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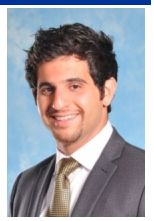
ISSUERS AND INVESTORS BEWARE: THE SECURITIES ACT 2012 IS HERE

Melissa Inglefield & Colin Sabga



*The Securities Act, 2012, (the '**2012 Act'**) was proclaimed into law on 31st December, 2012. It was passed by Parliament amidst the threat that Trinidad and Tobago ('T&T') would become "blacklisted" by the International Organization of Securities Commissions if the securities law to enhance investor protection and increase the regulatory powers of the T&T Securities and Exchange Commission (the 'Commission') were not revamped by December 2012. To this end, the 2012 Act seeks to increase the range of market actors required to be registered and the regulatory and supervisory powers of the Commission. Notwithstanding its proclamation, there are already whispers in the air of reviews and possible changes to the law in the near future. This article seeks to address some of the major changes brought about by the 2012 Act, and considers how the industry may be most affected.*

Employed by a Registrant? You may need to be registered!

Under the 2012 Act, securities companies, broker-dealers, investment advisers and underwriters (collectively 'registrant(s)') are subject to similar registration requirements as under the 1995 Act. However, in keeping with the stricter regulatory regime imposed by the 2012 Act, individuals who are senior officers or employees of a registrant may also themselves require registration with the Commission as 'registered representatives'.

The new requirement means that any person who engages in an act, action or course of conduct in connection with or even incidental to a regulated class of business for a registrant is now required to be registered.

We're all Reporting Issuers

Under the 1995 Act, the requirement to become a "Reporting Issuer" was reserved for both persons who proposed to make an issue of securities to the public and public companies. Issuers falling into either category were accordingly required to register with the Commission as such. Reporting Issuers were therefore, either companies that were already public companies, or persons who intended on issuing their securities to more than 35 persons. Strict disclosure and on-going reporting obligations were imposed on the Reporting Issuer under the 1995 Act. However, under the 2012 Act the concept of an 'offer to the public' was removed, and so *any* issuer not already registered with the Commission, but who proposes to make a distribution, is required to register as a Reporting Issuer. Luckily for some, however, there is one exception: the 2012 Act provides an exemption to the requirement for issuers who propose to make a 'limited offering'.

The concept of a limited offering is familiar to securities legislation, having existed since the 1995 Act. However, the 2012 Act has adopted a new definition of limited offering which may be more restrictive than the exception to the 'offer to the public' under the 1995 Act. Essentially, the result is that an issuer:

(1) who is a *private issuer* (a term defined in the 2012 Act);
(2) whose security holders are not greater than 35 persons on the conclusion of the distribution; and
(3) who does **not** incur any promotional expenses in connection with the distribution, except for professional services and other limited services allowed under the 2012 Act, will be exempt from having to register as a 'reporting issuer'. It should be noted, however, that the definition of 'limited

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offering' in the 2012 Act results in the exemption being of a much more limited scope than the 'offer to the public' concept in the 1995 Act, meaning that issuers will now have to pay greater attention to the registration requirement.

Distributing securities? Get registered!

… Unless, of course, it's a 'limited offering'….

The 2012 Act appears initially to clamp down on any distribution of securities by establishing that no security may be distributed unless first registered with the Commission. However, the 'limited offering' concept again is available as an exemption under the 2012 Act for those distributions which fall within the definition. Notably though, even if a security is exempt from the registration requirement, additional steps may be required under the 2012 Act for the issue of that security, such as filing a post-distribution statement.

Clarifying where your security falls under the 2012 Act, and determining your obligations, is therefore critical to a successful placement. Such obligations should be considered from the time you begin structuring your issue to ensure that compliance is manageable, thus avoiding the increased civil and criminal sanctions imposed under the 2012 Act.

Keeping Tabs… on Everything

While primary disclosure obligations on reporting issuers remain virtually the same, the new regime has imposed additional reporting and recording requirements to allow for detailed audits at the request of the Commission.

