LECTURE MEETING

Inbound Investment & Entry Strategy

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न भयं चास्ति जाग्रत:

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Venue **: Walchand Hirachand Hall**
Indian Merchants' Chamber, 4th Floor, Churchgate, Mumbai

Bombay Chartered Accountants' Society

Inbound Investment & Entry Strategy

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Share of Top Investing Countries FDI Equity Inflows

Ranks	*Country*	*2007-08 (April- May 2007)*	*Cumulative Inflows (from Aug. 1991 to May 2007)*	*%age with total Inflows (in terms of rupees)*
1.	**Mauritius**	7,946 (1,934)	87,108 (20,080)	**42.06**
2.	**U.S.A.**	823 (198)	25,359 (6,092)	**12.24**
3.	**U.K.**	169 (41)	16,829 (3,898)	**8.13**
4.	**Netherlands**	278 (67)	11,680 (2,704)	**5.64**
5.	**Japan**	1,543 (367)	10,857 (2,575)	**5.24**
6.	**Singapore**	705 (172)	7,754 (1,800)	**3.74**
7.	**Germany**	549 (134)	7,609 (1,835)	**3.67**

Source: Fact Sheet on Foreign Direct Investment
dipp.nic.in/fdi_statistics/india_fdi_nov05.pdf

Sectors Attracting Highest FDI Equity Inflows

Ranks	*Sector*	*2007-08 (April-May 2007)*	*Cumulative Inflows (August '91 to May '07)*	*% age with total Inflows (In terms of rupees)*
1.	**Electrical Equipments** (including computer software & electronics)	2,406 **(573)**	38,440 **(8,800)**	**18.56**
2.	**Services Sector** (financial & non-financial)	4,195 **(1,011)**	38,434 **(8,851)**	**18.56**
3.	**Telecommunications** (radio paging, cellular mobile, basic telephone services)	3536 **(867)**	20,227 **(4759)**	**9.77**
5.	**Construction activities** (including roads & highways)	1,892 **(464)**	11,515 **(2,610)**	**3.33**
6.	**Drugs & Pharmaceuticals**	30 (7)	5,311 (1,230)	**2.56**
7.	**Fuels (power + oil refinery)**	191 (45)	12,296 (2,877)	**5.94**

Source: Fact Sheet on Foreign Direct Investment dipp.nic.in/fdi_statistics/india_fdi_nov05.pdf

What attracts foreign investment?

- Rising demand in emerging markets – China, India, Singapore
- Global outsourcing of service functions
- Political Stability
- IPR Protection
- Business & Policy Environment
- Labor availability & Costs (including entrepreneurship)
- Fiscal and Financial Incentives
  - Tax breaks
  - Subsidies

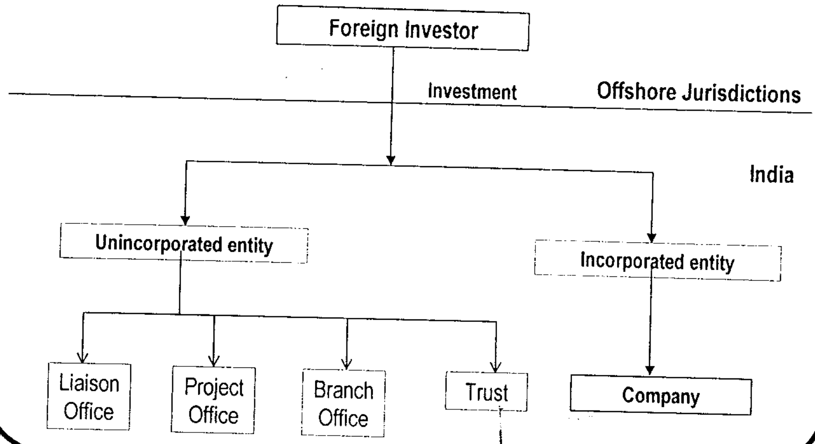
Favored investment destinations

- USA – largest host of FDI in the world
  - Investor friendly entrepreneurial culture
  - Infrastructure
- Singapore
  - Various bi-lateral free trade agreements e.g. CECA
  - Liberal investment climate
  - World class infrastructure
  - Highly educated work force
- China
  - Large domestic market
  - Availability of cheap labor
  - Rapidly growing economy

India scores over china
– Exit / repatriation
– language

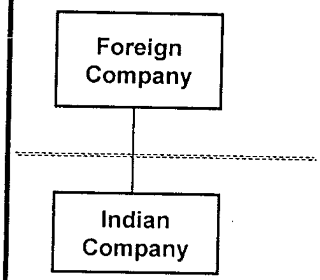
Structuring Greenfield Investments

Entity Options



FIPB approval required.

