Structuring family businesses & LLPs

Amidst your routine challenges, following areas are worth consideration

Dealing with New Regulations

- Direct Tax Code and GST
- Takeover Code
- Companies Bill
- IFRS becoming mandatory in phased manner
- LLP Act enacted

Business expansion / International presence

- Acquisitions – India / overseas
- Green field expansions
- Tax efficient repatriation of income streams
- Aligning structures to the changing regulatory scenarios

Fund raising / Consolidation

- Structures to facilitate fund raising
  - Domestic or overseas
- Increasing / maintaining promoter holding & control - creating leaverage float
- Taking the family owned businesses public

Need for promoters

- Tax efficient cash extraction strategies
- Increasing / maintaining promoter holding & control
- Succession planning
  - Trust / LLP or Holding Co structures
  - Migrating residential status

Dealing with New Regulations

Dealing with New Regulations
Direct Taxes Code – pointers to think for restructuring

- **GAAR provisions - onus on tax payer to prove that obtaining tax benefit not the main purpose of arrangement**
- **CFC and POEM provisions**
  - Equity and preference shares held by resident in a CFC also subject to wealth tax
- **MAT based on book profits – also payable by SEZ units / developers**
- **Cross border merger – not a tax neutral transaction**
- **Carry forward of losses in case of demerger now subject to continuity of business tests**
- **Indirect transfers "Vodafone" – subject to tax in India on the basis of proportion of assets**
  - FMV of assets owned by foreign company in India > 50% of total assets

Dealing with New Regulations
Takeover Code impact

- **Acquisition of 25% or more of the voting rights in the Target Company to trigger provisions of open offer**
  - Open offer for all the public shareholding
  - Acquisitions will become more expensive

- **Inter-se transfer among declared promoters possible subject to 3 years' holding condition (same as under existing Takeover Code)**

- **Inter-se transfers among "group" entities not available**
  - Transfers now require 3 year holding period

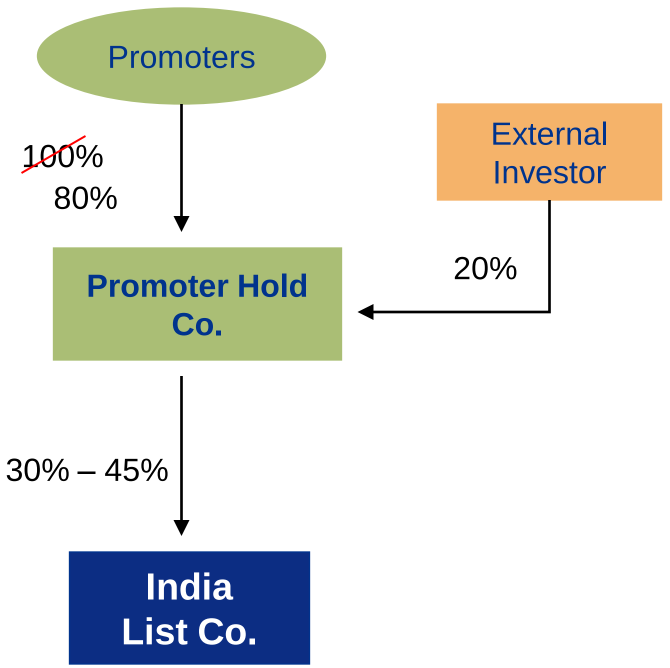
- **Acquisition of shares pursuant to merger / demerger subject to certain conditions**
  - Where Target Company is not party to merger / demerger, continuity of at least 33% common shareholding necessary

Internal restructurings to achieve promoter shareholding realignment should be completed early on.

Facilitating fund raising

Structure Options that may be adopted for enhancing the leverage capacity

Facilitating Fund Raise
Setting up Promoter Holding Companies



Promoter shareholding spread among various individuals, relatives and promoter companies to be consolidated in a single company

Wealth consolidated at Promoter Holding Company can be leveraged to raise external funding

Promoter control / ownership at List Co. protected

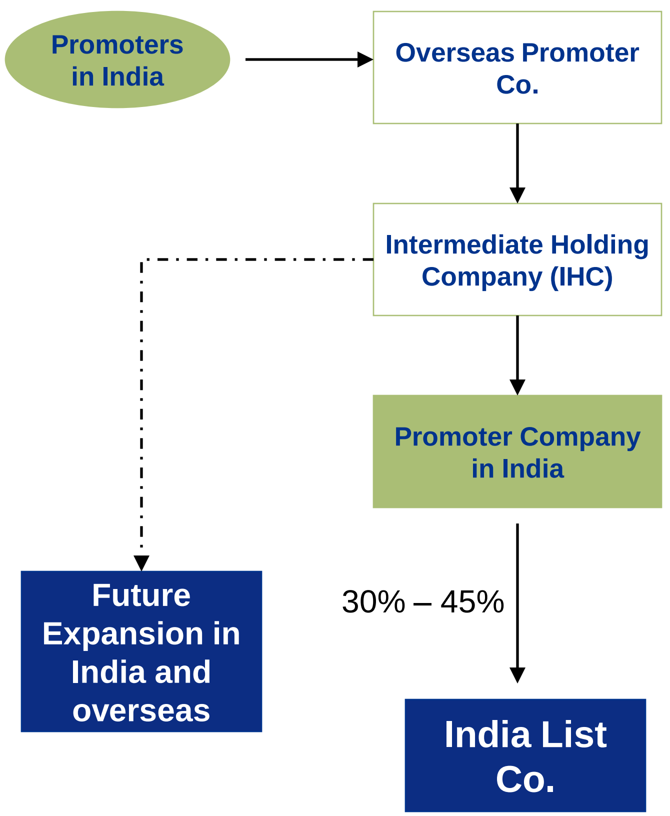
Funds could be raised through Private Equity. With increase in valuations, Hold Co. may also be listed

Promoter holding company may also be set up overseas – discussed in details subsequently

Café Coffee Day recently used this strategy to raise funds from KKR
Shriram Group followed a similar structure.

How does one structure external investor upside/ downside

Internalisation of shareholding



Promoters shareholding in an India List Co. may be consolidated in an International Holding Company

External Funds can be raised at these levels without diluting control over the India List Co.

