

Structuring Joint Ventures in India Avoiding Initial Pitfalls

ORGANISER

DAPG INDIA FORUM

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presented by

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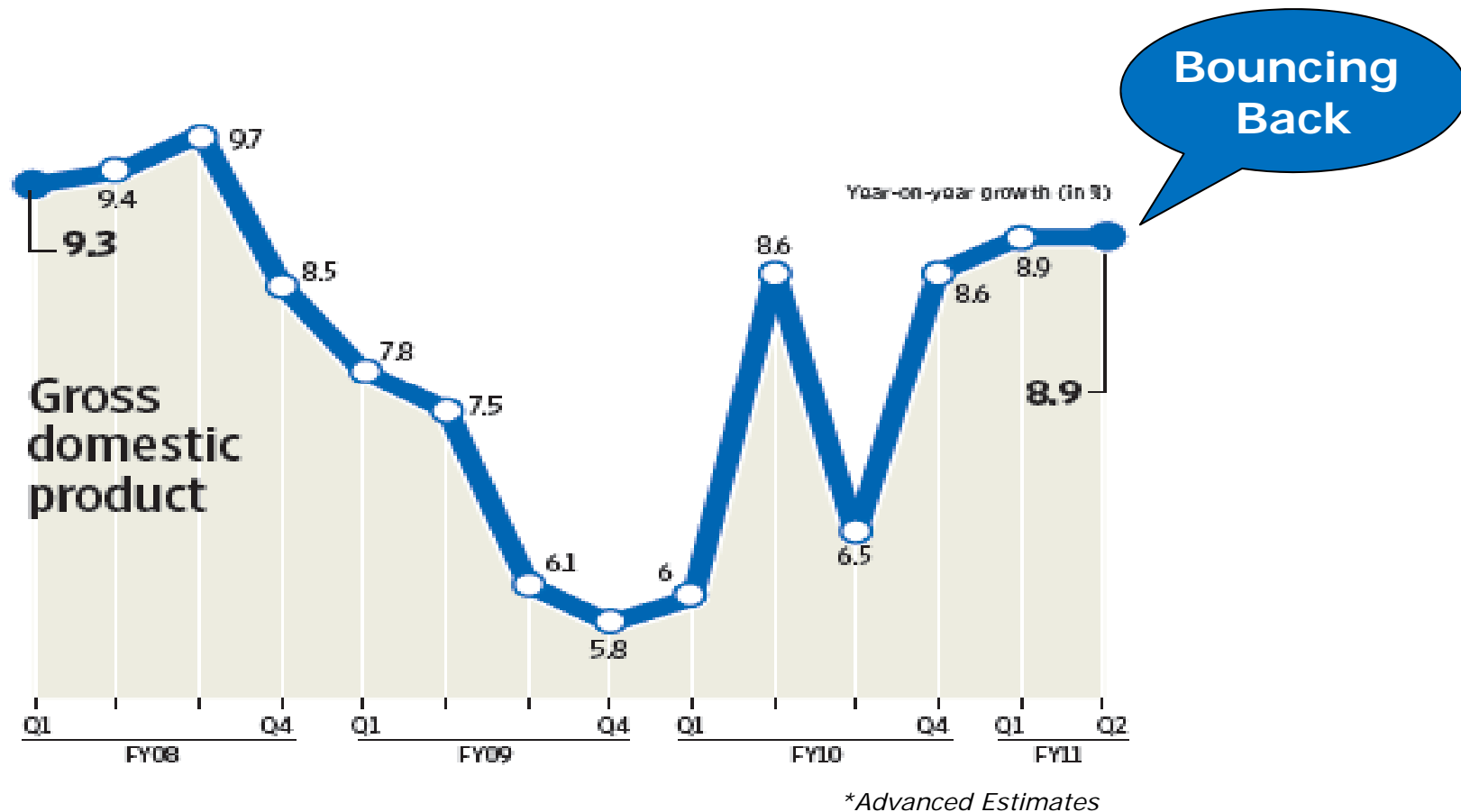
PRESENTATION OUTLINE

- ❑ SEGMENT - I
 - ❑ India Tour
 - ❑ Mode of Entry
 - ❑ Significant Issues & Changes
 - ❑ Realigned Regulatory Environment
- ❑ SEGMENT - II
 - ❑ Issues Involving Indian Partners