Direct Investment

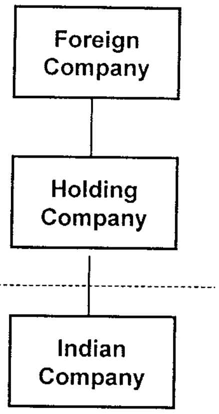


- Availability of tax holiday
- SEZ Act, 2005
- Tax Issues
- Tax Credit availability in foreign jurisdiction

Particulars	Amt (US$)
Taxable income	100
<u>Less</u>: Corporate Tax on the same (33.99%)	33.99
= Profits After Tax ("PAT")	66.01
<u>Less</u>: Transfer to reserve (10% of PAT)	6.60
= Profits available for distribution	59.41
<u>Less</u>: Dividend Distribution Tax (16.995%)	10.10
= Dividends distributed to Shareholder	**49.31**

credit of DDT ?

Use of intermediate jurisdiction



- Jurisdictions being used
  - Netherlands
    - Traditional holding co jurisdiction
    - Limited capital gains tax exemption → No LoB
    - Participation exemption
  - Mauritius
    - Favorable and settled offshore regime
    - Capital gains tax exemption
    - No tax benefit for interest income
    - Treaty re-negotiation-Threat?
  - Cyprus — Passport to EU market
    - Capital gains tax exemption
    - Interest taxed at 10%
    - Treaty re-negotiation
  - Singapore
    - LoB clause
    - Capital gains tax exemption tagged to Mauritius Treaty
    - Income characterization issues — Trading income or capital gains

Holding Companies

- Corporate Philosophy
  - Benefits of handling different ventures
  - Providing oversight functions for entire group
  - Capturing value at one level
  - Overall group tax rationalization
  - Ability to leverage on group strength
- Resistance by few jurisdictions
  - Mexico - Anti holding company regulations for investment through tax favorable jurisdictions
  - US – CFC Regulations, anti-inversion rules

Types of instruments

- Equity
  - Voting
  - Non-voting
- Preference Shares
  - Fully / Compulsorily Convertible – equity
  - Partly / Optionally Convertible
  - Redeemable

  Debt
- Debt
  - Debentures
    - Fully / Compulsorily convertible – equity
    - Partly / Optionally convertible
    - Non – convertible

    Debt
  - Other External Commercial Borrowings

Other structuring considerations

- Check-the-box issues
  - Type of entity – private/public
  - Loss making
- Regulatory Considerations
  - Press Note 1 – of 2005
  - Press Note 9 –
- Financial Considerations
  - Debt
  - Equity
- Profit repatriation
  - Dividend Distribution
  - Buy back of shares
- Exit options
  - Sale
  - Merger
  - IPO