Importantly, the 2012 Act imposes a new requirement on any registrant participating in a trade of securities that is not facilitated through a securities exchange, to keep a record of all such trades; and to file a report on the prescribed form. As a registrant includes broker-dealers, securities companies, underwriters, investment advisers, registered representatives and reporting issuers, the effect of this section will be widely felt. Such persons should therefore ensure that proper records of all trades are kept.

More than its concern with obtaining information from registrants, the Commission has also imposed new record-keeping and compliance review requirements. Market actors (*see inset*) must therefore be sure to comply with the new regime. Non-compliance will mean that a market actor risks being subject to 'compliance directions' issued by the Commission, in addition to civil and criminal sanctions.

Moreover, if you are "connected" with an issuer, you will also need to pay particular attention to your new reporting obligations. You are required to disclose all direct or beneficial ownership of, or control of direction over, securities of a reporting issuer. Certain restrictions on dealing are also imposed on "connected" persons.

It is therefore critical for persons who may be considered market actors to come to terms with the new requirements under the 2012 Act.

Please note that the 2012 Act seeks to regulate the filing and public availability of documents generally, i.e. all documents filed with the Commission will now be available for public inspection, unless otherwise determined by the Commission or the Court.

A market actor is defined in the 2012 Act as a:

- *registrant;*
- *person exempted under this Act from the requirement to be registered;*
- *senior officer, or promoter of a reporting issuer;*
- *custodian of assets, shares or units of a collective investment scheme;*
- *self-regulatory organization;*
- *designated rating organization;*
- *transfer agent for securities of a reporting issuer;*
- *registrar for securities of a reporting issuer;*
- *the partner of a market actor;*
- *contingency fund required under Part III of this Act;*
- *settlement assurance fund required under Part III of this Act;*
- *securities market;*
- *clearing agency; or*
- *another person or member of a class of persons prescribed to be a market actor.*

When *don't* you need a Prospectus?

Aligning itself with the general theme of increased regulation and supervision, the 2012 Act has substantially varied the provisions regarding the need for and filing of a prospectus.

Whereas under the 1995 Act, any distribution necessitated the preparation and filing of a prospectus or a block distribution circular, the 2012 Act eliminates the provision for a block distribution circular and broadens the reach of the prospectus requirement. Now, any person who trades in securities must also file a prospectus with the Commission. The importance of the revision lies in the use of the word 'trade' in the restriction, which is broadly defined under the 2012 Act.

The 2012 Act does provide for certain exemptions to the prospectus requirement (such as, the 'limited offering' exemption, or the 'accredited investors' exemption which, applies, among other things, to distributions by a reporting issuer to fewer than fifty (50) accredited investors). The circumstances under which an issuer may fall within such exemptions have been

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RELATED PARTY TRANSACTIONS AND TRANSFER PRICING: A BRIEF INTRODUCTION—PART II

Angelique Bart

In our previous article on transfer pricing, we noted that Multinational Enterprises (MNE) cause tax authorities in the countries in which they operate to become concerned about whether MNE's may be eroding their taxable base, by abusing inter-company cross border transactions through transfer mis-pricing techniques. Recently, companies such as Google, Amazon and Starbucks were heavily criticized by the British public for failing to pay "sufficient taxes" in the United Kingdom through what many considered an abuse of inter-company transactions to artificially adjust income and/or expenses.

The issue of transparency of inter-company transactions led the Organization for Economic Cooperation and Development ('OECD') to codify what is probably the most internationally recognised and accepted transfer pricing guidelines in existence. These guidelines have formed the legislative basis for specific transfer pricing laws in various countries. Of course, countries such as the USA, Brazil and India have varied aspects of the OECD guidelines to meet their local needs and contexts.

In Trinidad & Tobago, we noted that the existing tax legislation was inadequate since there was a general broad anti-tax avoidance provision and another provision which arbitrarily imposes a 2% restriction on tax deductions for management charges whether those sums are paid to a related party or not. Based on the limited local legislative position, and the fact that Government announced its intention to adopt the OECD transfer pricing guidelines, this article will take a brief look at those guidelines.

What is "transfer pricing" again?