INDIA TOUR

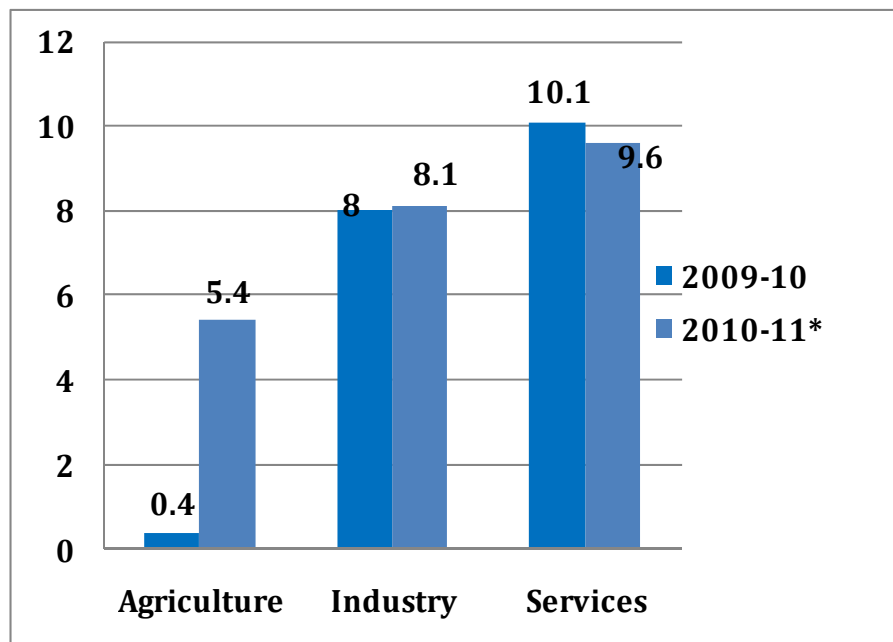
Some Facts

REGAINING ECONOMY...



... BECAUSE OF ...

All Three Sectors Grew Well



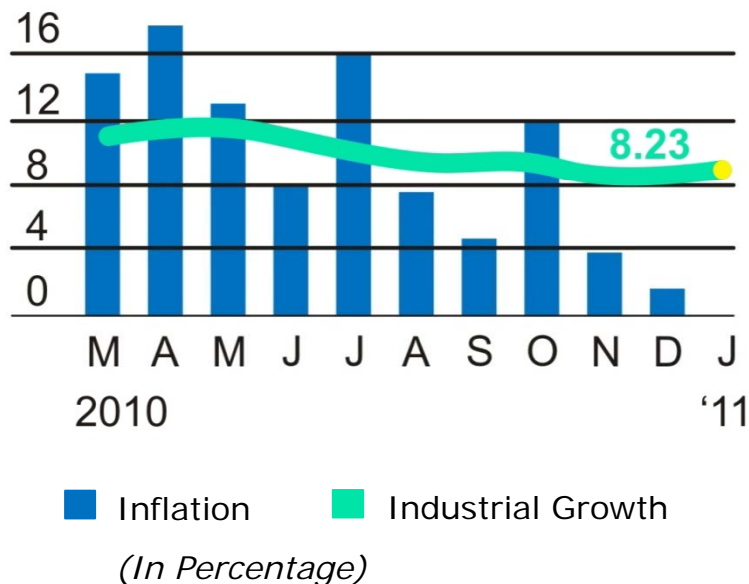
And Global Recovery Helped Too

Real GDP Growth (%)	2010	2011*
USA	4	4.1
UK	2	3
Germany	2.1	2.7
China	10	9
Japan	2.7	3
Brazil	5.2	4.5

**Research Report*

... AND THE RISK IS

High Inflation and Slack in Industrial Growth



pose new challenges because:

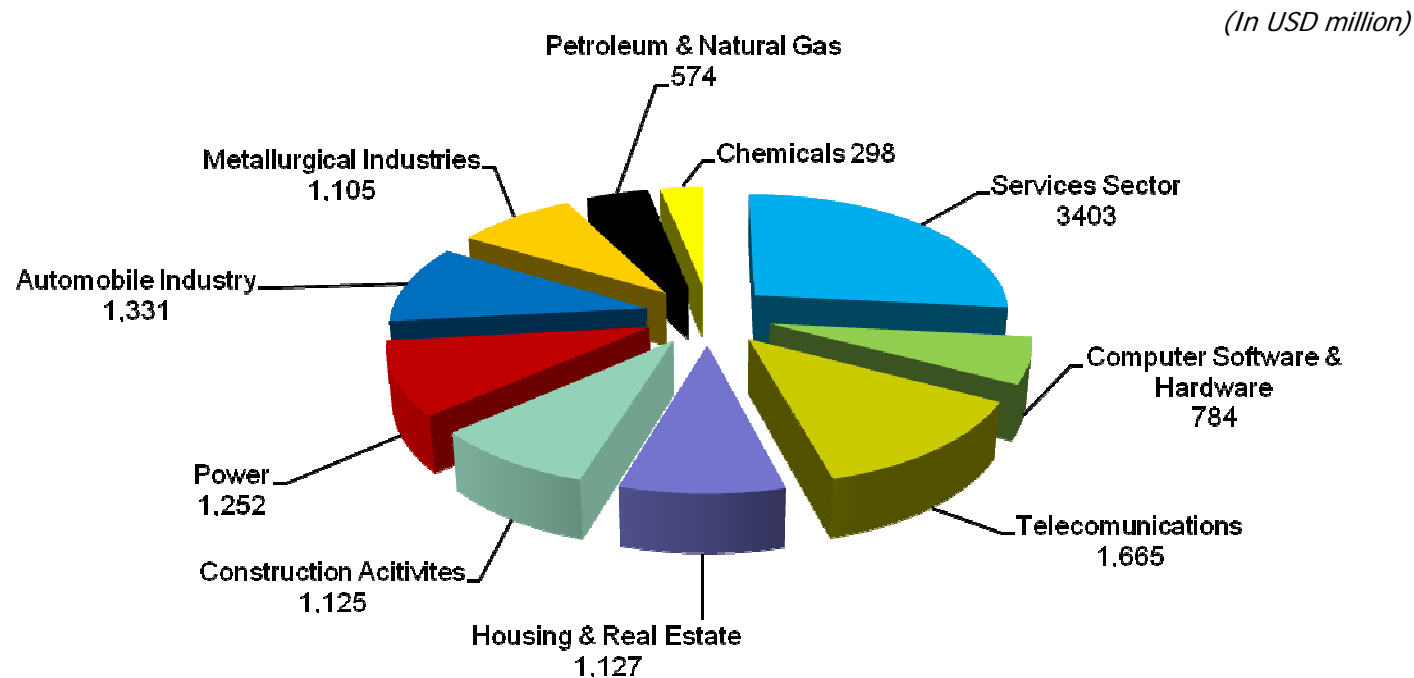
- Interest rates will have to rise to curb inflation, which will further impact industrial growth
- Current account deficit may not fall as is expected in the Survey
- Quality and quantity of government expenditure is still a worry
- Critical policy reforms are still stuck in political logjam

FOREIGN DIRECT INVESTMENT – COUNTRY WISE

FDI INFLOWS (Top 10 Countries)					
<i>(in USD million)</i>					
Rank	Country	2009-2010	2010-2011	Cumulative Inflows (April' 00 to March'11')	% of total Inflows
1	Mauritius	10,376	6,987	54,227	42
2	Singapore	2379	1,705	11,895	9
3	USA	1943	1,170	9,449	7
4	UK	657	755	6,639	5
5	Netherlands	899	1,213	5,700	4
6	Japan	1183	1,562	5,276	4
7	Cyprus	1627	913	4,812	4
8	Germany	626	200	2,999	2
9	France	303	734	2,264	2
10	UAE	629	341	1,890	1