Funds raised may be utilized for expansion of business in India and overseas

Though there would be restrictions on the extent of funds that can be invested into the India List Co. due to the Takeover Code regulations, funds can be freely invested to pursue new opportunities

Essar and Vedanta followed these models followed by an International Listing

Key Challenges faced in setting up these international structures

Transfer of shares to an international holding company requires availability of free cash

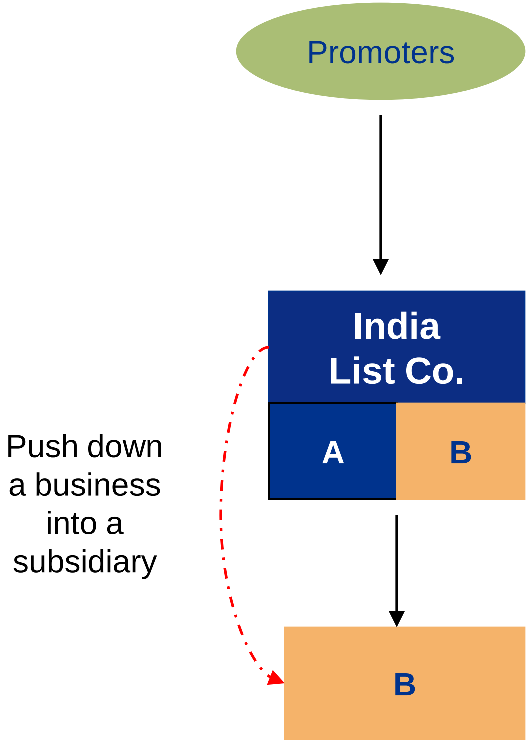
Recent FEMA regulations around pricing mandates share transfers to be done at market price (for listed companies) / DCF (for unlisted companies)

FEMA risk on transition of wealth to an overseas jurisdiction through round tripping

Meeting SEBI / Listing agreement requirements on transfer of shares

Achieving internalisationa through merger/ demergers in a cashless manner
The E trade/ Vodafone effect

Facilitating Fund Raise
Subsidiarising certain business verticals



In case of groups that have multiple businesses, certain segments, projects may be pushed down to subsidiaries

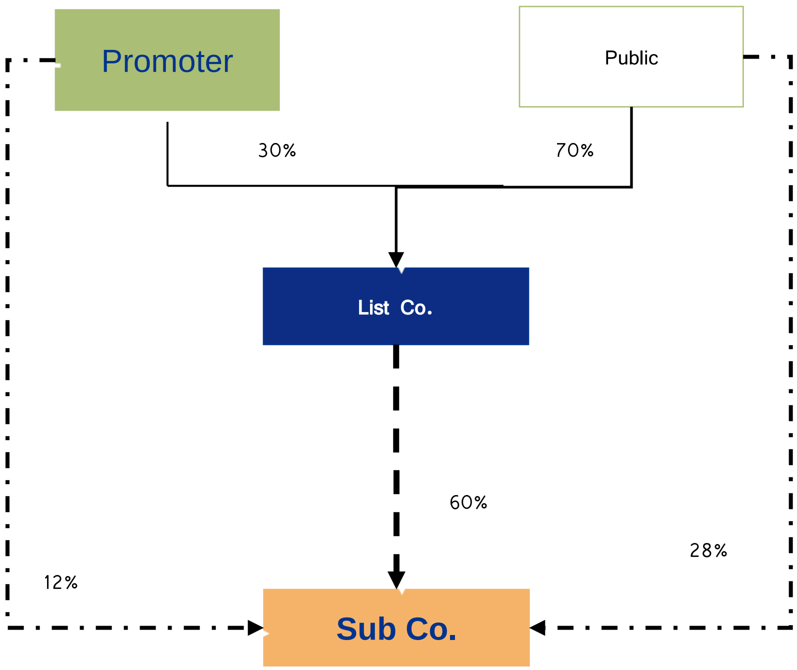
External funds can be raised at subsidiary level by primary infusion or also secondary sale

List Co. can dilute upto 51% and still ensure control and accounting consolidation

Infra companies push down projects in subsidiary companies to facilitate project level funding

Consolidation of overseas value for international listing

Facilitating Fund Raise
Hybrid Demerger



Hybrid Demerger sets up a Listed subsidiary company, whilst ensuring consolidation

Facilitates focus on SBU's – that command different valuations

Provides flexibility to raise funds for the growth of business

Provides immediate liquidity at the counter

Accounting consolidation of Sub Co. into List Co. may still be done

Merger of Promoter Group Companies into List Co. can also be considered overtime to increase Promoter Share in List Co.

Facilitating Fund Raise
Enhancing the foothold of the Promoter

Buyback

- Can automatically increase promoter control
- Facilitates effective use of excess cash
- Can enhance EPS
- May be considered as a repatriation option

Warrants / Preferential Allotment

- Only 25% cash required to be paid upfront
- Payment schedule/ issue of shares could be deferred over 18 months

Creeping Acquisition

- Direct acquisition from Open market - up to 5%
- No approvals required
- Overall ceiling limit increased to 75 per cent

Helping maximise Promoter Control in an efficient manner.

Provides additional window to leverage

Employee Welfare Trust

- Shares may be issued to a Trust set up for employees‘ benefit
- Promoters may act as Trustees
- Though no shares allotted to promoters, economic control can be enhanced

Capital Reduction

- Surplus cash may be returned
- Rightsizing capital structure
- Improved Return on Equity

Innovative Court Scheme

- Merger of Promoter owned company into Target company
- Consolidating holdings / cross-holdings in Trust structures on merging group companies

