INVENTUSLAW

The Global Technology Law Firm

STRUCTURING INDIA – U.S. OPERATIONS

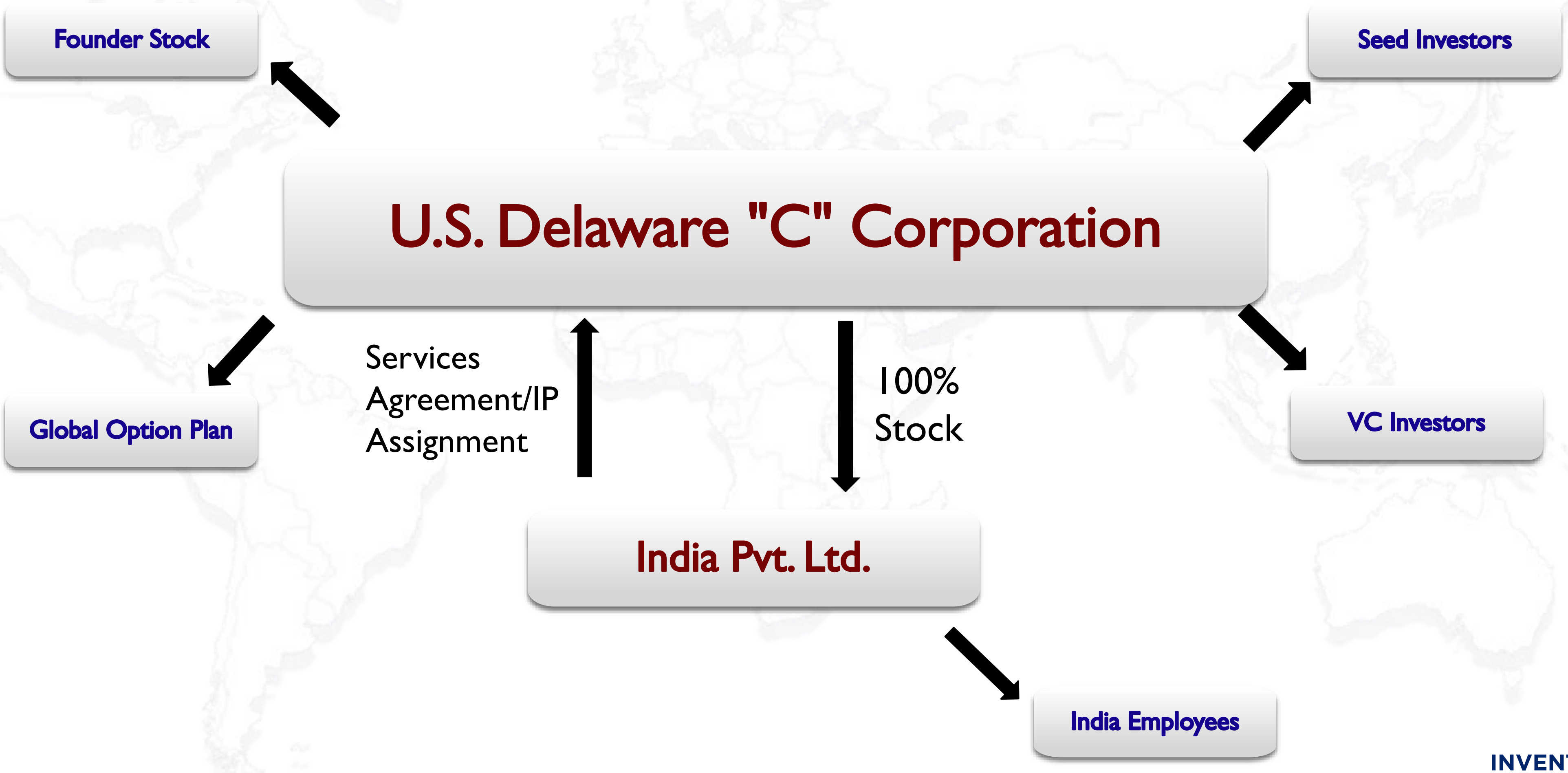
STRUCTURING INDIA- U.S. OPERATIONS: VARIOUS OPTIONS

