurisdiction by way of share for share exchange by the existing shareholders

Transfer subsidiary companies under the new holding company



2. Setting up an IP holding company

Many international groups are setting up dedicated holding companies to take charge of the development, protection and commercialisation of IP.

Bringing together the IP and its management into a single company can help to increase its value. Income will either be generated through royalties, or if the IP holding company is included in the supply chain, through the mark-up on the pricing of goods or services.

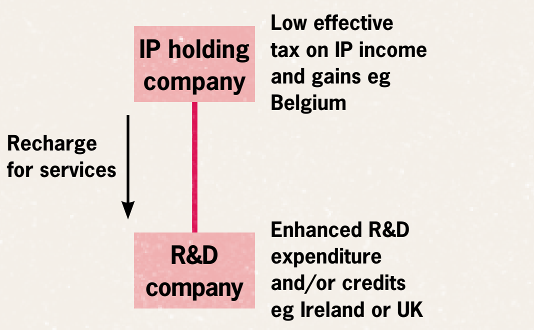
The profits attributed to IP can be very significant – for example Ireland allows a deduction for amortisation of IP transferred from group companies, based on the market value (rather than book value).

3. Offshoring

Moving operations to low cost locations can generate significant savings. Offshoring has tended to focus on the centralisation and relocation of support services. But offshoring is now moving up the value ladder into areas such as research and development (R&D). Centres of excellence would therefore be located in destinations that combine access to technical personnel and tax arrangements designed to promote investment in R&D.

In deciding on the best structure and location for an R&D centre of excellence, it is important to consider whether the centre will undertake research on its own behalf, effectively owning the associated IP, or whether it will perform contract R&D on behalf of the IP owner (see Figure 3).

Figure 3: Considerations for structure and location of R&D



4. Centralising high volume functions

The location of high volume functions such as manufacturing and distribution tends to be determined by commercial factors such as the location of suppliers, customers and a skilled workforce. However, there may still be opportunities to centralise these in a cost- and tax-efficient regional hub.

5. Changing the risk model

Where it is not appropriate to physically relocate certain functions, then an alternative may be to operate through a commissionaire, franchising or licence model. Under such an arrangement, the risks borne by the local distribution or manufacturing entity may be substantially reduced. This in turn can limit the profits attributable to these entities, with increased profits being generated by the central entrepreneur company. It is worth noting that commissionaire arrangements have been a concern of tax authorities for a number of years and they have now become one of the higher profile issues within the OECD BEPS initiative.

Changing the risk model can be an effective way of transferring profit-generation from the sales or manufacturing entity to the principal with minimal physical disruption to the business as few staff need to relocate.

6. Setting up a treasury company

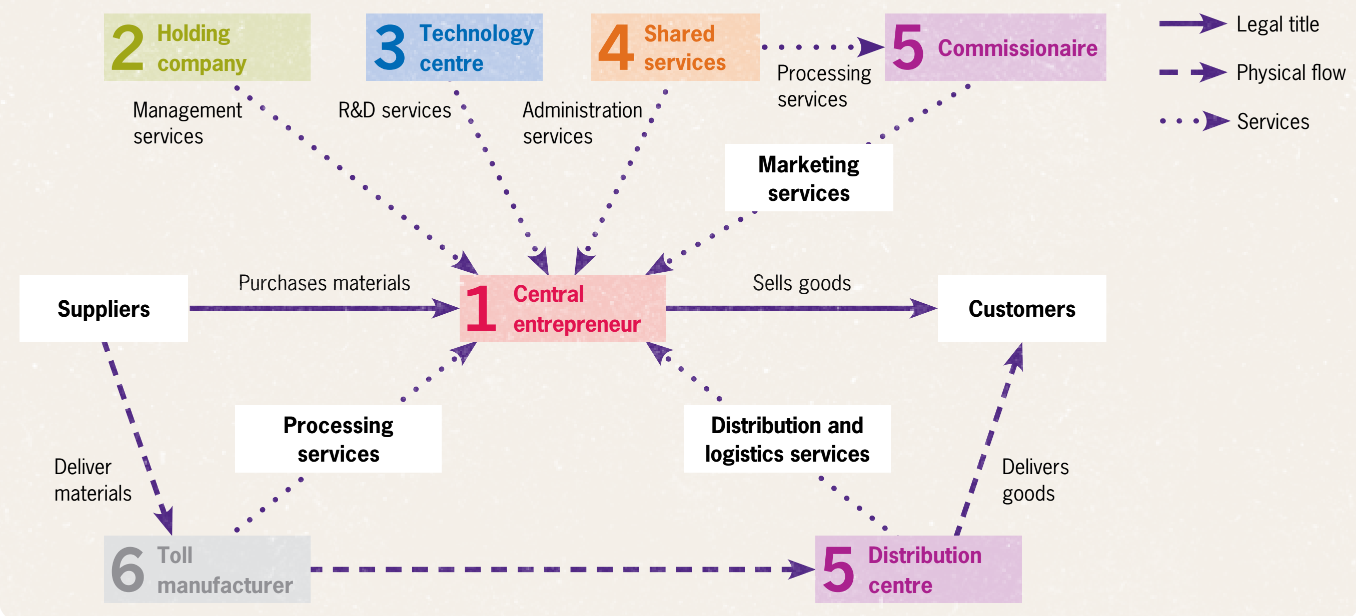
Treasury companies can be used to manage and pool the cash facilities for the group to maximise the return on surplus cash and minimise the expense on overall group debt. Decisions over the ideal locations will not only be driven by commercial factors, but also by the WHT demands on the interest.

Where to go – choosing the right locations

Choosing the best place to locate particular business functions depends on a myriad of business factors, though some destinations are likely to prove more appropriate than others.