Source: Department of Industrial Promotion, March 2011

FOREIGN DIRECT INVESTMENT – SECTOR WISE

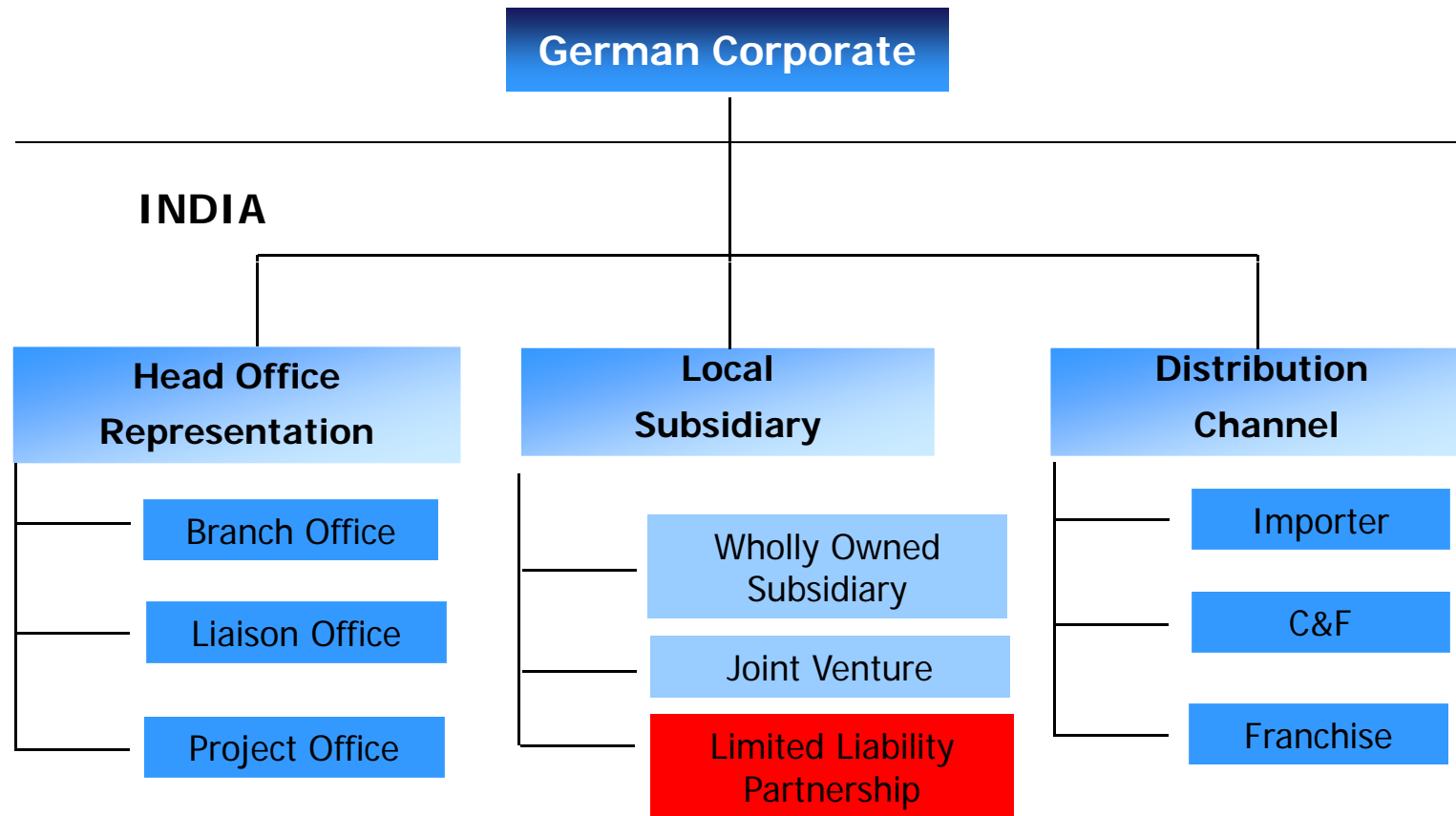


Source: Department of Industrial Promotion, March 2011

INDIA ENTRY

Mode of Investment

INDIA ENTRY - Mode of Investment



INDIA ENTRY - Alternate Entity Comparison

	Corporate [CO]	Liaison Office [LO]	Project Office [PO]	Branch Office [BO]
Characteristics	Share capital owned by parent company	No commercial activities allowed	Temporary site office, specific projects	Commercial activities allowed
Status	Shareholders	Foreign Company	Foreign Company	Foreign Company
Tax Rate	30% + +	Non Taxable	40% + +	40% + +
Control	Board of Directors	Parent Company	Parent Company	Parent Company
Set-up	FIPB Approval / Automatic Route (8-12 weeks)	RBI approval (8 weeks)	RBI approval (8 weeks)	RBI approval (8 weeks)
Closure	ROC (12-15 months)	RBI (3-6 months)	RBI (3-6 months)	RBI (6-8 months)