- Option 1: U.S. Parent Company
- Option 2: Hybrid Investment Model
- Option 3: India Parent Company
- Option 4: Singapore Parent Company
- Option 5: Cayman Parent Company

RECOMMENDATIONS

- Once a holding company is created, "flipping" it into another jurisdiction is often difficult, expensive and tax inefficient – even more so once the company has raised outside investments, filed patents and/or received significant customer revenues.
- Need to be careful about structuring investments within the current and anticipated future Indian regulations applicable to cross-border investments.
- For SAAS, enterprise, ecommerce, consumer businesses focused on U.S. and/or global markets, ***structure as a US Parent***.
- For consumer businesses, if any significant part of current or future investments, customer growth or exit is likely to be outside India, then structure as a US Parent.
- Consider a Singapore holding company if focus is on broader Asia Pacific region.
- For purely India consumer focused consumer businesses or companies in a restricted industry, structure as an India Parent.
- Where not certain whether investors will be from US or other foreign jurisdictions, and exit may or may not occur in India, consider a Cayman Parent. Use this option very judiciously and only in limited circumstances.

OPTION 1- US PARENT STRUCTURE



OPTION 1: U.S. PARENT COMPANY

- The Parent Company is a Delaware "C" Corporation ("US Parent").
- IP is owned by the US Parent.
- Founder stock, investor stock and option pool all set up at the US Parent.
- Ideal Structure for optimal exit either from an IPO in the US public markets or a sale to a large US acquirer.
- Structured like any other silicon valley startup.
- Set up a 100% subsidiary in India to provide development and support services to US Parent on a "cost-plus" basis.
- India subsidiary assigns all IP developed in favor of the US Parent as part of a Services Agreement.
- Employees, including founders, resident in India sign IP assignment in favor of India subsidiary.

OPTION 1: U.S. PARENT COMPANY

Advantages:

1. Ease of setting up the initial company.
2. Worldwide recognized as jurisdiction of choice for businesses, including from startups to billion-dollar companies.
3. Well settled body of corporate law and court precedents to support capital and investment structures and uphold shareholders' limitation of liability for actions of the corporation.
4. Well recognized and accepted laws relating to investment models, from venture financings to debt financings.
5. ***Silicon Valley based venture capital investors will almost always require a Delaware parent corporation***. Investors from all other jurisdictions also support such a structure.
6. Technology customers put a higher value on the IP registered in the name of a Delaware corporation than IP registered in the name of an India or any other foreign entity.
7. Most US corporations will require or prefer purchasing shares or IP held at a Delaware corporation in order to avoid legal, tax and regulatory issues or having to deal with uncertain application of local laws to an acquisition of a foreign company or assets.
8. Easiest to list on any of the U.S. stock exchanges, and most other foreign stock exchanges.

OPTION 1: U.S. PARENT COMPANY

Disadvantages:

1. India round tripping regulations that apply to investments by India residents in non-India entities.
2. India POEM regulations that apply to non-India entities deemed to be operating or managed from India.
3. Some India registered funds may not be able to invest in non-India holding entities.
4. New India regulations on foreign ownership of local ecommerce businesses.

Structuring Notes:

1. Very important to note that all the above issues are issues raised under India regulations and, therefore, apply to all non-India entities equally and in the same manner. Therefore, forming a Cayman or Singapore company does not alleviate these issues.
2. The above issues can be managed and structured within the confines of the current India regulatory structure:
   - In order to avoid round tripping, careful attention needs to be paid on how the initial founder stock is acquired.
   - India POEM regulations don't apply to companies with gross annual revenues under INR 50 Crores [approximately, USD 6.5MM]. In any event, most of the revenues from the business are passed on to the India subsidiary as service fees and subject to tax in India. Therefore, the net practical effect of PEOM is not substantial.
   - India funds' investment can be structured in the India subsidiary with an option to net proceeds upon exit at the US Parent company level.
   - India ecommerce business operations can be set up as an India owned entity, with the US Parent owning and licensing IP to the India company.