Building international presence

Key facets

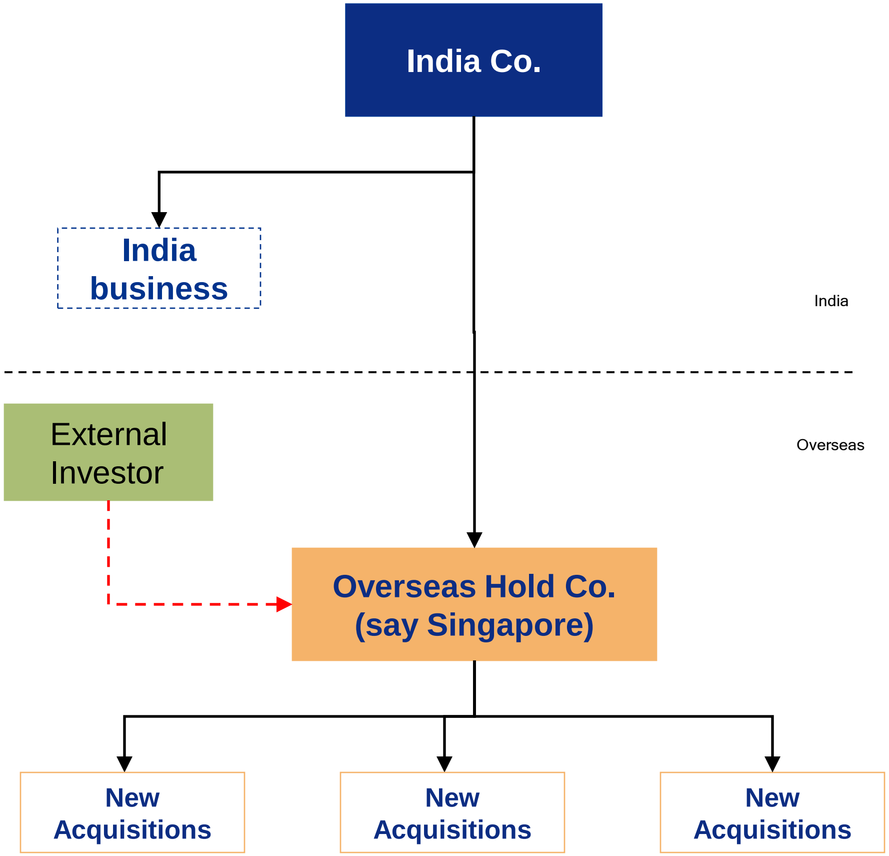
Structures have emerged with the need

Typical structure- holding companies, trading companies, IPR companies

Branch v/s companies

Overseas listing

Holding companies



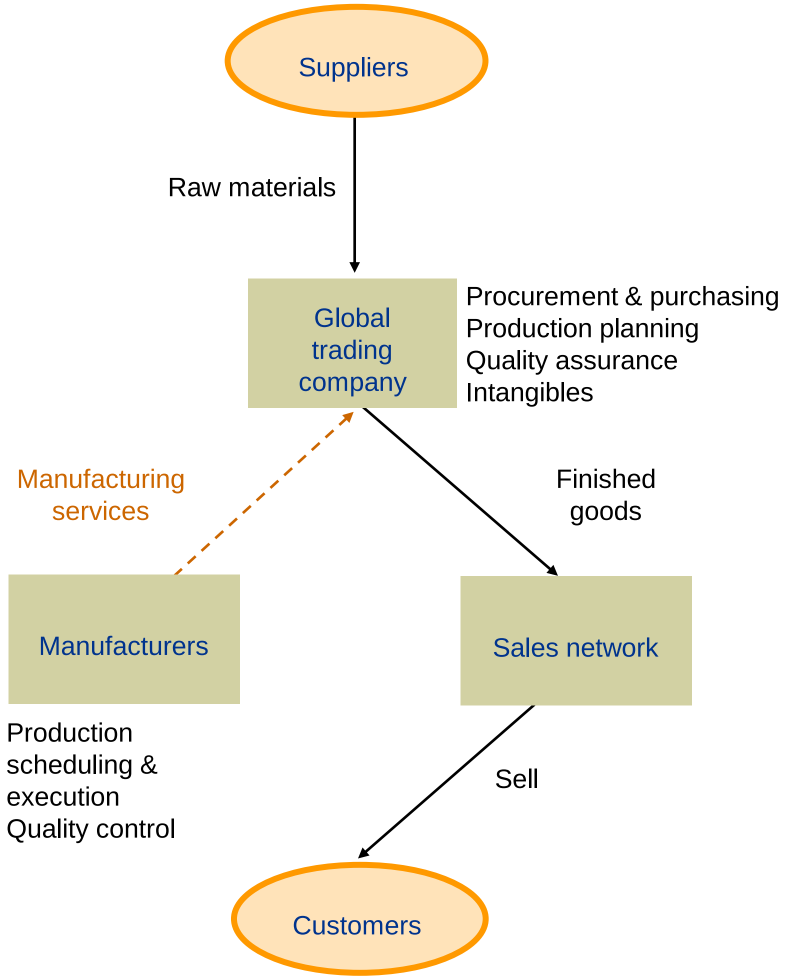
Overseas business to be consolidated under an overseas Holding Co.

Future funds raised overseas at Hold Co. / project level.

Overseas Hold Co. may also be listed overtime on an overseas market to raise funds

Promoter shareholding in India Co. protected / intact on any fund raise overseas

Global Trading companies



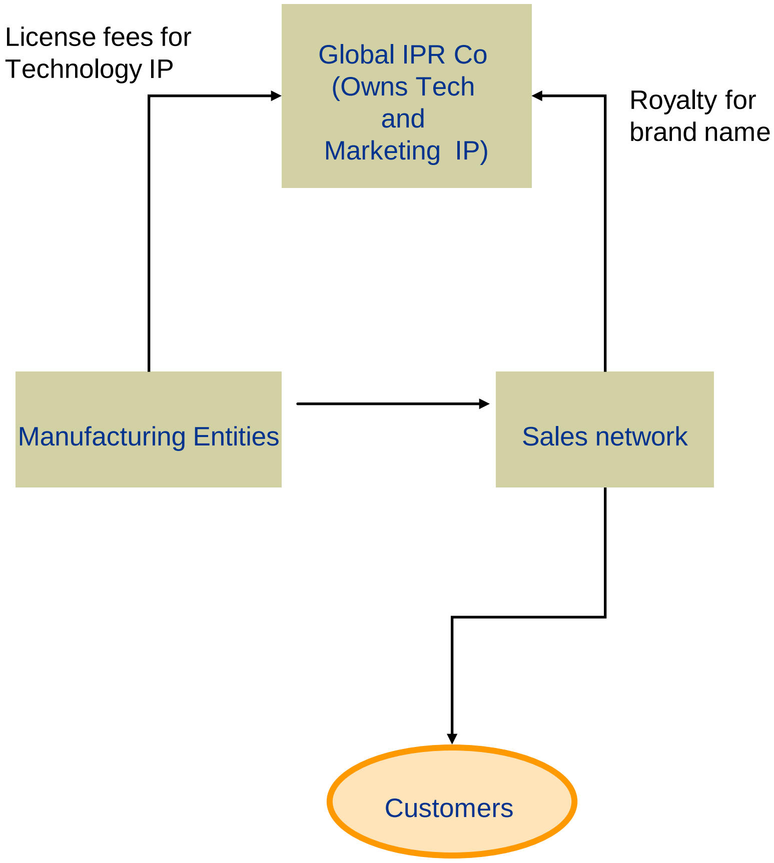
Location of Global Trading Co in a low tax jurisdiction to reduce the overall effective tax rate of the Group