Mergers & Acquisitions

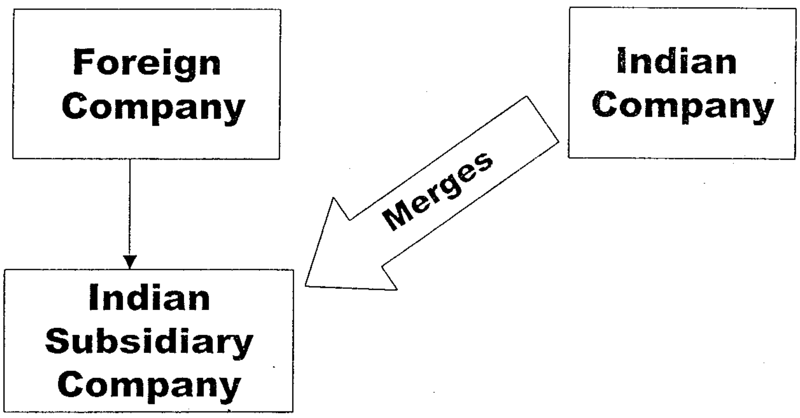
Merger

Foreign Company → **Merges into** → **Indian Company**

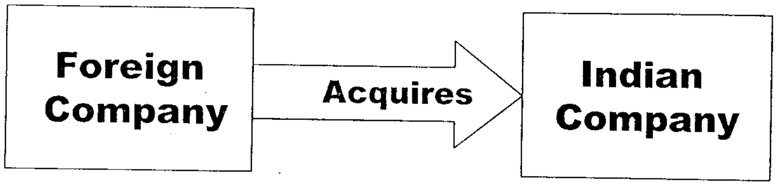
Legal and tax perspective

- Companies Act
  - High Court approval
  - Shareholder and creditor approval – 3/4th in value and majority in number
- Stamp duty – Instrument liable to stamp duty
- Exchange control – compliance with pricing guidelines, sectoral caps
- Tax-free merger
  - All assets and liabilities taken over
  - Continuing shareholders – at least 3/4th in value
  - Merged company should be Indian company
- Tripartite mergers also possible

Merger – Proposed structure



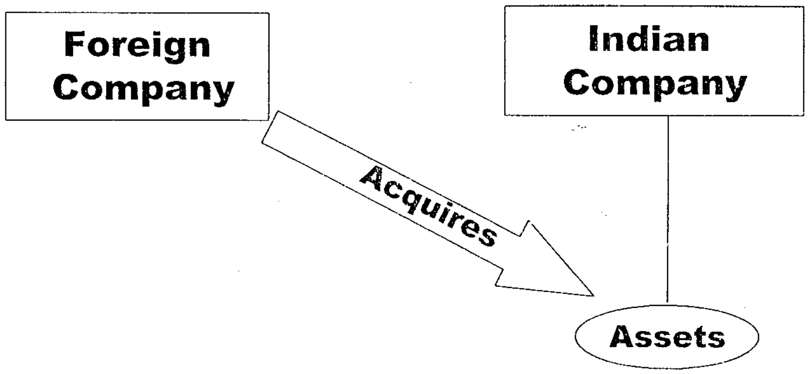
Share Acquisition



Legal and Tax Perspective

- Companies Act
  - Shareholder approval – sec 81(1A)
  - Minority squeeze out – sec 395 compliance
  - Listed companies – disclosure requirements
- Exchange control – compliance with pricing guidelines, sectoral caps
- Tax Implications
  - Seller liable to capital gains tax
  - Transfer pricing applicable if associated enterprises

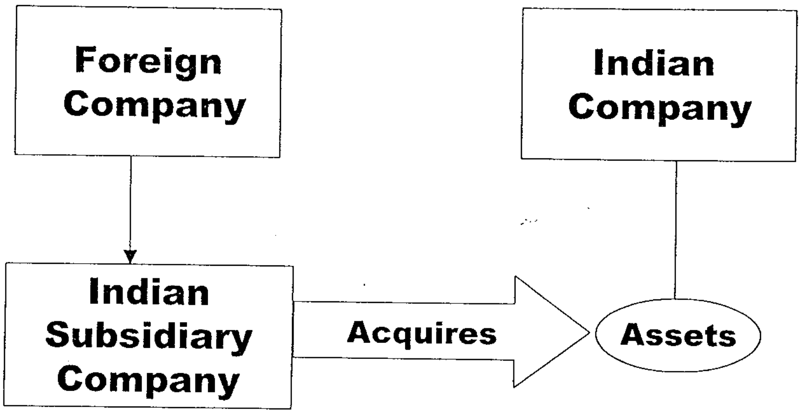
Asset Acquisition



Legal & Tax Perspective

- Companies Act
  - Shareholder approval for substantial disposal of assets
  - Listed companies – disclosure requirements
- Stamp Duty – on transfer of assets
- Exchange control – whether results in branch operations – RBI approval
- Tax Implications
  - Seller liable to capital gains tax
  - PE issues

Asset Acquisition – Proposed structure

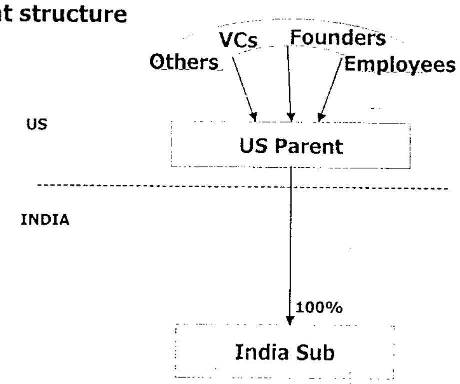


Other structuring considerations

- Role of seller
- Tax Planning in achieving tax treaty protection for capital gains
- Local Indian tax free merger rules or other means of combining operations tax-free
- Introduction of local debt
  - Debt push down
  - Share pledge – exchange control issues
- Procedural issues in aligning two different transfer pricing systems