OPTION 2: HYBRID INVESTMENT MODEL

- The Parent Company is an Indian private limited company ("India Parent").
- IP is owned by the India Parent. The India Parent is structured for an exit in India.
- Founder stock and option pool all set up at the India Parent level.
- U.S. investors invest in a Delaware LLC that in turns invests and acquires the proportionate equity ownership in the India Parent. We try to mirror investor rights and terms as much as possible with investor rights and terms in a Delaware corporation.
- Upon an exit, US LLC sells the shares in the India company to India acquirer and distributes proceeds to the LLC members.

Advantages

- Ideal Structure for India based startups looking for raising investments in and outside India but need to structure for exit in India.
- Allows India Parent to raise money from India based angel and other government and locally registered venture funds.

Disadvantages:

- Not a proven model. Application of the option subject to test under US and India tax regulations.
- Sale of the India company shares will be subject to tax in India. Taxation of proceeds to be received by US shareholders should fall within the protection against double taxation under the India – US tax treaty, but practical application of these provisions by IRS and Indian tax authorities has been uncertain.
- Not the optimal model for raising investments from US or other foreign investors, selling to global customers at a high value, or setting up for an exit outside India.

OPTION 3: INDIA PARENT COMPANY

- The Parent Company is an Indian private limited company ("India Parent").
- IP is owned by the India Parent.
- Founder stock, investor stock and option pool all set up at the India Parent level.
- **Advantages:** Ideal Structure for optimal exit either from an IPO in the India public markets or a sale to a large India corporation.
- **Disadvantages:**
  - Venture and other institutional investors may not want to invest in India parent company, and foreign acquirers may not want to acquire the India Parent, due to uncertain Indian tax, IP protection, legal and regulatory regimes that apply to investments and exits.
  - Most recent examples are (1) angel tax which was enforced on angel investments. This issue has been deferred for now, but there is no clarity or confirmation on future application; and (2) the new ecommerce policy that restricts foreign investments in, or ownership of, India ecommerce companies. For example, this is likely to have a material adverse effect on the value of Walmart's $15 Billion acquisition of Flipkart.
  - Safes a "gray area" and may not be a recognized investment instrument.

OPTION 4: SINGAPORE PARENT COMPANY

- The Parent Company is a Singapore Corporation ("Singapore Parent").

- IP is owned by the Singapore Parent.

- Founder stock, investor stock and option pool all set up at the Singapore Parent level.

Advantages [over a Delaware corporation]:
- This is the "tried and true" structure for Indian companies with plans to expand into the broader Asia Pacific region and take investments from Asia-Pacific based funds. Historically a tax favorable jurisdiction for Indian companies, but that advantage has disappeared (the Singapore-India tax treaty was allowed to lapse).
- No capital gains tax.

Advantages [over a Cayman corporation]:
- More robust from a substantive law perspective than the Caymans.
- Less skepticism from tax and regulatory authorities.

Disadvantages:
- Same disadvantages as in a Delaware Company: does not address issues of round tripping, POEM or ability for India registered funds to invest in a foreign entity like Singapore.
- Share registry and financial statements of Singapore companies easily accessible.
- US venture and other institutional investors may not want to invest in Singapore Parent
- Does not provide many of the advantages of investing in a Delaware Company.

OPTION 5: CAYMAN PARENT COMPANY

- The Parent Company is a Cayman Corporation ("Cayman Parent").
- IP is owned by the Cayman Parent.
- Founder stock, investor stock and option pool all set up at the Cayman Parent level.

Advantages [over a Delaware corporation]:
- In the event of future "flip" back into India, the Cayman Parent can be potentially restructured as an India holding company on a tax-free basis. However, we are not aware of any precedence where this has been accomplished or whether India and US tax authorities have allowed such a flip on a tax-free basis.

Disadvantages:
- Same disadvantages as in a Delaware Company: does not address issues of round tripping, POEM or ability for India registered funds to invest in a foreign entity like Cayman.
- Depending on the level of their holdings and board or other managerial control, investments in a Cayman entity may also require that US investors share their global investor list and board members share copies of their passports, SSN and other personal data, with Cayman authorities.
- US venture and other institutional investors may not want to invest in Cayman Parent due to higher scrutiny by India and US tax and regulatory authorities.
- Does not provide many of the advantages of investing in a Delaware Company.

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THANK YOU

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