RBI – Reserve Bank of India
FIPB – Foreign Investment Promotion Board
ROC – Registrar of Companies

Significant Issues & Changes

Planning India Investment

Investment Strategy

Existing Collaboration(s) in India – Erstwhile Press Note 1 (2005)

- ❑ Do you have an existing joint venture with an Indian partner for the very field in which you now intend to set-up business in India?
- ❑ Do you have an existing technology collaboration with an Indian partner for the same field in which you intend to do business in India?

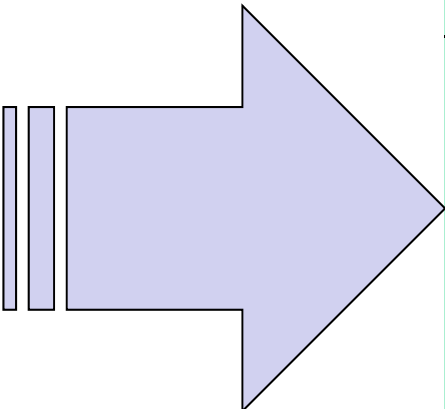
PAST

If yes, 'No Objection Certificate' was necessary from the existing Indian Partner. Such No Objection was submitted with FIPB to obtain approval for the new investment in the same field

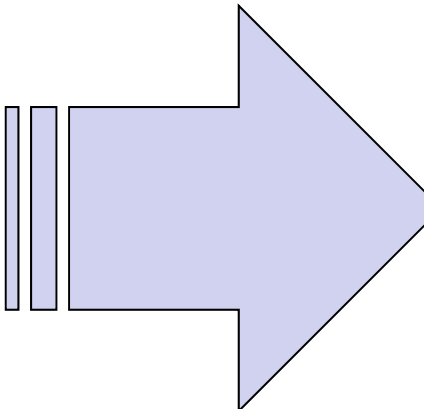
PRESENT

'No Objection Certificate' and/or prior approval from the FIPB not required

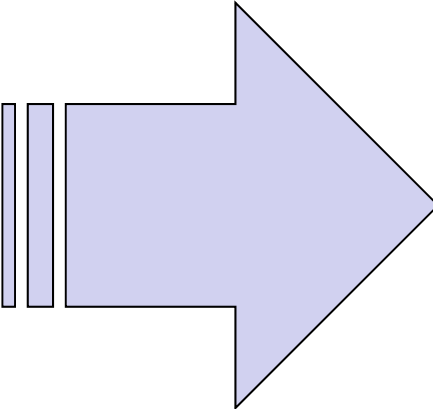
Transfer of Shares

Non Resident to Resident	Existing Provisions		New Provisions
Listed Companies	Prevailing Market price or Price arrived at by taking average quotations		Price not be less than price for preferential allotment under SEBI guidelines
Unlisted Companies	<p>If the consideration is up to INR 2 million; price as mutually agreed</p> <p>If the consideration exceeds INR 2 million; price as per Net Assets Value or Profit Earning; as certified by a Chartered Accountant or a Merchant Banker</p>		<p>Price shall not be less than fair value determined by SEBI Category I- Merchant Banker or CA as per Discounted Cash Flow Method</p>

Sector Specific Changes

Foreign Investment	Existing Guidelines		New Guidelines
Cigars & Cigarettes Manufacture	100 % FDI Permitted		FDI prohibited
Lottery, Gambling & Betting activities	Prohibited but No clarity for foreign technology collaboration including licensing for franchise, trademark, brand name		FDI, foreign technology collaboration, licensing for franchise, trademark has been prohibited
Development and production of Seeds and planting material	Permitted under controlled conditions (rainfall, temperature, solar radiation, air humidity etc)		The requirement for controlled condition has been removed.