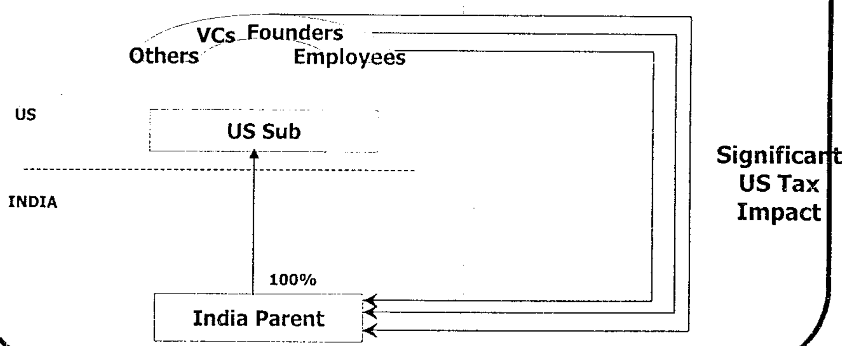
Flipping a structure: Inversion

Current structure



Flipping a structure: Inversion

After Flip



US Tax Issues

- Tax free re-organization – section 368 of IRC
- American Jobs Creation Act, 2004
  - Section 7874
    - A US company becomes a subsidiary of a foreign company or otherwise transfers substantially all of its property to a foreign company (that is, the US company inverts);
    - The shareholders of the US company end up holding 60% or more of the vote or value of the shares of the new foreign company; and
    - The new foreign parent company, alongwith all of its subsidiaries does not have "substantial business activities" in its country of incorporation when compared with the total business activities of the group.
  - Safe Harbour Test

Sector Specific Structures

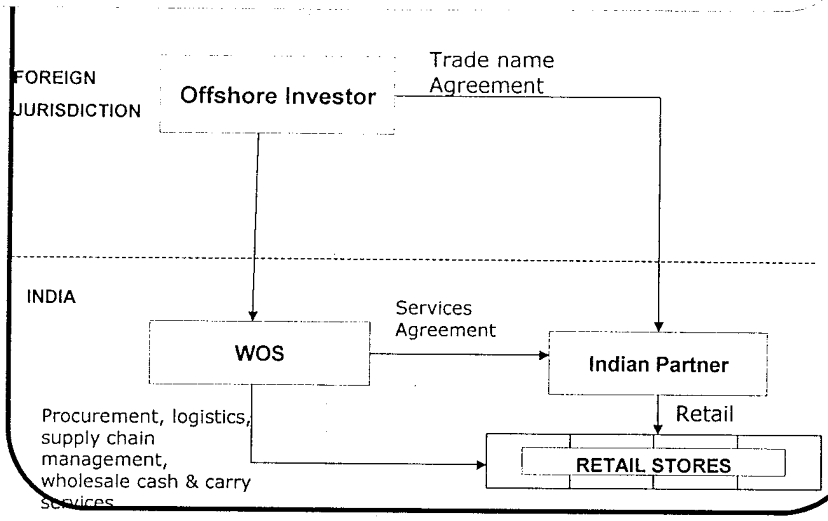
Franchising

- Tax Issues
  - FTS v. Royalty
  - Domestic tax rate – 10%
  - Service tax – 12.36%
- Exchange Control Issues
  - Lump sum payments > US$ 2m for purchase of franchise – RBI approval
  - Royalty payments > 8% exports/5% domestic sales on use of trademarks/brand name – RBI approval

Retail

- 51% FDI permitted
  - 'Single Brand' products only
  - Same international brand
  - Covers only products which are branded during manufacturing.