Essentially, transfer pricing refers to the price used for goods, services or the use of property (including intangible property) in related party transactions. Transfer pricing laws and regulations require related parties to deal with each other as if they were unrelated and negotiating in the open market. Thus, parties should deal with each other on an arm's length basis to avoid "manipulative" or "abusive" transfer pricing practices to reduce their taxable income in a particular jurisdiction ('arm's length principle').

> "transfer pricing refers to the price used for goods, services or the use of property (including intangible property) in related party transactions."

What is the cornerstone principle of the OECD Guidelines?

The OECD transfer pricing guidelines hinge on the conventional international approach of using the 'arm's-length' principle. Under local law, this is not a novel concept (see S67 of the Income Tax Act). However the existing legislation does not assist in determining an arm's length value or price for a related party transaction.

How does the 'arm's length' principle work under the guidelines?

In practice, the principle is applied by establishing "comparability" between controlled and uncontrolled transactions (i.e. comparing transactions between the associated enterprises with those of independent enterprises). The results from the comparability analysis are then used in the selection of the most appropriate transfer pricing method which then allows us to arrive at the "correct" arm's length price or profit. Thus, the two key facets of the 'arm's length' principle are:

- The transaction should be "comparable" to that of unrelated parties; and
- The value of the transaction should be determined using an approved OECD transfer pricing methodology.

How do you determine 'Comparable' Transactions?

The five (5) key attributes that determine "comparability" of a transaction are:

(1) The characteristics of property or services transferred;
(2) The functions performed by the parties (taking into account the assets used and risks assumed);
(3) The contractual terms;
(4) The economic circumstances of the parties; and
(5) The business strategies pursued by the parties.

In essence, the economically relevant characteristics of the situations being compared between related and unrelated parties must be sufficiently comparable or similar. Of course in the real word, no two situations will be the same, thus being "comparable" means that differences between two transactions being compared ought not to materially affect the transaction being examined or where it will materially affect it, reasonable adjustments can be made to neutralize the differences.

What are the OECD Transfer pricing methods?

There are five (5) transfer pricing methods to determine the arm's length price or value and these methods are as follows:

(1) **Comparable Uncontrolled Price (CUP):** where the prices charged for property and services in controlled transactions are compared with that of an uncontrolled transaction.
(2) **Resale price**: where the price for a product which has been purchased from an associated enterprise is measured against those products resold to an independent enterprise. This price is then discounted by the entity's operating and other expenditure;

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(3) **'Cost-plus'**: where the cost incurred by the supplier is added to an appropriate mark up.
(4) **Transactional net margin**: where the net profit is examined against an appropriate base (such as costs, sales etc.) which a taxpayer realises from a controlled transaction; and
(5) **Transactional split profit**: where profits from related parties are identified and split to reflect profits that independent enterprises would have expected to realise from engaging in such transactions.

Evidently, these transfer pricing methods are not exact sciences and the parties to the transaction will need to determine the "best method" that should be applied. As of 2010, there is no order of priority for the methods, however, the CUP remains the preferred method.

What are the challenges/issues with introducing transfer pricing legislation?

The introduction of transfer pricing legislation should help to provide a greater degree of certainty for MNEs but will bring with it several challenges, including the following:

- Taxpayers will incur significant costs to comply with the guidelines and the Tax Authority will have a heavier administrative burden to ensure compliance.

- Compliance requires highly specialized professionals and there is a paucity of appropriately qualified transfer pricing experts in private and public sector to ensure that the rules are applied in the manner intended.

- Finding "comparable" transactions will be challenging given the size of the local market; differences in size, structure, industry and issues between market actors; *de facto* monopolies in some sectors; vastly differing motivations for negotiating key contract terms between market actors; the absence of, and difficulty to build a comprehensive transfer pricing database from which comparable transactions can be drawn.

- Even where "comparable" cases are drawn from different countries, the lack of consideration for the local issues could be a significant impediment.