Wholesale Trading

FDI In Trading	Existing Guidelines		New Guidelines
<p>Cash & Carry Wholesale Trading / Wholesale Trading (WT)</p>	<p>WT not defined</p>		<p>WT defined as retailers, industrial, commercial, institutional or business users or other wholesalers, related service providers</p> <p>Type of customers to whom the sale is made to be the yardstick to determine WT</p>

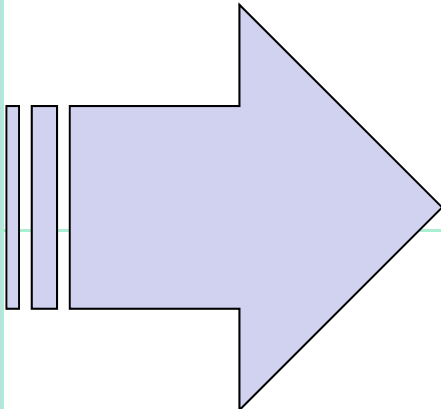
Investment Strategy

Wholesale Trading - Restricted

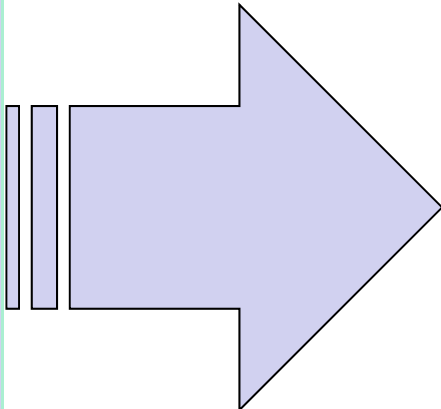
- ❑ WT of goods would be permitted among companies of the same group. Aggregate WT to group companies should not exceed 25% of the total turnover of the wholesale venture and the wholesale made to the group companies should be for their internal use only.
- ❑ A Wholesale/Cash & carry trader cannot open retail shops to sell to the consumer directly

Balance 75 per cent WT to
unrelated buyers such as
existing retail shops

Issue of Shares – Non Cash Basis

Conversion of Non Cash Items	Existing Guidelines		New Guidelines
Conversion of External Commercial Borrowings, Preference Shares (convertible), Lump-sum Technical fee, Know-how fee and Royalty,	Indian companies have been granted general permission subject to certain conditions		No Change
Conversion of value of Import of capital goods/ machinery/ equipment (including second-hand machinery),	Not Permitted		Compliance with the Export and Import Policy and Valuation norms, within 180 days from the date of shipment of goods

Issue of Shares – Non Cash Basis

Capitalisation of Expenses	Existing Guidelines		New Guidelines
<p>Pre-operative Exp, Pre-incorporation Expenses (including payments of rent etc.)</p>	<p>Not Permitted</p>		<p>Against evidences for remittance of funds by the overseas promoters for the expenditure incurred and verification and certification of the expenses by the statutory auditor AND the capitalization being done within the stipulated period of 180 days</p>

Realigned Regulatory Environment

Way Forward

POLICY FRAMEWORK – IN THE HORIZON

- ❑ Direct Tax Code *(April 1, 2012)*

- ❑ New Companies Bill *(awaited)*

- ❑ Indirect Taxes - Goods & Services Tax *(April 1, 2012)*

- ❑ International Financial Reporting Standards *(April 1, 2011) ?*

DIRECT TAX CODE ('DTC')

- ❑ **Tax rates** rationalized - corporate to pay a reduced tax of 30 per cent
- ❑ Tax on **royalties** enhanced - 20 per cent on gross payment
- ❑ Domestic companies to still pay a **dividend distribution tax** at 15 per cent. Similarly, foreign companies now to pay branch profit tax at 15 per cent on post tax profits
- ❑ Fresh tax exemptions to be 'investment linked' rather than 'profit linked'

DIRECT TAX CODE ('DTC')

- Introduction of **General Anti Avoidance Rule ('GAAR')** wherein commercial expediency of international transactions can be challenged by the authorities; primarily to check contentious issues viz. check round trip financing, lifting of corporate veil etc
- Provisions of DTC to have **overriding effect** over past tax treaties signed by India under specific circumstances

NEW COMPANIES BILL 2009

- ❑ Introduction of **One Person Company** (*'OPC'*)
- ❑ OPC can be formed for charitable purpose as well
- ❑ Companies can be struck off if business not commenced within one year of its incorporation
- ❑ **One Resident Director** mandatory for all companies
- ❑ A Whole-Time Director not to hold office in more than one company unless permitted by the company