The supply chain model set out in Figure 4 highlights the options available. In this section we outline the key factors and countries that might be considered in each of these functional areas.

Figure 4: Where to locate particular functions



1. Central entrepreneur

The central entrepreneur is the hub of the structure and therefore its location is key. As it will often own the group's intangible assets, identifying an appropriate IP tax regime can influence your effective tax rate.

Popular jurisdictions include Belgium, Hong Kong, Ireland, the Netherlands and Singapore. These enable your business to benefit from excellent commercial regimes, access to a sophisticated labour force and opportunities to manage tax arrangements more efficiently.

2. Holding company

The choice of holding company location is determined by shareholder considerations as well as company law. Popular locations include Belgium, Ireland, Luxembourg, Switzerland and the United Kingdom.

3. Technology centre

The technology centre will be responsible for R&D, and therefore its location will be influenced by access to appropriate staff and possible investment incentives from government. Countries such as France and the United Kingdom encourage investment in R&D through their R&D regimes.

4. Shared services

Shared services are often relocated to low cost markets. Popular destinations include Malta and Cyprus.

5. Commissionaire

Operations that can be physically difficult to move such as sales and distribution can be structured as a commissionaire or a limited risk distributor (LRD). These structures restrict the commercial risk and therefore the level of profits associated with the function. As mentioned previously, the commissionaire arrangements are one of the higher profile issues within the OECD BEPS initiative and many multinationals may look to switch to the LRD model for greater stability.

6. Toll or contract manufacturing

Toll or contract manufacturing is ideally located where there is a low cost base. Eastern European states and, increasingly, North Africa are widely used. This area is also under close scrutiny as a result of the OECD's BEPS Action Plan.

The big picture – factoring in all the issues

It is important to take full account of the potential impact of the operational, legal and tax issues that could arise from relocation. While, these are generally manageable, early and careful planning are essential.

Operational issues

Customers, suppliers and markets
Depending on the nature of your business, it is not only important to consider logistical issues such as time zones and supply routes, but also how customers might feel about where you operate from. Some customer-facing functions have been brought back onshore as a result.

Substance
Without real ‘substance’ within the operation, you could run into tax issues (see page 7). It is easy to demonstrate substance within functions such as manufacturing, but showing that there is sufficient personnel and appropriate levels of local management with the relevant expertise to manage the assets within holding and IP companies could be much harder.

People
It is important to consider how any relocated function will be staffed. This may involve moving existing personnel or recruiting locally. For existing staff, it is important to take account of whether they want to move and can gain the work permits to do so. In addition, in the context of an ‘assembled workforce’, the transfer or secondment of employees may result in the transfer of valuable know-how from one associated enterprise to another. Depending on the facts and circumstances, this may result in arm’s length compensation for these intangibles. The cost of both relocation and local hiring could be considerable.

Legal issues

Employment law
Any move, even within the EU, is likely to require a change in working practices. This includes allowable hours and holidays, along with the possible need to consult with works councils.

Contract law
When moving business operations overseas, it may be necessary to renegotiate contracts with current suppliers and customers.

Company law
Full migration is likely to give rise to extensive legal and listing requirements, along with changes in reporting.

Tax issues

Exit charges

Most countries apply exit charges for moving a function or asset out of a jurisdiction, though there are ways to reduce of defer these charges.

Residency and controlled foreign corporations (CFC) rules

Many tax authorities do not just levy taxes on companies incorporated in the territory, but also if they are managed there. It is therefore important that companies have an appropriate level of substance and management locally, otherwise additional tax costs could arise under the tax residence and CFC rules.

Transfer pricing

Increasing numbers of jurisdictions have introduced transfer pricing rules to ensure that intra-group pricing of goods, services, interest and royalties is deemed to take place at arm's length. The aim is to ensure that profits are not artificially diverted to another territory through manipulation of prices.

As a result, the level of profits that can be generated in a particular territory depend on the relative substance in terms of assets held, functions performed and risks borne. The OECD BEPS initiative may alter how rules are implemented so careful supply chain planning is essential.

BEPS Action Plan

The planned overhaul of international tax arrangements set out in the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan is likely to add further complexity to the international tax landscape. Even though the plans have yet to be finalised, the potential scenarios should be factored into any relocation evaluations.

So how will BEPS change the playing field? The Action Plan aims to bring tax closer to where real value is created. It will therefore be much harder to demonstrate that value is being created within a country that has little human capital and infrastructure to support IP generation, even if this is where the rights reside or from where investment has been financed. To meet tougher permanent establishment stipulations, groups will also need to demonstrate that people and structures are there to support the bearing of risk. Transfer pricing is going to be more complex and more important as a result. It will not be possible to look at value creation, transfer pricing and tax planning strategies in isolation – all should work in harmony.

Indirect taxes

It is important to consider whether the restructuring would alter the flow of goods, services or other payments. For example, royalty, interest and dividend flows need to be modelled to ensure that the resultant structure would not lead to additional taxes. Where there is a physical movement of goods or services, sales taxes and duties should be built into the cost of the restructuring.

Conclusion – Developing the right solution

As your business seeks out new markets for growth and looks at how it can best manage tax, operational and compliance costs, the rationale for restructuring and/or relocating at least some of your assets and operations can only increase.

1. Model your supply chain and identify key value drivers. This will help you identify areas where relocation/restructuring could add value.

2. Determine which functions and assets could, should or should not be relocated, and assess possible locations.

3. Undertake feasibility and cost-benefit analyses. This shouldn't just look at the costs, but also any potential reputational issues.

The choices that emerge from these evaluations may prove very different from what you originally envisaged. While these assessments are likely to identify a number of challenges, most can be managed with the right structuring and planning. What you cannot afford to do is simply consign relocation to the 'too difficult pile' as you could lose out to competitors as a result.

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