Supply Chain analysis to ensure centralised procurement & purchasing strategy, proper manufacturing set-up and sales network, thereby reducing inefficiencies

Substance requirement in jurisdiction necessary

Dubai and Singapore are most commonly used destinations for setting up Global Trading Companies. Singapore also offers host of tax advantages to Global Trading companies

Planning the IPRs and Brand Management



All group IPR holdings consolidated under one entity – value consolidation and enhancement, centralized brand management

Consideration on exploitation of IPRs consolidated under one entity – could be deployed for future brand acquisitions or brand marketing/promotional activities

Location of Global IPR Co. in a low tax jurisdiction to reduce the overall effective tax rate of the group

Switzerland and Luxembourg are being increasingly used for setting up global IPR companies

Impact of the Proposed DTC on existing overseas structures

CFC regulations	**Income of overseas subsidiary to be taxed in Indian if more than 50% of its income is of the nature of dividend, interest, income from house property, capital gains, royalty, sale of goods/supply of services to related parties, income from management, holding or investment in securities/shareholdings, any other income under the head income from residuary sources, etc**
Place of effective Management	**Overseas companies whose place of effective management is in India – would be considered as Indian tax residents and liable to tax in India**

Existing overseas Holding companies need to be evaluated in light of these amendments. Need to revisit existing structures and plan for the future

Meeting promoters' requirements

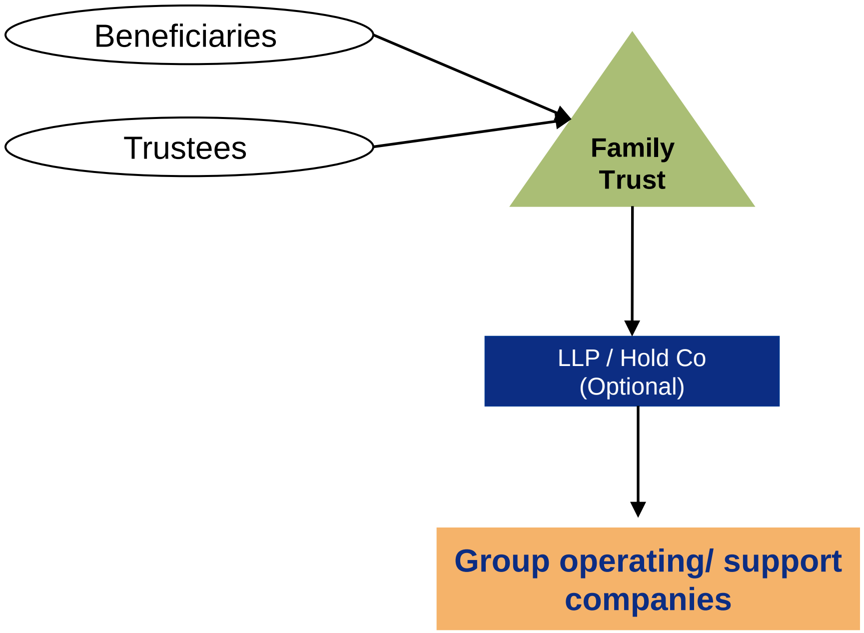
Planning at the Promoter Level
Trust Structures are being increasingly adopted for wealth management and succession planning

Why Business families have a keen interest for Trust set ups?

- De-risking and demarcating business wealth from personal wealth
- Pooling of assets for collective benefit and welfare of all family members
- Creation of fixed source of income for the family members in a long run
- Proper management and preservation of property
- Succession planning for the family including settlement of family disputes
- Longevity of business beyond generations

Broad Structure Set up of Family Trusts

Domestic Trust

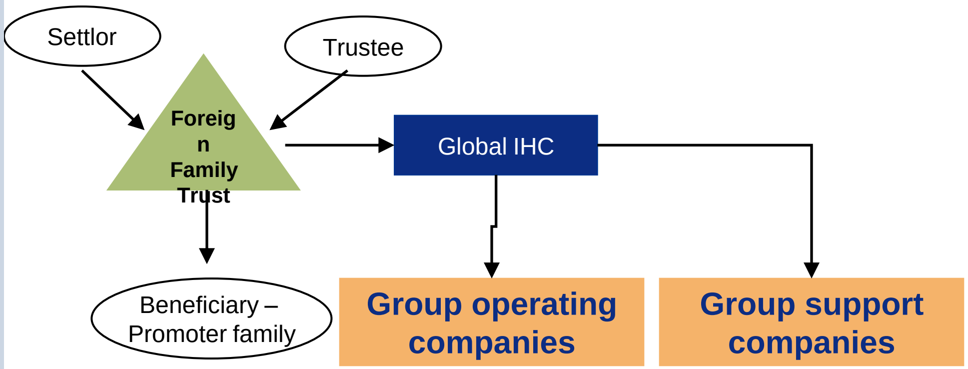


- All business activities concentrated in a small geography with little vision to expand across geographies
- High Sentimental values attached with the business
- Settlement of assets in trust not subject to tax
  - Stamp duty costs to be evaluated
  - Takeover code impact if listed assets
- Trust deeds usually provide for distribution of assets among family members
  - Control with the trustees
  - Distribution of income without necessarily distributing control / wealth possible
- Tax efficient distribution of income
- LLP / Hold Co – provides ease in leveraging