INDIRECT TAXES

- ❑ Central Sales Tax / VAT & Service Tax – to be merged into a single Goods & Service Tax ('GST') by **April 1, 2012**

INTERNATIONAL FINANCIAL REPORTING STANDARDS (*IFRS*)

- India to have two sets of Accounting Standards
 - Indian Accounting Standards (*IAS*)
 - IFRS Converged Indian Accounting Standards (*IFRS-AS*)
- IFRS-AS will become applicable to listed companies in phases beginning from **April 1, 2011 ?**
- Paradigm shift in the basis of recording transactions
 - Impresses substance over form
 - Detailed disclosures required

Intense discussions on opening multi brand retailing...

- Minimum Foreign Investment – USD 100 million
- 50% FDI in backend infrastructure
- Minimum population in cities – 1 million
- Goods sourced from SMEs – 30%
- Minimum sales to small retailers – 30%

Segment II

Indian Partner – First Few Steps

Why an Indian Partner ?

□ Pros

- Operating Infrastructure
- Ready Distribution Channel
- Government Dealing
- Labor Management

□ Cons

- Management and Control
- Dilution of Profits
- Protection of Technology, Trademarks and Trade Names

Credit Worthiness Check of Partner

- Financial health of joint venture partner
- Ongoing litigation or contingency
- Market Reputation and reach of partner