Retail Structure



Real Estate

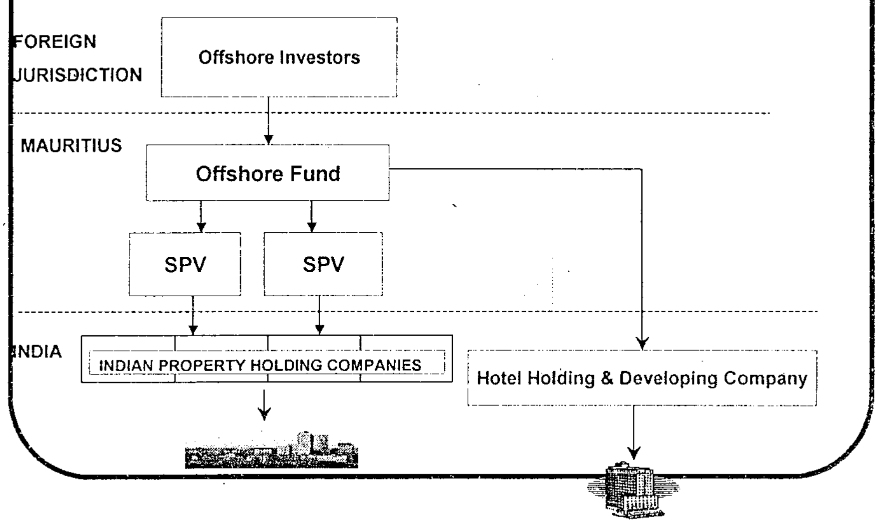
- Direct holding of land not permitted
- ECB not permitted
- Requirements of Press Note 2 to be complied with
  - Minimum capitalization (US$ 5m/US$10m)
  - Lock in period of three years of 'original investment'
  - Minimum area size
  - Investment in SEZ/Hotels excluded from PN2 requirements

Lock in applies to original investments only and may not to further substantial investment

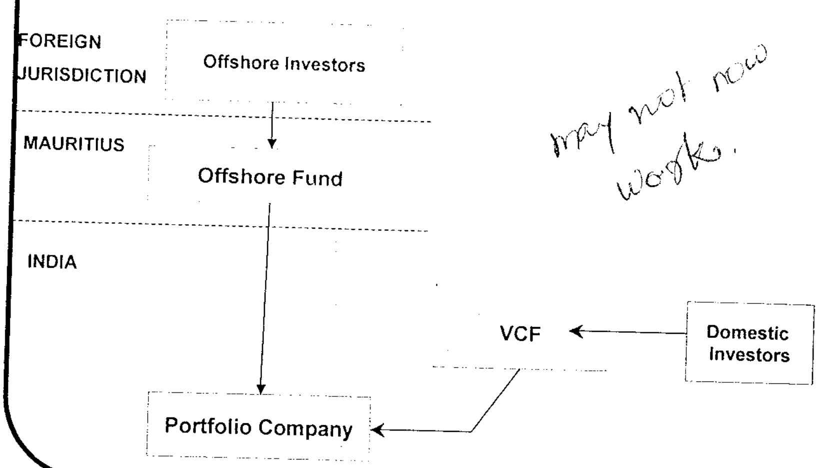
Hotel Industry

- 100% FDI permitted
- Real estate v. Hotel
- Provisions of PN2 not applicable
- ECB permitted

Real Estate Structure

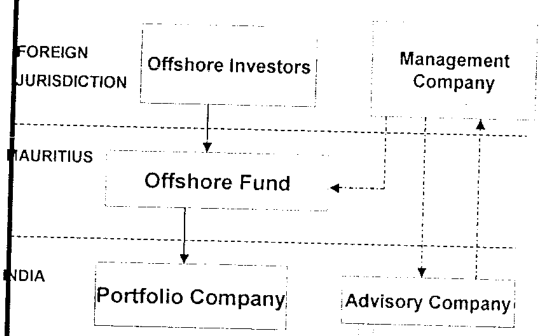


Venture Capital Fund Structure



may not now work.

Advisory Services from India



Dos and Don'ts

- Arm's length relationship
- Non binding advice
- Fixed place of business
- Decision making authority
- Nominee Directors on Portfolio Companies
- Directorship in Mgt Company

Indirect Foreign Investment

- Impacts joint ventures in telecom, insurance, broadcasting (capped sectors)
- Foreign shareholding – pro rata?
  - Press Note 9 – Downstream investment subject to sectoral caps
- On the Anvil - DIPP Proposal
  - No foreign shareholding
    - Foreign investment < 10%
    - Indian company not acting in concert with other foreign investors
  - Other cases – foreign shareholding to be taken on pro-rata basis

Impediments

- No tax consolidation, so no underlying tax credit
- No dividend franking system - Tax leakage at time of payment of dividend between group companies
- Transfer Pricing challenges

THANK YOU!

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