Broad Structure Set up of Family Trusts

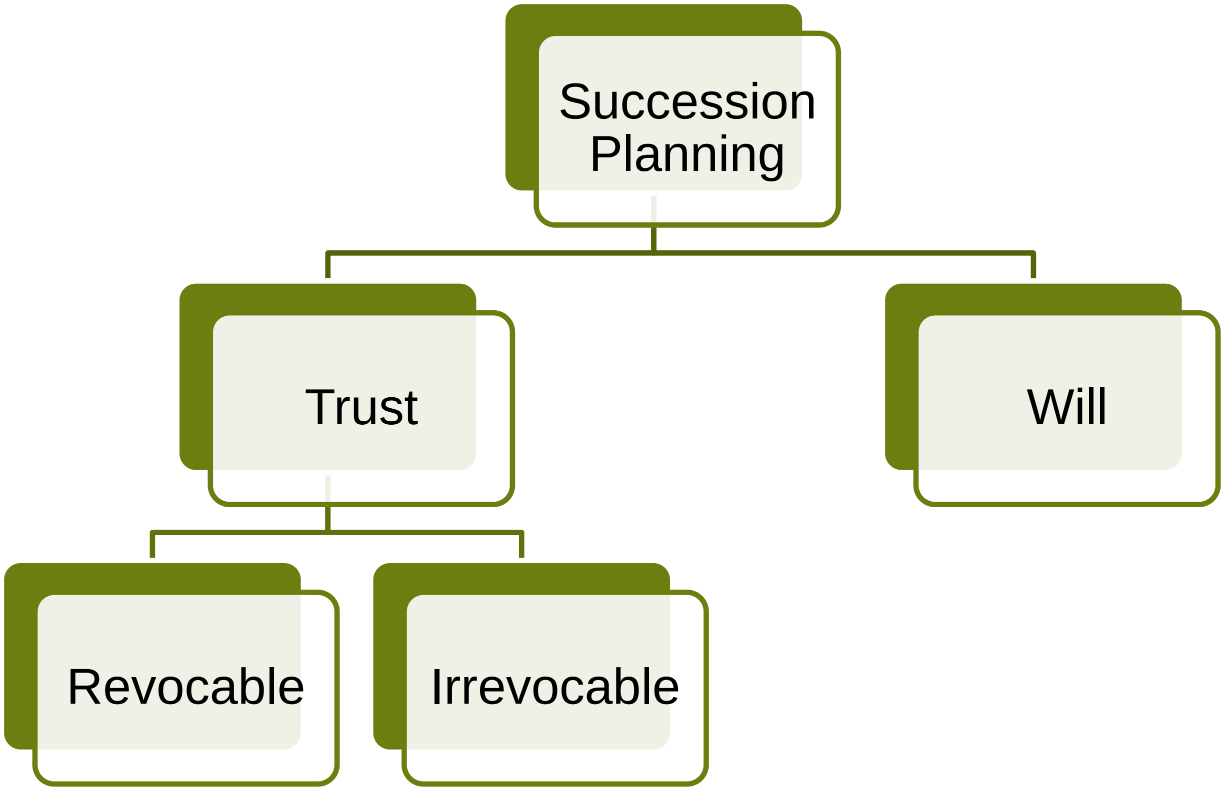
- Business interests spread across multiple geographies
- Ambitious plans to expand foothold overseas markets
- Multi-dilution strategy for different business in different geographies
- Geographical de-risking of wealth
- Preference of Professional Trustees for Global Wealth management

Overseas Trust



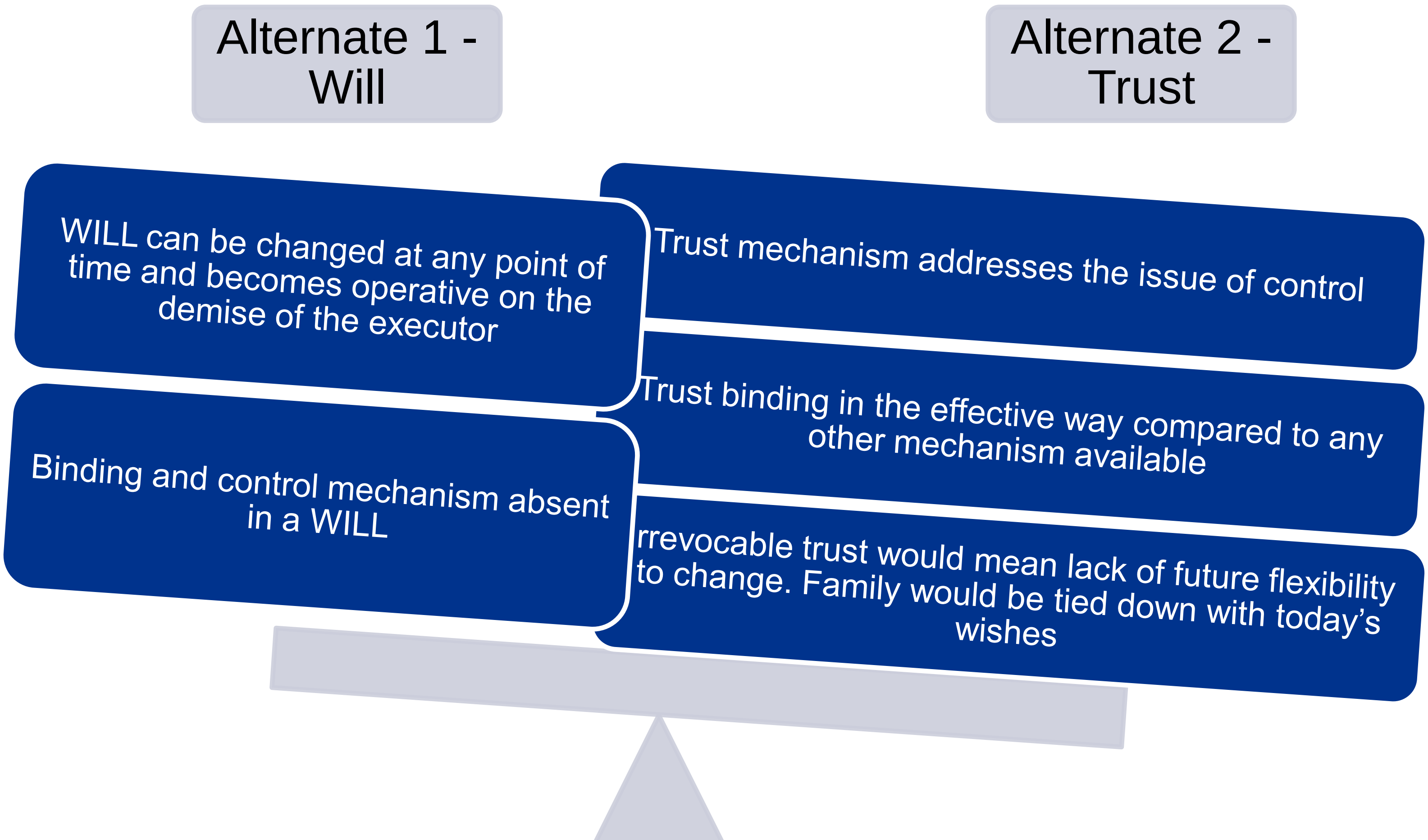
Alternate options for proposed restructuring – (1/2)