**Lack of published
information and
credit rating
makes this the
most critical issue
in JV**

Sources

Published Sources

- Financial Statements
- Credit Rating Agency
- News Reports

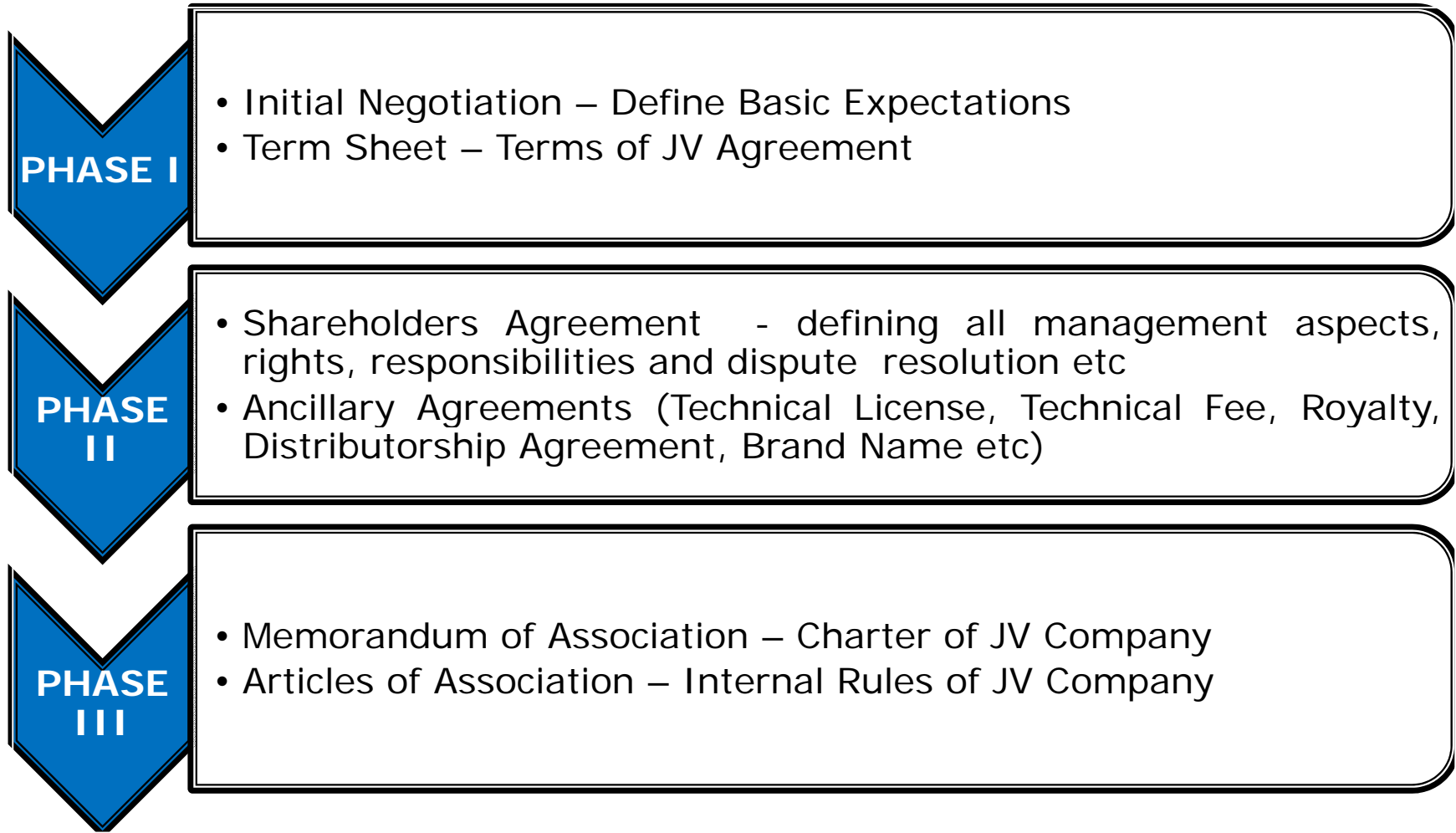
Unpublished Sources

- Market Reputation
- Trade Chambers
- Informal Sources

Regulatory Bodies

- Exchange Control
- Corporate Registrar
- Income Tax

Joint Venture - Documentation



Term Sheet – Some Key Guidelines

Management

- Chairman, Managing Director,
- Board of Directors
- Functional Roles

Control

- Contribution of Partners / Role Play
- Shareholding Structure
- Executive Directors and other key positions

Exit

- Lock-in Period
- Pre-emptive rights to purchase the other

Shareholding Structure

- ❑ Shareholding structure has a major bearing on the quality of management, its ability to decide and respond to business dynamics.

The law broadly recognizes the following power thresholds for shareholders:

- **10 Per Cent (Minority Control)**
- **51 Per Cent (Simple Majority)**
- **75 Per Cent (Absolute Majority)**

Shareholding Structure

- ❑ ***10 Per Cent & Above - Minority Control***
 - Calling an extraordinary general meeting on requisition - **Section 169**
 - Demand for Poll during voting - **Section 179**
 - Investigation of affairs of company - **Section 235**
 - Prevention of oppression of minority shareholders and to prevent mismanagement of the company - **Section 399**

Less than 10 per cent deprives the above rights

Shareholding Structure

- ***51 Per Cent & Above - Simple Majority***
- **Section 79** – Issue of shares at a discount specifying the maximum rate, subject to sanction of Company Law Board
- **Section 81(4)** - Issue of further shares with Government's consent where special resolution is not passed
- **Section 94(2)** - Alteration of share capital

.....contd

Shareholding Structure

- ❑ ***51 Per Cent & Above - Simple Majority***
- Declaration of Dividend - **Section 205**
- Adoption of Annual Accounts & Director's report - **Section 210**
- Appointment of external auditor - **Section 224**
- Appointment of Director, Managing Director - **Section 256, Section 269**

Shareholding 50: 50
– High Chances of deadlock
in case of disagreement
amongst the partners; all
of above powers
compromised.

Shareholding Structure

- ❑ ***75 Per Cent & Above - Absolute Majority***
- Issue of further shares to persons other than existing members - **Section 81(1A)**
- Alteration in the Memorandum of Association & Articles of Association - **Section 16 & 31**
- Changing the registered office address of the company from one state to another - **Section 17**
- Change in the name of the company - **Section 21**

Shareholding Structure

- ❑ ***75 Per Cent - Absolute Majority***
 - Buy-back of shares - **Section 77A**
 - Reduction of share capital - **Section 100**
 - Winding up a company by Court - **Section 433(a)**
 - Voluntary Winding up a company - **Section 484(1) (b)**

Virtual control of the company; suitable for technology providers or where customers have global commitments and firm order available

Shareholding Structure

- ❑ ***Reserved Matters – An important tool***
- ☞ Alteration of the structure of issued capital
- ☞ Issue of shares and other securities
- ☞ Transfer of shares
- ☞ Change in constitution of the Board of Directors
- ☞ Declaration of any dividend, other distribution

THANK YOU

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