- Advanced tax rulings are key for certainty around transfer pricing compliance, and the OECD recommends these rulings. If such rulings are given in Trinidad & Tobago, will they be given on a timely basis so as not to impede the pace at which business takes place? And will the Tax Authorities renege/ reverse their rulings at a later date since they are not bound by the principles of estoppel and *res judicata?*

- The 'wholesale' introduction of the guidelines prevents us from taking advantage of key useful and successful transfer pricing developments from other countries. For example, the guidelines discourage the use of 'safe harbor rules' i.e. rules or laws which set out circumstances in which the Tax Authority will accept the transfer price declared by the taxpayer without challenging the transaction. However, countries such as USA, India, Brazil and Mexico recognise the value of introducing such safe harbor rules as they provide a level of certainty and ultimately ease the administrative burden for the Tax Authority.

Final Thoughts

Transfer pricing guidelines will likely be a fairer basis for determining the arm's length value of related party transactions rather than each taxpayer subjectively determining values with little evidence to back it up. However, these rules require a high level of compliance, and it is critical to consider the local context since the rules may act as a deterrent to foreign direct investment rather than being seen as boosting certainty of tax policies in respect of related party transactions.

Angelique Bart is a Senior Associate in Hamel-Smith's Transactional Department.

Shades of Grey..... Navigating the parallel import market

Fanta Punch

Parallel imports, or grey market goods, are genuine products which have been manufactured (either by the trade mark owner or by consent) and are then imported into a country and sold without the trademark owner's permission. These goods are not counterfeit, although there may be differences such as pricing or alternate packaging.

The extent to which a trademark owner can control the distribution of its brands in multiple markets depends on the nature of the "exhaustion of rights" in the goods associated with that brand. Generally, there are two approaches to the legal nature of exhaustion of rights:

- National or Regional Exhaustion; and
- International Exhaustion.

National Exhaustion occurs where a trademark owner's intellectual property rights in a product, when sold in a domestic market, are extinguished on sale. The exclusive right over any further commercialization of the item, such as its resale or rental is not permitted, but the trade mark owner is able to oppose another party's right to import the same goods into the market. Regional Exhaustion is based on the same principle, but the level of control which the trademark owner can exert extends to a region.

The second concept, International Exhaustion, applies in circumstances where the intellectual property rights in the product are exhausted when the product is sold, regardless of jurisdiction.

These competing approaches have implications for trademark owners, and also affect intellectual property rights as they relate to commercialization of trade channels worldwide. For example, the US case of *Kirtsaeng v. John Wiley & Sons, Inc.* (although about copyright law) illustrates some of the difficulties faced by proprietors in controlling exclusive intellectual property rights, and the extent to which these rights can be controlled. The case, which is currently before the US Supreme Court, involves the legality of the importation and sale of several textbooks by a Thai student studying in the United States. The books were purchased in his homeland and then resold online in the US without the permission of the copyright owner.

While our current Trade Marks Act does not expressly deal with parallel imports, the new Trade Mark Bill (which it is hoped may be laid before Parliament in the near future) includes provisions for the International Exhaustion of intellectual property rights. Should it be passed, trade mark owners may wish to consider limiting its effect on their business by taking steps such as:

- reviewing license and distributor agreements to ensure they address parallel importation;
- examining warranty agreements to restrict the ability of a purchaser of grey market goods to rely on warranties obtained from the original source; and
- holding promotional campaigns to highlight differences between parallel imports and goods sold on the domestic market.

Fanta Punch is a Senior Associate in the Dispute & Risk Management Department.

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condensed from those available under the 1995 Act, re-emphasizing the focus of the 2012 Act on enhanced disclosure.

Out with the old and in with the new – Don't be caught unprepared!

Almost three months have passed since the proclamation of the 2012 Act, with its stringent requirements imposed on those regulated by the Commission. Market actors in the securities industry should therefore become very familiar with the new provisions and sweeping changes imposed by the 2012 Act, particularly in view of the increased sanctions for non-compliance.

Melissa Inglefield and Colin Sabga are Associates in Hamel-Smith's Transactional Department.

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E-mail: mhs@trinidadlaw.com / Web: www.trinidadlaw.com
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