The holding company structure can be worked upon either by way of a WILL or a Trust mechanism



Alternatively one can have a Will that leads to a creation of Trust to achieve all objectives

Alternate options for proposed restructuring – (2/2)



Both Trust and Will can be structured today but disclosed to children in the future

Will Structure

WILL can be changed at any point of time and becomes operative on the demise of the executor

Will can be structured today but disclosed to children in the future

Taxation of Private Discretionary Trusts

Taxability of Private trusts

- **Shares of beneficiaries are determinate**
  - Where income does not include business profits
    - The trustee is assessable at the rates applicable to each beneficiary
  - Where income includes business profits
    - The whole of the income of the trust is taxable at Maximum Marginal Rate i.e.30.9%
- **Shares of beneficiaries are indeterminate**
  - Where income does not include business profits
    - The income of the trust is Taxable in the hands of trustees at the rates applicable to the AOP i.e. at the rate applicable to each beneficiary according to his other taxable income
  - Where income includes business profits
    - The whole of the income of the trust is taxable at Maximum Marginal Rate i.e.30.9%

The income of the Trust is taxable in the hands of the Trustee(s) as a 'representative assessee' or in the hands of the beneficiaries

Migrating Residential Status

- Heads of Promoter families shifting residential base overseas
- Interaction with global business leaders
- Easier access to global technology and resources required for sustainable business growth
- Looking out for potential overseas business opportunities
- Observing global conglomerates up close – to replicate the good practices in India
- Shifting Place of Effective Management out of India – for tax purposes
- Building wealth overseas to provide flexibility for future restructurings in India

Migration to be carefully planned considering the tax and regulatory nuances

LLPS

Evolution of LLP in India

Expert Committees (Naresh Chandra & JJ Irani) and Concept Paper by MCA in 2006

LLP Bill 2008 passed by Lok Sabha in December 2008 and President's assent in January 2009

LLP Act 2008 notified on 31 March 2009 and Rules on 1 April 2009

Discussion Paper on FDI in LLP in September 2010

Press Note by Government for FDI in LLP in May 2011

RBI Guidelines awaited

LLP combines limited liability of a company and flexibility of a partnership

LLP – Regulatory Framework

Governed by the LLP Act, 2008

Key features of a LLP

- Body Corporate formed under the LLP Act – administered by Registrar of Companies
- Perpetual Succession
- Separate legal entity – can hold property / sue in its own name
- Liability of Partner limited to its Capital contribution (except in case of fraud / wrongful acts)
- No restrictions on draw down of capital

Minimum 2 Partners in a LLP

- No limit on maximum number of Partners
- Partner can be an individual or a LLP / Company (Indian / Foreign);
- Partner is an agent of the LLP but not of other Partners
- Profit sharing ratio amongst Partners can be different from their Capital contributions
- Interest in LLP can be assigned / transferred by a Partner

LLP – Regulatory Framework

Designated Partner (DP) in a LLP

- Minimum 2 DPs; at least one to be resident in India
- Body corporate can be a DP, to appoint individual as nominee to act as a DP
- DP responsible for compliance obligations and filings under the LLP Act

LLP Agreement

- Governs the mutual rights and duties of Partners
- Provisions of LLP Act to govern matters not covered in LLP Act

Contribution of a partner may consist of cash, tangible, intangible, movable or immovable property, contracts for services performed or services to be performed

- Monetary value of contribution to be valued by a CA, Cost Accountant or approved valuer

LLP – Regulatory Framework

- Provisions prescribed for incorporation of LLP; conversion of firm / private company / unlisted public company into a LLP

- Restructuring provisions include amalgamation of LLP and arrangement between LLP and its partners / creditors

- Foreign LLP having established place of business in India to be registered under the LLP Act

Step 1 – Decide Partners / Designated Partners

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Step 2 – Obtain DPIN

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Step 3 – Check name availability

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Step 4 – Draft LLP Agreement

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Step 5 – File incorporation documents

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Step 6 – Issue of Certificate of Registration

LLP – A Comparison

Particulars	Partnership Firm	Private Company	LLP
No. of Members	Min 2; Max 20 (10 for banking)	Min 2; Max 50	Min 2; Max no limit
Members' Liability	Unlimited	Limited	Limited
Separate entity	Not a legal entity separate from partners	Separate legal entity	Separate legal entity
Body Corporate	No	Yes	Yes
Existence	Not perpetual	Perpetual	Perpetual
Board / Shareholders Meetings	Not required	As stipulated by the Cos. Act	No provision
Transfer of profits to Reserves	Not required	Required	Not required

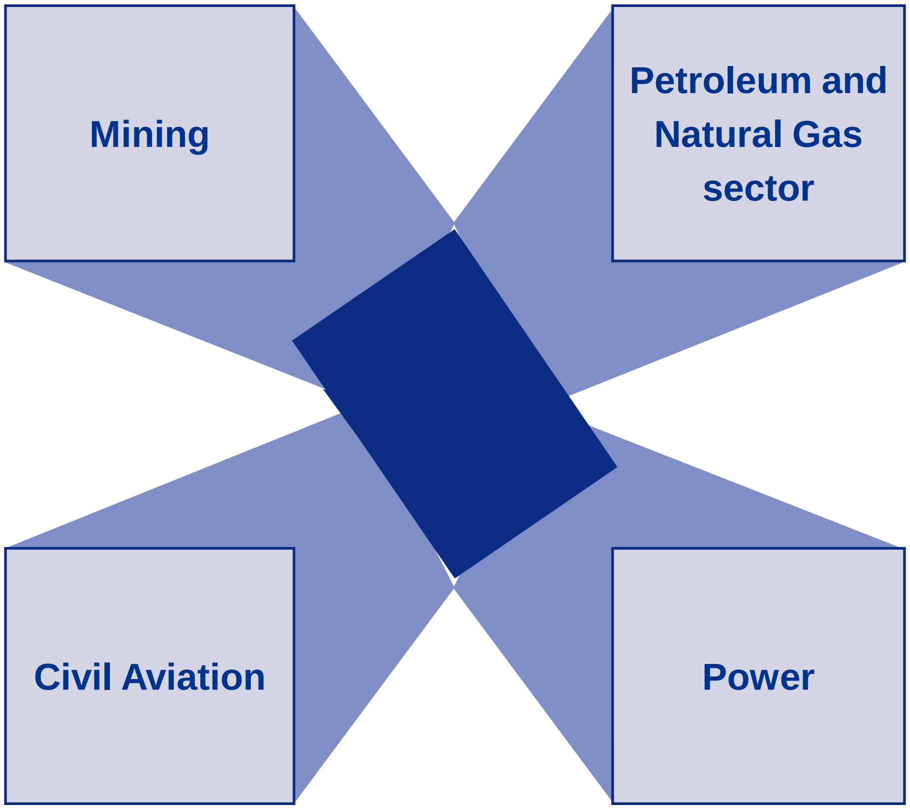
FDI in LLP…

FDI now permitted in LLP with prior FIPB approval

What is permitted	Important points
▪ Allowed in sectors where 100% FDI is permitted under Automatic Route and there are no FDI-linked performance related conditions ▪ Downstream investment by an Indian Company with FDI, into a LLP permitted, if Indian company and LLP both operate as above	▪ Examples of sectors with FDI-linked performance related conditions are NBFC, Development of Townships, Housing, Built up infrastructure and Construction-development projects, etc. ▪ FDI in LLP not permitted in Agricultural / Plantation activity, Print Media and Real Estate business ▪ Investments in LLP by FII / FVCI not permitted ▪ DP to be Indian company or person resident in India ▪ Capital contribution only in cash by way of inward remittances / through NRE / FCNR accounts ▪ Downstream investment by LLP with FDI - not permitted ▪ LLP not permitted to avail External Commercial Borrowings (ECB) ▪ Conversion of Company with FDI, into LLP also permissible

FDI in LLP…

Indicative list of sectors falling under 100% Automatic Route but subject to conditions under respective legislations



- Will the conditions under the respective legislations be interpreted to be FDI-linked performance related conditions?
- Would FDI in LLP be therefore permitted in the above sectors ?
- In some of these sectors, a Company form of entity may be an imperative

Foreign Exchange Regulatory Framework

Key watch outs

- RBI guidelines on FDI in LLP awaited
- Procedures for secondary Approval / Intimation / Compliance
- Lock-in of Capital
- Valuation parameters qua
- Admission
- Retirement
- Transfer / realignment
- Restrictions on Interest on Capital

LLP - Taxation aspects

- Under the IT Act, a LLP is treated as a firm
  - Tax rate 30.90% vis-a-vis 32.45% for a Company
- No MAT (20.01%) on book profit of LLP
  - AMT is applicable on adjusted total income
- Distribution of profits by LLP not liable to Dividend Distribution Tax (16.22%)
- Share of profit from LLP exempt from tax for Partner
- Interest and remuneration (Individual Working Partner) paid to a Partner
  - Tax deductible for LLP
  - Taxable as business income for Partner
- Deemed Dividend provisions do not apply
- Wealth Tax not applicable to LLP and on Partners vis-à-vis their interest in LLP
- Lower threshold (10%) for trigger of Transfer Pricing provisions
- Change in profit sharing ratio / admission of new partners – No impact on carry forward of losses

Company vs. LLP – A Comparison

Only a Company eligible for certain incentives / allowances

- 200% weighted deduction on expenditure on in-house scientific research
- Investment linked tax deduction for laying / operating cross-country natural gas or crude or petroleum oil pipeline network
- Profit linked tax deduction for developing, operating and maintaining "infrastructure facility"
  - However, investment linked tax deduction for such activities under the draft DTC not restricted to a Company
- Tax neutral amalgamation / demerger of Companies possible
- Expenditure on amalgamation / demerger of Companies to be amortised in 5 years
- Carry forward of unabsorbed losses allowed in case of amalgamation / demerger of Companies meeting specified conditions

Implications of above in case of LLP ?

Company vs. LLP – A Comparison

- Dividend received by a Company from specified foreign companies taxable @ 15% – No such provision for LLPs
- No restriction in carry forward of losses to closely held Company, if change in shareholding is upto 49%
  - However, proportionate brought forward loss relatable to retiring / deceased partner in LLP in excess of his profit share in the year of retirement, not allowed to be carried forward and set off
- Interest in LLP will qualify as a Long Term Capital Asset if held for more than 36 months unlike a share in a Company held for more than 12 months

Company vs. LLP – A Comparison

Particulars	Company	LLP
Profit before tax	100.00	100.00
Less: Income-tax	32.45	30.90
Profit after tax	67.55	69.10
Less: Transfer to Reserves	6.75	-
Less: Dividend distribution tax @16.22%	8.50	-
Dividends / Profits available for distribution	52.30	69.10
Total Tax	40.95	30.90

Benefit of 16.8%

Benefit of 10.05%

LLP Advantage – substantial tax savings / increase in distributable profits

Company vs. LLP – MAT v AMT…

	Minimum Alternative Tax	Alternative Minimum Tax
Tax applied on	Book profit subject to certain specified adjustments	Tax profit before giving effect to specified tax holiday / incentives under the IT Act
Rate	20.01% (incl. surcharge and cess)	19.05% (No surcharge, only cess)
Brought forward book loss / depreciation	Brought forward book loss / depreciation (lower of the two) to be reduced while computing book profit	Not applicable since AMT is computed on tax profits after taking into account brought forward tax losses
Carry forward of credits	10 years	10 years

Company vs. LLP – MAT vs. AMT

Particulars		Company	LLP
Profit Before Tax	(A)	100	100
Less: Tax Adjustments / deduction		50	50
Taxable Income	(B)	50	50
Income tax on (B)	(C)	16.23	15.45
Book Profit for MAT		100	--
Income for AMT		--	50
MAT on (A)	(D)	20.01	-
AMT on (B)		-	9.53
Tax (higher of (C) and (D))	(E)	20.01	15.45
Profit after tax (A – E)		79.99	84.55

Key International tax aspects / issues surrounding LLP

Share of Profits in LLP

- Share of profits in LLP tax exempt for all Partners as per IT Act
- No withholding tax in India
- Issues surrounding taxation in Home Country
- Nature of income
- Arguably not Dividends
- Year of Taxability
- Credit to Capital Account or on Distribution?
- Manner of computing Taxable Income
- Credit for underlying taxes paid by LLP in India?
- Comparative position vis-à-vis Dividends especially for jurisdictions having beneficial participation exemption / holding company regime

Key International tax aspects / issues surrounding LLP

Interest on Partner's Capital

- Nature of Interest Income on capital
  - Business Income under IT Act
  - Arguably not Interest on Loan as no 'debt incurred' or 'money borrowed'
  - No withholding tax in India
- Possibility of Double Dip
  - Deduction for LLP in India
  - Taxed as share of Partnership Profits in Home country
  - Underlying Tax Credit / Exemption?
- Transfer Pricing / Arm's–Length Criteria

Key International tax aspects / issues surrounding LLP

Transfer of Partner's Rights

- Transfer of Partner's Right is a taxable event in India
- Under many Tax Treaties this transfer may not be taxable in India
- Withholding tax provisions to apply accordingly
- Taxation in Home Country including credit for Taxes paid in India to be examined
- Transfer Pricing / Arm's-Length Criteria

Treaty Benefits

- Whether Indian LLP or its Partners eligible to Tax Treaty Benefit in Source Country?
- If Partners of Indian LLP liable to tax in Source Country, then whether Indian LLP will get credit in India for taxes paid / withheld Overseas

For India entry, imperative to take holistic view considering Home and Host Country tax implications

Migration to LLP structure

- Possible modes of migration from Company to LLP
  - Merger of a Company into LLP – Not permitted under Companies Act or LLP Act
  - Demerger of a Company into LLP - Not permitted under Companies Act or LLP Act
  - Conversion of Company into LLP – Permitted under LLP Act
  - Slump Sale of business from Company to LLP – Possible

Conversion of Company into LLP

- **Key conditions for tax neutrality of Conversion from Company to LLP under the IT Act:**
  - **Turnover < INR 6 mn in each of the 3 previous years**
  - **Accumulated profits cannot be withdrawn for 3 years**
  - **Profit sharing ratio and capital contribution should correspond to shareholding in the company**
  - **Esrtwhile shareholders to have aggregate profit sharing ratio of at least 50% for 5 years**
- **Implications of tax neutral Conversion**
  - **Written down value (WDV) of assets of the Company to be the WDV of the LLP**
  - **Cost of capital assets of the Company to be cost in the hands of the LLP**
  - **Transfer of unabsorbed business loss and depreciation of the Company to the LLP**
  - **Cost of LLP interest for a Partner to be cost of shares held in the Company**
  - **No carry forward of MAT credit from Company to the LLP**

Conversion of Company into LLP

- Violation of tax neutrality conditions results in
  - Taxation in the hands of LLP / Shareholders of erstwhile Company
  - Set off of loss / allowance shall be deemed to be income of the LLP
- Non fulfillment of tax neutrality conditions – whether Conversion is taxable?
  - Possible view that in the hands of Company, Conversion does not constitute 'transfer'; in any case no consideration received by Company
  - For shareholders, whether Conversion constitutes 'transfer'? Treaty protection to be examined
- Other considerations
  - Stamp Duty
  - Existing contracts, agreements, statutory licenses and regulatory approvals

Tax risk mitigation by obtaining Advance Ruling on taxability of conversion

Slump Sale of Business by Company to LLP

Implications for Company

- Sale consideration less tax networth of depreciable assets and book value of other assets, would be chargeable as Capital Gains
- If the business carried for more than 36 months, tax on Long Term Capital Gains @ 21.63%, else @ 32.45%
- Cash trap in the Company

Implications for LLP

- Cost of assets in the hands of LLP would be based on allocation of purchase price paid
- Stamp duty
- No carry forward of loss in the hands of the successor LLP

Innovative structures for tax efficient migration of Company to LLP possible

Key accounting Implications

On a simplicitor conversion of a Company into a LLP, there are limited IFRS implications

- No impact on the Balance Sheet or profit and loss account of the LLP (erstwhile Company) except deferred taxes
- No impact on the carrying amount of investments of the shareholder (now a Partner in the LLP)

Slump sale by Company to a LLP – either at cost or at nominal value

- Assets and liabilities will be transferred at carrying value even though the slump sale is at nominal value, whether the difference will be treated as capital reserve?
- No impact from shareholder's perspective as this is a common control transaction

Merger of a Company into another Company, which is then converted into a LLP

- The consideration for purchase of the company (securities, other investments etc.) - whether to be recorded at fair value or nominal value?
- The other impacts will be similar to slump sale by Company to LLP

The LLP Advantage

Tax Benefits

- Not liable to DDT (16.22%), facilitating tax free profit repatriation
- Not liable to MAT (20.01%) on book profits (subject to AMT)
- Surcharge not applicable (effective savings 1.55%)

Operational flexibility

- Perpetual succession and limited liability of partners
- Separate legal entity - can hold property / sue in its own name
- Flexibility in capital drawdown by partners
- LLP agreement - governs ownership, control and

Lower Compliance

- No board meeting / shareholders' approval for business conduct
- No restriction on related party transactions
- No requirement to transfer profits to reserves

The LLP caution points

- Will DDT be introduced on LLP?
- What terms and conditions will FIPB put in?
- How will RBI frame the valuations guidelines?
- How will lenders look at it?
- Industry specific issues

Questions

&

Answers

KPMG

cutting through complexity™

Thank You